THE PEW CHARITABLE TRUSTS

# STILL WAITING: *"Unfair or Deceptive" Credit Card Practices Continue as Americans Wait for New Reforms to Take Effect*

*October 2009*

## EXECUTIVE SUMMARY


Congress has passed sweeping new legislation aimed at making credit cards safer and more transparent, but Americans are still waiting for the new law to protect them. Although the president signed the Credit CARD Act of 2009 last May, most parts of the bill will not take effect until February of 2010 or later. The new legislation came in the wake of last year's Federal Reserve Board determination that certain practices in the credit card industry were "unfair or deceptive" to consumers, and it targets many of those practices.

In July 2009, the Pew Health Group began a new study to evaluate how widespread these practices were and to identify trends since our last review in December of 2008. Our research included an examination of nearly 400 credit cards, including all consumer credit cards offered online by the largest 12 bank issuers in America. These banks control more than 90 percent of outstanding credit card debt nationwide.

We found that median advertised interest rates on bank credit cards were between 13 and 23 percent higher compared to rates in December of 2008, depending on a consumer's credit profile. Meanwhile, practices labeled "unfair or deceptive" by the Federal Reserve remained as widespread as they were before Congress passed the new credit card law. In fact, some of these practices had become even more common. In sum, all surveyed bank cards included at least one "unfair or deceptive" practice. None of these cards would have met the requirements of the Credit CARD Act.

Our recent review includes, for the first time, credit unions. Although the largest 12 credit unions control only 1 percent of overall credit card lending, many consumers will find it helpful to know that these credit unions offered prices that were generally lower compared to those of the largest banks. Also, because credit union penalty charges were both less frequent and less severe than those of banks, their cards may be useful benchmarks as the Federal Reserve creates new "reasonable and proportional" penalty rules, as required under the Credit CARD Act.

### SUMMARY OF FINDINGS

This report, based on our latest research of nearly 400 credit cards offered by the largest 12 bank and largest 12 credit union issuers, shows the following:

1. **One hundred percent of credit cards from the largest 12 banks used practices deemed "unfair or deceptive" under Federal Reserve guidelines. None of these bank issued cards would meet the requirements of the Credit CARD Act of 2009.**

- **99.7 percent of bank cards** allowed the issuer to raise interest rates on outstanding balances by changing the account agreement unilaterally—up from 93 percent in December 2008.
- **90 percent of bank cards** had penalty interest rates that could be triggered by late payments or overlimit transactions. All but 10 percent of these cards had penalty repricing terms that would qualify as "hair trigger" under Federal Reserve guidelines (triggers of one or two late payments in 12 months).
- **95 percent of bank cards** allowed issuers to apply payments in a manner that the Federal Reserve found likely to cause substantial monetary injury to consumers. The other 5 percent did not disclose the issuer's policy.

In addition, a new trend is emerging as bank issuers move away from fixed rate cards. More cards now feature partially variable interest rates with fixed minimum rate requirements. Rates on these cards will go up when third-party index rates rise but cannot decrease below a fixed minimum set by the issuer.



**Nick Bourke**
**Ardie Hollifield**
*The Pew Charitable Trusts*

## 2. As the Federal Reserve prepares new rules for "reasonable and proportional" penalties under the Act, banks continue to charge substantial penalty rates and fees.

Starting in August 2010, the Credit CARD Act will require penalty fees and charges to be "reasonable and proportional" to the "acts or omissions" of cardholders, based on rules the Federal Reserve will establish. Meanwhile, penalty rates and fees have remained mostly unchanged since Congress passed the new law:

- **99 percent of bank cards** included a late fee (median $39).
- **80 percent of bank cards** included an overlimit fee (median $39).
- **The median bank penalty interest rate** was 28.99 percent. Most (90 percent) penalty rate increases could continue indefinitely even if the cardholder resumes on-time payments.

Whether current levels of penalty fees and charges meet the new law's "reasonable and proportional" requirement will depend on rules the Federal Reserve is currently developing. Relevant factors may include how large the penalty is compared to the monthly required minimum payment or how long penalty rate increases may apply once cardholders return to on-time payment behavior.

## 3. Credit unions offered significantly lower advertised rates compared to bank credit cards, with penalty fees that were half the cost of comparable bank fees and fewer dangers associated with "unfair or deceptive" practices.

The observed credit unions presented a distinct alternative to credit card pricing and other practices of the observed banks. In July 2009, median advertised interest rates on cards from the 12 largest credit unions were between 9.90 and 13.75 percent annually, depending on a consumer's credit profile—approximately 20 percent lower than comparable bank rates. Meanwhile, credit union penalties were generally less severe than those of banks.

- **99 percent of credit union cards** included a late fee (median $20).
- **89 percent of credit union cards** included an overlimit fee (median $20).
- **The median credit union penalty interest rate** was 17.90 percent. These penalties were less likely to last indefinitely (one-third of penalties would terminate after 3 to 12 months of on-time payments) compared to those of banks.

Like bank cards, the vast majority of credit union cards included terms allowing the issuer to change any rates or terms at any time, or take other actions that the Credit CARD Act will eventually prohibit. However, compared to bank cards, credit union cards more closely complied with guidelines against "unfair or deceptive" practices that the Federal Reserve developed last year. For example, nearly half of the credit union cards included no penalty rates at all, and more than three-quarters of those that did have penalty rates would have met the Federal Reserve's fairness rules.

## KEY POLICY RECOMMENDATIONS

The Credit CARD Act of 2009 provides many important consumer protections. While some new disclosure rules became effective in August 2009, most substantive protections will not take effect until February of 2010 or later. Until then, banks may continue to raise rates on outstanding balances, use what the Federal Reserve labeled "hair trigger" penalty rate increases, apply payments in a way that maximizes interest costs, charge unrestricted overlimit fees and more.

Some banks have recently announced plans to discontinue overlimit fees, end mandatory arbitration programs or make other changes. However, more needs to be done to achieve the vision of safer and more transparent products that underpins recent legal developments. Congress is considering a new bill to accelerate the implementation date of the Credit CARD Act of 2009. Our research supports implementing the Act's core safeguards against retroactive interest rate increases and other costly practices immediately.

Going forward, bank regulators have a crucial role to play in ensuring the goals of the Act are met. In particular, the Federal Reserve is responsible for creating new rules to ensure that all penalty fees and charges are "reasonable and proportional."

Based on our latest research, and the Safe Credit Card Standards we developed after more than a year of analysis and dialogue with industry and consumer groups, we make the following key recommendations:

1. Congress should act to ensure rapid implementation of the core protections against "unfair or deceptive" practices found in the Credit CARD Act of 2009.

2. The Federal Reserve should regulate penalty interest rate increases, as well as fees, in its rules governing "reasonable and proportional" penalty charges under the Credit CARD Act.

   A. Regulators should provide consumers a guaranteed right to "cure" penalty rates, restoring original non-penalty rates after six months of on-time payment whether repayment begins immediately or in later billing cycles.

   B. Regulators should limit penalty interest rate increases to a maximum of seven percentage points above the non-penalty rate of interest.

3. The Federal Reserve should prohibit all credit card penalties that do not further the Act's goals of improving price transparency and protecting consumers from unfair, misleading or deceptive practices. Specifically,

   A. Late fees should be judged in proportion to the amount that is past due, not the overall account balance.

   B. Late fees that may apply immediately on the payment due date should be closely scrutinized for adherence to factors identified in the Act (cost, deterrence and cardholder conduct).

   C. Overlimit fees should be prohibited because they cannot be justified based on the factors identified in the Act. At a minimum, overlimit fees should be restrained significantly in terms of cost and when they may apply.

4. Bank regulators should scrutinize partially variable rates, which rise with changes in an index but cannot fall below a fixed minimum set by the issuer. Cards with partially variable rates including minimum rate requirements should not be eligible for exemptions to certain notice and interest rate rules under the Act, which were created for true variable rates.

Much of the data discussed in this report is summarized in the appendices.

## CREDIT CARD ANNUAL INTEREST RATES (APRs) AND FEES AT A GLANCE

| Median Fee or Charge | Bank Issuers | | Credit Union Issuers |
|---|---|---|---|
| | December 2008 | July 2009 | July 2009 |
| Purchase APR | 9.99% to 15.99% | 12.24%-17.99% | 9.90% to 13.75% |
| Cash advance APR | * | 20.24%-21.24% | 10.20% to 13.75% |
| Penalty APR | 27.99% | 28.99% | 17.90% |
| Late fee | $39 | $39 | $20 |
| Overlimit fee | $39 | $39 | $20 |
| Cash advance fee | * | 3% | 2% |
| Balance transfer fee | * | 3% | 2.5% |
| Overdraft protection fee | * | 3% | None |

*Notes: Data marked (*) above was not calculated for December 2008. December 2008 data for credit unions is not available. No credit unions offered overdraft protection. For purchase and cash advance annual percentage rates (APRs), issuers typically advertise a range of rates depending on a consumer's credit profile. Data represents all consumer credit cards offered online by the 12 largest bank and 12 largest credit union issuers, which together control more than 91 percent of credit card outstandings.*

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## INTRODUCTION

Despite recent legal developments that will create stronger consumer protections in the coming year, credit cards remain a potentially dangerous part of most Americans' financial lives. Though the Federal Reserve has lowered the federal funds rate to historic lows to make it easier and less costly for banks to borrow money, credit cardholders have not experienced a corresponding benefit. New research from The Pew Charitable Trusts shows that credit cards continue to include harmful practices and became more costly for American families in the first half of 2009.

Last December, the Pew Health Group's Safe Credit Cards Project conducted the first-ever comprehensive study of consumer credit card products from the largest bank issuers.[1] We found that practices labeled "harmful" and "unfair or deceptive" by the Federal Reserve were endemic.[2] Since then, the Federal Reserve and other regulators have announced groundbreaking new rules to protect consumers.[3]

In May, the president signed a new bill, the Credit CARD Act of 2009, which placed many of the Federal Reserve's proposals into law. The bill also added new protections, including many safeguards featured in Pew's Safe Credit Card Standards.[4] The new law will stop penalty interest rate increases on outstanding balances except when accounts are seriously delinquent, prevent rate increases generally during the account's first year, limit harmful penalty fees and introduce a host of other important protections.[5] Unfortunately for cardholders, most parts of the new law will not take effect until February of 2010 or later.[6]

Meanwhile, Pew began a new study of credit card products in July 2009. Our goal was to evaluate whether practices deemed "unfair or deceptive" last year by the Federal Reserve remained widespread, and how issuers were responding to the concerns reflected in recent regulatory and legislative actions. As before, this analysis included all consumer credit card products offered online by the largest 12 bank issuers, which controlled 90 percent of credit card debt nationwide.[7]

The following pages present the findings of our latest review. We show the interest rates, fees and penalty provisions for credit cards offered by the largest 12 bank issuers based on application disclosures gathered in July of 2009. Where possible, we show how these features have changed since our December 2008 survey or where new trends may be emerging. Also, for the first time, we include an analysis of cards from the largest 12 credit unions. Throughout the report, we provide comparisons between bank card and credit union card data. Although credit unions control only a small portion of credit card outstandings, comparisons between credit union and bank product models illustrate options available to consumers and potential benchmarks for future regulatory rulemaking efforts.

The report concludes with a set of recommendations for policymakers and issuers based on our research, our analysis of the Credit CARD Act and our Safe Credit CARD Standards.[8]

In sum, this report presents Pew's findings about the state of the credit card market on the eve of significant new federal regulations designed to eliminate unfair or deceptive practices and foster safer and more transparent products. How well these goals are realized depends on the decisions that both card issuers and regulators make during the coming months.

### ABOUT THE SAFE CREDIT CARDS PROJECT

In 2007, The Pew Charitable Trusts launched an effort, in partnership with the Sandler Foundation, to address growing concerns about perceived abuses in the credit card industry. The project team researched consumer use of credit cards, conducted economic analyses of card issuer operations and reviewed hundreds of credit card products. Our team spent more than a year in discussions with over 20 credit card providers and consumer groups. This work led to publication of our Safe Credit Card Standards, intended to support industry leaders and policymakers as they evaluate responses to the urgent needs of American cardholders. The Safe Credit Card Standards and other information are available at www.pewtrusts.org/creditcards.

## CREDIT CARD INTEREST RATE TRENDS

Starting in 2010, the Credit CARD Act will prevent issuers from raising interest rates on outstanding balances. As of July 2009, almost all surveyed bank card disclosures (99.72 percent) allowed the issuer to change any interest rate at any time—up from 93 percent of cards in December 2008. Among credit unions, the figure was 89 percent.

Our research also showed that advertised interest rates rose significantly in the first half of 2009. A significant number of issuers shifted toward a combination fixed/variable rate mechanism that allows rates to go up as indexes rise, but prevents rates from falling below a fixed minimum of the issuer's choosing. At the same time, penalty interest rate increases remained a nearly ubiquitous feature on bank cards. While the vast majority of bank credit cards continued to employ what the Federal Reserve characterized as "hair trigger" penalty repricing, only one credit union offered cards meeting that description.

