4-1-2009

Congressional Regulation of Credit Card Interest Rates: The Case of Credit Card Fair Fee Act of 2008

Yvonne Shilenge

Congressional Regulation of Credit Card Interest Rates: The Case of Credit Card Fair Fee Act of 2008

Yvonne Shilenje

A Practicum Paper
Submitted in Partial Fulfillment of the Requirements for the

Master of Public Administration

Kennesaw State University
May 2009

Congressional Regulation of Credit Card Interest Rates:
The Case of Credit Card Fair Fee Act of 2008

Executive Summary

The Credit Card Fair Fee Act of 2008 was introduced as a bill in 2008 following an increased uproar from the public regarding the current system of setting fees that merchants pay for credit card transactions. Many viewed the current system as unfair, unjust, anti-competitive and secretive with the hidden fees.

The bill was introduced in the House Judiciary Committee on March 6, 2008 by John Conyers; Chris Cannon from Utah was among the forty five co-sponsors of the legislation. The bill is designed to reinforce transparency and competition in the credit card industry. This bill does not set prices. Instead, it requires that fees be set in a transparent manner so that other companies can compete for business and consumers do not pay artificially high rates.

The Credit Card Fair Fee Act of 2008 authorizes providers of a single covered electronic payment system (e.g. Visa or Master charge credit cards) and any merchants to jointly negotiate and agree upon rates and terms for access to such a system. It defines covered electronic payment system as any system that has been used for at least twenty percent of the combined dollar value of United States credit, signature-based debit, and PIN-based debit card payments processed in the applicable base year. Moreover, it grants limited antitrust immunity to such providers and merchants, as well as to those providers who jointly determine among themselves the proportionate division of paid access fees. It also sets forth procedures to determine rates and terms for access to a covered electronic payment system.

The Act prohibits any other rates and terms from being imposed upon a merchant for accessing a covered electronic payment system except as specified in a voluntarily negotiated access agreement. It also sets to create a panel of three full-time Electronic Payment System Judges, appointed by the Antitrust Division of the Department of Justice and the Federal Trade Commission Bureau of Competition, to determine the schedule of rates and terms for three-year periods. The judges will act as the judicial review committee of the bill. It will authorize providers and merchants to engage in voluntarily negotiated access agreements. It will declare that such voluntarily negotiated access agreements shall be given effect with respect to the signatories in lieu of any determination by the judges.

Congress began debating on the Act on March 6, 2008 with a growing number of card issuers increasing their profits by loading their credit cards with tricks and traps. The bill did not go through the first time but the current economic situation in America and the rising consumers' complaints made Congress to revisit the bill. The bill's first phase of implementation will be in November of 2009.

The purpose of this paper is to examine the Credit Card Fair Fee Act of 2008, analyze the inception of the Act's concept and compare what other scholars and writers are saying and/or writing about the Act. The paper also highlights what society has to say about the inception of the bill.

Currently, there is still a lack of short-term credit in the United States economy, making financing for businesses, individuals, and even governments difficult. Credit markets remain paralyzed, with everything on hold and with many major corporations having failed or at the brink of failing. At the same time, hedge funds and private equity funds, that have provided some small amount of lending, are unwinding, accelerating the economic decline. Until bank and non-bank financial institutions resume lending, there will be a continuing downward economic spiral. The Act, if approved by both houses of the U.S. Congress and signed into law, will provide for better lending terms to avoid future relapse on the current situation.

Congressional Regulation of Credit Card Interest Rates:
The Case of Credit Card Fair Fee Act

Table of Contents

Acknowledgements

I would like to thank my supervisor Dr. Andrew Ewoh. This study would not have been possible without the encouragement and constant support from him; I am deeply grateful to my supervisor for his inspiration, ideas, guidance and constructive comments.

I would like to thank Mr. Coleman Emmanuel, my manager at the Bank of America, for instigating the idea of this paper for my practicum; and for granting me the time off from work to conduct the research required for this paper. I would like to thank my colleagues at work and course mates who extensively gave me guidance and help as I wrote the paper.

Last but not least, my appreciation goes out to the staff in the Horace W. Sturgis library, and the Writing Center for the support given when searching for literature and journals. In fact, I appreciate everybody's help and input during the process

Dedication

I would like to take this time to dedicate this project to my mother, Nancy O. Shilenje, who has always desired the best for me. She has honestly inspired me every minute of her life, praying for me and giving me advice, love and support to pursue my education. She never gave up on me and her constant push helped me to pursue my masters program. I am truly grateful.

To my dad, John Shilenje, who always inspired my career and set an extraordinary example in goal setting. I would also like to acknowledge my friends, Doris and Beryl for believing in me. My education process has not been easy, and without the love and encouragement they gave me I would not be where I am today.

Finally, I would like to dedicate this paper to my late beloved fiancé, Emmanuel Mumelo, who believed in me and encouraged me to follow my career and pursue my dreams; for always being a source of encouragement until his last day on earth, thank you.

Congressional Regulation of Credit Card Interest Rates:
The Case of Credit Card Fair Fee Act of 2008

Introduction

After years of having its way with American consumers the multi-million credit card businesses may soon face greater oversight and tighter reins. For years, retailers and merchants have been waging a quiet war with the financial industry over "interchange fees" -- the hidden costs of processing credit transactions that can wipe out a store's profits while earning banks a pretty penny (Bosworth, 2008).

The Credit Card Fair Fee Act of 2008 authorizes providers of a single covered electronic payment system (e.g., Visa or Master charge credit cards) and any merchants to jointly negotiate and agree upon rates and terms for access to such a system. It defines covered electronic payment system as any system that has been used for at least twenty percent of the combined dollar value of U.S. credit, signature-based debit, and PIN-based debit card payments processed in the applicable base year. Moreover, it grants limited antitrust immunity to such providers and merchants, as well as to those providers who jointly determine among themselves the proportionate division of paid access fees. It also sets forth procedures to determine rates and terms for access to a covered electronic payment system.

