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Will Credit Cardholders Default over Minimum Payment Hikes?

By Julia Lane*

I. Introduction

Early in his career, the former CEO of Citibank, Walter Wriston was asked by his boss, "'What is this with people wanting credit?'" He replied curtly, "'Look, we just put five years of our life in a brown suit carrying an M1 rifle, and we want the refrigerator now.'"[1] It is this type of mentality that has allowed the credit card industry to flourish in the United States, becoming one of the largest and most lucrative industries in our economy.[2] Credit card issuers have tapped into the pent-up demand for consumer goods that commenced with the baby boomer generation and has been embraced by Americans ever since.[3] The American attitude of "buy now, pay later" fuels an industry that boasted profits of $30 billion in 2004.[4] Over the past twenty-five years, the credit card industry has soared in popularity and the American people have become increasingly dependent upon it to finance even some of their most basic needs

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[1] Robin Stein, *The Ascendancy of the Credit Card Industry*, PUB. BROADCAST SERVICE, FRONTLINE, Nov. 23, 2004, http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/rise.html.

[2] *Id.*

[3] *Id.*

[4] Melody Hobson, *New Rules Will Double Typical Monthly Minimums – Is it Good News for Consumers?*, ABC NEWS, Jul. 20, 2005, *available at* http://abcnews.go.com/GMA/print?id=954593.

such as food and other necessities.[5] Today, 76% of American households own at least one credit card,[6] and the total consumer debt carried by Americans in 2005 was $800.1 billion.[7]

The desire for instant satisfaction has caused Americans to pay billions in interest and financing fees, which can double the total cost of their purchases.[8] But are consumers aware of the terms of their cards, and, if so, why have they allowed their balances to get so high? Further, at the high annual percentage interest rates offered, will Americans be able to pay back their debt in their lifetimes?

Between 2004 and early 2006, almost all credit card companies have increased, or even doubled, the monthly minimum payment a cardholder must make to avoid defaulting on his credit card loan.[9] For the 40% of Americans who pay their balances in full, this change will have no effect on their personal finances.[10] Moreover, it would probably surprise those cardholders who pay in full that the credit card industry terms them "deadbeats."[11] Credit card companies do not make a dollar off consumers who pay their balances in full, and essentially give those consumers a short-term,

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[5] Karen Krebsbach, *Consumers are Overspending. That's Work for Credit Counselors*, US BANKER, Jan. 3, 2005, at 41.

[6] Emily Heffter, *Credit-Card Rule may Break your Back*, The Seattle Times, Jan. 1, 2006, at L6.

[7] Demos: A Network for Ideas and Action, *Comments Regarding Advance Notice of Proposed Rulemaking Review of the Open-End (Revolving) Credit Rules of Regulation Z*, Fed. Reserve System Docket No. R-1217 (2005) [hereinafter Demos], *available at* http://www.federalreserve.gov/SECRS/2005/March/20050329/R-1217/R-1217_110_1.pdf. Also quoted as $802.1 billion in revolving debt as of November, 2005. Fed. Reserve, *November 2005 Consumer Credit Statistical Release*, Jan. 9, 2006, http://www.federalreserve.gov/releases/g19/current/g19.pdf.

[8] Demos, *supra* note 7, at 2. At an industry average rate of 2% of a cardholder's total balance (including all fees, interest and finance charges) or $10, whichever is greater, a cardholder with an outstanding balance of $10,000 and an annual percentage rate (APR) of 18% will take 50 years to pay off his debt and may incur $28,524 in additional interest cost. *Id.* This assumes he makes no new purchases over the 50 years. *Id.*

[9] Mara Der Hovanesian, *Tough Love for Debtors*, BUSINESS WEEK, Apr. 25, 2005, at 98.

[10] Patrick McGeehan et al., *Soaring Interest Is Compounding Credit Card Woes for Millions*, N.Y. TIMES, Nov. 21, 2004, at A11.

[11] Pub. Broadcast Service ("PBS"), *Secret History of the Credit Card: Introduction*, Frontline, Nov. 23, 2004, http://www.pbs.org/wgbh/pages/frontline/shows/credit/etc/synopsis.html.

interest free loan.[12]

In order to compensate for "deadbeat" customers, over the past two decades, credit card companies have developed creative marketing tactics, with intentionally ambiguous terms and complicated surcharges and fee systems, to trap the borrower who cannot pay in full.[13] The 115 million Americans who carry at least some debt over to the next month, nicknamed "revolvers" for their use of "revolving" credit, more than make up for "deadbeats" by paying usurious interest rates (typically, more than 18% annually) on their purchases.[14] "Revolvers" fall into traps set by the credit card companies that keep their minimum payments low, spreading their principal payments over time and allow the credit card company to reap a greater amount of interest.[15]

Recently, federal regulations and mandates have required credit card companies to adhere to federal regulations[16] that require them to increase their minimum payments from 2% of the cardholder's total credit card balance (including fees and interest) to at least 1% of the principal owed on the card.[17] This new rule insures

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[12] Stein, *supra* note 1. The credit card company does make a small amount of money from customers who pay in full. Merchants who accept credit cards must pay a fee to the credit card company for every purchase made with a card. Therefore, the credit card company makes money indirectly from customers who pay in full. *Id.*

[13] PBS, *supra* note 11, at 2.

[14] *Id.*

[15] Demos, *supra* note 7, at 2. By requiring minimum payments that are less than the amount of interest accrued per month, the credit card company can extract greater interest from the cardholder than if he paid a greater percentage of the principal owed on the loan per month. *Id.*

[16] See discussion *infra* Part III.A. A joint effort by the FDIC, Federal Reserve Board and the Office of the Comptroller of the Currency (OCC) have issued an advisory letter to nationally chartered banks warning them of potential violations of the Truth in Lending Act (TILA) if they do not increase disclosures and require higher monthly minimum payments for cardholders, who may be unaware of the extent of the cost of their credit cards. Joint Press Release, Fed. Deposit Ins. Corp., NR 2003-01, *FFIEC Agencies Issue Guidance on Credit Card Account Management and Loss Allowance Practices* (Jan. 8, 2003), *available at* http://www.occ.treas.gov/ftp/release/2003-01.htm.

[17] Kristin Arnold, *Higher Credit Card Minimum Payments in 2006*, BANKRATE.COM, Jan. 2, 2006, http://www.bankrate.com/brm/news/cc/20060102a1.asp. The Office of the Comptroller of the Currency initially only advised credit card companies to ensure that the rates they offered allowed debtors to pay back debt "within a reasonable time." The OCC later clarified this to mean

that the cardholder's monthly payment covers more than the amount of interest assessed for that period and has some impact on reducing the existing balance.[18] It is estimated that 7% of Americans make only the minimum payments on their credit cards each month.[19] For these Americans, this seemingly small increase could be the difference between filing for bankruptcy and staying financially afloat;[20] especially given the fact that a recent bankruptcy law passed by Congress makes filing for bankruptcy more difficult and expensive for consumers.[21]

This article will trace the legal history of the credit card industry and its rise to power in achieving deregulation. Part II will address how the Office of the Comptroller ("OCC"), through a series of Supreme Court decisions, came to regulate the credit card industry. Part III of the article will discuss new legislative attempts by Congress and the OCC to better educate consumers and correct some of the abuses that credit card companies have utilized in achieving huge profits. Part III will also examine the effect of the new bankruptcy law, focusing on Title XIII, Consumer Credit Disclosures, and its effect on those consumers who make only their minimum payments each month. Part IV will discuss how the legislation discussed in Part III will affect consumers who carry extensive credit card debt to manage their finances. Finally, Part IV will discuss some short-comings of the new law in using disclosure as a primary method of remedying the problem.

