



Portfolio Media, Inc. | 648 Broadway, Suite 200 | New York, NY 10012 | www.law360.com
Phone: +1 212 537 6331 | Fax: +1 212 537 6371 | customerservice@portfoliomedia.com

Basics Of The Credit Card Reform Bill

Law360, New York (June 04, 2009) -- As of May 29, credit cardholders actually have rights when it comes to credit card fees. When President Barack Obama signed the "Credit Cardholders Bill of Rights," it changed the game for credit card issuers by limiting fees and contract changes.

The Credit Card Accountability Responsibility and Disclosure Act of 2009 passed overwhelmingly by Congress and signed with much fanfare by the president on May 22, 2009. The law doesn't set any limits on interest rates, but it does make it much harder for card-issuers to raise those rates without notice, or retroactively, or with notices written in "mice type."

The act is aimed at correcting many of the industry's perceived abuses. The overarching issue is the rate of acceleration of the balance owed. Previously, those with credit card balances found their debt growing faster and faster due to interest charges, late payment penalties and mysterious fees.

That meant that the cardholder's ability to pay down, or even contain the debt, evaporated. At some point it became impossible for the cardholder to make any progress. The act addresses the problem with varied provisions, many of which do not take effect for another nine months.

The cards have a number of different devices that they used to accelerate the debt. One of the more pernicious practices that the act tries to eliminate is universal default. Many card agreements gave the issuer the right to invoke default terms (higher interest for example) if the cardholder was in default on the card of a different issuer.

In other words, the cardholder finds himself paying a higher interest rate to credit card "A" even though he may be making his payments to credit card "A" like clockwork. The act eliminated this practice by prohibiting credit card "A" from invoking default provisions unless and until the cardholder is in default as to credit card "A."

Another debt acceleration tactic the act sought to eliminate is double-cycle billing, which operates as a penalty if your credit card balance is prone to substantial ups and downs. Credit cards generally calculate interest based on the average daily balance. The question is how long a period is used to calculate the average day's balance.

Double-cycle billing averages the balance over two billing periods rather than one as a cardholder might logically expect. To illustrate, assume that the billing period is 30 days and the credit card holder charges \$100 to the card on the first day of the billing period.

With single-cycle billing, interest is calculated on the average daily balance of \$100. Assume that the cardholder pays the interest charge and carries the \$100 balance into the next billing period. On the first day of the new period, the holder charges an additional \$50.

With double cycle billing, interest is calculated on the average daily balance of \$75 instead of the \$50 incurred on the first day of the new cycle. The result is that the cardholder with a fluctuating balance pays more interest.

The act also bans unfair payment applications. It is not uncommon for credit cards to charge different rates of interest for different types of balances. For example, a card might charge a higher rate for cash advances than it does for charges. Or, the card might charge a higher rate for every dollar over some minimum balance.

The cards that have these varying rates often apply payments to the lowest interest rate balances first — which means that the higher rate balances keep on accelerating. The act requires payments in excess of the minimum to be allocated proportionally among the varying balances or to the highest interest rate balance first.

Other provisions of the act are more basic. Card issuers no longer will be able to bury unfavorable terms in the fine print of statements and card agreements. Statements have to be understandable and show prominently how much the credit is costing the cardholder.

You may be wondering why the credit card issuers were looking to accelerate balances that they knew cardholders could not pay. The answer is that there was a high demand for those loans in the secondary market. It was similar in some respects to what happened with mortgages.

Wall Street pooled mortgage loans and sold the right to receive a fraction of the payments on each mortgage in the pool to investors. The high demand for these "mortgage backed securities" led to a high demand for mortgages to include in the pools.

This gave mortgage originators incentive to make loans without adequate assurance that they would be repaid. Wall Street employed the same procedure for credit card

loans, though the resulting investments were perceived as riskier because the underlying loans were unsecured.

One way the act address this problem is by restricting the issuance of cards to minors (yes, credit cards were issued to unemployed 17 year olds). Another way is prohibiting the issuers of subprime cards from charging fixed fees to the card.

Subprime cards are issued to borrowers with low income or subprime credit. The issuers extract heavy fees — as much as 25 percent of the credit limit — in exchange for providing credit to these borrowers. The interest rates are also likely to be higher for a subprime card. Without the restriction, the cardholder confronts the ever-accelerating balance problem before he charges anything to the card.

The act won't solve the problems of those who are already in serious trouble with credit card debt. The act won't reduce existing balances. It will, however, help the balance acceleration problems that caused consumers to reach the "hopeless" point.

Though no provision of the act affords significant relief by itself, taken together the prohibitions and restrictions will inhibit balance growth.

What the act does not do is change the spending habits that tens of thousands of people developed during the go-go 90s. That will mean that consumers will have to start using cash or debit cards whenever they can.

They will need to "save up" for purchases like they did when they were kids. And, for those who can't wait, they'll need to have a plan to pay for the purchase with the money they would be saving up if they could wait. Lastly, they must reduce the number of cards they have and mark them, mentally at least, "For Emergencies Only."

--By Christopher G. Brown, Partner, Begos Horgan & Brown LLP

Chris Brown is a partner with Begos Horgan & Brown in the firm's Westport, Conn., office and head of the firm's debtor/credit practice group.

The opinions expressed are those of the author and do not necessarily reflect the views of Portfolio Media, publisher of Law360.