A summary of interest rate data discussed below is provided in Appendix A.

### ADVERTISED INTEREST RATES

Credit card interest rates are rising. In July 2009, median advertised annual percentage rates (APRs) for purchases on bank issued cards were between 12.24 and 17.99 percent, compared to a range of 9.99 to 15.99 percent in December 2008 (issuers advertise a range of rates depending on applicant credit profiles).[9] Compared to December of last year, lowest advertised bank rates grew by more than 20 percent, while highest advertised rates grew by 13 percent.[10] It is difficult to measure the impact of rate increases on existing balances; however, our previous report identified that issuers raised rates on nearly one-quarter of existing accounts, costing consumers a minimum of $10 billion in a one-year period between 2007 and 2008.[11]

In general, the largest credit unions offered lower rates than did the largest banks. In July 2009, median advertised purchase rates were between 9.90 and 13.75 percent on surveyed credit union cards, approximately 20 percent lower than comparable bank rates.

Similarly, interest rates for bank cash advances were higher than their counterparts at credit unions. Median cash advance rates ranged from 20.24 to 21.24 percent for bank cards. For credit unions, median cash advance rates ranged from 10.20 to 13.75 percent, more than 35 percent lower than comparable bank rates.

### PENALTY INTEREST RATE INCREASES

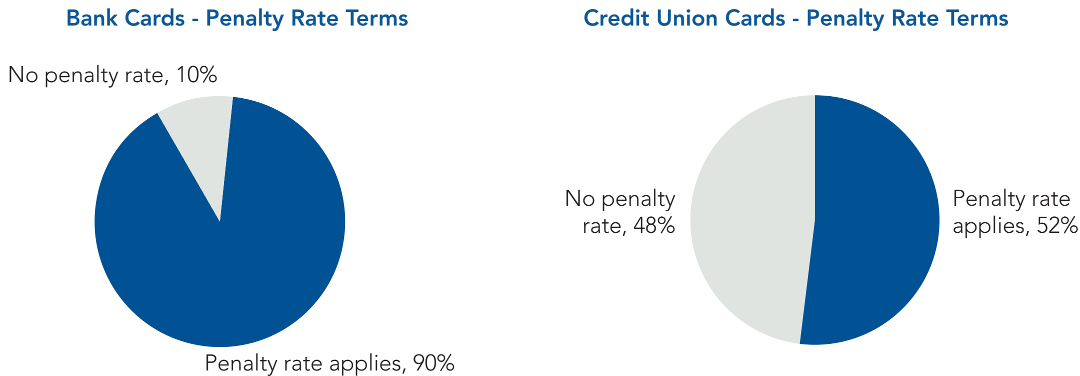
Credit card agreements often give issuers the power to impose penalty interest rate increases as a punishment for paying late, exceeding the credit limit or other reasons. Our review found that most issuers continued to include penalty rate terms on their cards, allowing interest rates on existing balances to jump as high as 30.24 percent.

#### *Data on Penalty Interest Rate Increases*

Penalty rate terms were most common among bank issuers. In July 2009, all of the largest 12 bank issuers used penalty rate provisions, affecting 90 percent of their card offerings. At the same time, 7 of the largest 12 credit union issuers imposed penalty rate terms, accounting for 52 percent of credit union cards.

FIGURE 1

**CREDIT CARDS WITH AUTOMATIC PENALTY INTEREST RATE INCREASES, JULY 2009**




*Note: Data represents all consumer credit cards offered online by the 12 largest bank and 12 largest credit union issuers, which together control more than 91 percent of credit card outstandings. Percentage of cards expressed as portion of all surveyed cards by type of issuer. All observed penalty rates applied to all balances (future and outstanding).*

**Bank penalty interest rate increases were more easily triggered than those of credit unions.**

- Among the subset of bank cards that included penalty rates, 51 percent could trigger penalty rates for a single missed due date, and most of the rest (39 percent) could be triggered upon the second missed payment in a 12-month period. In addition, 80 percent of bank penalty rates could be triggered by one or more overlimit transaction.
- Credit union penalty rate trigger periods were significantly longer compared to those of banks. One credit union offered cards with penalty rates that could be triggered upon the second late payment in 12 months. Otherwise, credit union penalty interest rate increases could apply only once accounts became 30 or more days paste due. None of the credit union cards included penalty triggers for exceeding the credit limit.

**Credit unions generally had lower penalty interest rates compared to banks.**

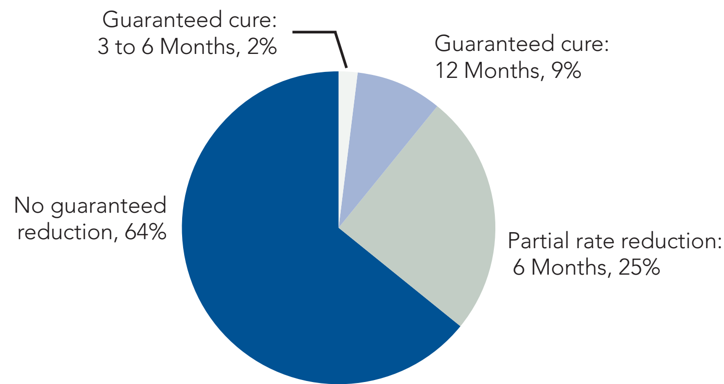
- As of July 2009, the median bank penalty rate was 28.99 percent, representing a premium of between 11.00 and 16.75 percentage points above median advertised purchase rates. Overall, the median bank penalty rate increased by one percentage point since December 2008. The maximum observed penalty rate on any surveyed card was 30.24 percent in July 2009, and the largest observed penalty premium was 23 percentage points above the advertised purchase rate.
- The median credit union penalty rate was 17.90 percent. This rate represents a premium of between 4.15 and 8.00 percentage points compared to median advertised credit union purchase rates.

**Once a penalty rate is triggered, most issuers claimed the right to impose the rate indefinitely, exposing cardholders to ongoing penalty charges even after they have re-established a history of timely payments.**

- Nineteen of the 24 surveyed issuers used penalty rates, but only 4 guaranteed they would restore original non-penalty rates once cardholders resumed on-time payment (referred to as "cure").
- Pentagon Federal Credit Union offered the shortest cure period (3 consecutive months of on-time payment), followed by USAA (6 months), Capital One (12 months) and Wescom (12 months).
- One issuer, Bank of America, promised to reduce rates partially after six months of on-time payments (by a minimum of two percentage points).
- The remaining 14 issuers included no definite cure provisions in their application disclosures.[12]

FIGURE 2

CURE PROVISIONS ON CREDIT CARDS WITH PENALTY RATES, JULY 2009




*Note: Chart represents the portion of all cards that included penalty rates (based on study of all consumer credit cards offered online by the 12 largest bank and 12 largest credit union issuers, which together control more than 91 percent of credit card outstandings). All assessments based on issuer-provided application disclosures. A "guaranteed cure" indicates that the issuer will restore the original non-penalty rate of interest automatically after receiving a given number of consecutive on-time payments. Percentage of cards expressed as portion of all surveyed cards.*

## ANALYSIS OF PENALTY INTEREST RATE TRENDS

While the Credit CARD Act will significantly alter credit card penalty rate practices when it takes effect next year, our survey shows that most of the largest issuers continue to fall far short of the new threshold.

Beginning in February, 2010, the Credit CARD Act will prevent issuers from triggering any kind of penalty rate increase on existing balances, except when accounts become 60 days past due. This requirement surpasses an earlier proposal, issued by the Federal Reserve under its authority to regulate "unfair or deceptive acts and practices," to create a 30-day threshold for penalty interest rate increases.[13] Under either guideline, penalty rate increases could only be justified by delinquent payments and not, for example, by overlimit transactions.

- As of July 2009, the vast majority of bank penalty rate triggers failed to meet either threshold from the Federal Reserve or from the Credit CARD Act.
- Conversely, the vast majority of credit union cards either did not include penalty rates or met the Federal Reserve 30-day penalty trigger threshold. Over half of the credit union cards that included penalty rates also complied with the 60-day trigger established in the Credit CARD Act. None of the credit union cards included a one-time late penalty trigger, and only one credit union issuer used penalty triggers that met the Federal Reserve's "hair trigger" definition. None of the credit union cards included penalty triggers for exceeding the credit limit.
- See Appendix B for a table summarizing the penalty rate triggers for each surveyed issuer. The table indicates whether each trigger would meet the Credit CARD Act's 60-day requirement or the Federal Reserve's 30-day "unfair or deceptive" threshold.

**With penalties that could instantly double the rate of interest (or more) and add hundreds or thousands of dollars per year to a cardholder's debt burden, credit cards retained their power to shock.**

- The median bank penalty rate, 28.99 percent, would add costs of between $110 and $167.50 annually (or up to $14 per month), for every $1,000 borrowed.
- In comparison, the 17.90 median credit union penalty rate would add between $41.50 and $80.00 annually (or up to $7 per month) per $1,000 borrowed.[14]
- In recent comments to the Federal Reserve, we demonstrated how accounts with modest balances of $3,000 would experience a 65 percent increase in the monthly minimum payment due based on existing penalty rate provisions.[15]

Under current law, a penalty rate increase may be permanent or temporary, at the issuer's sole discretion. Beginning in 2010, the CARD Act will require issuers to terminate penalty interest rate increases within six months of the date they are imposed, but only if the cardholder pays on time during that entire period. While this requirement will help many consumers, it will leave some without a remedy. If the cardholder does not pay on time starting immediately when the penalty is triggered, or misses a payment during that period, the law's cure period will not apply regardless of the cardholder's subsequent payment behavior.

Only two issuers (covering 2 percent of cards with penalty rates) offered cure periods that appeared to meet the new law's cure requirement. In each of these cases, however, the cure would exceed the law's mandate by applying even if the required period of on-time payments does not begin immediately after the penalty is imposed.

## PARTIALLY VARIABLE RATES WITH MINIMUM RATE REQUIREMENTS

Since December 2008, a new trend has emerged as issuers discontinue "fixed" interest rate offers and move toward partially variable rates that cannot fall below a fixed minimum.

### *Data on Partially Variable Interest Rates*

Nearly two-thirds (64 percent) of credit union cards featured "fixed" purchase rates in July 2009. Among banks, however, there was a strong trend against fixed rate pricing. Less than 1 percent of bank cards included fixed rates, down from 31 percent in December 2008.

As issuers move away from "fixed" rates, Pew's research shows, there is a related and possibly troublesome trend emerging. A growing number of credit cards include terms designed to ensure that even variable rates will not fall lower than a fixed minimum. For these cards, issuers will benefit as interest rates rise according to operation of an index rate, but many cardholders will be prevented from enjoying the benefits of falling index rates due to the fixed floor limits set by issuers. We call this mechanism a *minimum rate requirement*.

The example in Figure 3, taken from the application disclosure of a sampled credit card product, illustrates how the minimum rate requirement works. For this card, a minimum rate applies regardless of the disclosed variable interest rate formula.

Use of partially variable rates with fixed minimum rate requirements is growing rapidly, both in terms of the number of issuers using the requirement and the percentage of cards affected. Table 1 summarizes this phenomenon among the largest 12 bank issuers and the largest 12 credit union issuers.

FIGURE 3

## EXAMPLE CARD DISCLOSURE FEATURING MINIMUM RATE REQUIREMENT[16]

| | |
|---|---|
| **Annual percentage rate (APR) for purchases** | Introductory APRs range from 0.00% to 5.90% for the first 6 or 9 billing periods the account is open.[1] After that, APRs range from 8.65% to 22.65% depending on applicant's credit qualifications. |

| | |
|---|---|
| **Variable rate information** | Your APRs for purchase, cash advance and overdraft protection balances may vary. The purchase APR is determined by adding a margin ranging from 2.90 to 16.90 percentage points to the Index Rate. The cash advances and overdraft protection advances APR is determined monthly by adding 17.74 percentage points to the Index Rate. The Default Rate varies and is determined monthly by adding up to 23.99 percentage points to the Index Rate.[3] |

[3]This Index Rate is equal to the highest prime rate published in the Money Rates column of *The Wall Street Journal* three business days prior to your billing statement closing date, subject to the applicable minimum APRs. The standard APRs for purchases are subject to minimum rates ranging from 8.65% to 22.65% and will not decrease below the applicable minimum rate regardless of changes to the Index Rate. The standard APRs on cash advances and overdraft protection advances are subject to a minimum rate of 23.49% and will not decrease below 23.49% regardless of changes to the Index Rate.