II. Background

Credit cards emerged shortly after World War II.[22] They were initially unprofitable but have soared in popularity since the 1970s to

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at least 1% of the principal payment. *Id.*; *See also* Michelle Singletary, *We'll Have to Pay More. Good!*, The Wash. Post, Sept. 25, 2005, at F01. Dean DeBuck, a spokesman for the Office of the Comptroller was quoted by the Washington Post saying, "'Because banks were having trouble deciding what was reasonable, we have gravitated toward 1 percent of the principal,' DeBuck said. 'This is not a hard and fast rule, and banks may establish other payment amounts."' *Id.*

[18] See discussion *infra* Part III.B.1.

[19] Arnold, *supra* note 17, at 3.

[20] Stein, *supra* note 1.

[21] *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23 (2005).

[22] Stein, *supra* note 1.

become one of the most lucrative industries in the United States.[23] Part of the success of the credit card industry can be attributed to the fact that states are virtually powerless to regulate it and, until recently, the OCC never restricted the industry's credit terms.[24] Without regulation or competition from other types of credit, the industry has lent credit at high rates for more than twenty-five years, while simultaneously expanding the number of merchants and stores that accept credit cards.[25]

A. Legal History of the Credit Card Industry

The first general purpose credit card was released by Bank of America in 1958.[26] The bank sent a mass mailing of 60,000 cards ("card drop") to residents in Fresno, California, hoping to attract customers with a new type of "revolving" credit, which could be used for purchases everywhere and paid off over time.[27] Other banks quickly followed with their own "card drops," and merchants reacted to provide their customers with the option of using their cards instead of cash.[28] In the first decade of use, "card drops" caused much commotion and fraud with few profits.[29] However, by the 1970s, banks that survived the initial start up issues began to produce profits, and the "revolving credit" revolution had proved that it was here to stay.[30]

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[23] *Id.*

[24] *See generally* Mark Furletti, *The Debate Over the National Bank Act and the Preemption of State Efforts to Regulate Credit Cards*, 77 Temp. L. Rev. 425 (2004).

[25] Stein, *supra* note 1.

[26] *Id.*

[27] *Id.*

[28] *Id.* Advances in technology allowed merchants to use automated systems improving efficiency. *Id.* Also, the two companies that would become Visa and MasterCard worked together to link a nationwide network of merchants who would accept their cards. *Id.*

[29] *Id.*

[30] Stein, *supra* note 1. An incident dubbed "The Chicago Debacle" that occurred during the holiday season in 1966, shocked Americans. A group of Midwestern banks "dropped" five million cards into the mail addressed to anyone from toddlers, to convicted felons and even dogs. *Id.* Corrupt postal workers sold the cards to organized crime rings and suburban housewives were billed for charges they never made. *Id.* The incident caused such a disruption that there was even a

1. State Laws

Early credit cards were issued by local, state-chartered banks[31] and were regulated by state usury laws.[32] States had statutes that set maximum rates of interest that a credit card company or bank could charge a debtor.[33] Typically, state usury laws created ceilings for interest rates that were comparatively lower than the rates charged by credit card companies today.[34]

As credit cards gained popularity, banks specializing in credit cards emerged.[35] These banks had national charters and solicited customers across state lines to offer their services to customers in other states.[36] As a result of a series of Supreme Court decisions and a favorable economic climate, credit card companies discovered they could circumvent the more restrictive state laws by moving to states with higher or no ceilings for interest rates[37] and take advantage of the less stringent regulations enjoyed by nationally chartered banks.[38]

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movement toward outlawing credit cards. *Id.*

[31] Furletti, *supra* note 24, at 427-32. State banks are chartered in the state they are located and regulated by state law as well as the Federal Reserve Board and the Federal Deposit Insurance Corporation ("FDIC").

[32] *Id.* Usury is simply understood as the taking of interest. Usury laws have their origins in antiquity, and the idea that it is improper for creditors to charge debtors interest on loans has been prevalent in Western society since. Modern usury statutes have relaxed the prohibition on interest to foster the modern banking industry. However, states are hesitant to remove the limits altogether and leave interest rates to market forces. Jonathan R. Macey, Geoffrey P. Miller & Richard Scott Carnell, *Banking Law and Regulation,* 156-57 (Aspen Law & Business 3d ed. 2001).

[33] *Id.*

[34] Furletti, *supra* note 24, at 427-32.

[35] *Id.*

[36] *Id.*

[37] Stein, *supra* note 1. *See* Tiffany v. Nat'l Bank of Missouri, 85 U.S. 409, 413 (1873) (discussing that the "national banks have been National favorites" and were established to for the purpose of providing a currency for the whole country, so should they not be subject to unfriendly legislation by the States); Marquette Nat'l Bank of Minn. v. First of Omaha Serv. Corp., 439 U.S. 299, 302 (1978) (holding that the NBA preempted Minnesota state usury laws that restricted rates offered to Minnesota customers); Smiley v. Citibank (S.D.), N.A., 517 U.S. 735 (1996).

[38] Furletti, *supra* note 24, at 443.

2. Inflation and Voluntary Elimination of State Usury Laws as Barriers

In the late 1970s, credit card companies were squeezed by double-digit inflation rates and the low interest ceilings of state usury laws.[39] For example, Citibank, located in New York, was subject to a 12% usury ceiling and a 20% inflation rate.[40] Lending at 12% would have been suicide for Citibank, because it would have lost 8% on each loan.[41] Inflation had other negative effects on the national economy and states such as South Dakota and Delaware took their usury laws off the books in attempts to encourage lending that would stimulate the economy.[42] These states attracted credit card issuers which further served to provide their citizens with jobs and stimulate their local economies.[43] Within a short time, the credit card industry came to be located in only a few states which solicited cardholders across the country.[44] With this adjustment came a change in the regulation of the credit card industry from state to federal law.[45]

Today, nationally chartered banks underwrite almost three quarters of credit card loans made in the United States, all of which are located in only six states that comprise 4% of the total population.[46] These banks are nationally chartered by a division of the Treasury called the Office of the Comptroller of the Currency ("OCC").[47] The OCC was created by the National Bank Act ("NBA")

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39 Stein, *supra* note 1.

40 *Id.* When New York legislators refused to change the usury laws, Citibank moved to South Dakota where state usury laws were being eliminated to stimulate the economy. Citibank promised former Governor, Bill Janklow that if he passed a law to eliminate usury laws, Citibank would provide at least 400 new jobs to South Dakota residents in its bank that would not function as a normal bank, but would only issue cards. The governor, faced with a dire economic situation, complied with Citibank's request, allowing Citibank to even draft the emergency bill. Within a year 3,000 new jobs were created for South Dakotans. *Id.*

41 *Id.*

42 *Id.*

43 *Id.*

44 Stein, *supra* note 1.

45 *Id.*

46 Furletti, *supra* note 24. As of December 31, 2002, nationally chartered banks held almost $400 billion of the $550 billion debt in U.S. managed bank card loans. *Id.* at 456.

47 *Id.* at 427.

of 1864.[48] The agency is granted broad authority by the NBA and via the Supremacy Clause of the United States Constitution,[49] has the ability to preempt state banking laws.[50] Through a series of Supreme Court decisions, the OCC's power to preempt state laws was repeatedly affirmed.[51] This greatly restricted the states' ability to protect their consumers from both high interest rates and other fees imposed by credit card issuers.[52]

3. *Marquette v. First Omaha* and the Imposition of "Home-State" Law

Before 1978, credit card banks that solicited cardholders residing in another state were subject to the state usury laws enacted by the foreign state.[53] For example, when a nationally chartered credit card issuer based in Delaware solicited an Ohio resident, the rate the issuer could offer to the Ohio resident was constrained by Ohio state usury laws.[54] However, in *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*, the Supreme Court interpreted a provision of the NBA to allow nationally chartered banks to export the rates permitted in the "home-state" of the credit card issuer to customers out of state, thereby overriding any existing state laws.[55]

In *Marquette*, a Minnesota credit card issuer ("Marquette"),

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[48] *Id.* at 425-26.