The Act prohibits any other rates and terms from being imposed upon a merchant for accessing a covered electronic payment system except as specified in a voluntarily negotiated access agreement. It also sets to create a panel of three full-time Electronic Payment System Judges, appointed by the Antitrust Division of the Department of Justice and the Federal Trade Commission Bureau of Competition, to determine the schedule of rates and terms for three-year periods. It will authorize providers and merchants to engage in voluntarily negotiated access agreements. It will declare that such voluntarily negotiated access agreements shall be given effect with respect to the signatories in lieu of any determination by the judges (Berner, 2008).

Purpose of the Study

A growing number of credit and loan issuers increase their profits by loading their credit cards with tricks and traps so that they can catch consumers who stumble or mistake those traps for treasure and find themselves caught in a snare from which they cannot escape (Darlin, 2005). The paper examines the Congressional Credit Card Fair Fee Act that begun being debated upon in the House of Representatives on March 6, 2008. The analysis is a descriptive study of what other scholars, writers, general public are writing and saying about the Act. It also compares what different people in the society are saying about the Act and whether or not it is beneficial to them. It ascertains whether or not the Act is a positive law to be enacted.

To accomplish this, other acts that work hand in hand with the Credit Card Fair Fee Act are mentioned in the paper establishing the background and formation of the Act. Some of these acts include the Fair Credit and Charge Card Disclosure Act of 1988, the Home Equity Loan Consumer Protection Act of 1988, the Home Ownership and Equity Protection Act of 1994, the TILA Amendments of 1995, and the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA).

Due to the fact that this is a very controversial topic, different views collected along the way are used to show how, over the years, the act has been instigated. The society's reception is also investigated in the paper. Definitions and tables are appended to this paper to clarify to reader's information they may not know.

Background

The Credit Card Fair Fee Act of 2008 draws from the Truth in Lending Act. The Truth in Lending Act (TILA) of 1968 is a United States federal law designed to protect consumers in credit transactions, by requiring clear disclosure of key terms of the lending arrangement and all costs. The statute is contained in Title I of the Act, as amended.

Congress calls the bill the Credit Card Fair Fee Act of 2008 and is still looking at other bills at the moment that deal with the same information. The bill has not been passed but the current economic repression in America is facilitating the rebirth of the Credit Card fair Fee Act of 2008. The first phase is going to be passed in November of 2009.

The Credit Card Fair Fee Act of 2008 was sponsored and introduced in the House Judiciary Committee by John Conyers and co-sponsored by 45 members of Congress. The bill is designed to reinforce transparency and competition in the credit card industry. The current system of setting fees that merchants pay for credit card transactions is anti-competitive and secretive. This bill does not set prices. Instead, it requires that fees be set in a transparent manner so other companies can compete for business and consumers would not pay artificially high rates (Gavin, 2007).

The main players in the formation and presentation of the Credit Card Fair Fee Act of 2008 are: Mr. Conyers; Mr. Canon, Ms. Zoe Lofgren of California; Mr. Shuster, Mr. Weiner, Mr. Delahunt, Mr. Platts, Mr. Welcof Vermont, Mr. Sullivan, Mr. Wilson of South Carolina, Mr. Gohmet, Mr. Hall of Texas, Mr. Boozman, and Mr. Peterson of Pennsylvania. These legislators introduced the bill, which was referred to the House Judiciary Committee.

Literature Review

Visa and MasterCard have for a long time kept their interchange fee structure hidden for many years, preventing merchants from accurately gauging how much they are really paying, and leading a group of merchants to file a class-action lawsuit demanding changes to the system. Both Visa and MasterCard have since published their fee breakdowns, although critics charge the structures are still too complex for anyone to understand (U.S. Government Accountability Office*,* September 2006). Both Visa and MasterCard have set aside considerable war chests to pay for the potential costs of losing the litigation, and have committed to massive Initial Public Offerings (IPOs) in order to defray more risk onto shareholders.

Interchange fees cost the average American family three hundred and fifty per year, according to statistics from the National Retail Federation. Americans pay interchange fees of two percent on all transactions made with plastic, higher than any industrialized nation in the world (National Retail Federation, 2004).

Retailers testified to Congress in July 2007 on the hidden penalties of interchange fees, and today they welcomed the new legislation. The bill would allow businesses to negotiate their credit card transaction fees. Since merchants often recover these high fees by increasing their prices, consumers will likely receive a positive result if the bill is passed. A lot of retailers are in agreement with the Act and believe that Congress should have acted on it before now (Hughes, Middlebrook, and Brooks, 2006).

Credit card statistics are easy to find and hard to verify. However, it appears that roughly seventy-five percent of American households have credit cards, and about fifty percent of all households carry balances on those cards (Rinearson, 2004). The average debt load per credit card is about ten-thousand dollars, and the average interest rate on that debt is currently about fifteen percent (Rinearson, 2004). Consumers are generally unaware of interchange fees, as they are folded into the total price of items bought and are not disclosed on receipts. But merchants are acutely aware of the fees, as they force storeowners and retailers to raise prices on all their items in order to make a profit, effectively penalizing customers who shop only with cash and not pay fees of any kind (Rinearson, 2004).

Sullivan (1999) was of the view that that many consumers are, in fact, stalled in the middle of the busy intersection between Rock Street and Hard Place Boulevard in today’s tough economy. Consumers can expect to see their fees and penalties more clearly defined and more completely explained. They can expect to see interest-rate penalties capped in a rational manner. Probably most significantly, they will be insulated from rate increases caused by adverse information that might appear on credit reports. In other words, credit card issuers will be prohibited from jacking up rates on consumers who have a negative pop on their credit reports. In addition, certain types of predatory sales practices primarily targeting young and inexperienced credit card users will be limited or stopped (Sullivan, 1999).