TABLE 1

## PARTIALLY VARIABLE RATES WITH MINIMUM RATE REQUIREMENTS (MRR)

*Portion of Cards with MRR for Cash Advance Rate*

| | December 2008 | July 2009 |
|---|---|---|
| Banks | 10% (3 banks) | 38% (6 banks) |
| Credit Unions | n/a | 11% (3 credit unions) |

*Portion of Cards with MRR for Purchase Rate*

| | December 2008 | July 2009 |
|---|---|---|
| Banks | 1% (1 bank) | 9% (5 banks) |
| Credit Unions | n/a | 9% (2 credit unions) |

*Note: Percentage of cards expressed as portion of all surveyed cards by type of issuer (bank or credit union). Data represents all consumer credit cards offered online by the 12 largest bank and 12 largest credit union issuers, which together control more than 91 percent of credit card outstandings. December 2008 data for credit unions is not available.*

## ANALYSIS OF PARTIALLY VARIABLE INTEREST RATE TRENDS

The move away from "fixed" interest rates may be due to a change in how that term will be defined. On credit card products, the term "fixed rate" has meant that rates will not fluctuate according to a third-party index rate. It has not meant that the rate is unchangeable.[17] Starting in February 2010, the CARD Act will require that rates advertised as "fixed" must be unchangeable for a stated period of time. As noted above, fixed rates were almost entirely absent from our July 2009 review of bank card offerings.

As "fixed" rates have become rare, partially variable rates with fixed minimums have become more common. This mechanism affects cardholders by adding a premium on top of the interest rate that a variable formula would otherwise provide. In the example application above, the minimum rate requirement was 8.65 percent (for cardholders qualifying for the lowest advertised rate). While the disclosed variable rate formula would have yielded a rate of 6.15 percent (2.90 margin plus then-current index rate of 3.25 percent), the issuer's required minimum of 8.65 percent represented a premium of 2.5 percentage points.[18]

A list of all reviewed cards containing partially variable purchase rates with fixed minimum rate requirements is provided in Appendix A. Minimum rate premiums on surveyed cards ranged from (-1.75) to 5.00 percentage points for purchase rates, and from 0.00 to 5.00 percentage points for cash advance rates. A negative premium indicates the variable rate based on the current index is higher than the required minimum. Similarly, a zero-point premium indicates the two rates are equal.

## CREDIT CARD PENALTY FEE TRENDS

In addition to interest, most credit card issuers also charge a variety of fees that can sometimes add significantly to the cost of using a card. Almost every card in our survey included penalty fees for paying late, and most also included fees for exceeding the credit limit. Most cards continued to include penalty fees that would violate the Credit CARD Act's requirements, and in general, fee structures have changed little since December 2008.

Overall, penalty fees were slightly more common among credit union cards than among bank cards, but credit unions charged significantly lower fee amounts ($20 compared to $39 for most bank cards).

A summary of fee data discussed in this report is provided in Appendix C.

### LATE FEES

All 24 bank and credit union issuers and 99 percent of the cards they offered charged a penalty on cardholders who missed a payment due date. For bank cards, the median fee applicable to most accounts was $39. For credit unions, the median fee was $20.

Late fees on some cards are flat fixed fees, while on other cards they are tiered based on the outstanding account balance (for example, a late fee may be $29 for account balances up to $499.99 and $39 for balances $500 and up). All credit union late fees were fixed, while the late fee was tiered based on account balance on 95 percent of bank cards.[19] For these bank cards with tiered late fees, the amount of fee is demonstrated in Table 2. Most cards included three tiers of fees, with the lowest fee ($15) applying only to accounts with balances of $100 or less and the highest fee ($39) charged on accounts with balances exceeding $250. With these thresholds, the vast majority of bank card customers are subject to the maximum tiered late fee of $39 since the average outstanding balance per active credit card account is $2,901.[20]

**TABLE 2**

**CREDIT CARD LATE FEES, BANKS (TIERED ACCOUNTS), JULY 2009**

| | Median Balance Threshold | Median Late Fee | Range of Late Fee |
|---|---|---|---|
| Low tier | $0 to $100 | $15 | $15 to $25 |
| Middle tier | $100 to $250 | $29 | $15 to $29 |
| High tier | $250 or above | $39 | $35 to $39 |

*Note: Late fees on cards with tiered arrangements are based on the outstanding account balance. In the table above, the minimum late fee ($15 median) applies to accounts with balances up to $100 and the highest late fee ($39 median) applies to accounts with balances exceeding $250. The average outstanding balance per active credit card account is $2901 (Nilson Report, April 2009). Ninety-five percent of bank cards had tiered late fees, and 5 percent were fixed (median $39). All credit union late fees were fixed (median of $20).*

### OVERLIMIT FEES

Ten of 12 bank issuers and 10 of 12 credit union issuers charged a penalty fee for cardholders who exceeded their credit limits, but 4 of the 24 surveyed issuers did not use overlimit fees at all. These issuers were Pennsylvania State Employees' Credit Union, Schools First Federal Credit Union, Target and USAA. Overall, fees for exceeding the credit limit applied to 81 percent of cards in the sample (80 percent of the bank cards and 89 percent of the credit union cards).

As with late fees, all credit union overlimit fees were fixed. Among banks, approximately two-thirds of credit card overlimit fees were fixed, with the remainder tiered based on account balance or credit limit, as shown in Table 2.[21] Overall, the median overlimit fee applicable to most bank issued accounts was $39. For credit unions, the median fee was $20.

**TABLE 3**

**CREDIT CARD OVERLIMIT FEES, BANKS (TIERED ACCOUNTS), JULY 2009**

| | Median Balance Threshold | Median Late Fee | Range of Late Fee |
|---|---|---|---|
| Low tier | $0 to $500 | $15 | $15 to $19 |
| Middle tier | $500 to $1,000 | $25 | $15 to $29 |
| High tier | $1,000 or above | $39 | $35 to $39 |

*Note: Overlimit fees on cards with tiered arrangements are based on the outstanding account balance. In the table above, the minimum late fee ($15 median) applies to accounts with balances up to $500 and the highest late fee ($39 median) applies to accounts with balances exceeding $1,000. The average outstanding balance per active credit card account is $2901 (Nilson Report, April 2009). Two-thirds of bank cards had fixed overlimit fees (median $39). Among credit unions, all overlimit fees were fixed (median $20).*

### ANALYSIS OF CREDIT CARD PENALTY FEE TRENDS

The Credit CARD Act of 2009 includes several new rules on penalty fees, including limiting the circumstances in which issuers can charge late fees. The Act will also prohibit overlimit fees unless the cardholder proactively chooses to opt in to an overlimit program. As of July 2009, none of the cards with overlimit fees had instituted "opt in." In fact, none of the surveyed cards contained any provision to allow the cardholder to *opt out* of an overlimit fee. In addition, the new law will prohibit charging more than one overlimit fee per billing cycle. While it was unclear in the majority of instances whether surveyed cards met this requirement, some card disclosures specifically stated that the overlimit fee would be charged *per occurrence*.

Most significantly, the Act requires the Federal Reserve to issue rules ensuring that any penalty fee or charge, including a late or overlimit fee, is "reasonable and proportional" to the cardholder actions that trigger the penalty. This requirement is not scheduled to take effect until August 2010.

# OTHER CREDIT CARD TRENDS

## APPLICATION OF PAYMENTS

Currently, credit card issuers may choose to apply monthly payments in a way that maximizes interest charges. Many accounts have multiple types of balances, for purchases, balance transfers, cash advances and so on. Each balance can have its own interest rate that is higher or lower than other balances on the account. The Federal Reserve identified that when an issuer applies a cardholder's monthly payment first to balances with low interest rates before paying down high-rate balances, cardholders can suffer "substantial monetary injury" or lose the benefit of "low rate" promotional offers. Consequently, bank regulators called this practice "unfair or deceptive" in their 2008 rulemaking.[22]

In our December 2008 survey, we found that 100 percent of cards applied payments first to low-rate balances. Our July 2009 survey of cards found that 95 percent of bank issued cards continued the practice. The remaining 5 percent of cards expressed no application of payments policies.

Most credit union issuers were silent on their application of payments policies. Eight of the 12 credit union issuers surveyed expressed identical rates for all transaction types, meaning application of payments is not a relevant concern for those cards. Only one credit union issuer, Wescom, specifically stated a payment application policy; in this case, payments applied first to promotional balances then regular cash advance and purchase rate balances.

The Credit CARD Act requires amounts in excess of the minimum required payment be paid first to balances with the highest rates. Although this new rule will benefit many cardholders and help make advertised prices more reflective of the true cost of credit, issuers will remain free to apply a part of each payment first to low-rate balances. None of the 24 bank or credit union issuers surveyed explicitly complied with the new law, but one may infer compliance from the eight credit unions that offered a single rate for all transaction types.

## TRANSACTION SURCHARGE FEES

Transaction surcharges such as cash advance and balance transfer fees were common among the cards we reviewed. These fees are expressed as a percentage of each transaction, but typically a minimum fee applies (for example, the fee may be 3 percent of each balance transfer, with a minimum fee of $10). Less often, issuers will set a maximum fee cap as well.

Transaction surcharge fees are not "unfair or deceptive" practices under the Federal Reserve's recent rulemaking. Nor did the Credit CARD Act restrict their use.[23] As issuers adapt to the new regulatory environment, it is possible they will rely more heavily on unregulated fee income, including transaction surcharges. In fact, we found that one major issuer has already increased cash advance fees to 5 percent of each transaction. These surcharges may add significantly to the cost of "low rate" balance transfer offers, cash advances or other transactions. In this section, we provide information about how transaction surcharge fees are used in the market today.

Fee data discussed below is summarized in Appendix C.

### *Cash Advance Fees*

All of the largest 12 bank issuers charged cash advance fees, affecting 99 percent of bank cards. The median cash advance fee was 3 percent of the transaction amount with a range of 3 to 5 percent. By comparison, only half of the largest 12 credit unions disclosed cash advance fees, on 59 percent of their cards. The median credit union cash advance fee was 2 percent, with a range of 1.5 to 2.5 percent.

Almost all bank cards that had cash advance fees (99 percent) had a per-transaction required minimum fee, with a median of $10. Among credit unions, this figure was 58 percent, with a median required minimum fee of $2.

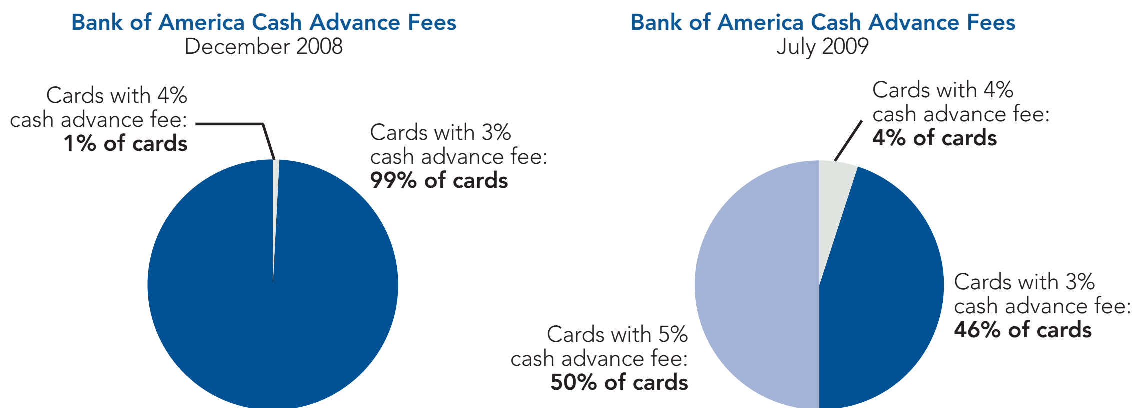
While 65 percent of credit union cash advance fees were capped (median $50 cap, with a range from $10 to $50), only 12 percent of bank cash advance fees included caps (median $75, with a range from $50 to $75).

Between December 2008 and July 2009, cash advance fees on bank cards generally remained constant. However, there is some evidence that higher fees are coming. The most notable change was at Bank of America, which, with more than 100 cards offered, had the most cards of any issuer in our review. As illustrated in Figure 4, half of Bank of America cards moved from a 3-percent cash advance fee in December 2008, to a 5-percent cash advance fee in July of 2009. This cash advance fee was the largest observed across all surveyed issuers.

FIGURE 4

**BANK OF AMERICA CASH ADVANCE FEES**

*Percent of all cards offered, December 2008 vs. July 2009*




*Note: Data represents all consumer credit cards offered at the Bank of America website during the periods shown.*

## BALANCE TRANSFER FEE

Balance transfer fees were present on 88 percent of bank cards and 25 percent of credit union cards surveyed. The median balance transfer fee for bank cards was 3 percent with a range of 3 to 4 percent. For credit union cards, the median balance transfer fee was 2.5 percent with a range of 2 to 2.5 percent.

Among banks, 94 percent of cards that had balance transfer fees also included a minimum fee requirement, of $5 (median). For credit unions, the figure was 100 percent, with a median required minimum balance transfer fee of $2.50.

While 100 percent of credit union cards charging a balance transfer fee included a maximum fee cap (median $50, ranging from $50 to $100), only 13 percent of bank cards did (median $75, ranging from $75 to $249). Because balance transfer fees were not calculated in Pew's December 2008 study, we are unable to estimate how they may have changed since then.