[49] U.S. CONST. art. VI, cl. 2. The clause reads as follows:

> This, Constitution, and the laws of the United States which shall be made in pursuance thereof; and all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the Constitution or Laws of any State to the Contrary notwithstanding.

[50] Furletti, *supra* note 24, at 428.

[51] *See, e.g.,* Smiley v. Citibank (S.D.), N.A., 517 U.S. 744 (1996) ("there is no doubt that § 85 pre-empts state law."); Marquette Nat'l Bank of Minn. v. First of Omaha Serv. Corp., 439 U.S. 299, 302 (1978) (holding that the NBA preempted Minnesota state usury laws that restricted rates offered to Minnesota customers).

[52] Furletti, *supra* note 24, at 428-30.

[53] *Id.* at 430.

[54] *Id.*

[55] *Marquette Nat'l Bank of Minn.*, 439 U.S. at 302 (holding that the NBA preempted Minnesota state usury laws that restricted rates offered to Minnesota customers).

sought to enjoin a competing, nationally-chartered credit card issuer based in Nebraska ("First of Omaha"), from soliciting Minnesota residents for its BankAmericard program.[56] BankAmericard offered interest rates of 18% per year for the first $999.99 and 12% per year on amounts over $1,000 with no annual fee.[57] At the time, Minnesota usury laws only permitted an interest rate of 12% on all debt, so Minnesota banks imposed a $15 annual fee to compensate for the reduced interest.[58] First of Omaha was able to seduce Minnesota customers with cards that charged no annual fee by importing the higher, "home-state" interest rates.[59]

Marquette hinged upon the Supreme Court's interpretation of Section 85 of the NBA that uses the phrase "where the bank is located" to determine which state law would apply to a customer solicited by a foreign state card issuer.[60] In rendering its holding, the Supreme Court looked to the legislative history of the NBA and concluded that the word "located" was intended to designate the state where the national bank was organized.[61] Therefore, the Court determined that, First of Omaha and its BankAmericard program were "located" in Nebraska, and a plain language reading of Section 85 meant that the bank may charge the rate allowed by the laws of Nebraska for any loan.[62] Further, because there was no law barring Minnesota residents from physically crossing state lines to obtain a loan from a Nebraska bank with terms under Nebraska law, it was inconsequential that Minnesota residents had been solicited by mail.[63]

The *Marquette* decision, coupled with the spiraling inflation rate that encouraged states to abandon their usury laws, caused the credit card industry to consolidate in states like South Dakota and Delaware.[64] These states permitted credit card issuers to charge higher interest rates, allowing them to remain solvent without

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56 *Id.*

57 *Id.*

58 *Id.* at 303.

59 *Id.*

60 *Marquette Nat'l Bank of Minn.*, 439 U.S. at 303.

61 *Id.* at 310.

62 *Id.* at 313.

63 *Id.* at 310.

64 Furletti, *supra* note 24, at 432.

imposing annual fees.[65] Credit card companies in states that maintained their usury laws could not compete and consequentially, were eliminated or forced to relocate.[66]

After *Marquette*, the industry saw huge gains in profits as inflation rates fell throughout the 1980s.[67] Consumers were willing to pay 18% interest rates long after the Federal Reserve Board lowered the interest rates it charged banks.[68] Because interest rates remained high, credit card companies secured a 10% point margin over the prime rate.[69] Between 1980 and 1990, the number of credit cards doubled and the average balance per American household increased five-fold from $518 to almost $2,700.[70] Credit cards became increasingly popular and Americans were willing to pay for them at higher interest rates.

4. The Expanded Meaning of "Interest" and Increasing Anti-Consumer Practices of Credit Card Issuers

As the credit card industry matured, issuers thought of new ways to extract more profits from customers. Throughout the 1980s, credit card companies invented surcharges for past due payments, fees for spending over the credit limit and returned check fees.[71] Although *Marquette* paved the way for exported periodic interest rates, it did not reach the question of whether fees permitted by the "home-state" could be exported as well.[72] Consumers brought suits against credit card companies in the Third Circuit,[73] the U.S. District Court for the District of Minnesota,[74] and the Supreme Courts of

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65 *Id.*

66 *Id.*

67 *Id.*

68 *Id.*

69 Stein, *supra* note 1.

70 *Id.*

71 Furletti, *supra* note 24, at 433.

72 *Id.* at 432.

73 *See* Spellman v. Meridian Bank (Del.), No. 92-CV-03860, 1995 WL 764548 (3d Cir. 1995) (holding that the Pennsylvania state law that limited late and over limit fees charged by an out-of-state nationally chartered bank was preempted by the NBA).

74 *See* Tikkanen v. Citibank (S.D.), 801 F. Supp. 270, (D. Minn. 1992) (holding that a Minnesota state statute that limited late and over limit fees charged

Colorado,[75] Pennsylvania,[76] and New Jersey.[77] These suits charged that imposing additional fees were violations of state usury laws.[78] The plaintiffs in these cases argued that although federal law may preempt the periodic interest rates charged by states, state law could still regulate the types of surcharges and fees imposed on cardholders.[79] Despite these efforts, however, most of the resulting holdings strengthened the credit card companies' ability to levee additional costs to cardholders.[80]

The Supreme Court of New Jersey was the only court to rule that late fees and penalties were separate and distinct from interest which it defined as periodic finance charges.[81] In its examination of the legislative history of the NBA, the court found that the Congressional concern was primarily focused on numerical or percentage interest rates and not fees.[82] The court further held that New Jersey state usury laws regarding non-percentage rates as applied to credit cardholders were not preempted by the NBA.[83]

It was a Third Circuit decision, however, that would eventually be utilized by most other jurisdictions. In *Spellman v. Meridian Bank (Delaware)*, the court affirmed the power of the OCC

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by an out-of-state nationally chartered bank was preempted by the NBA).

75 *See* Copeland v. MBNA Am. Bank, 907 P.2d 87 (Co. 1995) (holding that a Colorado state statute limiting late and over limit fees charged by out-of-state federally chartered bank was preempted by NBA); *see also* Richardson v. Citibank (S.D.) N.A., 908 P.2d 532 (Co. 1995).

76 *See* Bank One, Columbus, N.A. v. Mazaika, 680 A.2d 845 (Pa. 1996) (citing Smiley v. Citibank (S.D.), N.A., 517 U.S. 735 (1996)) (holding that flat fees were included in the term "interest" under Section 85 of the NBA and the flat fees therefore could be exported along with the interest rates of the home-state to out-of- state cardholders).

77 Sherman v. Citibank (S.D.), N.A., 668 A.2d 1036, 1040 (N.J. 1995). The New Jersey's Supreme Court was the only court to hold that, "the understanding of the word 'interest' as expressed and authorized in the NBA does not include distinctive and contingent loan terms or charges such as late fees, that are unrelated to interest rates." *Id.*

78 *Id.*

79 Furletti, *supra* note 24, at 433.

80 *Id.*

81 *Sherman*, 668 A.2d at 1043.