It is interesting to note that the argument on credit cards did not spring into Congress in 2008 but dates back to as early as the 1900s. Other acts work hand in hand with the 2008 Credit Card Fair Fee Act. Some of these acts include: the Fair Credit and Charge Card Disclosure Act of 1988, the Home Equity Loan Consumer Protection Act of 1988, the Home Ownership and Equity Protection Act of 1994, the TILA Amendments of 1995, and the Economic Growth and Regulatory Paperwork Reduction Act of 1996. The most important Act is the Truth in Lending Act of 1968.

The Truth in Lending Act (TILA) of 1968 is a United States federal law designed to protect consumers in credit transactions, by requiring clear disclosure of key terms of the lending arrangement and all costs (Title 15 of the United States Code). The purpose of TILA is to promote the informed use of consumer credit by requiring disclosures about its terms and the cost to standardize the manner in which costs associated with borrowing are calculated and disclosed. TILA also gives consumers the right to cancel certain credit transactions that involve a lien on a consumer's principal dwelling, regulates certain credit card practices, and provides a means for fair and timely resolution of credit billing disputes. With the exception of certain high-cost mortgage loans, TILA does not regulate the charges that may be imposed for consumer credit. Rather, it requires uniform or standardized disclosure of costs and charges so that consumers can shop. The regulation prohibits certain acts or practices in connection with credit secured by a consumer's principal dwelling as mandated by Consumer Credit Protection Act of 1968.

> The TILA was first amended in 1970 to prohibit unsolicited credit cards. Additional major amendments to the TILA and Regulation Z were made by the Fair Credit Billing Act of 1974, the Consumer Leasing Act of 1976, the Truth in Lending Simplification and Reform Act of 1980. Regulation Z also was amended to implement section 1204 of the Competitive Equality Banking Act of 1987, and in 1988, to include adjustable rate mortgage (ARM) loan disclosure requirements. All consumer leasing provisions were deleted from Regulation Z in 1981 and transferred to Regulation M (12 CFR 213) (Comptroller's Handbook Truth in Lending Act, 1).

The Home Ownership and Equity Protection Act of 1994 imposed on the TILA new disclosure requirements and substantive limitations on certain closed-end mortgage loans bearing rates or fees above a certain percentage or amount. The law also included new disclosure requirements to assist consumers in comparing the costs and other material considerations of a reverse mortgage transaction, and authorized the Board of Governors of the Federal Reserve System (Board) to prohibit specific acts and practices in connection with mortgage transactions (Comptroller's Handbook Truth in Lending Act).

The TILA Amendments of 1995 dealt primarily with tolerance for real estate secured credit. Regulation Z was amended on September 14, 1996 to incorporate changes to the TILA that limit lenders' liability for disclosure errors in loans secured by real estate consummated after September 30, 1995. The EGRPRA amendments were made to simplify and improve disclosures related to credit transactions (Comptrollers' Handbook Truth in Lending Act).

The Electronic Signatures in the Global and National Commerce Act (the E-Sign Act), 15 USC 7001 *et seq.*, was enacted in 2000 and did not require implementing regulations. On November 9, 2007, the amendments to Regulation Z and the official staff commentary were issued to simplify the regulation and provide guidance on the electronic delivery of disclosures consistent with the E-Sign Act (Comptrollers' Handbook Truth in Lending Act).

The statute TILA is divided into two main parts:

1. Subpart A contains general information such as the authority, purpose, coverage, and organization of the regulation; the definitions of basic terms; the transactions that are exempt from coverage (which would be any business purpose loan); and the method of determining the finance charge.
2. Subpart B contains the rules for open-end credit. It requires that initial disclosures and periodic statements be provided, as well as additional disclosures for credit and charge card applications and solicitations and for home-equity plans, subject to the requirement by law. The Subpart also covers the right of rescission requirements and the advertising restrictions for open-end credit. For example, a home equity line of credit advertisement cannot mention any tax benefits without verbiage suggesting that the consumer consult a tax adviser (Comptroller's Handbook Truth in Lending Act).

Regulation Z, which is subpart A of the TILA remains highly influential in the arguments been raised in congress in regard to the Fair Fee Act of 2008. A major argument being raised is with the involvement of credit cards; generally exempt credit (e.g., business purpose credit) is subject to the requirements that govern the issuance of credit cards and liability for their unauthorized use. Credit cards must not be issued on an unsolicited basis and, if a credit card is lost or stolen, the cardholder must not be held liable for more than fifty dollars for the unauthorized use of the card.

TILA played a very significant part in the formation of the Credit Card Fair Fee Act of 2008. However, there are other bills in 2009 that Senators across the United States are introducing to the Senate for discussion. These bills are examining the fact that seventy percent of the United States credit and debit market collected thirty-billion in interchange fees in 2007. There is no meaningful competition or negotiation involved in the setting of interchange fees, as major credit cards companies like Visa and MasterCard simply set non-negotiable interchange fees rates for all banks and retailers that participate in the card systems. These rates result in increased revenue for the card issuers but drain the bottom lines of retailers and raise prices for consumers. Retailers are forced to abide by these fees because their credit and debit cards are used over forty-percent of all transactions in the United States and most retailers cannot stay in business if they do not accept these cards (Saunders, 2008).

The public commends the President of the United States, Barrack Obama, for confronting credit card issuers about abusive practices and renewing his push for credit card reform legislation. “The President recognizes that we cannot let the very banks we rescued compound the hardships of ordinary Americans with extra ordinary unfair fees and interest charges,” Comments Senator Levin (Levin, 2009).

Senator Carl Levin of Michigan, who is the chairman of the Permanent Subcommittee on Investigators, has conducted an ongoing investigation into unfair and abusive credit card practices. In two investigative hearings, Levin pulled the curtain back on some of the outrageous credit card abuses such as imposing interest rates as high as thirty-two percent, charging interest for debt that was paid on time, imposing excessive fees and hiking interest rates for consumers who can pay on time (Levin, 2009).