## OVERDRAFT PROTECTION FEE

On certain credit cards, overdraft protection services were available. Issuers offered overdraft protection as a way to help cardholders avoid overdraft fees on enrolled checking accounts by using credit card advances to cover any debits that would exceed the available checking account balance. For each transaction, the credit card issuer would impose a surcharge fee to the credit card account, similar to a cash advance fee.

While no credit union cards offered overdraft protection, 42 percent of the surveyed bank cards did offer it. The median bank credit card overdraft protection fee was 3 percent of the transaction amount, with a range of 3 to 4 percent. The median required minimum overdraft protection fee was $10 with a range of $5 to $10. About 9 percent of these cards expressed a maximum overdraft protection fee cap ranging from $10 to $20. As with balance transfer fees, overdraft protection was not a part of Pew's December 2008 review and so a trend analysis is not available.

### ANALYSIS

Recent legal developments have done little to inhibit the use of transaction surcharge fees, yet the fees merit attention because they can add significantly to the cost of using a credit card. Figure 5, an excerpt from a cardholder's monthly statement demonstrates how a $22 cash advance resulted in a $10 (45 percent) surcharge fee. Because the surcharge is treated as a finance charge under applicable bank law, the issuer's statement shows that the fee represents an effective APR of 539 percent.

**FIGURE 5**

### EXAMPLE CREDIT CARD STATEMENT WITH CASH ADVANCE FEE AND APPLICABLE APR[24]

| | | | | |
|---|---|---|---|---|
| Feb 07 | Feb 09 | LOGAN CIRCLE SUBWAY #2 WASHINGTON DC | 24427337039710012916904 5814 | $6.37 |
| Feb 08 | Feb 09 | BRANCH BANKING/CHURCH CIRANNAPOLIS MD | 74088107039336739007827 6011 | $22.00 |
| Feb 09 | Feb 09 | CASH ADVANCE FEE, A FINANCE CHARGE | 74088107039336739007827 0000 | $10.00 |

**FOR BILLING ERRORS AND IMPORTANT INFORMATION, SEE REVERSE OF PAGE 1.**

**Balance Category**

| | Average Daily Balance | Daily Periodic Rate | Corresponding APR | Finance Charges | Grace Terms |
|---|---|---|---|---|---|
| Purchase - Current Cycle | $0.00 | .0000% | 0.00% | $0.00 | Term A |
| Cash - Current Cycle | $1.80 | .0657%* | 23.99%* | $0.04 | Term B |

**Effective ANNUAL PERCENTAGE RATE (APR): 539.54%** ***These rates may vary.**

The Corresponding APR is the rate of interest you pay when you carry a balance on purchases or cash advances. The Effective APR represents your total finance charges - including transaction fees such as cash advance and balance transfer fees - expressed as a percentage.

### FEES FOR THE ISSUANCE OR AVAILABILITY OF CREDIT

Sixteen percent of bank cards and 11 percent of credit union cards charged an annual fee in July 2009. The median annual fee was $50 for bank cards and $15 for credit union cards. The prevalence of annual fees increased slightly since last year (Pew's December 2008 study found that 11 percent of bank cards charged an annual fee). However, there was no change in the median annual fee ($50). The range of annual fees for bank cards was substantial, from $19 to $500, while the range for credit union cards was smaller, $15 to $45.

Annual fees were the most common type of fee for issuance or availability of credit among observed cards. A small number of cards included monthly maintenance charges, such as fees for closed accounts that continue to have an unpaid balance. Some cards included provisional annual fees that would apply only after the first year or only if the cardholder failed to use the card to complete a transaction during the year.

The Credit CARD Act will prevent issuers from financing fees under certain circumstances but generally will not limit issuers' ability to charge fees for issuance or maintenance of accounts. Because accounts with multiple types of these fees can be difficult to evaluate in terms of cost and value, our Safe Credit Card Standards call for all such fees to be expressed as a single annual fee. Currently, most large issuers appear to follow that practice though we did observe some cards with multiple types of maintenance fees.

## MANDATORY ARBITRATION

Many consumer credit card agreements include mandatory binding arbitration clauses that prevent cardholders from suing issuers in a court of law. Instead, any disputes between the cardholder and issuer would be addressed through a binding arbitration process administered by a private company or individual. Based on our July 2009 review of credit card application disclosures from the 12 largest bank and 12 largest credit union issuers, nine bank issuers included a mandatory arbitration provision in these disclosures (covering 68 percent of bank cards). None of the surveyed credit unions indicated that mandatory arbitration would apply.[25] It is unclear from card applications whether the other 14 issuers did or did not have an arbitration clause as part of their full cardholder agreements.

The Credit CARD Act did not address arbitration clauses. However, arbitration can prevent cardholders from accessing courts to challenge unfair and deceptive practices or other legal violations, impairing individual rights and potentially allowing those violations to spread unchallenged by thorough legal or public scrutiny. Pew's Safe Credit Card Standards call for the elimination of pre-dispute, binding arbitration agreements.

In August 2009, Bank of America announced it will no longer enforce mandatory arbitration in disputes with customers and two other issuers, American Express and JPMorgan Chase and Co., announced that they are evaluating the practice as well.[26] These announcements came after the National Arbitration Forum settled a lawsuit with the Minnesota Attorney General and agreed to "voluntarily cease to administer consumer arbitration disputes" as of July 24, 2009.[27] Similarly, the American Arbitration Association recently announced that it will no longer handle consumer debt-collection cases.[28]

## POLICY RECOMMENDATIONS

Two recent federal legal initiatives have established strong new rules aimed at making credit cards safer for American consumers. The Federal Reserve's recent rules against "unfair or deceptive" acts and practices laid the foundation for reform while the Credit CARD Act of 2009 produced a number of strong new policies that will protect millions of American cardholders.

Issuers have a responsibility to further the goals of the Credit CARD Act by providing transparent pricing structures that promote responsible use of credit cards. Some issuers have made tentative steps in that direction. For example, American Express and Discover recently announced plans to phase out overlimit fees (four other issuers in our study do not charge the fee currently); and other issuers have withdrawn from practices such as mandatory binding arbitration.[29] Though commendable, these steps have not yet led to the elimination of unfair or deceptive practices. We encourage issuers to comply with the Credit CARD Act immediately, and to adopt the practices found in our Safe Credit Card Standards and discussed below.[30]

Likewise, policymakers have much work left to do. Congress is considering a new proposed bill, H.R. 3639, to accelerate the implementation date of the Credit CARD Act of 2009. Our research supports implementing the Act's core safeguards against "hair trigger" penalty rate increases and other costly practices immediately.[31]

Going forward, banking regulators have a responsibility under the Act to issue a variety of new rules. In particular, the Federal Reserve must establish guidelines for "reasonable and proportional" penalty fees or charges currently due to be implemented in August 2010.

The Pew Charitable Trusts has provided extended comments to the Federal Reserve Board on these provisions, and our recommendations are discussed below.[32] Additional information, including copies of our comment letters to regulators and the Safe Credit Card Standards we developed after more than a year of analysis and dialogue with industry and consumer groups, is available at www.pewtrusts.org/creditcards.

### 1. Congress should act to ensure rapid implementation of the core protections found in the Credit CARD Act of 2009.

Our research shows that practices the Federal Reserve deemed "unfair or deceptive" and "harmful" in 2008 have remained widespread in 2009. Issuers have continued to design their credit cards to give them the power to raise rates on outstanding balances, use what the Federal Reserve labeled "hair trigger" penalty rate increases, apply payments in a way that maximizes interest costs, charge unrestrained overlimit fees and more. Each year, these practices cost individual cardholders hundreds or thousands of dollars, and they collectively add billions of dollars in costs that are not adequately reflected in advertised credit card rates. Though the Credit CARD Act will eventually curtail these practices when it becomes fully effective in 2010, Congress should ensure that issuers immediately stop using the "unfair or deceptive" practices that are the focus of the Act's reforms.

### 2. The Federal Reserve should regulate penalty interest rate increases under its "reasonable and proportional" rules.

The Credit CARD Act requires the Federal Reserve to issue rules ensuring that all penalty fees and charges are "reasonable and proportional" to a cardholder's acts or omissions. As punishments for late payments or overlimit transactions, penalty interest rate increases qualify as a "penalty fee or charge" under the Act. Without regulation from the Federal Reserve, cardholders will be left at risk of drastic and indefinite penalty charges—even after they resume perfect on-time payment behavior. The Federal Reserve is responsible for ensuring that these penalties are not unreasonable or disproportionate.

The Act will clearly restrict when a penalty rate may apply (only once accounts are 60 days past due). It also establishes a minimum safeguard on how long penalty rate increases may apply (six months, if cardholders resume on-time payment immediately). However, it leaves the Federal Reserve to decide how large a penalty rate premium may be, or how long it may last for those cardholders who cannot repay immediately.

### A Regulators should provide consumers a guaranteed right to "cure" penalty rates, restoring original non-penalty rates after six months of on-time payment whether repayment begins immediately or in later billing cycles.

The Credit CARD Act provides a conditional right to cure, guaranteeing a right to return to non-penalty rates but only for cardholders who make six consecutive on-time payments beginning immediately when the penalty is applied.[33]

This conditional cure is not sufficient to ensure reasonability and proportionality. As demonstrated below, many cardholders will experience significant jumps in the required monthly minimum when penalty rates are triggered, and some will struggle to adjust immediately. With just a partial right to cure in place, penalty rates could apply indefinitely, even permanently, for anyone who pays on time for six months but does not begin doing so immediately when the penalty rate is triggered.

The Federal Reserve should presume that any penalty rate that may last indefinitely is in violation of the "reasonable and proportional" penalty requirements of the Credit CARD Act. Our Safe Credit Card Standards would require issuers to restore original non-penalty rates of interest whenever cardholders resume on-time payment behavior for six consecutive months.

### B Regulators should limit penalty interest rate increases to a maximum of seven percentage points above the applicable non-penalty rate.

Both as a way to control long-term penalty costs and to ensure against short-term price shocks caused by severe penalty rate increases, Pew's Safe Credit Card Standards include a maximum penalty rate premium of seven percentage points.[34]

Our research shows that the median penalty rate is 28.99 percent, or between 11 and 16.75 percentage points higher than median advertised non-penalty purchase rates. This penalty premium adds hundreds or thousands of dollars to per year to the cost of a credit card. Absent regulatory rules, most issuers will remain free to set penalty rates as high as they choose even after the Credit CARD Act takes effect.[35]

Regulatory review should consider how severely penalty rate increases affect the amount of the monthly minimum payment due. In recent comments to the Federal Reserve, we demonstrated how accounts with modest balances of $3,000 would experience a 65-percent increase in the monthly minimum payment due based on existing penalty rate provisions. By comparison, our recommended seven-point maximum penalty increase would add only 28 percent to the required monthly payment. This threshold would greatly reduce the risk of insurmountable price shocks to consumers while allowing issuers to generate millions of dollars of additional revenue to compensate for any marginal costs of delinquencies.[36]

## 3. The Federal Reserve should prohibit all credit card penalties that do not further the Act's goals of improving price transparency and protecting consumers from unfair or deceptive practices.

The Federal Reserve's responsibility for ensuring "reasonable and proportional" penalties under the Credit CARD Act includes the regulation of late and overlimit fees. Pew's June 25, 2009 comments to the Federal Reserve suggested specific guidelines for "reasonable and proportional" penalty fees, which are summarized below.[37]

### A Overlimit fees should be prohibited.

We question whether any overlimit fees can be justified based on the "reasonable and proportional" factors identified in the Credit CARD Act (cost, deterrence and cardholder behavior). Because overlimit transactions are processed automatically, it is unclear what additional costs the issuer may be said to incur due to a "violation or omission" of the cardholder.

Further, because the cardholder often will have incomplete information about the account's proximity to the credit limit, and because the issuer always can control whether the account exceeds the limit, it is difficult to see how an overlimit fee furthers such

goals as deterrence or punitive action. Indeed, better forms of deterrence and punishment are available, in the form of denied transactions.

Therefore, the best way to address overlimit fees is to prohibit them (issuers would remain free to allow certain transactions that exceed the account's credit limit, but could not charge a fee for it). Pew's Safe Credit Card Standards call for the elimination of overlimit fees entirely because they can cause unfair or confusing results for cardholders, and because of the complexities involved in safeguarding against potential abuses.

As noted above, four of the 24 issuers in our study included no overlimit fees on their credit cards. Other issuers, including American Express and Discover, recently announced that they will voluntarily discontinue the use of overlimit fees (though as of our July 2009 survey both issuers continued to charge overlimit fees on most advertised cards).[38] We encourage other issuers to simplify their products and improve price transparency by likewise eliminating overlimit fees.