82 *Id.*

83 *Id.* at 1053.

to preempt *any* state usury law that outlawed levying fees.[84] The Third Circuit held that the word "interest" in Section 85 of the NBA included fees as well as periodic finance charges.[85] The court relied heavily on an 1873 case called *Tiffany v. National Bank of Missouri*.[86] In *Tiffany*, the Supreme Court interpreted the NBA to mean that national banks were to be "national favorites," or the "most favored lender" and free from banking regulations that could hinder their banking efforts.[87] The Third Circuit interpreted *Tiffany* to mean that Congress intended to protect national bank lending activities from state intervention, to ensure that they would eventually replace state banks.[88] Moreover, the Third Circuit concluded that restricting the meaning of interest to only periodic finance charges would lead to "an undesirable hodgepodge of fee limits and periodic rate provisions" under the laws of both the bank's home state and the borrower's state.[89]

In 1996, the Supreme Court resolved to settle the divide in the law when it reviewed a California court's decision in *Smiley v. Citibank (S.D.), N.A.*[90] However, just two months before the Supreme Court's decision, the OCC issued an official regulation declaring its power to regulate nationally chartered banks' fees and interest rates.[91] The OCC regulation defined the meaning of interest under Section 85 of the NBA to include: numeric periodic rates, late fees, not sufficient funds fees, overlimit fees, annual fees, cash advance fees, and membership fees.[92] In its ruling, the Supreme Court adopted the OCC's interpretation[93] and in a unanimous decision written by

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[84] *Spellman*, 1995 WL 764548 at *15.

[85] *Id.*

[86] Furletti, *supra* note 24, at 434. *See also* Tiffany v. Nat'l Bank of Missouri, 85 U.S. 409, 413 (1873) (discussing that the "national banks have been National favorites" and were established to for the purpose of providing a currency for the whole country, so should they not be subject to unfriendly legislation by the states).

[87] *Tiffany*, 85 U.S. at 413.

[88] *Spellman*, 1995 WL 764548 at *16.

[89] *Id.*

[90] Smiley v. Citibank (S.D.), N.A., 517 U.S. 735 (1996).

[91] Furletti, *supra* note 24, at 435.

[92] *Id.*

[93] *Id.* at 436. The OCC issued its official regulation on February 9, 1996. 61 Fed. Reg. 4849-03, 4869 (Feb. 9, 1996) (codified at 12 C.F.R. § 7.4001(a)). The Supreme Court heard arguments for *Smiley* on April 24, 1996. The OCC

Justice Scalia, the Court reasoned that Congress granted the OCC the power to interpret any ambiguities found in the NBA.[94] Further, the Court held that it would grant deference to the OCC's interpretations, requiring only that the regulation be reasonable to be upheld.[95] The Court concluded, without much deliberation, that the OCC regulation was reasonable.[96] The ruling ended any debate on the matter thereby encouraging credit card companies to impose additional fees unhindered by state law.[97]

5. California's Failed Attempt to Require Minimum Warning Payments

In the past decade, consumers have become increasingly dependent, yet dissatisfied with their credit card lenders. In 2003, the OCC received 80,000 complaints from consumers.[98] Credit card companies accounted for the largest source of complaints.[99] New York Attorney General, Eliot Spitzer, reported that his office gets thousands of complaints every year about credit card issues, but more often than not, the banks' responses have been dismissive.[100] Banks have repeatedly told Spitzer that, "we don't need to deal with you because the OCC has told us—indeed directed us—not to deal with

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interpretation is as follows:

> The term "interest" as used in 12 U.S.C. § 85 includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees. It does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports.

61 Fed. Reg. at 4869.

94 *Smiley*, 517 U.S. at 744-45.

95 Furletti, *supra* note 24, at 436.

96 *Smiley*, 517 U.S. at 744-45.

97 Furletti, *supra* note 24, at 436.

98 McGeehan *supra* note 10, at 9.

99 *Id.*

100 *Id.*

state enforcement entities."[101]

In 2002, the California legislature took matters into its own hands and enacted California Civil Code Section 1748.13.[102] The bill sought to reduce its citizens' unprecedented levels of insolvency arising from credit card debt.[103] The law required credit card companies to provide a warning to customers about the dangers of paying only the minimum payment on their monthly statements.[104] In addition to the general warning about minimum payments, the bill required that credit card companies either:[105] (1) provide a statement describing the amount of time and total cost it would take to pay off three hypothetical balances if a cardholder only paid the minimum, or (2) make a customized statement for each cardholder that gave estimates of the amount of time and cost each individual would endure in only paying the minimum.[106]

Credit card companies jointly sued the Attorney General of California for injunctive relief from the bill.[107] They charged that the law was preempted by federal banking laws,[108] and thus inapplicable

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[101] *Id.*

[102] CAL. CIVIL CODE § 1748.13 (2002), *invalidated by* American Bankers Ass'n v. Lockyer, 239 F. Supp. 2d 1000 (E.D. Cal., 2002).

[103] *Id.*; *See* Donald R. Cassling, *Federal Banking Laws Completely Preempted a State Law Designed to Warn Credit Cardholders About the Dangers Associated with only Paying Their Minimum Balances*, 120 BANKING L.J. 548, 548 (2002) (discussing American Bankers Ass'n v. Lockyer, 239 F. Supp. 2d 1000 (E.D. Cal., 2002)).

[104] Cassling, *supra* note 103.

[105] CAL. CIVIL CODE § 1748.13(a)(2)(A). The California law also required that a toll-free number be available for customers who might have questions regarding their statement and the new warnings. *Id.* at § 1748.13(a)(3)(A). However, card companies who required that cardholders pay 10% of their outstanding balance or more, or did not impose finance charges, were exempt from having to place the warning on their customer's statements. *Id.* at § 1748.13(c)(1).

[106] These provisions are almost identical to those contained in the new bankruptcy law that amends TILA. See *infra* Part III.B for a discussion of the provisions of BAPCPA that amend disclosure requirements for credit card companies.

[107] American Bankers Ass'n v. Lockyer, 239 F. Supp. 2d 1000, 1001-002 (E.D. Cal., 2002); Cassling, *supra* note 103, at 548.

[108] *American Bankers Ass'n*, 239 F. Supp. 2d at 1002. The plaintiffs sought summary judgment on the grounds that Section 1748.13 was preempted by the NBA, Home Owners' Loan Act ("HOLA"), the Office of Thrift Supervision ("OTS") and the Federal Credit Union Act ("FCUA"). *Id.* at 1006.

to nationally chartered credit card banks.[109] The district court granted temporary injunctive relief to prevent the bill from going into effect as scheduled in July of 2002.[110] The court eventually granted summary judgment in favor of the plaintiffs in December of the same year, noting that consumer protection has traditionally been the sole province of the NBA.[111] The court held that the bill's requirement that credit card lenders provide three hypothetical balances with repayment terms and a toll-free number was preempted by the NBA, and therefore unenforceable.[112] However, the court noted that the law could be severed to require credit card lenders to provide only a generic warning about paying the minimum payment, as the burdens placed on credit card lenders would be insignificant and the terms they offered would not be affected.[113] Nevertheless, because the legislature did not include a severability clause, the law was struck down in its entirety.[114]

B. Common Anti-Consumer Practices in the Credit Card Industry

Much to the frustration of individual states, and despite increasing insolvency due to credit card debt, federal preemption has been a major blockade for states attempting to hold credit card companies responsible for their anti-consumer actions.[115] Improvements in technology have allowed credit card companies to become increasingly aggressive in their tactics to extract greater profits from customers who carry balances.[116] Demos, a non-profit, non-partisan, national research group investigated the primary methods credit card companies have used to exploit their customers.[117] Below is a summary of the anti-consumer practices that

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[109] *Id.* at 1002.