Levin introduced a 2007 credit card reform bill, S. 1395, whose provisions were largely incorporated into S. 3252 of the Credit Card Fair Fee Act of 2008. The Senate bill (S. 3252) was introduced by Banking Committee chairman Chris Dodd, D-Connecticut, and cosponsored by Levin, then Senator Obama, and other Senators. The 2009 Credit Card Act, S. 414, is the successor to the Credit Card Fair Fee Act of 2008 (Levin, 2009).

Last year, the House approved a less ambitious credit card reform bill that is yet to be acted on by the Senate. Earlier this week, the House Financial Services Committee approved a similar bill that is expected to be presented to the full House for another vote. In December 2008, the Federal Reserve approved regulations to end some credit card abuses (Levin, 2009).

Another U.S. Senator, Dick Durbin, on June 5, 2008 introduced a legislation to allow large and small businesses to negotiate directly with credit card companies to reduce the interchange fees that are charged on every credit card transaction. According to Durbin, "higher interchange fees for businesses mean higher costs for retailers and consumers. Every time you make a purchase with plastic, the bank that issued your credit gets a cut from the sale amount. American businesses and consumers are getting nickled and dimed by the big banks. Interchange fees need to be fairly and transparently negotiated between the merchants and the credit card companies who represent the banks' interest so working American's do not get short changed" (Durbin, 2009).

The Credit Card Fair Fee Act of 2008 Provisions

The Act provides the following:

- Consumers under the age of twenty-one should be allowed to choose whether to receive credit card solicitations. Card issuers can only solicit young consumers if they receive affirmative consent in advance.
- Card issuers cannot use the widespread practice of charging higher interest rates on balances incurred before a rate increase goes into effect.
- Credit card issuers cannot alter credit card agreements while they are in force without specific written consent from the cardholder. This will stop issuers from giving themselves the right in cardholder agreements to increase interest rates and fees at any time, for any reason.
- Penalty fees ought to be reasonably related to the costs that credit card issuers incur because of a late or over-limit transgression.
- Credit card issuers cannot increase a cardholders' interest rate based on adverse information relating to other creditors they find on the consumers credit report.
- Card issuers should be required to limit penalty interest rate increases to seven percent above the previous rate if a consumer fails, for instance, to make a payment on time.
- Late fees on payments that have been postmarked by a designated date be disclosed to the consumer.
- Issuing credit or raising credit limits to consumers should be done only when the consumer is capable of making scheduled payments based on their current income, obligations, and employment status.

- Lenders should make a firm offer of credit that includes specific — not deceptively low — terms, including the interest rate, fees, and credit line (Journal of Money, Credit and Banking).

Similarities between the TILA and the Credit Card Fair Fee Act of 2008

The Credit Card Fair Fee Act is intended to ensure that credit terms are disclosed in a meaningful way so consumers can compare credit terms more readily and knowledgeably. On the same note, the TILA of 1968 also advocated for truth in lending. Before its enactment, consumers were faced with a bewildering array of credit terms and rates. It was difficult to compare loans because they were seldom presented in the same format. Now, all creditors must use the same credit terminology and expressions of rates. Some similarities of TILA and the Credit Card Fair Fee Act of 2008 include the following:

- Both TILA and the Credit Card Fair Fee Act of 2008 protect the consumers against inaccurate and unfair credit billing and credit card practices;
- Both provide consumers with rescission rights;
- Both provide for rate caps on certain dwelling-secured variable rate loans; and
- They both impose limits on home equity lines of credit and certain closed-end home mortgages.

Evaluations to be Followed before Giving Credit

To accomplish its goals, the Credit Card Fair Fee Act borrowed from the TILA's evaluations to be used when determining if credit is for consumer purposes, the creditor must evaluate all of the following:

- Any statement obtained from the consumer describing the purpose of the proceeds:

  > For example, a statement that the proceeds will be used for a vacation trip would indicate a consumer purpose. If the loan has a mixed-purpose (e.g., proceeds will be used to buy a car that will be used for personal and business purposes), the lender must look to the primary purpose of the loan to decide if disclosures are necessary. A statement of purpose from the consumer will help the lender make that decision. A checked box indicating that the loan is for a business purpose, absent any documentation showing the intended use of the proceeds could be insufficient evidence that the loan did not have a consumer purpose (Truth in Lending Act, 5).

- The consumer's primary occupation and how it relates to the use of the proceeds. The higher the correlation between the consumer's occupation and the property purchased from the loan proceeds, the greater the likelihood that the loan has a business purpose. For example, proceeds used to purchase dental supplies for a dentist would indicate a business purpose.
- Personal management of the assets purchased from proceeds. The less the borrower is personally involved in managing the investment or enterprise purchased by the loan proceeds, the less likely the loan will have a business purpose. For example, money borrowed to purchase stock in an automobile company by an individual who does not work for that company would indicate a personal investment and a consumer purpose.

- The size of the transaction. The larger the size of the transaction, the more likely the loan will have a business purpose. For example, if the loan is for a $5,000,000 real estate transaction, that might indicate a business purpose.
- The relative amount of income derived from the property acquired by the loan proceeds; the less the income derived from the acquired property relative to the borrower's total income, the more likely the loan will have a consumer purpose. For example, if the borrower has an annual salary of $100,000 and receives about $500 in annual dividends from the acquired property that would indicate a consumer purpose (Comptroller's Handbook Truth in Lending Act, 7-15).

All five factors must be evaluated before the lender can conclude that disclosures are not necessary. Normally, no one factor by itself is sufficient to determine the applicability of Regulation Z from TILA. In any event, the bank may routinely furnish disclosures to the borrower. Disclosure under such circumstances does not determine that the transaction is covered under the Regulation Z but can assure protection to the bank and in compliance with the law.

Terms Commonly Used When Dealing With Credit

The Credit Card Fair Fee Act of 2008 helps to assure that consumers have a right to know about the agreements that they are getting into in terms of fees, payment and rates on their loans. A lot of times the consumers do not know the terms that banking and lending institutions use. One of the major arguments was that some terms are not well defined. Outlined below are some of the words commonly used in the banking and lending industry that the common person does not know off hand unless s/he conducts some studies.