**B If overlimit fees remain permissible, regulators should only accept a nominal overlimit fee amount, which may apply only once an account has exceeded the credit limit by a significant threshold.**

In judging whether the size of an overlimit fee is reasonable and proportional, regulators may look to a number of examples. As shown in this report, penalty fees at the largest credit unions are nearly half the size of those at large banks. Also, some states have set limits on penalty fees (California state banks may charge no more than a $10 overlimit fee, for instance).

Overlimit fees should only be permitted where an account is significantly overlimit. The threshold for determining "significant" should be large enough to avoid problems associated with a cardholder's lack of information about the account's proximity to the credit limit, holds placed against the account, "rent seeking" motivations on the part of the issuer, and so on ("rent seeking" refers to situations in which issuers would have a perverse incentive to allow or even encourage their customers to engage in "bad" behavior as a way of maximizing penalty fee income). For example, California allows its state banks to charge overlimit fees only where accounts are the lesser of five hundred dollars or 120 percent beyond their limit.[39]

A small number of issuers in our survey included an overlimit fee threshold, including Suncoast Schools Federal Credit Union (no overlimit fee unless balance exceeds limit by 5-percent threshold), Vystar Credit Union (1-percent threshold) and Wescom Credit Union (20 percent threshold).[40]

**C Late fees should be judged in proportion to the amount that is past due, not the overall account balance.**

Generally, the size of a late fee should be in proportion to the amount that is past due (i.e., the minimum payment due), not the overall account balance. The median late fee ($39) represents only 1.3 percent of the median household's credit card balance but approximately 60 percent of the applicable required minimum payment. A fee that increases the minimum payment due by 60 percent may be difficult to justify as being proportional.

**D Late fees that may apply immediately on the payment due date should be closely scrutinized for adherence to factors identified in the Act (cost, deterrence and cardholder conduct).**

For the fee to be based on deterrence and cardholder behavior factors, it is appropriate to create a leniency period of several days after the due date to ensure that the payment is not late due to factors beyond the cardholder's control, such as mail delivery or payment processing delays. A leniency period is especially appropriate given that issuers are unlikely to incur additional costs immediately on the due date.

Some issuers already provide such a leniency period. For example, five issuers in our review included in their application disclosures a leniency period before late fees would apply: Patelco Credit Union (late fee applies once account is 10 days past due), Schools First Federal Credit Union (15 days), Suncoast Schools Federal Credit Union ("5th day after due date or closing date whichever comes first"), Vystar Credit

Union (10 days) and Wescom Credit Union (15 days). In our conversations with other issuers, some indicated to us that they have a policy of allowing a leniency period before charging penalty fees but do not disclose it to cardholders.

**E In general, the Federal Reserve should narrowly interpret the justification factors for penalty fees and charges under the Credit CARD Act, and allow penalties only when they further the Act's primary goals of improving price transparency and protecting consumers from unfair, misleading or deceptive practices.[41]**

Section 102(b) of the Act instructs the Federal Reserve to establish rules for reasonable and proportional penalties based on three specific factors: the cost incurred by the creditor for the associated omission or violation, the deterrence value of the penalty and the conduct of the cardholder. The Federal Reserve may also identify other factors it deems appropriate.

The factors identified in the law (cost, deterrence and cardholder behavior) establish a very narrow basis for justifying penalties, including late and overlimit fees. The Federal Reserve's rules should reflect that narrowing approach, particularly in regard to the cost considerations that may justify a penalty. For example, the only relevant costs incurred by the creditor are those that relate to the specific "omission or violation" that is being penalized. Generally applicable costs of doing business, including risk exposure, must not be included; rather, the only relevant costs are whatever actual marginal costs the issuer incurs in responding to the penalized behavior.

Similarly, because the law is designed in favor of maximizing price transparency and market efficiency, the Federal Reserve's rules generally should err on the side of those goals by constraining the proliferation of confusing or potentially "rent seeking" fee structures.

For penalties that are not readily justifiable based on the factors provided in the law, the Federal Reserve should tolerate no more than nominal fees.

Our June 2009 comments to the Federal Reserve also included suggestions, not included here, on setting safe harbor guidelines for "reasonable and proportional" penalty fees.[42]

**4. Bank regulators should scrutinize partially variable rates, which rise with changes in an index but cannot fall below a fixed minimum set by the issuer. Cards with partially variable rates including minimum rate requirements should not be eligible for exemptions to certain notice and interest rate rules under the Act, which were created for true variable rates.**

In a comment letter to the Federal Reserve, dated September 21, 2009, we explained the following recommendations related to the trend toward partially variable rates with fixed "minimum rate requirements" explained above.[43]

**A The Federal Reserve should rule that card accounts with variable rates including fixed minimum rate requirements are not eligible for the variable rate exception to the general ban on retroactive rate increases.**

Beginning in February, 2010, Section 101(b) of the Credit CARD Act of 2009 will generally prohibit issuers from increasing the annual interest rate on any outstanding balance. However, the law provides a limited number of exceptions to this rule. One such exception allows variable interest rates to fluctuate in accordance with a credit card agreement that provides for changes in the rate "according to operation of an index" that is "not under the control of the creditor." This exception should not apply to cards with minimum rate requirements, and rate increases on outstanding balances should not be allowed based on index rate changes for these accounts. Partially variable rates do not meet the requirements for the exception under the law for at least three reasons. First, these accounts do not provide for changes "according to operation of an index." Furthermore, by placing a minimum fixed floor against which the index cannot operate, the issuer has exercised control over the index in a way that contradicts the law's requirements. Finally, accounts with minimum rate requirements do not justify an exception allowing rate increases on

outstanding balances because they allow issuers to expose cardholders to risk of higher rates if the index rises while limiting cardholders' ability to benefit if the index falls.

**B For similar reasons, the Federal Reserve should enforce the Credit CARD Act's 45-day notice and right to cancel rules on card accounts with minimum rate requirements.**

Section 101(a) of the Credit CARD Act requires issuers that wish to raise interest rates or make other significant changes to notify cardholders at least 45 days before doing so and to inform cardholders that they may reject the proposed changes and cancel the account. The same exceptions, including the variable rate exception, that apply to the prohibition against raising rates on outstanding balances (Section 101(b) of the Act) apply to these notice requirements. For the same reasons noted above, cards including minimum rate requirements should not be eligible for these exceptions in the case of notice requirements.

As use of minimum rate requirements increases, problems of deception or confusion may also arise. Currently, we have no data on the extent to which consumers are misled or deceived by the minimum rate rule. We encourage banking regulators to scrutinize the practice for compliance with the Credit CARD Act and to watch for signs that it is undermining the goals of that Act by hindering pricing transparency or exposing consumers to unfair, misleading or deceptive practices.[44]

## 5. Issuers and policymakers should take the following additional steps to make credit cards safer and more transparent

In addition to complying with the Credit CARD Act as quickly as possible, we encourage issuers to adopt our Safe Credit Card Standards. The Standards suggest guidelines not yet implemented by policymakers, including discontinuing the use of overlimit fees, removing mandatory arbitration clauses from consumer credit card agreements, imposing no more than a seven-point penalty interest rate premium and restoring original non-penalty rates of interest whenever a delinquent cardholder makes six consecutive on-time payments.[45]

Below are additional recommendations for issuers and policymakers, based on our recent research and the Safe Credit Card Standards

**A Transaction surcharge fees should be kept small enough to avoid becoming significant hidden costs that can undermine the value of "low rate" promotional offers.**

Because surcharge fees for balance transfers and other transactions have not been affected by recent legal developments aimed at protecting consumers, issuers may rely on them more heavily in the future. Surcharge fees can equate to high effective rates of interest, an outcome that cardholders may find surprising especially in conjunction with "low-rate" balance transfer offers. We encourage issuers to keep the transparency and fairness goals of the Credit CARD Act in mind to ensure that transaction surcharge fees do not become a significant hidden cost to cardholders. Policymakers should monitor these fees to ensure against misleading "low rate" promotional offers with unreasonably high transaction costs.

**B Fees for the issuance or availability of credit should be consolidated into a single fee for all accounts.**

The Pew Safe Credit Card Standards assert that all account maintenance fees should be expressed as a single annual fee. Consolidating fees in this way clarifies the cost to the cardholder and reduces incentives issuers may have to embed multiple service fees that make the overall price of credit difficult to identify or compare. The Federal Reserve has used the phrase "fees for the issuance or availability of credit" to include annual or periodic fees for account activity or inactivity as well as any non-periodic fees related to opening an account.[46] We have encouraged the Federal Reserve to strengthen its definition of this and other types of fees to help promote the specific goal of the Credit CARD Act to ensure price transparency and restrain penalty fees to reasonable levels.[47]

### C Payments should always be applied first to balances with the highest interest rate.

While the Credit CARD Act added an important new safeguard by requiring payments to be applied first to highest-rate balances, it provided a carve-out exempting minimum payment amounts from the rule. More could be done to protect consumers, particularly those who are struggling to get ahead of their debt in times of high unemployment.

Pew's Safe Credit Card Standards would require the entire amount of the payment, including the minimum amount due, be applied to the balances with the highest APRs first. Some have defended the minimum rate carve-out as a way to preserve low-rate promotional offers, but that argument rests on the assumption that issuers can only offer low-rate promotions if they attract customers with "low" rates but manipulate payments on the back end to maximize interest income.[48] We encourage issuers to reject this formula and to apply all payments first to high-rate balances. Also, we encourage policymakers to monitor cardholder experiences after the rule takes effect in 2010, to determine whether the carve-out can remain justified based on the value of promotional rates or other factors.

### D Mandatory arbitration clauses should not be part of consumer credit card contracts.

Neither the Credit CARD Act nor the regulations issued by the Federal Reserve directly address mandatory binding arbitration. Arbitration clauses in cardholder agreements limit a cardholder's legal rights to settle disputes with the issuer in a court of law, and instead require the cardholder to submit to the decision of a privately employed arbitrator. The Pew Safe Credit Card Standards continue to call for the elimination of pre-dispute binding arbitration. We encourage all credit card issuers to abandon the practice as Bank of America and others appear to be doing.[49]

## CONCLUSION

Those who hold credit cards have a responsibility to use their cards wisely and repay their debts promptly. But as Americans wait to see the benefits of legal actions intended to make credit cards safer and more transparent, responsible cardholders remain at risk of widespread unfair or deceptive practices. Congress can help by advancing the effective date of the core protections against these practices found in the Credit CARD Act of 2009.

The Federal Reserve and other regulators have much work to do. We encourage them to use their mandate to constrain the use of overlimit fees, ensure proportional late fees based on the amount that is past due and not the overall account balance, prevent unreasonably severe penalty charges by limiting the size and duration of penalty rate increases, and generally maximize transparency by minimizing hidden or unpredictable credit card costs.

Issuers, too, have a key role to play. Though the new laws are designed to restore competition in the American credit card marketplace based on transparent pricing, this goal will not be accomplished unless industry leaders embrace it.

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Shelley Hearne, Managing Director

**Project Team**
Nick Bourke
Eleni Constantine
Ardie Hollifield
Alexander Martone

All data on credit card pricing and terms presented in this report was acquired by The Pew Charitable Trusts from publicly available sources. Findings and recommendations are the sole responsibility of Pew.

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For more information on the Safe Credit Cards Project or the issues we cover, see **www.pewtrusts.org/creditcards.**

## APPENDIX A: INTEREST RATE DATA

### TABLE A-1: MEDIAN ADVERTISED ANNUAL PERCENTAGE RATES (APRs) - PURCHASES

| | Purchase APR — OVERALL | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Lowest Advertised APR | | Change (percentage points / % change) | | Highest Advertised APR | | Change (percentage points / % change) | |
| | December-08 | July-09 | | | December-08 | July-09 | | |
| All Banks | 9.99% | 12.24% | 2.25 points | 23% | 15.99% | 17.99% | 2.00 points | 13% |
| All Credit Unions | n/a | 9.90% | | | n/a | 13.75% | | |

| | Purchase APR — BANKS (TOP 12) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Lowest Advertised APR | | Change (percentage points / % change) | | Highest Advertised APR | | Change (percentage points / % change) | |
| | December-08 | July-09 | | | December-08 | July-09 | | |
| American Express | 13.99% | 13.24% | (-0.75) points | -5% | 13.99% | 13.24% | (-0.75) points | -5% |
| Bank of America | 9.99% | 11.99% | 2.00 points | 20% | 14.99% | 18.24% | 3.25 points | 22% |
| Barclays | n/a | 13.74% | | | n/a | 17.24% | | |
| Capital One | 14.90% | 17.80% | 2.90 points | 19% | 14.90% | 17.80% | 2.90 points | 19% |
| Chase | 9.99% | 10.24% | 0.25 points | 3% | 18.99% | 18.24% | (-0.75) points | -4% |
| Citi | 12.49% | 13.24% | 0.75 points | 6% | 13.99% | 16.24% | 2.25 points | 16% |
| Discover | 9.99% | 12.99% | 3.00 points | 30% | 17.99% | 18.99% | 1.00 points | 6% |
| HSBC (1) | 8.99% | 9.74% | 0.75 points | 8% | 17.99% | 14.74% | (-3.25) points | -18% |
| Target | 11.99% | 13.99% | 2.00 points | 17% | 20.99% | 22.99% | 2.00 points | 10% |
| U.S. Bank | 11.99% | 11.99% | 0.00 points | 0% | 13.99% | 16.24% | 2.25 points | 16% |
| USAA | 5.75% | 7.75% | 2.00 points | 35% | 16.90% | 18.90% | 2.00 points | 12% |
| Wells Fargo | 10.82% | 10.65% | (-0.17) points | -2% | 21.40% | 22.65% | 1.25 points | 6% |

Continued...

