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Expert Analysis

The CARD Act: The Good, the Bad And the Ugly

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President Obama signed the Credit Card Accountability, Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, on May 22, 2009. It is now referred to as the CARD Act. The act's primary purpose is to end the allegedly unfair treatment of cardholders by banks that issue credit cards. Some of the act's provisions became enforceable Aug. 20, many went into effect Feb. 22 and some will become effective Aug. 22.

The following summarizes the more significant CARD Act provisions, including their pros and cons, and what they mean to consumers.

AUG. 20 PROVISIONS

More Advance Notice of 'Significant' Changes in Terms

Credit card issuers are now required to notify cardholders 45 days in advance of any interest rate increases or other significant changes. Account closures or decreases in credit limits are not defined as "significant" and thus do not require advance notice from the card issuer. This is true unless the decision to adversely change the terms was based on the consumer's credit reports or credit scores, where the Fair Credit Reporting Act requires notice, albeit not in advance. The provision also does not require the consumer to acknowledge receipt of the 45-day advance notice. This provision, however, does allow the cardholder to cancel the card and pay off the debt at the lower rate, which allows for less expensive debt reduction but can lower the cardholder's credit scores because of the loss of available credit.

Extended Grace Periods

Credit card issuers are now required to mail cardholder statements at least 21 days before their due dates. The previous requirement was 14 days. This provision allows consumers to avoid late fees by providing a longer grace period. For consumers who receive and pay their credit card statements online, it equates to a true 21-day grace period because the mail timing is eliminated. Additionally, payments received the day after a weekend or holiday due date cannot result in any penalty to the cardholder (this is a Feb. 22 provision).

FEB. 22 PROVISIONS

No Rate Increases for Casual Delinquency

A credit card issuer cannot increase a cardholder's interest rate on new purchases unless the cardholder pays at least 60 days late. And, the issuer must restore the lower rate if the cardholder has made all payments on time for six consecutive months. This provision protects many cardholders from penalties due to low-level payment delinquency caused by bona fide issues such as lost mail. However, it restricts the credit card issuer from immediately mitigating its credit risk for those consumers who will continue beyond 60 days past due into more severe delinquency and default.

Improved Disclosure of Account Terms

Card issuers now must give consumers clear disclosures of account terms prior to opening an account. This provision allows consumers to be better informed about which credit cards to use before becoming contractually engaged with any product. Additionally, the disclosure language must be clearly written so laymen can understand its meaning and intention.

Interest Rates Remain Constant for First Year

Except in limited circumstances, the interest rate originally assigned to a newly opened credit card account cannot be increased during the first year. The exceptions are limited to the expiration of promotional rates, severe late payments (at least 60 days past due), variable interest rates tied to a moving index or failure to complete a debt-repayment plan.

No Charges for Payment Options

Credit card issuers are no longer allowed to charge additional fees for accepting payments via "non-mail" methods such as pay by phone, electronic funds transfer or paying at a bank branch location. And, payments received by 5 p.m. must be credited on that day. The only exception is the use of last-minute, expedited-payment methods, which might cause the credit card issuer to incur a fee.

Restrictions on Marketing to Younger Consumers

Credit card issuers will not be able to issue credit cards to consumers who are under age 21 unless the prospects can prove that they have the capacity to pay their bills or have an adult cosign for the card. Arguably, this provision is discriminatory, as no meaningful research has been published that proves a 21-year-old is any more responsible with credit than someone who is 18. Credit-scoring systems reward consumers for "age of credit history" characteristics, and many young consumers will be required to wait an additional three years to build that component of their credit rating. Finally, there is a significant downside to a parent or other adult who cosigns for an account because that person has equal liability for repayment of the debt. This provision, while well-intended, was a bad idea.