The Annual Percentage Rate

The *Annual Percentage Rate* (APR) is a function of:

- The *amount financed*, which is not necessarily equivalent to the loan amount. If the consumer must pay at closing a separate one percent loan origination fee (prepaid finance charge) on a $100,000 residential mortgage loan, the loan amount is $100,000, but the amount financed would be $100,000 less the $1,000 loan fee, or $99,000.
- The *finance charge*, which is not necessarily equivalent to the total interest amount. Interest, which is defined by state or other federal law, is not defined by Regulation Z. Charges may or may not be considered a finance charge because of exemptions or conditions. For example, if the consumer must pay a $25 credit report fee for an auto loan, the fee must be included in the finance charge. The finance charge in that case is the sum of the interest on the loan (i.e., interest generated by the application of a percentage rate against the loan amount) plus the $25 credit report fee. If the consumer must pay a $25 credit report fee for a loan secured by real property, the credit report fee must be excluded from the finance charge. Assuming there are no additional fees or charges assessed in the connection with the mortgage loan, the finance charge would be only the interest on the loan. Refer to the section on finance charge for clarification.

- The *payment schedule*, which does not necessarily include only principal and interest (P + I) payments. If the consumer borrows $2,500 for a vacation trip at 14 percent simple interest per annum and repays that amount with 25 equal monthly payments beginning one month from (Truth in Lending Act Comptroller's Handbook, 12).

The Credit Card Fair Fee Act argues that consumers knowing this information will assist in making educated decisions and thus being fair on consumers.

Determining the Balance and Computing the Finance Charge

Each finance charge imposed must be individually itemized. The aggregate total amount of the finance charge need not be disclosed. The Credit Card Fair Fee Act of 2008 dictates that the examiner must know how to compute the balance to which the periodic rate is applied. Common methods used are the previous balance method, the daily balance method, and the average daily balance method:

- *Previous balance method*. The balance on which the periodic finance charge is computed is based on the balance outstanding at the start of the billing cycle. The periodic rate is multiplied by this balance to compute the finance charge.
- *Daily balance method*. A daily periodic rate is applied to either the balance on each day in the cycle or the sum of the balances on each of the days in the cycle. If a daily periodic rate is multiplied by the balance on each day in the billing cycle, the finance charge is the sum of the products. If the daily periodic rate is multiplied by the sum of all the daily balances, the result is the finance charge.

- *Average daily balance method*. The average daily balance is the sum of the daily balances (either including or excluding current transactions) divided by the number of days in the billing cycle. A periodic rate is then multiplied by the average daily balance to determine the finance charge. If the periodic rate is a daily one, the product of the rate multiplied by the average balance is multiplied by the number of days in the cycle (Credit Card Fair Fee Act of 2008).

  If a creditor fails to comply with any requirements of the Act, other than with the advertising provisions of chapter three, it may be held liable to the consumer for the actual damage and the cost of any legal action together with reasonable attorney's fees in a successful action.

A creditor that fails to comply with the Act's requirements for high-cost mortgage loans may be held liable to the consumer for all finance charges and fees paid by the consumer. Any subsequent assignee is subject to all claims and defenses that the consumer could assert against the creditor, unless the assignee demonstrates that it could not reasonably have determined that the loan was subject to section 226.32 of the Criminal Liability Section 112(Credit Fair Fee Act of 2008).

The Credit Card Fair Fee Act of 2008 authorizes federal regulatory agencies to require banks to make monetary and other adjustments to the consumers' accounts when the true finance charge or APR exceeds the disclosed finance charge or APR by more than a specified accuracy tolerance. That authorization extends to unintentional errors, including isolated violations (e.g., an error that occurred only once or errors, often without a common cause, that occurred infrequently and randomly).

Under certain circumstances, the Act requires federal regulatory agencies to order banks to reimburse consumers when understatement of the APR or finance charge involves: patterns or practices of violations (e.g., errors that occurred, often with a common cause, consistently or frequently, reflecting a pattern with a specific type or types of consumer credit); gross negligence; and willful noncompliance intended to mislead the person to whom the credit was extended.

Any proceeding that may be brought by a regulatory agency against a creditor may be maintained against any assignee of the creditor if the violation is apparent on the face of the disclosure statement or other documents assigned, except where the assignment was involuntary (Comptroller's Handbook Truth in Lending Act).

Relationship of the Credit Card Fair Fee Act of 2008 to State Law

State laws that impose responsibilities on banks offering consumer credit, or that require such institutions or consumers to follow certain procedures, or that grant rights to consumers or banks in consumer credit contracts: may be preempted by the Credit Card Act; may not be preempted by the Credit Card Act; or may be substituted for the TILA and Regulation Z requirements.

The TILA does not preclude preemption of state law by other federal statues, such as the National Bank Act. State law provisions are preempted to the extent that they contradict the requirements in the following chapters of the TILA and the implementing sections of Regulation Z which were the main sub branches of the Credit Card Fair Fee Act of 2008.

Major Arguments of the Credit Card Act of 2008

Arguments backing the importance of the legislation of the Act notwithstanding any provision of the antitrust laws show that in negotiating access rates and terms and participating in any proceedings in accordance with subsection (d), declare that any providers of a single covered electronic payment system and any merchants may jointly negotiate and agree upon the rates and terms for access to the covered electronic payment system, including through the use of common agents that represent either providers of a single covered electronic payment system or merchants on a non-exclusive basis. Any providers of a single covered electronic payment system also may jointly determine the proportionate division among themselves of paid access fees.

Proceedings under this Act shall determine rates and terms for access to a covered electronic payment system during the 3-year period beginning on January first of the second year following the year in which the proceedings are to be commenced, except where a different transitional period is provided under section 6. Except as specified in a voluntarily negotiated access agreement, no other fees, terms, or conditions of any kind may be imposed directly or indirectly on any merchant for accessing a covered electronic payment system. The parties to each proceeding shall bear their own costs (Credit Card Fair Fee Act of 2008).