[110] *Id.* at 1006.

[111] *Id.* at 1016, 1022.

[112] *Id.* at 1014.

[113] Cassling, *supra* note 103, at 550.

[114] *Id.*

[115] Demos, *supra* note 7, at 10.

[116] Stein, *supra* note 1, at 1.

[117] Demos: A Network for Ideas and Action is a nonprofit, nonpartisan national research and public policy organization based in New York who produced two credit card industry practice studies and their effects on the entire population as

have become commonplace over the past decade.[118]

1. Lowering Minimum Payment Requirements and Credit Extension

One common way that credit card issuers unwittingly extract profits from consumers is through negative amortization.[119] Negative amortization is accomplished when a credit card issuer offers a cardholder more credit and lowers the amount required to make a minimum payment, so that a cardholder paying only the minimum payment, does not reduce his principal.[120]

On average, general purpose credit cards (e.g. Visa, MasterCard and Discover) have lowered the minimum monthly payment requirement from 5% to between 2 and 3% of a cardholder's total outstanding balance and have tripled the amount of credit offered to customers between 1993 and 2000.[121] This trend increased the amount of credit made available to consumers, while requiring smaller payments per month, which vastly increased the amount of time a debtor remained in debt and the amount of interest a credit card company could collect.[122] As a result, a credit cardholder's minimum payments hardly make a dent in his credit card balance.[123] For example, a credit cardholder who pays only his minimum payment (2% of his balance) and has a credit card balance of $5,000, assuming an APR of 18% and no other charges are made on the card, would take forty-six years to pay off with interest costs of $7,789.[124]

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well as several sub-groups. Demos, *About Demos*, http://www.demos-usa.org/page2.cfm (last visited Feb. 4, 2006). These comments were used by the Federal Reserve Board in determining a course of action for the Rulemaking discussed in Part III of this article.

[118] Demos, *supra* note 7, at 4-6.

[119] *Id.* at 4.

[120] *Id.*

[121] *Id.* The amount of credit offered to consumers rose from $777 billion to $3 trillion between 1993 and 2000. *Id.* The average household now has six credit cards with an average credit line of $3,500 on each for a total of $21,000 in available credit. *Id.*

[122] *Id.* at 4-5

[123] Demos, *supra* note 7, at 5.

[124] *Id.* at 8.

2. Late Fees and Payment Cut-off Time

Another popular anti-consumer practice is the assessment of late fees and penalties. Late fees and penalties are now the fastest growing source of revenue for the industry.[125] After the Supreme Court's decision in *Smiley*, credit card companies adopted late fees and raised them from $5 or $10,[126] if a payment was not received within a twenty-five day grace period, to $29 or $39, often with no grace period at all.[127] Credit card companies have due dates for each payment set to a specific hour on the date that the payment is due.[128] Often, the times are at such early hours in the morning, that practically all payments received on the due date incur a late fee.[129]

In addition to charging late fees, credit card companies use this "late" payment as an excuse to trigger a "default interest rate" with a much higher annual percentage rate ("APR") or to cancel a cardholder's lower introductory rate.[130] The credit card company is not required to notify the cardholder of the increased rate, because it is usually written in fine print on the credit card application.[131] Therefore, a cardholder may continue to use the card unaware of the increased rate, until his next statement arrives.

3. Universal Default

In addition, card issuers routinely check the credit score of their cardholders and increasingly engage in a practice known as "universal default."[132] Without ever notifying the debtor of the change, a creditor may raise the debtor's interest rate based on his

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125 Stein, *supra* note 1, at 1.

126 *Id.* at 6.

127 Demos, *supra* note 7, at 5.

128 *Id.*

129 *Id.*

130 *Id.* Often, to entice new cardholders or to get a consumer to switch to their card, a credit card company will offer a cardholder an introductory rate with a lower APR than the industry standard. In fine print, the new contract will explain that after the promotional rate or any series of events, including a payment received after the due date (or due hour), a significantly higher default rate is triggered.)

131 McGeehan, *supra* note 10, at 1.

132 Demos, *supra* note 7, at 5.

poor credit performance with another creditor.[133] For example, if a debtor fails to make his MBNA credit card payment that month, his Bank One Visa creditor may raise his rate on the Visa, even if he never missed a payment on the card he holds with Bank One.[134] Events that trigger credit card companies to raise a cardholder's rate can be as minor as a late payment on a utility bill or simply because the credit card company felt the customer had taken on too much debt.[135]

4. Retroactive Application of Any Change of Terms

Credit card issuers typically reserve the right to change the terms of each card for any reason, allowing them to apply higher default rates to balances that existed before the event that triggered the default rate even occurred.[136] For instance, if a cardholder with a balance of $1,000 and an introductory APR of 10% misses a payment, the cardholder will be charged the default rate (as much as 29%), not only on new purchases, but on the $1,000 balance he accrued before the missed payment.[137] Further, credit card companies such as Discover, reserve the right to look back eleven months before the cardholder obtained the card to justify the increase.[138] Because the credit card company has reserved the right to change the terms at anytime, it is not required to notify the cardholder of the retroactive rate.[139] The credit cardholder is left confused, with little recourse, because the OCC has upheld the practice so long as the credit card companies are not intentionally deceiving their customers.[140]

III. Federal Regulators Finally Respond in 2003

For decades, credit card companies defended their territory by having state laws struck down for preemptive reasons with no

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[133] *Id.*

[134] *Id.*

[135] McGeehan, *supra* note 10, at 2.

[136] *Id.*

[137] *Id.*

[138] *Id.* at 5.

[139] *Id.*

[140] McGeehan, *supra* note 10, at 8.

response from Congress or the OCC.[141] Finally in 2003, the Federal Financial Institutions Examination Council ("FFIEC"), a joint committee of: the OCC, the Federal Deposit Insurance Corporation ("FDIC"), the Federal Reserve Board and the Office of Thrift Supervisions, used its administrativė power to regulate the companies.[142] In a joint action, the four agencies issued an advisory to nationally chartered banks that issue credit cards that required them to revise some of their anti-consumer practices.[143] The eight page advisory letter was released on January 8, 2003 and is applicable to all institutions that offer credit card programs under the agencies' supervision.[144]

A. Advisory Letter and Its Provisions

The advisory issued to credit card lenders recommended changes in six different areas: (1) Credit Line Management, (2) Over-Limit Practices, (3) Minimum Payment and Negative Amortization, (4) Workout and Forbearance, (5) Income Recognition and Loss Allowance Practices, and (6) Policy Exceptions.[145] It threatened "immediate corrective action" by the agencies for activities of credit card companies deemed imprudent or inadequate.[146] However, the joint effort of the federal banking regulators did not require compliance by a specific deadline or give concrete instructions of practices that were to be discontinued.[147] Rather, the agencies recognized that some institutions would need time to make the changes necessary to comply with the new rules.[148]

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[141] Cassling, *supra* note 103, at 548.

[142] Joint Press Release, *supra* note 16.

[143] *See generally* Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and the Office of Thrift Supervision, OCC 2003-01, *Credit Card Lending: Account Management and Loss Allowance Guidance* (Jan. 8, 2003), *available at* http://www.occ.treas.gov/ftp/bulletin/2003-1a.doc (an interagency advisory issued to nationally chartered banks requiring them to revise some of their anti-consumer practices).

[144] *Id.* at 2.

[145] *Id.* at 1.

[146] *Id.* at 2.

