Credit Card Industry Practices

IN BRIEF

Dēmos
A NETWORK FOR IDEAS & ACTION

REGULATORY BACKGROUND

- Before 1978, 37 states had usury laws that capped interest rates and fees on credit cards for customers in their state, most at less than 18 percent APR.[1]
- Two court cases effectively invalidated state usury laws, *Marquette vs. First Omaha Service Corp* in 1978 and *Smiley vs. Citibank* in 1996.
- *Marquette* held that national banks could charge credit card customers the highest interest rate allowed in the bank's home state, as opposed to the customer's. As a result, major banks moved to states like South Dakota and Delaware, where there were no usury ceilings on rates.[2] Because the credit card market is dominated by national issuers, what few state usury laws remain are irrelevant.
- In 1996, *Smiley* effected the same outcome for fees which, like interest rates, used to be regulated at the state level. Late fees averaged $16 before *Smiley*. Now, it's $32.[3]

INDUSTRY PRACTICES

1. Rate hikes and fees for late payments

- All the major issuers now raise a cardholder's interest rate when their payment is late—often to 29% or even 34%. Late payment penalties affect millions of cardholders of all credit risk levels, as there is no longer a late payment **grace period**. A payment is "late" if it arrives after 1:00 or 2:00 on the specified due date. Issuers have also begun systematically mailing statements closer to the due date, giving customers less turn-around time.
- In addition to raising the interest rate on the card, issuers also charge the consumer a late fee, now typically between $29 and $39.[4] According to one survey nearly 60% of consumers had been charged a late fee in the past year.[5]
- Revenue Generated by Late Fees:[6]
  1996: $1.7 billion 2002: $7.3 billion

2. Penalty and Other Fees Skyrocketed in the late 1990s

- While annual fees have largely disappeared, credit card issuers now levy several different fees, other than the late fee: the balance transfer fee; the over-the-limit fee; the cash advance fee and the foreign exchange fee.
- Revenue Generated by All Fees:[7]
  1995: $8.3 billion 2004: $24 billion

3. "Bait and Switch" / Universal Default Policies

- Card issuers now routinely check their cardholders' credit reports and will raise the interest rate on the card if there has been a change in the consumer's score. For example, if a Bank One Visa cardholder is late on their MBNA MasterCard, Bank One will now raise the cardholder's interest rate—even if that cardholder has never missed a payment with them. Interest rate increases can also be triggered when a cardholder's profile has changed due to the addition of new loans, such as a mortgage, car loan or other type of credit.[8]

4. New Low Minimum Payment Requirements

- Credit card companies have also lowered their minimum payment requirement from a standard 5 percent to only 2 or 3 percent of the outstanding balance.[9] This makes it easier for consumers to carry more debt each month. It also ensures more interest income for the card companies, as consumers who pay only the minimum will revolve their balances over a longer period of time.

Amount of time and interest payments for selected credit card balances and interest rates

Credit Card Balance	*Annual Interest Rate*	*Years to Pay Off Credit Card Debt*	*Interest Cost*
$5,000	15%	32	$7,789
$5,000	18%	46	$13,931
$8,000	15%	37	$12,790
$8,000	18%	50	$22,805
$10,000	15%	39	$16,122
$10,000	18%	50	$28,524

Most credit cards assume a minimum payment of 2 percent of the balance or $10, whichever is higher.
Source: Demos' calculations.

5. Aggressive Marketing and Credit Line Extension

- In 1993, credit card companies sent 1.52 billion solicitations to American homes; in 2001, they sent over 5 billion.[10]
- Between 1993 and 2000, the amount of credit extended to the American public grew from $777 billion to almost $3 trillion.[11]

Notes

1. Lewis Mandell. *The Credit Card Industry: A History*. (Twayne Publishers: Boston), 1990. See also, Diane Ellis, "The Effect of Consumer Interest Rate Deregulation on Credit Card Vlumes, Charge-Offs, and the Persaonl Bankruptcy Rate", FDIC, Number 98-05, March 1998, www.fdic.gov/bank/anlystical/bank/bt_9805.html.
2. Vincent D. Rougeau, "Rediscovering Usury: An Argument for Legal Controls on Credit Card Interest Rates," *University of Colorado Law Review*, Winter 1996.
3. Card Web. "Late Fee Bug," *CardTrak*, May 17, 2002; CardWeb. "Fee Revenues," *CardTrak*, July 9, 1999; Card Web. "Fee Escalation," June 18, 2003. www.cardweb.com.
4. Ibid.
5. Ibid.
6. Ibid.
7. Robert D. Manning, *Credit Card Nation*: *The Consequences of America's Addiction to Credit,* (Basic Books: New York), 2000 and Cardweb.Com, "Fee Income 2003" http://www.cardweb.com/cardflash/2004/january/12a.xcml Figures cited are in nominal dollars.
8. Amy C. Fleitas, "20 Sneaky Credit Card Tricks." Bankrate.com. www.bankrate.com/brm/news/cc/20021106a.asp.
9. Ibid. See also Consumer Federation of America, Press Release, "Credit Card Issuers Aggressively Expand Marketing And Lines Of Credit On Eve Of New Bankruptcy Restrictions, February 27, 2001.
10. Mail Monitor, a service of BAIGlobal, Inc. See also Consumer Federation of America, Press Release, "Credit Card Issuers Aggressively Expand Marketing and Lines Of Credit On Eve Of New Bankruptcy Restrictions, February 27, 2001.
11. Ibid.