Determinations of the Electronic Payment System Judges

The Credit Card Fair Fee Act of 2008 determined that the judges will look at applicability that is, the schedule of rates and terms determined by the Electronic Payment System Judges with respect to a single covered electronic payment system shall, subject to paragraph (4), be binding on all providers of that single covered electronic payment system and merchants affected by this paragraph during the 3-year period specified in subparagraph (1). For any given covered electronic payment system, such rates and terms shall be the same for all merchants, regardless of merchant category or volume of transactions (either in number or dollar value) generated (Credit Card Fair Fee Act of 2008).

The standard for determination will be used in establishing rates and terms for access to a covered electronic payment system by merchants, the Electronic Payment System Judges shall establish rates and terms that most closely represent the rates and terms that would be negotiated in a hypothetical perfectly competitive marketplace for access to an electronic payment system between a willing buyer with no market power and a willing seller with no market power. In determining such rates and terms, the Electronic Payment System Judges shall consider the costs necessary to provide and access an electronic payment system for processing credit and/or debit card transactions as well as a normal rate of return in such a hypothetical perfectly competitive marketplace. The Electronic Payment System Judges shall not include any anticompetitive rates or terms (Credit Card Fair Fee Act of 2008).

Participants in the arguments that were raised in Congress brought up common methods that banks have in calculating the balance to which the periodic rate is applied. By reading the bank’s explanation, the examiner should be able to calculate the balance to which the periodic rate was applied. In some cases, the examiner may need to obtain additional information from the bank to verify the explanation disclosed. Any inability to understand the disclosed explanation should be discussed with management, who should be reminded of Regulation Z's requirement that disclosures be clear and conspicuous. If a balance is determined without first deducting all credits and payments made during the billing cycle, that fact and the amount of the credits and payments must be disclosed (Kulikowski, 2008).

If the bank uses the daily balance method and applies a single daily periodic then the disclosure should state the balance for each day in the billing cycle. The daily periodic rate is multiplied by the balance on each day and the sum is the finance charge. It should also include the balance for each day in the billing cycle on which the balance in the account changes. The finance charge is figured by the same method as discussed previously, but the statement shows the balance only for those days on which the balance changed. Another important inclusion is the sum of the daily balances during the billing cycle. The balance on which the finance charge is computed is the sum of all the daily balances in the billing cycle. The daily periodic rate is multiplied by that balance to determine the finance charge. Finally the average daily balance during the billing cycle if stated, however, the bank must explain somewhere on the periodic statement or in an accompanying document that the finance charge is or may be determined by multiplying the average daily balance by the number of days in the billing cycle, rather than by multiplying the product by the daily periodic rate (Truth in Lending Act Comptroller's Handbook, 16).

On the other hand, if the bank uses the daily balance method, but applies two or more daily periodic rates, the sum of the daily balances may not be used. Acceptable ways of disclosing the balances include: a balance for each day in the billing cycle; a balance for each day in the billing cycle on which the balance in the account changes; or two or more average daily balances. If the average daily balances are stated, the bank shall indicate on the periodic statement or in an accompanying document that the finance charge is or may be determined by multiplying each of the average daily balances by the number of days in the billing cycle (or if the daily rate varies, by multiplying the number of days that the applicable rate was in effect), multiplying each of the results by the applicable daily periodic rate, and adding the products together.

In explaining the method used to find the balance on which the finance charge is computed, the bank need not reveal how it allocates payments or credits. That information may be disclosed as additional information, but all required information must be clear and conspicuous.

Examples of Loans Taken By Consumers

In explaining the Credit Card Fair Fee Act of 2008, examples were pulled from the TILA report. For example, consummation of a transaction of 2,500 with the monthly principal and interest payment will be $115.87, if all months are considered equal, and the amount financed would be $2,500. If the consumer's payments are increased by $2.00 a month to pay a non-financed (for illustrative purpose, there is no interest component) $50 loan fee over the life of the loan, the amount financed would remain at $2,500 but the payment schedule would be increased to $117.87 a month, the finance charge would increase by $50, and there would be a corresponding increase in the APR. This would be the case whether or not state law defines the $50 loan fee as interest. If the loan above has 55 days to the first payment and the consumer prepays interest at consummation ($24.31

to cover the first 25 days), the amount financed would be \$2,500 minus \$24.31, or \$2,475.69. Although the amount financed has been reduced to reflect the consumer's reduced use of available funds at consummation, the time interval during which the consumer has use of the \$2,475.69, 55 days to the first payment, has not changed. Since the first payment period exceeds the limits of the regulation's minor irregularities provisions (see section 226.17(c)(4)), it may not be treated as regular. In calculating the APR, the first payment period must include the additional 25 days, i.e., the first payment period may not be treated as one month (Michel, Bernstein, and Allegretto, 2007).

Another instance offered in a *Newsweek* article took a closer look at a ten thousand dollar credit card balance and a fourteen percent APR. At this rate, the annual debt service (the amount of interest paid each year) is about one thousand five hundred dollars. This particular figure represents simple interest only. Cardholders who make their minimum payment each month will usually continue to see their bottom-line credit-card debt grow – and they will be charged interest on that amount as well. Essentially, strapped cardholders pay interest on interest. This is called compound interest, which is the eighth wonder of the world for credit card issuers and a potential nightmare for cardholders (Berner, 2008).

Views and Opinions about the Credit Card Fair Fee Act of 2008

Due to the controversy of the subject matter, Congress created an online link, (http://www.opencongress.org/bill/110-h5546/show) where people give views on Credit Card Fair Fee Act of 2008. Some views collected include:

Kim, Jane J.