[147] *Id.*

[148] *See* Joint Press Release, *supra* note 16. Credit card companies were instructed to work with their direct regulator, the OCC to ask for additional time for

1. Tightening Credit Lines

The first area that the advisory sought to correct was credit line management, due to the concern that credit card lenders were not considering the repayment capacity of their borrowers.[149] The advisory required that lenders test, analyze and document the criteria used before determining credit-line increases and assignments.[150] It was further recommended that lenders base their decisions on factors such as repayment history, risk and behavior scores.[151] Credit lenders were asked to review their methods of determining how much credit was offered to an individual consumer and to ensure that assignment of credit was conservatively tailored to the individual's ability to repay the credit.[152] The provisions also stated that it was unacceptable for lenders to issue additional cards to borrowers who had previously experienced payment problems on existing cards.[153]

2. Minimum Payments and Negative Amortization

The most significant area of reform for the purposes of this article came in the form of one sentence stating that the "[a]gencies expect lenders to require a minimum payment that will amortize the current balance over a reasonable period of time."[154] This sentence put credit card companies on notice that negative amortization, inappropriate fees and other practices that inordinately extend or prolong consumer debt are subject to close scrutiny by the OCC.[155]

The advisory did not define what a reasonable period of time would be. However, in later press releases, the OCC clarified that "a reasonable period of time" for a payment plan to mean one that required 1% of the principal be paid per month or approximately 4%

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compliance. *Id.* This article will discuss only the provisions of the new rules that affect credit card users.

149 Office of the Comptroller of the Currency et al., *supra* note 143, at 2.

150 *Id.*

151 *Id.*

152 *Id.*

153 *Id.* at 2.

154 Office of the Comptroller of the Currency et al., *supra* note 143, at 3. (". . . with the unsecured, consumer-oriented nature of the underlying debt and the borrower's documented creditworthiness.").

155 *Id.*

of a consumer's total balance,[156] and on December 1, 2005, Comptroller of the Currency, John C. Dugan announced that most banks were expected to be in compliance with the negative amortization provisions by the end of 2005.[157] In a press release, he emphasized that lenders were encouraged to work with consumers who had trouble meeting the higher minimum payment requirements and to avoid "to the maximum extent possible" writing down the loan and cutting off the customer's credit.[158] In early January of 2006, Kevin Murki, a spokesman for the OCC, said that nearly all banks have complied with the regulation and those that have not were required to give the OCC "a good reason" for their noncompliance.[159]

3. Workout and Forbearance Programs

The third major part of the advisory dealt with "Workout" or Forbearance Programs for credit card holders.[160] This addressed the issue of cardholders, who formerly had open-end credit cards with the lender but now had their credit availability closed and their balance placed on a fixed repayment schedule with modified terms.[161] The agencies encouraged lenders to work with debtors who had defaulted on their payments to create alternative payback programs.[162] The advisory emphasized that the programs should be designed to maximize principal reduction,[163] and must require that borrowers repay their credit card debt within sixty months.[164] The

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[156] Der Hovanesian, *supra* note 9, at 1. Barbara J Grunkemeyer, Deputy Controller for Credit Risk at the OCC, explained, "[w]e were concerned that people were making smaller and smaller payments, but not making any headway" in paying off loans.) *See also* Singletary, *supra* note 17.

[157] Press Release, Office of the Comptroller of the Currency, NR 2005-117, *Comptroller Dugan Expresses Concern about Negative Amortization* (Dec. 1, 2005), *available at* http://www.occ.treas.gov/toolkit/newsrelease.aspx?Doc=I51QIBS3.xml.

[158] *Id.*

[159] David Lazarus, *Minimum Payment Millstones*, S.F. CHRON., Jan. 4, 2006, at C1.

[160] Office of the Comptroller of the Currency et al., *supra* note 143, at 4.

[161] *Id.* at 2.

[162] *Id.* at 4.

[163] *Id.*

[164] *Id.* at 2.

agencies suggested that credit card lenders reduce or eliminate interest payments and fees so that they may feasibly recover the principal within the sixty month workout period.[165]

4. Compliance

The advisory broadly applies to all institutions that offer credit card programs but lacks an independent enforcement mechanism. It leaves enforcement to the specific agency designated to regulate each institution (e.g. the OCC regulates nationally chartered credit card banks).[166] Each agency will assess the risk profile of each institution to determine whether its account management practices are sound.[167] The advisory requires that each agency more rigorously scrutinize higher-risk portfolios such as those that use negative amortization for over-limit accounts.[168] An agency may use its discretion to regulate the credit card banks it regulates, and the advisory threatens institutions with the penalty of immediate corrective action when it is found to engage in practices deemed inadequate or imprudent.[169] However, there are no specific penalties for infractions listed in the advisory, leaving execution of any enforcement actions solely to the discretion of the regulating agency.

5. OCC Enforcement

The OCC and all other federal banking regulators have both a supervisory role and an enforcement role in carrying out policy.[170] All banks are subject to a comprehensive, annual examination by their regulator in which a team of examiners make on-site visits and analyze the details of individual loans made by the institution.[171] In addition, banks are required to submit quarterly reports of condition ("call reports") that contain detailed balance sheet data allowing the regulator to assess the soundness of the lending institution.[172]

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165 Office of the Comptroller of the Currency et al., *supra* note 143, at 4.

166 *Id.* at 2.

167 *Id.*

168 *Id.*

169 *Id.*

170 Macey, *supra* note 32, at 640.

171 *Id.* at 644.

172 *Id.*

If the lending institution is found to be unsound, the OCC may enforce its policies through various means.[173] The OCC may take formal actions such as issuing a cease and desist order, removing management, imposing civil money penalties of as much as $1 million a day, denying FDIC insurance or even imposing criminal penalties.[174] Additionally, because banking regulators have such tremendous power over the institutions they regulate, the OCC also enforces certain actions indirectly, using what is known as its "arm-twisting" power.[175] For example, the agency may threaten to deny licenses, refuse to enter into procurement agreements, disseminate adverse publicity or impose other sanctions against a non-compliant bank.[176] However, as of January 2006, the OCC has not yet taken any action for practices in violation of the advisory guidelines.

B. Bankruptcy Law Amends TILA Requiring More Disclosure

Following the OCC's lead, Congress has also attempted to correct some of the anti-consumer policies adopted by credit card companies that have led to an increased number of personal bankruptcy filings.[177] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") went into effect on October 17, 2005, and amends the Truth in Lending Act ("TILA") to require, among other things,[178] greater disclosure of credit terms to cardholders in an effort to curb bankruptcy filings derived from credit card default.[179] The bill does not require credit card issuers to make any changes in rates, but rather seeks to better educate the credit cardholder by requiring more comprehensive disclosures of the terms

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[173] *Id.* at 662.

[174] Michael P. Malloy, *Principles of Bank Regulation*, at 299-235 (Concise Hornbook Series, 2d ed., West 2003).

[175] Macey, *supra* note 32, at 664.

[176] *Id.* at 665.

[177] *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23 (2005).

[178] Other sections of the act seek to discourage both personal and corporate bankruptcy filings by amending current bankruptcy law. *Id.* at § 221. These sections may affect consumers who are now required to make higher minimum payments. However, only the added disclosures will be discussed for the purposes of this article.