## TABLE A-1: MEDIAN ADVERTISED ANNUAL PERCENTAGE RATES (APRs) - PURCHASES

...continued

| | *Purchase APR — Credit Unions (TOP 12)* | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Lowest Advertised APR | | | | Highest Advertised APR | | | |
| | | July-09 | | | | July-09 | | |
| America First CU (2) | | 10.50% | | | | n/a | | |
| Boeing Employees CU | | 6.90% | | | | 18.00% | | |
| Digital FCU | | 8.50% | | | | 13.75% | | |
| Golden 1 CU | | 10.90% | | | | 13.00% | | |
| Navy FCU | | 9.40% | | | | 18.00% | | |
| Patelco CU | | 12.90% | | | | 12.90% | | |
| PA State Employees CU | | 9.90% | | | | 9.90% | | |
| Pentagon FCU | | 13.99% | | | | 13.99% | | |
| Schools First FCU | | 8.90% | | | | 17.90% | | |
| Suncoast Schools FCU | | 12.90% | | | | 12.90% | | |
| Vystar CU | | 10.90% | | | | 10.90% | | |
| Wescom CU | | 11.15% | | | | 13.15% | | |

Median amounts for lowest advertised rates and highest advertised rates are provided. Issuers typically advertise a range of rates that may apply depending on an applicant's credit profile. December 2008 figures are not available for credit unions, nor for Barclays (a new entrant to the top 12 issuer category since December due to Chase's acquisition of Washington Mutual). In the table above, "FCU" indicates Federal Credit Union.

(1) Because of limited availability of application disclosures on the HSBC website only one card is included in the survey. Other HSBC disclosures were not available until after personal identification such as social security numbers were provided.

(2) America First disclosures include a lowest possible rate but do not say how high rates may go; therefore, we have not included high advertised rates for this issuer.

## TABLE A-2: MEDIAN ADVERTISED ANNUAL PERCENTAGE RATES (APR) - CASH ADVANCE AND PENALTY RATES (JULY 2009)

| Overall | Cash Advance APR | | Penalty APR |
|---|---|---|---|
| | Low | High | |
| All Banks | 20.24% | 21.24% | 28.99% |
| All Credit Unions | 10.20% | 13.75% | 17.90% |

| Banks (Top 12) | Cash Advance APR | | Penalty APR |
|---|---|---|---|
| | Low | High | |
| American Express | 21.24% | 21.24% | 18.24% to 27.24% |
| Bank of America | 19.24% | 19.24% | 27.24% |
| Barclays | 20.24% | 20.24% | 30.24% |
| Capital One | 24.90% | 24.90% | 29.40% |
| Chase | 19.24% | 23.24% | 29.99% |
| Citi | 21.99% | 21.99% | 29.99% |
| Discover | 23.99% | 23.99% | 29.99% |
| HSBC (1) | 19.24% | 19.24% | 27.24% |
| Target | 25.99% | 25.99% | 29.99% |
| U.S. Bank | 20.99% | 20.99% | 28.99% |
| USAA | 7.75% | 18.90% | 11.00% to 22.15% |
| Wells Fargo | 23.49% | 23.49% | 27.24% |

| Credit Unions (Top 12) | Cash Advance APR | | Penalty APR |
|---|---|---|---|
| | Low | High | |
| America First CU (2) | 9.50% | 10.50% | n/a |
| Boeing Employees CU | 6.90% | 18.00% | 27.90% |
| Digital FCU | 8.50% | 13.75% | 17.50% |
| Golden 1 CU | 10.90% | 13.00% | 17.50% |
| Navy FCU | 11.40% | 18.00% | 17.90% |
| Patelco CU | n/a | n/a | n/a |
| PA State Employees CU | 9.90% | 9.90% | n/a |
| Pentagon FCU | n/a | n/a | 17.99% |
| Schools First FCU | 8.90% | 17.90% | 17.90% |
| Suncoast Schools FCU | 12.90% | 12.90% | n/a |
| Vystar CU | 10.90% | 10.90% | n/a |
| Wescom CU | 11.15% | 13.15% | 18.00% |

Median amounts for lowest advertised rates and highest advertised rates are provided. Issuers typically advertise a range of rates that may apply depending on an applicant's credit profile. Some credit unions do not disclose penalty interest rates or separate cash advance rates. In the table above, "FCU" indicates Federal Credit Union.

(1) Because of limited availability of application disclosures on the HSBC website, only one card is included in the survey. Other HSBC disclosures were not available until after personal identification such as social security numbers were provided.

(2) America First disclosures include a lowest possible rate but do not say how high rates may go; therefore, we have not included high advertised rates for this issuer.Disclosures do not specify a separate cash advance APR, but AmericaFirst charges a 1.5 percent cash advance fee so we have assumed the same rates for cash advances as for purchases.

## TABLE A-3: CARDS INCLUDING PARTIALLY VARIABLE RATES WITH FIXED MINIMUM RATE REQUIREMENTS (MRR) FOR PURCHASES

### THE MRR IS A FIXED MINIMUM RATE SET BY THE ISSUER. THE MRR PREMIUM IS THE DIFFERENCE BETWEEN THE RATE OTHERWISE PROVIDED BY THE VARIABLE RATE FORMULA AND THE REQUIRED MINIMUM RATE.

The table includes all credit cards from Pew's July 2009 survey that included terms designed to ensure that variable rates (advertised margin plus 3.25 percent Wall Street Journal prime index rate as of July 2009) will not fall lower than a fixed minimum. The difference between the fixed minimum and the rate given by the variable rate formula is the minimum rate requirement (MRR) premium. A negative premium indicates the variable rate based on the current index is higher than the required minimum. Similarly, a zero-point premium indicates the two rates are equal. Issuers typically advertise a range of rates that may apply depending on an applicant's credit profile, and the table shows MRR premiums for both lowest and highest advertised rates. The July 2009 survey included all consumer cards offered online by the largest 12 bank issuers and the largest 12 credit union issuers, which together control more than 91 percent of credit card outstandings.

| | | Lowest Advertised Rates | | | | Highest Advertised Rates | | | |
|---|---|---|---|---|---|---|---|---|---|
| Issuer | Card | Advertised Margin | Margin + 3.25 Index Rate | MRR | MRR Premium | Advertised Margin | Margin + 3.25 Index Rate | MRR | MRR Premium |
| Barclays | Clark Platinum MasterCard | 7.99% | 11.24% | 16.24% | 5.00% | 11.99% | 15.24% | 20.24% | 5.00% |
| Barclays | EmigrantDirect Platinum MasterCard | 5.99% | 9.24% | 14.24% | 5.00% | 12.99% | 16.24% | 21.24% | 5.00% |
| Barclays | EmigrantDirect World MasterCard | 5.99% | 9.24% | 14.24% | 5.00% | 12.99% | 16.24% | 21.24% | 5.00% |
| Barclays | Performance Bicycle Rewards MasterCard | 5.99% | 9.24% | 14.24% | 5.00% | 13.99% | 17.24% | 22.24% | 5.00% |
| Target | Visa Credit Card | 7.99% | 11.24% | 13.99% | 2.75% | 16.99% | 20.24% | 22.99% | 2.75% |
| USAA | American Express Cash Rewards | 1.75% | 5.00% | 7.75% | 2.75% | 12.90% | 16.15% | 18.90% | 2.75% |
| USAA | American Express Total Rewards | 1.75% | 5.00% | 7.75% | 2.75% | 12.90% | 16.15% | 18.90% | 2.75% |
| USAA | MasterCard Cash Rewards | 1.75% | 5.00% | 7.75% | 2.75% | 12.90% | 16.15% | 18.90% | 2.75% |
| USAA | MasterCard Total Rewards | 1.75% | 5.00% | 7.75% | 2.75% | 12.90% | 16.15% | 18.90% | 2.75% |
| Wells Fargo | Cash Back Card | 4.90% | 8.15% | 10.65% | 2.50% | 16.90% | 20.15% | 22.65% | 2.50% |
| Wells Fargo | Cash Back College Visa Card | 9.90% | 13.15% | 15.65% | 2.50% | 16.90% | 20.15% | 22.65% | 2.50% |
| Wells Fargo | College Visa Card | 5.90% | 9.15% | 11.65% | 2.50% | 15.90% | 19.15% | 21.65% | 2.50% |
| Wells Fargo | Home Rebate Card | 4.90% | 8.15% | 10.65% | 2.50% | 16.90% | 20.15% | 22.65% | 2.50% |
| Wells Fargo | Rewards Card | 4.90% | 8.15% | 10.65% | 2.50% | 16.90% | 20.15% | 22.65% | 2.50% |
| Wells Fargo | Visa Platinum Card | 2.90% | 6.15% | 8.65% | 2.50% | 16.90% | 20.15% | 22.65% | 2.50% |
| Digital Federal CU | Visa Classic Card | 3.00% | 6.25% | 8.50% | 2.25% | 10.50% | 13.75% | 8.50% | -5.25% |
| Digital Federal CU | Visa Gold Card | 3.00% | 6.25% | 8.50% | 2.25% | 10.50% | 13.75% | 8.50% | -5.25% |
| Digital Federal CU | Visa Platinum Card | 3.00% | 6.25% | 8.50% | 2.25% | 10.05% | 13.30% | 8.50% | -4.80% |
| U.S. Bank | College Rewards Visa | 7.99% | 11.24% | 11.99% | 0.75% | 16.99% | 20.24% | 20.99% | 0.75% |
| U.S. Bank | Young Adult Visa | 7.99% | 11.24% | 11.99% | 0.75% | 16.99% | 20.24% | 20.99% | 0.75% |
| U.S. Bank | Bed Bath & Beyond MasterCard | 10.99% | 14.24% | 14.99% | 0.75% | 10.99% | 14.24% | 14.99% | 0.75% |
| U.S. Bank | Cache Specialty Rewards Visa Platinum Card | 7.99% | 11.24% | 11.99% | 0.75% | 16.99% | 20.24% | 20.99% | 0.75% |
| U.S. Bank | Sierra Trading Post Rewards Visa Platinum | 7.99% | 11.24% | 11.99% | 0.75% | 16.99% | 20.24% | 20.99% | 0.75% |
| U.S. Bank | SKYPASS Visa No Annual Fee | 12.99% | 16.24% | 16.99% | 0.75% | 12.99% | 16.24% | 16.99% | 0.75% |
| U.S. Bank | SKYPASS Visa Signature | 12.99% | 16.24% | 16.99% | 0.75% | 12.99% | 16.24% | 16.99% | 0.75% |
| U.S. Bank | Cash Rewards Visa Platinum | 5.99% | 9.24% | 9.99% | 0.75% | 18.99% | 22.24% | 22.99% | 0.75% |
| U.S. Bank | Select Rewards Visa Platinum | 5.99% | 9.24% | 9.99% | 0.75% | 18.99% | 22.24% | 22.99% | 0.75% |
| U.S. Bank | Travel Rewards Visa Platinum | 5.99% | 9.24% | 9.99% | 0.75% | 18.99% | 22.24% | 22.99% | 0.75% |
| U.S. Bank | Visa Platinum | 5.99% | 9.24% | 9.99% | 0.75% | 18.99% | 22.24% | 22.99% | 0.75% |
| U.S. Bank | Visa Signature | 5.99% | 9.24% | 9.99% | 0.75% | 5.99% | 9.24% | 9.99% | 0.75% |
| U.S. Bank | Harley-Davidson High Performance Visa | 9.99% | 13.24% | 13.99% | 0.75% | 9.99% | 13.24% | 13.99% | 0.75% |
| U.S. Bank | Gymboree Visa Platinum Card | 11.99% | 15.24% | 15.99% | 0.75% | 11.99% | 15.24% | 15.99% | 0.75% |
| US Bank | DISTANCIA Visa Card | 11.99% | 15.24% | 15.99% | 0.75% | 11.99% | 15.24% | 15.99% | 0.75% |
| US Bank | DISTANCIA Visa Signature Card | 11.99% | 15.24% | 15.99% | 0.75% | 11.99% | 15.24% | 15.99% | 0.75% |
| Navy Federal CU | Navy FCU CashRewards Visa | 6.40% | 9.65% | 7.90% | -1.75% | 13.40% | 16.65% | 18.00% | 1.35% |

# APPENDIX B: PENALTY INTEREST RATE TRIGGERS

### TABLE B-1: ISSUER PENALTY RATE TRIGGERS
### COMPLIANCE WITH FEDERAL GUIDELINES ON PENALTY INTEREST RATE TRIGGERS – JULY 2009