Kim Jane asks if the Truth in Lending Act can be the law that saves the American consumer from foreclosure and financial death. Will attorneys finally get a clue and learn this area of ”mortgage law” and start the massive wave of class action lawsuits that have yet to make noise in our Federal Court system? The facts are that this law represents an uncharted territory and it is a new and exciting frontier for those of the legal cloth that wish to explore this potentially lucrative area (suing lenders). This law is exciting and should be used to its full capabilities, so it can be used to protect borrowers who are in toxic mortgages and or facing foreclosure (Retrieved March 2, 2009).

Moe Berdard: Capital Times

Most people remember the late U.S. senator from Wisconsin, William Proxmire, for his monthly “Golden Fleece” awards, which he used to cite government programs for their colossal waste of taxpayers’ dollars.

Proxmire made consumer protection his mission when he was elected to the U.S. Senate, taking the seat held by the censured and expired Joe McCarthy. He believed that the financial industry was frequently misleading borrowers about the true cost of credit on everything from mortgages to auto loans.

During the 1960s he and a handful of fellow members of Congress introduced a number of reforms. Getting them passed took a while. The financial industry fought tooth and nail against them. There were some small gains, like giving a borrower a window to get out of a loan on second thought.

Finally in 1968, Congress passed Proxmire’s Truth in Lending Act, a major piece of legislation that for the first time required lenders to make the interest rate and total cost of a loan absolutely clear. That act produced the APR, the annual percentage rate, that takes into account both the interest rate and any fees that the lender may tack on.

The *Capital Times* goes on to explain that this law may have a profound effect on lending institutions and investors, if a particular class action case is allowed to proceed in the Federal Court of Milwaukee. His opinion is that this is only a logical conclusion and ending of a lending world that was not clear on the mortgages they sold to consumers. The terms were a far cry from “absolutely clear.” In fact they were “absolutely unclear, unfair and deceptive.” Not only did the consumer get unfair and deceptive treatment from the lenders, they also got it from the realtors, the appraisers, title agents, investments brokerages, and many more.

Now using the law and other consumer laws to protect the American people, the time is now and the fight is starting. Get on the legal gloves and do something. Interestingly, Proxmire’s act may figure prominently in the current subprime mortgage crisis, which has many home buyers feeling betrayed by their financial institutions.

Carey Spivak

Milwaukee Journal Sentinel reporter Carey Spivak reported recently on a Cedarburg couple who filed a class-action suit against Washington, D.C.-based Chevy Chase Bank. The couple had refinanced their home with the bank for what they thought was a 1.95 percent interest rate for five years. Turned out, though, that the couple was stunned to learn that the one point ninety-five percent was a “teaser” rate for just one month.

The mortgage industry is worried that if the lawsuit is allowed to proceed as a class action, rather than people being required to sue individually, the door could be opened to several other large suits, adding to the financial misery that the industry is already suffering.

No matter which way the courts rule — whether the suit can proceed as a class action or the couple must sue as individuals — the basis for the suit is that 1968 Truth in Lending Act, which requires lenders to leave no ambiguity about the true interest rate. Proxmire's trailblazing efforts are still serving to protect consumers some 40 years later.

Martin Bosworth

Martin Bosworth says "The outset that this legislation is a typical beltway boondoggle. Credit card debt is up, housing is down, and so Congress goes after the evil credit card companies. Never mind about the consumer who spends every dime he makes plus another 25% or so." The main question asked is, should fraudulent and deceptive practices be targeted? Absolutely, and there are plenty of laws and regulations to do so. The problem with the legislation, however, is that it takes aim at the wrong problem while creating several others at the same time. If a voluntary agreement cannot be reached, both sides would have to submit to binding arbitration overseen by the Justice Department and the Federal Trade Commission (Bosworth, 2008).

This legislation does not stop credit card companies from making the profit the market allows them to make. What it will do, however, is change how they do it. If you limit a credit card company's ability to increase rates, they would just increase the starting rate. Balance transfer credit cards and cash back credit cards will probably be affected, too. The point is that credit card companies make what the market will bear.

Apart from stopping deceptive and fraudulent practices, the government should not get in the way of the free market.

His question on Congress is “why don’t you enact the Consumer Reform Act of 2008?” Here would be its salient points:

- A consumer’s total used and available credit on all credit cards may not exceed an amount equal to 20% of their gross annual salary;
- All credit card charges must be paid in full before the next billing cycle except where (1) the interest rate charged by the credit card company is 0%, or (2) a true financial emergency prohibits payment of the full charges; and
- All high schools must offer and all high school students must take a course on personal finance, including how to use credit cards responsibly.

Conclusion

In conclusion, it is true that credit card companies can increase interest rates, sometimes excessively (although states already have laws limiting the maximum interest rate that can be charged). And yes, credit card companies charge fees for late payments that greatly exceed the actual damage they suffer from the late payment. But there is a simple solution to these problem–consumers can either use the credit they have responsibly or not get a credit card in the first place. Are there circumstances truly outside a consumer’s control that causes them to pay a credit card bill late? Probably; but do we need federal legislation to tackle that problem?

The first phase to be implemented in November is definitely a curtain raiser to the Credit Card Fair Fee Act of 2008. Current recession and decline of the economy in general has pressures both the government and consumers to enact the Act sooner than expected.

Do credit card companies take advantage of consumers in financial crisis? Sure. Should this be stopped if it constitutes fraudulent or deceitful practices? Most definitely—to say the least. However, blaming the credit card companies is, in my opinion, pointing the finger in the wrong direction, it is not going to solve the current problem on credit cards and right pricing. Standardization has proved to be effective over the years and having a basic standard for all financial institutions will definitely help stabilize the rates that that financial institutions impose on the public.

References

Berner, Robert. 2008. A Credit Card You Want to Toss. *Business Week*. Retrieve on April 20, 2009 from http://www.businessweek.com

Bosworth, Martin H. 2008.Congress Takes On Credit Card Interchange. Retrieved on April 17, 2009 from http://www.consumeraffairs.com/news04/2008/03/credit_card_fees.html

Darlin, Damon. 2005. Credit Cards with Rewards Worth a Look. *New York Times,* December 31. Retrieved on May, 8, 2009 from http:///www.nytimes.com.