[179] *Id.* § 1301 (codified at 15 U.S.C. § 1637 (2005)).

offered.[180]

1. Minimum Payment Warnings

One of the goals of BAPCPA is to better educate consumers about the terms of credit they receive.[181] BAPCPA amends TILA by adding a provision that requires issuers of open-ended credit plans to post a "Minimum Payment Warning" on monthly billing statements.[182] The warning must appear on all accounts that require a minimum payment of less than 4% of the balance.[183] The warning is required to include an example showing that at an interest rate of 17%, a balance of $1,000 would take eighty-eight months to repay if only the 2% minimum payment was made.[184] The credit lender must also list next to the warning a toll-free phone number maintained by the Federal Trade Commission ("FTC").[185] Borrowers may call this number to obtain an estimate of the number of months it would take to pay off their balance in full.[186] Interestingly, the provisions of the Act are almost identical to those contained in California statute that was held in violation of the NBA.[187]

The Act requires a different warning for credit cards that require minimum payments of more than 4% of a cardholder's total balance.[188] The warning must state that a minimum payment rate of 5%, at 17% interest, will take twenty-four months to pay off a balance of $300 in full.[189] However, the Act provides an escape hatch. If a credit lender chooses to maintain its own toll-free number for the purpose of providing customers with the actual number of

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[180] *Id.*

[181] *Id.*

[182] *Id.* § 1301.

[183] *Id.* (codified at 15 U.S.C. § 1637(b)(11)(A)).

[184] *Id.*

[185] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23, § 1301 (2005).

[186] *Id.*

[187] *See* CAL. CIVIL CODE § 1748.13 (2002), *invalidated by* American Bankers Ass'n v. Lockyer, 239 F. Supp. 2d 1000 (E.D. Cal., 2002); see *supra* Part II.A.5 for a discussion of the California statute.

[188] *Id.* (codified at 15 U.S.C. § 1637(b)(11)(B)).

[189] *Id.*

months required to pay a balance in full, it may omit the example and state only the boilerplate warning.[190]

2. Introductory Rates and Late Fees

Another major area of regulation relates to greater clarity in disclosing terms such as introductory APRs and late fees.[191] Specifically, the Act requires that the issuer disclose under what circumstances a borrower may incur a late fee and the amount of the penalty.[192] Lenders are also required to disclose, "clearly and conspicuously" on each billing statement, the date in which the payment is due, or if different, the earliest date in which a late fee may be assessed, as well as the amount of the late fee.[193]

In addition, introductory rates, or those offered for less than one year, must be "clearly and conspicuously" disclosed on the application.[194] The issuer must provide a general description of the temporary APR as well as the APR that will apply after the temporary period.[195] Also, the application is required to give a general description of the circumstances that may cause a temporary rate to be revoked and whether the new rate would be a higher fixed rate or one that would vary with an index.[196] Six months after BAPCPA's enactment, the Board will meet with other federal banking agencies to better define what is meant by "clear and conspicuous".[197]

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[190] *Id.* (codified at 15 U.S.C. § 1637(b)(11)(J)). A creditor that maintains a toll-free telephone number for the purpose of providing customers with the actual number of months that it will take to repay an outstanding balance shall include the following statement: 'Making only the minimum payment will increase the interest you pay and the time it takes to repay your balance. For more information, call this toll-free number: ______." *Id.* (codified at 15 U.S.C. § 1637(b)(11)(K)).

[191] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23, § 1305 (2005) (codified at 15 U.S.C. § 1637(b)(12)).

[192] *Id.*

[193] *Id.*

[194] *Id.* § 1303 (codified at 15 U.S.C. § 1637(c)(6)(i)).

[195] *Id.*

[196] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23, § 1303 (codified at 15 U.S.C. § 1637(c)(ii)-(iii)).

[197] *Id.* § 1309(c). The Act sets a standard stating:

IV. Consumer Impact

The advisory and the amendments to TILA contained in BAPCPA are significant steps in correcting some of the abusive practices engaged in by credit card issuers but may not be a complete solution given the lack of specific penalties for infractions. It is promising that both Congress and federal regulators have recognized that credit card debt is becoming a considerable source of personal bankruptcy filings and have reacted formally with legislation. However, because the advisory can only be enforced at the discretion of the OCC and BAPCPA contains loopholes that allow credit card lenders to evade compliance, the actions will not reverse all of the anti-consumer practices that have become the norm over the past three decades.

In the long run, increased minimum payments will benefit consumers.[198] Consumers' total costs will decrease, allowing them to become debt-free within a shorter period of time.[199] However, consumers who have adjusted their finances around the lower minimum payments will most likely suffer short-term effects. Thus far, banks have experienced more customer defaults since the enactment of payment raises.[200] Bank of America, one of the first to raise its minimums in the second quarter of 2004, experienced a 63% increase in net charge-offs for bad loans totaling $691 million in that quarter.[201] However, by the end of the year the amount was reduced to $40 million that could be attributed to charge-offs, suggesting that banks will have an initial adjustment period that will eventually stabilize.[202]

> In promulgating regulations under this section, the Board shall ensure that the clear and conspicuous standard required for disclosures made under the provisions of the Truth in Lending Act referred to in subsection (a) can be implemented in a manner which results in disclosures which are reasonably understandable and designed to call attention to the nature and significance of the information in the notice.

[198] Singletary, *supra* note 17, at 1.

[199] *Id.*

[200] Der Hovanesian, *supra* note 9, at 2.

[201] *Id.*

[202] *Id.*

A. Credit Lenders Exercise Caution on the OCC's Watch

The guidance given to credit card companies by the OCC has already led to a decrease in some of the anti-consumer practices previously engaged in by the industry.[203] Under the close scrutiny of the OCC, several credit card companies have dropped their "universal default" policies.[204] Particularly, the OCC's concern with negative amortization will discourage credit card lenders from developing additional anti-consumer practices that extend the time and amount of interest extracted from each account.

While agencies regulating the credit card industry are primarily concerned with avoiding bank defaults and over-extension of credit[205] rather than protecting consumers, the OCC effectively accomplishes both goals by requiring that banks tailor the amount of credit offered to the consumer's ability to repay.[206] The advisory lets credit card issuers know that their anti-consumer methods of extracting profits are under surveillance and will not go unnoticed.

Because the advisory does not list specific consequences for actions deemed inappropriate, the OCC regulates the credit card industry in a way that is similar to a parent disciplining a disobedient child. As credit card companies certainly realize that they have over extended credit and engaged in "negative amortization," the advisory will cause them to adjust their behavior to avoid the uncertain consequences of upsetting their disciplinarian. It is up to the OCC to remain strict in enforcing its provisions, so that credit card companies will not revert to their old practices.

By issuing a general list of areas that credit card companies will be under scrutiny to improve upon, the OCC retained the capacity to clarify terms after banks begin to comply. For example, the advisory's vague request that lenders require minimum payments amortizing current balances "over a reasonable time," allowed banks to react to the request, while the OCC determined its own definition of at least 1% of principal per month.[207] The ambiguity of the advisory, coupled with the ominous idea that credit card lenders

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203 Barbara A. Rehm, *Citi Shake-Up, Wal-Mart, and Other Highlights of a Truly Stormy Year*, AM. BANKER, Dec. 1, 2005, at 29A.

204 *Id.*

205 Office of the Comptroller of the Currency et al., *supra* note 143, at 2.

206 *Id.*

207 Office of the Comptroller of the Currency et al., *supra* note 143, at 2; Der Hovanesian, *supra* note 9, at 98.

know they are being watched, will most likely cause lenders to change some of their less scrupulous policies. The fact that the consequences for particular infractions have not been spelled out may promote change throughout the industry to amend practices such as negative amortization, out of fear of "arm-twisting".