Restrictions on Over-Limit Fees

Prior to the CARD Act, cardholders would be charged an over-limit fee by card issuers when charging a purchase that put them over their credit limit. The CARD Act will now require the cardholder to essentially "opt in" to allow the card issuer to approve any transaction that would go over their credit limit and thus potentially lead to a fee. Many large credit card issuers have tens of millions of cardholders, and communicating an "opt in" message efficiently and effectively is unrealistic. Many credit card issuers are choosing to forego over-limit fees but will likely decline a higher percentage of over-limit transactions. In this case the merchant, the cardholder and the card issuer all lose. As with the under-21 provision, this one also was a bad idea.

Fair Payment Allocation

Credit card issuers will be required to apply any payment amount in excess of the contractual minimum toward the balance with the highest interest rate. This change allows consumers who have chosen to aggressively pay down their credit card debt to eliminate more costly balances. This provision eliminates the practice of credit card issuers applying payments to lower interest balances and leaving higher rate balances to accrue more costly interest.

The So-Called 'Experian Rule'

Companies that market free credit reports as a subscription service teaser now will have to clearly disclose that the free report being offered is not the free credit report disclosure mandated by federal law. This is being called the "Experian rule" because of the Web-based advertisements for freecreditreport.com, which is owned by Experian. The advertisements offer free credit reports in exchange for signing up for a trial membership to a subscription credit-monitoring service.

AUG. 22 PROVISIONS

Gift Card Protections

This provision prohibits gift card issuers from assessing inactivity fees on cards that are dormant. Further, gift cards will not be subject to expiration for the first five years of issuance. This provision reads well on paper, but there is downside. First, if a publicly traded company issues the gift card, there are difficulties with recognizing it as "revenue" until it has expired or has been redeemed. Second, studies have shown that without an expiration date, many gift-card holders do not have the sense of urgency to redeem the card and might lose it or forget about it.

IMPLICATIONS OF THE CARD ACT

Anticipating the effective date of the act's more significant provisions, credit card companies have increased interest rates and cut credit limits across the board. All consumers, blue chip as well as those in the riskier pools, are affected. Studies indicate that the average FICO score of consumers whose credit limits have been cut is 770, suggesting that cuts are being made for reasons other than elevated credit risk.

Credit card companies took other proactive but not necessarily consumer-friendly steps in advance of the August 2009 and February 2010 implementation dates to mitigate against, and in some cases undermine, the act's intent. To some extent, the act's features, such as the restriction on interest-rate increases for casual delinquencies, have been preempted by across-the-board interest-rate hikes. At the same time, it is beyond question that consumers will benefit from extended grace periods, clearer disclosures of financing and other terms, the end of universal defaults, and the elimination of double-cycle billing.

Legislators profess to have been caught by surprise by credit card companies' preemptive moves in anticipation of the effective date of the act. In fairness, credit card companies warned during the debate over the CARD Act that enacting legislation limiting their ability to raise interest rates for higher risk consumers likely would result in less unsecured credit being issued (credit card debt) and higher interest rates for most consumers. Despite these ominous warnings, immediately following enactment of the CARD Act, many in Congress were quick to proclaim victory even though efforts to impose many of the new restrictions by Dec. 1, 2009 (prior to the holiday shopping season), were rejected in favor of the Feb. 22, 2010, implementation date. Those proclamations were premature. While the act does benefit consumers in some instances, credit cards are becoming harder to get, are more expensive for many and offer fewer benefits.

Consumers who pay their balances in full each month benefit little from the act. Those who roll over balances month-to-month benefit the most. Yet, given the interest-rate hikes that have already been implemented, the value of that benefit is hard to determine. Benefits like low introductory rates, cash rewards and other reward programs have been curtailed, and in many cases eliminated. Among the more controversial of the act's provisions is the restriction on extending credit to young adults under age 21.

Potential litigation against credit card companies looms on the horizon. Class actions will likely be filed against any company that fails to fully implement all the CARD Act provisions. The biggest challenge that lies ahead for credit card companies may be in redesigning their information technology systems to ensure that they can cash the proverbial check that Congress has written. WJ

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