Federal Reserve Board Law Library Publication Series. 2002. The Federal Reserve Act as Amended. Retrieved on March 20, 2009 from http://www.frbdiscountwindow.org/federalreserveact.html

Garvin, Robert. 2007. Credit Card Companies Woo Struggling Mortgage-Holders. *Boston Globe*. September, 12. Retrieved on May 8, 2009 from http://www.boston.com.

Hughes, Jane Sarah, Stephen, Middlebrook T., and Brooks, Peterson W. 2006. Developments in the Law Concerning Stored Value and Other Prepaid Payment Products. *Business Lawyer*, 62 (1): 229-250.

Kulikwoski, Laurie. 2008. USB Analyst hits Credit Cards. Retrieved on March 12, 2009 from www.TheStreet.com

Lawrence, Michel, Bernstein, Jared, and Allegretto Sylvia. 2007. *The State of Working America*. New York, NY: Cornell University

Levin, Carl. 2009. Levin applauds President's Call for Credit and Card Reforms. Retrieved on May 7, 2009 from http://www.senate.gov/newsroom/release.cfmm?id=310836

Rinearson, Judith and Woods, Chris. 2004. Beware Strangers Bearing Gift Card. *Business Law Today,* Nov/Dec, Vol. 14(2): 16.

Saunders, Joseph. 2008. Durbin Moves to bring Down Credit Card Costs. Retrieved on May 02, 2009 http://www.durbin.senate.gov

Sullivan, Bob. 1999. Gotcha Capitalism: How Hidden Fees Rip You off Every Day-and What You Can Do About It. Retrieved on May 8, 2009 from http:///www.gotchacapitalism.com.

The Ohio State University, Journal of Money, Credit and Banking. 2008. The Ohio State University 40(1).

U.S. Congress. 2008. 110th Congress Session Credit Card Fair Fee Act 2008. Retrieved on April 17, 2009 from http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h5546ih.txt.pdf

United States Government Printing Press. 2008. Credit Card Reform Act of 2008. Retrieved on March 16, 2008 from http://www.doughroller.net/credit-cards/credit-card-reform-act-of-2008-congress-to-the-rescue/

United States Government Printing press. 2008. Truth in Lending Act Comptroller's Handbook (1-30). Washington, DC.

APPENDIX

DEFINITIONS

‘‘Access Agreement’’ means an agreement giving a merchant permission to access a covered electronic payment system to accept credit cards and/or debit cards from consumers for payment for goods and services as well as to receive payment for such goods and services, conditioned solely upon the merchant complying with the rates and terms specific field in the agreement.

‘‘Acquirer’’ means a financial institution that provides services allowing merchants to access an electronic payment system to accept credit cards and/or debit cards for payment, but does not include independent third party processors that may act as the acquirer’s agent in processing general-purpose credit or debit card transactions.

‘‘Antitrust Division’’ means the Antitrust Division of the U.S. Department of Justice

‘‘Antitrust Laws’’ has the meaning given it in subsection (a) of the first section of the Clayton Act (15 U.S.C. 12(a)), except that such term includes section 5 of the Federal Trade Commission Act (15 U.S.C. 45) to the extent section 5 applies to unfair methods of competition as well as any similar State law.

‘‘Base year’’ means the most recent full calendar year prior to the initiation of a proceeding under this Act.

‘‘Commission’’ means the Federal Trade Commission Bureau of Competition.

‘‘Credit card’’ means any general-purpose card or other device issued or approved for use by a financial institution allowing the cardholder to obtain goods or services on credit on terms specified by that financial institution.

‘‘Covered electronic payment system’’ means an electronic payment system that has been used for at least 20% of the combined dollar value of U.S credit, signature-based debit, and PIN-based debit card payments processed in the applicable base year.

‘‘Debit card’’ means any general-purpose card or other device issued or approved for use by a financial institution for use in debiting a cardholder’s account for the purpose of that cardholder obtaining goods or services, whether authorization is signature-based or PIN-based.

‘‘Electronic payment system’’ means the proprietary services and infrastructure that route information and data to facilitate transaction authorization, clearance, and settlement that merchants must access in order to accept a specific brand of general-purpose credit and/or debit cards as payment for goods and services.

‘‘Financial institution’’ has the same meaning as in section 603(t) of the Fair Credit Reporting Act.

‘‘Issuer’’ means a financial institution that issues credit cards and/or debit cards or approves the use of other devices for use in an electronic payment system, but does not include independent third party processors that may act as the issuer’s agent in processing general-purpose credit or debit card transactions.

‘Market power’’ means the ability profitably to raise prices above those that would be charged in a perfectly competitive market.

‘‘Merchant’’ means any person who accepts credit cards and/or debit cards in payment for goods or services that they provide.

‘‘Normal rate of return’’ means the average rate of return that a firm would receive in an industry when conditions of perfect competition prevail.

‘‘Party’’ means either all providers of a single covered electronic payment system collectively or all merchants collectively.

‘‘Person’’ has the meaning given it in subsection (a) of the first section of the Clayton Act (15 U.S.C. 12(a)).

‘‘Provider’’ means any person who owns, operates, controls, serves as an issuer, or serves as an acquirer for a covered electronic payment system.

‘‘State’’ has the meaning given it in section 4G(2) of the Clayton Act (15 U.S.C. 15g(2)).

‘‘Terms’’ means all rules applicable either to providers of a single covered electronic payment system or to merchants, and that are required in order to provide or access that covered electronic payment system for processing credit and/or debit card transactions.

‘‘Voluntarily negotiated access agreement’’ means an executed agreement voluntarily negotiated between 1 or more providers of a single covered electronic payment system and 1 or more merchants that sets the rates and terms pursuant to which the1 or more merchants can access that covered electronic payment system to accept credit cards and/or debit cards from consumers for payment of goods and services, and receive payment for such goods and services.

.