*The following table summarizes credit card penalty triggers (the events that can cause penalty interest rate increases to apply) for the largest 12 bank and largest 12 credit union issuers based on a review of application disclosures in July of 2009. The table indicates whether the issuer's current penalty trigger would comply with federal consumer safety guidelines scheduled to take effect in 2010.*

| | Penalty Trigger | CARD Act of 2009 *60-day trigger Effective 2/22/2010* | Federal Reserve Rules *against "unfair or deceptive acts" 30-day trigger Not active - superseded by CARD Act* |
|---|---|---|---|
| America First CU | None (no penalty rates) | ✓ | ✓ |
| Patelco CU | None (no penalty rates) | ✓ | ✓ |
| PA State ECU | None (no penalty rates) | ✓ | ✓ |
| Suncoast Schools FCU | None (no penalty rates) | ✓ | ✓ |
| Vystar CU | None (no penalty rates) | ✓ | ✓ |
| Golden 1 CU | 60 days past due twice in 12 months, or 90 days past due | ✓ | ✓ |
| Digital FCU | 30 days past due twice in 6 months | ✗ | ✓ |
| Schools First CU | 30 days past due twice in 12 months | ✗ | ✓ |
| Wescom CU | 30 days past due twice in 12 months | ✗ | ✓ |
| Pentagon FCU | No payment by "second due date" | ✗ | ✓ |
| USAA | Account is "two payments past due" | ✗ | ✓ |
| Boeing ECU (1) | • 30 days past due; or<br>• "Your Account is considered in default for any reason" | ✗ | ✗ |
| Wells Fargo (2) | • No payment for "two consecutive billing periods;" or<br>• Over limit two consecutive months | ✗ | ✗ |
| Capital One (3) | Three days late twice in 12 months | See note | See note |
| US Bank | • 15 days past due;<br>• Five days late twice in 12 months (some cards); or<br>• Over limit twice in 12 months | ✗ | ✗ |
| Navy FCU | Twice late in 12 months | ✗ | ✗ |
| Bank of America (4) | Twice either late or over limit in 12 months | See note | See note |
| American Express (5) | • Once or twice late in 12 months; or<br>• Over limit three times in 12 months | ✗ | ✗ |

Continued...

## TABLE B-1: ISSUER PENALTY RATE TRIGGERS ...continued

| | Penalty Trigger | CARD Act of 2009<br>*60-day trigger*<br>*Effective 2/22/2010* | Federal Reserve Rules<br>*against "unfair or deceptive acts"*<br>*30-day trigger*<br>*Not active - superseded by CARD Act* |
|---|---|---|---|
| Target | One time late | ✗ | ✗ |
| Discover | • One time late; or<br>• Twice over limit in 12 months (most cards) | ✗ | ✗ |
| Chase (6) | • One time late; or<br>• One time overlimit (most cards) | ✗ | ✗ |
| Citi | • One time late;<br>• One time over limit (most cards); or<br>• "If you default under any card agreement you have with us" | ✗ | ✗ |
| Barclays | One time late or over limit | ✗ | ✗ |
| HSBC (7) | One time late or over limit | ✗ | ✗ |

*Notes: The Credit CARD Act of 2009 (Pub. L.111-24) will ban all penalty rate increases on existing balances except where the account is 60 days past due, while the Federal Reserve would have used a 30-day threshold (74 FR 18 5498 et. seq., originally scheduled for implementation in July 2010 but superseded by Credit CARD Act). Neither guideline has taken effect yet, so current non-compliance does not indicate a violation of law or regulation. Data represents all consumer credit cards offered online by the 12 largest bank and 12 largest credit union issuers, which control more than 91 percent of credit card outstandings All assessments based solely on issuer-provided application disclosures. In the table above, "FCU" indicates Federal Credit Union and "ECU" indicates Employees' Credit Union.*

*Unless otherwise noted in the table above or in the notes below, our survey found that all cards from a given issuer have identical penalty interest rate terms. Not all triggers are shown; for example, some penalty rates could also be triggered if a payment is not honored by the cardholder's bank. We interpreted the terms "second due date," "two payments past due," and "two consecutive billing periods" to indicate that penalty rates could apply to accounts that are more than 30 but fewer than 60 days past due.*

*(1) Though Boeing Employees' Credit Union included a 30-day trigger, we did not consider their cards as meeting the Federal Reserve threshold because the penalty rate could also apply if the account "is considered in default for any reason."*

*(2) Wells Fargo cards would have met the Federal Reserve threshold but for the overlimit trigger.*

*(3) All Capital One cards included penalty interest rates, with one exception. The MTV Visa card for those with limited credit included no penalty rate and would therefore meet the thresholds set by the Credit CARD Act and the Federal Reserve.*

*(4) Nearly three-quarters of all Bank of America Cards included penalty interest rates with a trigger of either two times late or overlimit (overlimit was not a trigger for Visa Signature and World MasterCard accounts, which do not have set credit limits), and these cards would not meet the Credit CARD Act nor the Federal Reserve penalty trigger thresholds. Approximately one-quarter of Bank of America cards, a group of cards marketed for students, included no penalty rates and would therefore meet these thresholds.*

*(5) All American Express cards included penalty interest rates. The majority included a two-tiered trigger, where a "default" rate applies after one late payment and a "serious default" rate applies after the second late payment in 12 months; the remainder included a trigger of 2 late payments in 12 months.*

*(6) One Chase card, the* Disney Rewards Visa *card, included a trigger other than what is shown above (trigger is two times late in six months).*

*(7) Because of limited availability of application disclosures on the HSBC website, only one card is included in the survey. Other HSBC disclosures were not available until after personal identification such as social security numbers were provided.*

# APPENDIX C: FEE DATA

## TABLE C-1: MEDIAN PENALTY FEES - JULY 2009

| | Late Fee (1) | | Overlimit Fee (2) | |
|---|---|---|---|---|
| | Cards w/Fee | Amount | Cards w/Fee | Amount |
| Banks | 99% | $39 | 80% | $39 |
| Credit Unions | 100% | $20 | 89% | $20 |

*(1) All credit union late fees were fixed. For bank issued cards, 5 percent of late fees were fixed with a median fee of $39, and the remainder were tiered with a median fee of $39 applying to accounts with balances $250 and up.*

*(2) All credit union overlimit fees were fixed. For bank issued cards, 63 percent of overlimit fees were fixed with a median fee of $39, and the remainder were tiered with a median fee of $39 applying to accounts with balances $1,000 and up.*

*(3) The average outstanding balance per active account is $2,901according to the August 2009 Nilson Report. Therefore, the maximum tiered rates would usually apply.*

## TABLE C-2: MEDIAN TRANSACTION SURCHARGE FEES - JULY 2009

| | Cash Advance Fee (1) | | | | Balance Transfer Fee (1) | | | |
|---|---|---|---|---|---|---|---|---|
| | Cards w/Fee | Fee Amount (%Txn) | Minimum (% cards) | Fee Cap (% cards) | Cards w/Fee | Fee Amount (%Txn) | Minimum (% cards) | Fee Cap (% cards) |
| Banks | 99% | 3% | $10 (98%) | $75 (12%) | 88% | 3% | $5 (94%) | $75 (13%) |
| Credit Unions | 59% | 2% | $2 (58%) | $50 (65%) | 25% | 2.5% | $2.50 (100%) | $50 (100%) |

*Notes: Minimums and fee caps are expressed as a percentage of all cards that include the fee.*

*(1) Transaction surcharge fees are stated as a percentage of the transaction. Most cards require a minimum fee regardless of transaction size. Some cards also include a maximum fee amount, or "fee cap." The table above indicates these minimums and caps and the percentage of applicable cards that include them.*

*(2) These figures represent cards expressing a standard balance transfer fee and their respective minimums and maximums. We have not included data on promotional balance transfer fees.*

# APPENDIX D: METHODOLOGY

Through ongoing research documenting practices across a broad range of products offered by the credit card industry, we seek to provide information and recommendations to support the development of sound policy, regulatory and business decisions.

Data in this report is based on an analysis of application disclosures provided by credit card issuers at the time a consumer applies for a credit card. Between July 8 and July 10 of 2009, Pew's research staff gathered these disclosures for all consumer credit card products offered online by the country's 12 largest bank issuers and 12 largest credit union issuers, identified in Table D-1 below. The largest 12 bank issuers hold $780.8 billion, or 90.4 percent of the overall credit card debt of $864 billion and include the top 10 Visa and MasterCard issuers, plus American Express and Discover. The largest 12 credit unions hold $9.4 billion or 1.1 percent of overall credit card debt and include the top 12 Visa and MasterCard issuing credit unions.[50]

## TABLE D-1: CREDIT CARD ISSUERS INCLUDED IN THE STUDY

| Bank Issuers | Credit Union Issuers |
|---|---|
| American Express | America First CU |
| Bank of America | Boeing Employees (BECU) |
| Barclays | Digital Federal CU |
| Capital One | Golden 1 CU |
| JPMorgan Chase | Navy Federal CU |
| Citigroup | Patelco CU |
| Discover | Penn. State Employees (PSECU) |
| HSBC | Pentagon Federal CU |
| Target | SchoolsFirst Federal CU |
| U.S. Bank | Suncoast Schools Federal CU |
| USAA Savings | VyStar CU |
| Wells Fargo | Wescom CU |

*Note: Due to limited availability of online application disclosures, only one of HSBC's cards is included in the survey. Other HSBC disclosures were not available until after personal identification, such as social security number, was provided. Also, because of the limited information available on its Web site, Arizona Federal Credit Union was excluded from the study despite being one of the 12 largest credit union issuers. We replaced it with Patelco Credit Union, the next-largest credit union issuer by volume.*

The data set included nearly 400 consumer credit card products offered by these top issuers. All cards were visible on issuers' websites and available for review to the general public. For each issuer, every Visa, MasterCard, American Express, and Discover branded consumer credit card was reviewed, including student cards but not including secured or business cards.

The analysis is based on the contractual powers of card issuers as provided in the application disclosures that issuers are required by law to provide to potential customers. Researchers coded each set of disclosures into a database, accounting for pricing terms (interest rates, fees), penalty conditions (triggers for penalty pricing, applicable cure periods), payment terms (application of payments, grace periods), change in terms conditions and so on. Data for July, 2009, in this report is based on this analysis. Data for December, 2008, is based on our previous report in which we conducted a similar analysis of the top 12 bank issuers.[51]

In most cases, the application disclosures provide complete information about the terms we reviewed. In some cases, however, issuers provided only incomplete information. For example, not all issuers disclose terms of mandatory arbitration agreements in the application disclosures. Therefore, we have reported whether the application disclosure mentions arbitration or not, but do not presume to know the details of the agreements. Similarly, we have reported whether the issuer has disclosed its contractual right to impose penalty interest rate increases, or the consumer's contractual right to cure the penalty and return to the originally agreed rate, but we do not presume to know the full extent of an issuer's policies on the use of penalty pricing. This approach is consistent with our viewpoint that consumers who are shopping for credit cards should understand their contractual rights and obligations before entering into an agreement, and know where issuers have sole discretion to decide important terms.

This report presents comparisons between credit cards offered by the largest 12 bank issuers and those from the largest 12 credit union issuers. We understand that for some analytical purposes a comparison between banks and credit unions would require more statistical nuance to account for the differences in size (the credit unions only hold about 1 percent of outstandings versus 90 percent for the banks), scope (demographics, credit profiles, geography), general risk factors (credit unions often offer cards that are tied to deposit accounts or in conjunction with membership regimes that allow for better risk control) and the like. Indeed, some members of the banking community have cautioned that providing simple comparisons between bank and credit union credit cards may be misleading if it is not controlled for these and other factors, such as chargeoff rates.

However, our purpose in providing the comparison is not to explain why banks have higher pricing or include more punitive terms on their credit cards. Rather, our purpose is to give useful comparative pricing information for consumers and to suggest possible benchmarking data for policymakers to analyze as they see fit. The Credit Union National Association has recently released data showing that there are 92.4 million credit union members, suggesting that these financial institutions' products are viable options for many Americans.[52]

## NOTES

[1] Results from our December 2008 study are summarized in The Pew Charitable Trusts, "Safe Credit Card Standards: Policy Recommendations for Protecting Credit Cardholders and Promoting a Functional Marketplace" (March, 2009), available at www.pewtrusts.org/our_work_detail.aspx?id=630. Additional findings are included in issue briefs and commentary available at www.pewtrusts.org/creditcards.

[2] For the Federal Reserve's comments on "harmful" and "unfair or deceptive" practices, see Board of Governors of the Federal Reserve System, Office of Thrift Supervision, Treasury and National Credit Union Administration, "Unfair or Deceptive Acts or Practices," 74 FR 18 (January 29, 2009) at p. 5498 et. seq.

[3] Ibid.

