Safe Credit Cards Project

Issue Brief: *Curing Credit Card Penalties*

May 2009

Congress is set to enact new legislation that will make credit cards safer and more fair for consumers. As lawmakers negotiate final details before President Obama can sign the bill, new analysis from the Pew Health Group highlights the importance of a safeguard found only in the Senate's version of the law.

82 Percent of Credit Cards Allowed Unlimited Penalty Rate Increases

When credit card accounts become past due, companies frequently impose penalty interest rate increases on outstanding balances, on top of late fees averaging $39. The penalty interest rate can lead to a significant increase in the cardholder's level of debt, and may continue to apply long after the cardholder has re-established a track record of responsible payment behavior.

The Pew Health Group studied all credit cards offered online by the largest 12 issuers, which control nearly 90 percent of outstanding credit card debt in America. The study included more than 400 credit card products. Based on a new analysis of this data, we found that **82 percent of credit cards allowed issuers to impose penalty interest rate hikes that could last indefinitely**, giving responsible cardholders no right to return to the originally agreed interest rate.

"Cure Period" Provision Would Help Curb Penalties Averaging $500 Per Year

The median allowable penalty interest rate was 28 percent per year, adding nearly 14 percentage points to the average non-penalty interest rate. **This penalty would cost $140 annually for every $1,000 in credit card debt, or nearly $500 per year for a typical repriced account**. In most cases, these added costs can continue as long as the account is open, regardless of the cardholder's subsequent payment behavior.

The Federal Reserve has announced rules to help limit penalties it deems "unfair and deceptive." But even under those rules, **Americans will be on track to pay credit card companies more than $7 billion per year in penalty interest charges** – unless congressional leaders adopt an important new Senate proposal. The proposal, often called a "cure period" or "pathway back," enables consumers to reverse penalty interest rates by making on-time payments for six months. Cardholders who pay on-time during the cure period can reduce penalty interest charges by half or more.

Congressional Leaders Should Preserve – or Improve – the Cure Period

To help credit cardholders return to responsible payment behavior and avoid hundreds or thousands of dollars in excessively punitive interest charges, we call on congressional leaders to include a strong cure period provision in the credit card legislation they are currently finalizing. Because a cure period is part of the Senate bill but not the House bill, its inclusion in the final law may depend on negotiations between leaders in Congress and the Administration.

The Senate's cure period proposal would protect cardholders who complete six months of on-time payments starting *immediately* after the penalty rate is imposed. Though this is a good safeguard, legislators could improve upon it by expanding the cure period to apply at *any time* the cardholder completes six consecutive months of on-time payment. Safe Credit Card Standards published by Pew call for penalty interest charges to end after six months of on-time payment, with penalty rates not to exceed seven percentage points above non-penalty rates.

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ESTIMATED ALLOWABLE PENALTY INTEREST CHARGES BY STATE

The following table estimates the allowable penalty interest charges on consumer credit card debt per year, in each of the fifty states and the District of Columbia. This summary shows the extent to which borrowers may be subject to these penalty increases if the Senate's right to cure provisions are not present in the final credit card legislation.