B. TILA Amendments Provide Too Much Leeway

On the other hand, Congress used the regulatory method of mandatory disclosure in enacting the TILA amendments in BAPCPA.[208] The philosophy behind increased disclosure of terms to consumers is to correct some of the asymmetries of information in the marketplace, allowing consumers to make better and more rational decisions.[209] This idea presupposes that the consumer is a rational actor, and will actually read the disclosures, understand them, and adjust his behavior to most efficiently allocate his resources.[210] After much prompting by numerous investigations in both the House and the Senate, Congress has decided to extend its efforts in curbing abusive lending to the credit card industry, in its attempt to decrease the number of personal bankruptcy filings with BAPCPA.[211] However, studies increasingly reveal that disclosure does not always work.[212] Moreover, while many Americans are aware of the dangers of paying only their minimum payments, they are faced with few alternatives to provide basic necessities for their families.[213]

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[208] Matthew A. Edwards, *Empirical and Behavioral Critiques of Mandatory Disclosure: Socio-economics and the Quest for Truth in Lending*, 14 CORNELL J.L. & PUB. POL'Y 199, 201-02 (2005).

[209] *Id.* at 203.

[210] *Id.*

[211] H.R. REP. NO. 109-31(1), at 17 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 88, 103 ("In addition, S. 256 amends the Truth in Lending Act to require certain credit card solicitations, monthly billing statements, and related materials to include important disclosures and explanatory statements regarding introductory interest rates and minimum payments, among other matters. These additional disclosures are intended to give debtors important information to enable them to better manage their financial affairs").

[212] Edwards, *supra* note 208.

[213] Demos: A Network for Ideas and Action & Ctr. for Responsible Lending, *The Plastic Safety Net: The Reality Behind Debt in America* 10-11 Oct. 2005), *available at* http://www.demos.org/pubs/PSN_low.pdf. A study conducted by Demos revealed that the majority of consumers who only pay their minimum balances are using their cards for essential purchases, not luxury items which are

1. How Clear and Conspicuous is 'Clear and Conspicuous'?

A Spokesman for the OCC, stated that the disclosures to consumers would ideally be as effective as the FDA food label, although admittedly the perils of minimum credit card payments have not achieved anywhere near the level of transparency of today's food labels.[214] Depending on how the Board eventually interprets the meaning of "clear and conspicuous," it may achieve some success. If the warning is sufficiently large and pervasive enough, consumers, who are not particularly financially literate, will likely be more inclined to read the warning and consider the meaning of the examples. Much of the success of the FDA food labels can be attributed to its standardized display of nutritional facts that is easily read by the consumer.[215] Similarly, a credit card holder would benefit from a uniform warning that leaves little leeway for credit card companies to make misrepresentations.

2. Toll-free Numbers are an Escape Hatch

Critics of BAPCPA complain that the law provides credit card companies with an escape hatch from full compliance with the mandatory disclosures.[216] A credit card company may opt to provide its own toll-free number allowing customers to call for an estimate of the number of months it will take to pay off their balance making only minimum payments.[217] In this case, the company is only required to list a boilerplate minimum payment warning.[218] The generic warning will have little or no effect on a bill payer if it is not accompanied by a specific example customized to the bill or even

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out of their budget. *Id.*

[214] Lazarus, *supra* note 159, at C1.

[215] The Nutrition Labeling and Education Act of 1990, Pub. L. No. 101-535, § 343, 104 Stat. 2353 (1990) (codified as amended in scattered sections of 21 U.S.C.). The FDA standardized terms, including portion sizes and which criteria (e.g. calories, fat, saturated fat, etc.) had to be disclosed, to better inform the consumer. For example, before the regulation of food labels, food producers could make their food appear more nutritious by providing nutritional information based on impractical portion sizes. *Id.*

[216] Lazarus, *supra* note 159, at C1.

[217] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23, § 1301 (2005) (codified at 15 U.S.C. § 1637(b)(11)(J)-(K)).

[218] *Id.*

three generic examples using standard debt amounts and APRs.[219] By requiring the consumer to make the phone call, rather than directly providing him with the information, the law has almost no effect on lessening the asymmetries in information that exist between debtor and lender.[220]

3. Disclosure is not the Whole Problem

Educating consumers about the actual terms of their credit cards is important but it is not enough. Studies have shown that the majority of credit cardholders who make only the minimum payment are aware that they need to make significantly greater payments than required by their minimum, but are simply unable to do so.[221] Further, when applying for credit cards, many borrowers underestimate their future borrowing.[222] Consumers may understand the terms of their cards, but do not consider the possibility that a late or missed payment will cause their APR to switch to the default rate.[223] Moreover, even if all terms are disclosed clearly to consumers, the consumer may not feel compelled to read or understand them and adjust their behavior accordingly.[224] Experts argue that disclosure remedies need to be more carefully crafted to overcome these behavioral biases.[225]

C. Few Alternative Sources of Credit

For millions of Americans who carry debt, increased minimum credit card payments will be a hardship on their already tight budgets.[226] Credit card debt is unique in that it is available to almost anyone. Interest rates charged are typically commensurate to the credit risk an individual poses, but even customers with very modest income and poor credit history are typically granted at least

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[219] Lazarus, *supra* note 159.

[220] *Id.* *See also* Edwards, *supra* note 208, at 204. The goal of TILA and greater disclosure is to correct asymmetries in the marketplace. *Id.*

[221] Demos, *supra* note 213, at 15.

[222] Edwards, *supra* note 208, at 233.

[223] *Id.*

[224] *Id.* at 234.

[225] *Id.* at 233-34.

[226] Demos, *supra* note 213, at 2.

some credit by credit card lenders.[227] If the credit card industry is too heavily regulated, those Americans who are most dependent upon credit may be denied the only source that was previously extended to them. Excessive credit card industry regulation could leave some worse off than before if credit card companies only lend to those who have assured payback capacity.

Studies show that homeowners may turn to home equity loans, which have lower interest rates, to substitute one creditor for another.[228] Experts fear that borrowers may use their homes to secure a loan with a lower interest rate, to pay off their balances. However, in doing so, the homeowner runs the risk of losing his home if he defaults on those payments.[229] Americans who rent their homes have even fewer financial resources than homeowners and may be forced to rely on loans from family members and fringe lenders, such as payday lenders and pawnshops, to cover the higher minimum payments.[230] This group will be most severely affected by the increased minimums and are at the greatest risk of having to file bankruptcy.

Workout plans provide another alternative for the insolvent borrower. The OCC has instructed credit card lenders to work with customers who will have trouble paying the higher minimum payments and has suggested reducing interest rates and waiving late fees to focus on the primary goal of recovering the principal.[231] However, credit card lenders will likely avoid this practice as they will lose significant profits.[232] Under the auspices of the OCC, reluctant credit card lenders may be forced to offer the workout plans suggested in the advisory to aid customers whose increased minimums will create a hardship.[233]

V. Conclusion

Over the last two decades, the virtually unregulated credit

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227 Edwards, *supra* note 208, at 205.

228 *See* Demos, *supra* note 213, at 14-15.

229 *Id.* at 19.

230 *Id.* at 14.

231 Der Hovanesian, *supra* note 9, at 98.

232 *Id.*

233 See *supra* Part III.A.3.

card industry has become complicated and anti-consumer oriented.[234] Consumers' desire for more credit regardless of the terms or their ability to repay, has led many Americans down a self-destructive path toward bankruptcy. The new attempts by Congress and the federal banking regulators are the first steps made in twenty-five years that attempt to restrict the credit card industry in any way. The advisory has the potential to require major changes in the way that credit card companies conduct business with their customers if the OCC stringently enforces it. BAPCPA places more of the responsibility on the consumer in mandating disclosure, but may be too easily circumvented by credit card companies to achieve its desired effect.

Although both the advisory and BAPCPA have their flaws, on the whole, Americans will benefit from paying higher minimum payments. In the short term, a few Americans may experience growing pains, but in the long run, Americans' personal finances will grow stronger when less crippled by the weight of credit card debt.

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[234] Stein, *supra* note 1, at 1.