[4] See The Pew Charitable Trusts (March, 2009), supra note 1.

[5] For the text of the Credit CARD Act of 2009, see Pub. L. 111-24 at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_public_laws&doc.d=f.publ1024.111pdf. For a summary of the Act, see Senate Banking Committee, "Summary: 'The Credit Card Accountability Responsibility and Disclosure Act,' The CARD Act of 2009," (May 19, 2009), available at http://banking.senate.gov/public/_files/051909_CreditCardSummaryFinalPassage.pdf.

[6] Most consumer protections under Title I of the Credit CARD Act of 2009 are scheduled to take effect on February 22, 2010. These include the prohibiting retroactive rate increases (with few exceptions) and double cycle billing, applying overlimit fee safeguards such as requiring specific consumer opt-in before the fee may apply, and requiring payments beyond the minimum payment due to be applied first to high-rate balances. Some protections have already become effective (advance notice and notice of right to cancel requirements). Other protections will not become effective until August 22, 2010, including "reasonable and proportional" penalty fee and charges rules, and the requirement that issuers implement policies allowing for the reduction of interest rates following interest rate increases that are predicated on risk factors. See Pub. L. 111-24.

[7] Issuer size is based on total outstanding credit card balances. Market data from Nilson, infra note 49. For an explanation of how we selected issuers and what issuers are included in the study, please see the Methodology section of this report.

[8] The Safe Credit Card Standards and related information are available at www.pewtrusts.org/creditcards. To date, Pew has submitted two letters to the Federal Reserve commenting on its current rulemaking efforts under the Credit CARD Act. See Nick Bourke, "Reasonable and Proportional Rules under Credit CARD Act of 2009 (Pub L. 111-24)" (The Pew Charitable Trusts, June 25, 2009), available at www.pewtrusts.org/news_room_detail.aspx?id=53840; see also Nick Bourke, "Regulation Z; Docket No. R-1364 (Interim Final Rule)" (The Pew Charitable Trusts, September 21, 2009), available at http://www.pewtrusts.org/news_room_detail.aspx?id=55149. Some of our comments are discussed within this report. See the Policy Recommendations section of this report for more discussion.

[9] In preliminary findings from this survey, Pew found that the median lowest advertised rate for bank issued cards in July of 2009 was 11.99 percent per year. Further analysis showed that rate to be 12.24 percent, due to the action of minimum rate rule mechanisms that allow issuers to advertise partially variable rates that rise according to a third-party index, but cannot fall below a fixed minimum rate. This minimum rate requirement mechanism and its use are discussed elsewhere in this paper. After accounting for applicable minimum rate requirements on the surveyed cards, we found that the median lowest interest rate was 12.24 percent per year. A similar review of our December 2008 data showed that minimum rate requirements did not affect median rates as determined in our original analysis.

[10] Pew's December 2008 survey found that median lowest advertised purchase rates on cards from the largest 12 banks ranged from 9.99 to 15.99 percent.

[11] The Pew Charitable Trusts, March, 2009, at p. 2. As the report noted, actual charges were likely far higher. The repricing events on outstanding balances for the affected accounts generated at least $10 billion in additional interest charges from a sample of accounts representing only 70 percent of outstanding balances. The calculation was based on a review of credit card issuer data supplied to the Federal Reserve by Morrison & Foerster in conjunction with Argus Information & Advisory Service.

[12] Bank of America's terms state that APRs will be reduced "a minimum of two percentage points, possibly as low as the previously applicable APR," after six consecutive on-time payments. We are aware that some issuers may disclose additional information about penalty rates in their cardholder agreements. Unfortunately, none of the surveyed banks would provide us with cardholder agreements when we requested them. Though some credit unions made the agreements available to us, a thorough review was not possible.

[13] The Federal Reserve and other banking regulators determined that "applying an increased annual percentage rate to an outstanding balance causes substantial consumer injury." To help offset that injury, their rules against unfair or deceptive acts or practices, announced in December 2008 for enactment on July 1, 2010, would have prohibited any penalty interest rate increase, including those triggered by overlimit conditions, except when an account becomes 30 days past due. Board of Governors of the Federal Reserve System, Office of Thrift Supervision, Treasury and National Credit Union Administration, "Unfair or Deceptive Acts or Practices," 74 FR 18 (January 29, 2009) at p. 5498 et. seq. The Credit CARD Act of 2009, passed in May of this year, superseded the Federal Reserve guideline by enacting a more stringent restriction, with penalty rate increases on existing balances prohibited unless an account is 60 days or more past due. See Pub. L. 111-24.

[14] When estimating annual interest charges per $1,000 borrowed, we use a simple interest calculation based on an average daily balance of $1,000.

[15] Bourke (June 25, 2009), supra note 8, at p. 18.

[16] Source: Wells Fargo Visa Platinum application disclosures taken from the Wells Fargo website, July 9, 2009.

[17] Our December 2008 survey found that 93 percent of surveyed bank cards, including all but two fixed rate cards, allowed the issuer to change the account agreement or any interest rate at any time.

[18] The current prime rate is published by the *Wall Street Journal*, available at http://online.wsj.com/mdc/public/page/mdc_bonds.html. Historical prime rates are available from the Federal Reserve Bank of St. Louis, available at http://research.stlouisfed.org/fred2/data/PRIME.txt

[19] Some products, including the majority of Barclaycard bank credit cards, include tiered penalty fees but stipulate that the maximum disclosed fee may apply if an account is in a delinquency status. America First credit union late fees were expressed as 5 percent of the *past due amount* (i.e., the minimum required payment), with a minimum of $10. We treated this fee as a $10 fixed fee since the vast majority of accounts would never be subject to a higher or a lower late fee.

[20] For average balance per active account, see The Nilson Report, Issue # 924 (April 2009). "Active accounts" includes any account with a revolving balance that is not paid off in full each month, and accounts that do not carry a revolving balance but have had transaction activity in the past 30 days.

[21] Twenty-seven of Capital One's 28 cards used a cardholder's credit limit (as opposed to outstanding balance) to determine the overlimit fee.

[22] 74 FR 18 (January 29, 2009) at p. 5512 et. seq.

[23] For the Federal Reserve's comments on "harmful" and "unfair or deceptive" practices, see Board of Governors of the Federal Reserve System et. al., supra note 2. Note that Section 105 of the Credit CARD Act of 2009 restricted how non-penalty fees could be financed on certain types of accounts but did not substantively regulate how those fees could be applied.

[24] Source: Washington Mutual Customer Account Statement, March 2007. (JPMorgan Chase acquired Washington Mutual in 2008).

[25] Among all issuers that disclosed a mandatory binding arbitration requirement, Discover was the only one that indicated a cardholder right to opt out of the requirement when opening the account.

[26] Maria Aspan, "Bank of America Ends Mandatory Arbitration," American Banker (August 14, 2009).

[27] National Arbitration Forum, "The National Arbitration Forum to Cease Administering All Consumer Arbitrations in Response to Mounting Legal and Legislative Challenges" (July 19, 2009), available at http://www.adrforum.com/newsroom.aspx?&itemID=1528&news=3

[28] American Arbitration Association, "AAA Announces Moratorium on Consumer Debt Collection Arbitration Cases" (July 27, 2009), available at http://www.adr.org/sp.asp?id=36432.

[29] See, e.g., Maria Aspan, "Law Hits Home as Cards Opt out of Overlimit Fees," American Banker, August 10, 2009. See also American Express, "How the New Credit Card Law Will Affect You" American Express Consumer Resources, available at https://www212.americanexpress.com/dsmlive/dsm/dom/us/en/cardlegislativewebpage/cardlegislativewebpage.do?vgnextoid=351ffca121452210VgnVCM100000defaad94RCRD. As of July, both American Express and Discover included overlimit fees on most of their cards. As discussed in the Fees section of this report, the four issuers that did not include overlimit fees in any surveyed credit cards were Pennsylvania State Employees' Credit Union, Schools First Federal Credit Union, Target and USAA.

[30] The Pew Charitable Trusts (March, 2009), supra note 1.

[31] The manager of Pew's Safe Credit Cards Project, Nick Bourke, recently testified in front of the House Financial Services Committee on the need for faster implementation of the Credit CARD Act. Bourke's written testimony is available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/fchrCC_100809.shtml.

[32] See Bourke (June 25, 2009) and Bourke (September 21, 2009), supra note 8.

[33] Note that the Credit CARD Act requires issuers to provide a six-month cure period for penalty interest rates, but only if the cardholder resumes on-time payment *immediately* when the penalty rate is imposed. Because penalty rates can lead to dramatic increases in the amount of the minimum monthly required payment, many cardholders who cannot resume on-time repayment immediately will remain at risk. See the Interest Rates portion of this report for more discussion.

[34] See The Pew Charitable Trusts (March, 2009), supra note 1.

[35] Federal credit unions are subject to a maximum rate cap of 18 percent annually, and many state-chartered credit unions are subject to similar restrictions. Interest rate caps found in these existing laws and regulations will continue to apply once the Credit CARD Act becomes effective.

[36] Bourke (June 25, 2009), supra note 8, at p. 18. See also pp. 10–13.

[37] Bourke (June 25, 2009), supra note 8.

[38] See, e.g., American Express, "How the New Credit Card Law Will Affect You" American Express Consumer Resources ("Effective October 1, 2009, American Express will not charge an overlimit fee"), available at https://www212.americanexpress.com/dsmlive/dsm/dom/us/en/cardlegislativewebpage/cardlegislativewebpage.do?vgnextoid=351ffca121452210VgnVCM100000defaad94RCRD. See also Aspan (August 10), 2009.

[39] For examples from California state law, see Cal Fin Code § 4001. As we noted in our June comments to the Federal Reserve, there is evidence of a "rent extraction" or "rent seeking" problem associated with penalty fees. See Bourke, (June 25), 2009, at p. 7.

[40] Recently, a number of the largest banks announced that they would create thresholds for overdraft fees applicable to checking accounts, such as not charging

a fee until an account is overdrawn by $5 or $10 (though multiple fees could apply, even within one day). See, e.g., "Overdraft Fee Ease Won't Stop Reg Plan," American Banker (September 24, 2009) at p.16. Although these leniency periods are not as strong as we have recommended for credit card overlimit fees, the trend to respond to concerns about excessive overdraft fees is encouraging.

[41] For a discussion of the legislative goals underlying the CARD Act of 2009, see, e.g., "Amending the Consumer Protection Act, to Ban Abusive Credit Card Practices, Enhance Consumer Disclosures, Protect Underage Consumers, and for Other Purposes," submitted by Senate Banking Committee Chairman Chris Dodd, May 4, 2009, available at http://www.thomas.gov/cgi-bin/cpquery/T?&report=sr016&dbname=111& ("The 'Credit Card Accountability Responsibility and Disclosure Act of 2009' was developed to implement needed reforms and help protect consumers by prohibiting various unfair, misleading and deceptive practices in the credit card market").

[42] Bourke (June 25, 2009), supra note 8, at pp. 9-13.

[43] Bourke (September 21, 2009), supra note 8.

[44] For a discussion of the legislative goals underlying the CARD Act of 2009, see Dodd (May 4, 2009), supra note 41.

[45] See the Safe Credit Card Standards and related information at www.pewtrusts.org/creditcards. See also note 33, supra, for discussion of the six-month cure period.

[46] See, e.g., Board of Governors of the Federal Reserve System, January 29, 200, at p. 5561. Note that, with the exception of the annual fees, we observed only a small number of cards with fees matching this "fees for the issuance or availability of credit" definition. For example: all cards offered by U.S. Bank contained a "closed account management fee" of $2.50. It is unclear from the disclosure if this is a one-time fee or charged on a monthly basis.

[47] See Bourke (June 25, 2009), supra note 8, at p. 4.

[48] For comments defending low-rate balance offers, see e.g. Oliver Ireland, Statement to the U.S. House of Representatives, Financial Services Committee, Subcommittee on Financial Institutions. The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers, Hearing, March 13, 2008 (Serial110-100), at p. 6. Available at http://financialservices.house.gov/hearing110/ireland031308.pdf. See also John Finneran, Statement to the U.S House of Representatives, Financial Services Committee, Subcommittee on Financial Institutions. The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers, Hearing, April 17, 2008 (Serial 110-109), at p. 7. Available at http://financialservices.house.gov/hearing110/capital_one.pdf.

[49] For more on the Bank of America announcement, see Aspan, (August 14, 2009). A bill currently under consideration in both Houses of the U.S. Congress, the Arbitration Fairness Act of 2009, addresses the arbitration issue. The bill, introduced in April 2009, would declare that no pre-dispute arbitration agreement is enforceable if it requires arbitration of a consumer dispute.

[50] The Nilson Report Issue #918 (January 2009), Issue #919 (February 2009), and Issue #924 (April 2009).

[51] See The Pew Charitable Trusts (March, 2009), supra note 1.

[52] Credit Union National Association, "Monthly Credit Union Estimates"(August 2009), available at http://advice.cuna.org/download/mcue.pdf.