State	Outstanding Revolving Debt as of 12/31/08 (Millions)[1]	Estimated Total $ Delinquent (Millions)[2]	Estimated Allowable $ Penalties per Year (Millions)[3]
Alabama (AL)	$12,410	$690	$95
Alaska (AK)	$2,391	$133	$18
Arizona (AZ)	$16,559	$921	$127
Arkansas (AR)	$7,082	$394	$54
California (CA)	$125,185	$6,960	$962
Colorado (CO)	$16,808	$935	$129
Connecticut (CT)	$15,359	$854	$118
Delaware (DE)	$2,847	$158	$22
District Of Columbia (DC)	$2,982	$166	$23
Florida (FL)	$56,502	$3,142	$434
Georgia (GA)	$25,962	$1,443	$199
Hawaii (HI)	$4,168	$232	$32
Idaho (ID)	$3,832	$213	$29
Illinois (IL)	$43,006	$2,391	$330
Indiana (IN)	$17,460	$971	$134
Iowa (IA)	$8,806	$490	$68
Kansas (KS)	$8,712	$484	$67
Kentucky (KY)	$10,927	$608	$84
Louisiana (LA)	$12,623	$702	$97
Maine (ME)	$3,684	$205	$28
Maryland (MD)	$21,616	$1,202	$166
Massachusetts (MA)	$26,457	$1,471	$203
Michigan (MI)	$28,367	$1,577	$218
Minnesota (MN)	$17,761	$988	$136
Mississippi (MS)	$6,887	$383	$53
Missouri (MO)	$16,577	$922	$127
Montana (MT)	$2,605	$145	$20
Nebraska (NE)	$5,379	$299	$41
Nevada (NV)	$8,216	$457	$63
New Hampshire (NH)	$4,489	$250	$34
New Jersey (NJ)	$35,195	$1,957	$270
New Mexico (NM)	$5,266	$293	$40
New York (NY)	$74,417	$4,138	$572
North Carolina (NC)	$25,194	$1,401	$194
North Dakota (ND)	$2,006	$112	$15
Ohio (OH)	$32,660	$1,816	$251
Oklahoma (OK)	$10,680	$594	$82
Oregon (OR)	$10,963	$610	$84
Pennsylvania (PA)	$40,070	$2,228	$308
Rhode Island (RI)	$3,446	$192	$26
South Carolina (SC)	$11,390	$633	$88
South Dakota (SD)	$2,351	$131	$18
Tennessee (TN)	$17,000	$945	$131
Texas (TX)	$74,447	$4,139	$572
Utah (UT)	$6,598	$367	$51
Vermont (VT)	$1,896	$105	$15
Virginia (VA)	$26,372	$1,466	$203
Washington (WA)	$21,383	$1,189	$164
West Virginia (WV)	$4,538	$252	$35
Wisconsin (WI)	$16,845	$937	$129
Wyoming (WY)	$2,015	$112	$15
Total:	**$960,391**	**$53,398**	**$7,380**

[1] Federal Reserve Board, Moody's Economy.com
[2] Product of Outstanding Revolving Debt by FRB 30+ day delinquency rate of 5.56% (Federal Reserve Statistical Release Charge Off and Delinquency Data Q42008)
[3] Product of Total $ Delinquent by average penalty rate increase of 13.82 percentage points (Pew analysis)

Methodology and Sources

Findings in this issue brief are based on Pew's survey of credit card products unless otherwise noted. As of December, 2008, this survey covered more than 400 credit card products from the largest 12 issuers.

The amount of additional interest charges caused by a penalty rate increase can vary widely depending on a cardholder's balance, the size of the issuer's rate increase and how long the rate increase applies. We estimate that the average penalty interest rate premium is 13.82 percent, or approximately $140 per $1,000 borrowed (based on comparing the average consumer credit card rate of 14.17 percent, reported by indexcreditcards.com as of May 4, 2009, and the median allowable penalty interest rate of 27.99 found in our card survey). A typical cardholder will pay nearly $500 in penalty interest per year, based on an average balance of $3,500 (this estimate is based in part on Ireland, Oliver, Letter to the Federal Reserve, et. al., Morrison & Foerster LLP, August 7, 2008, at Exhibit Two, Table One, showing that the average balance of accounts repriced due to being 30 or more days past due was $3,650).

The state level debt and delinquency chart is based on Federal Reserve and Moody's Economy.com data for Q4'2008. Our calculations determine the dollar value of allowable penalty interest rate increases based on the average penalty interest rate premium (13.82 percent, as described above), multiplied by the value of delinquent balances (approximately $53 billion dollars total). Delinquent balance figures are based on the total outstanding revolving credit, multiplied by the Federal Reserve Delinquency Rates for Q4'2008 (5.56%), to reach the total dollar amount delinquent by 30 days or more (the threshold when penalty interest rates may apply under Federal Reserve rules effective July, 2010). We acknowledge that the Federal Reserve outstanding revolving debt figures include a small percentage of balances not attributable to credit card debt, but believe that portion to be insignificant to this analysis.

About the Safe Credit Cards Project

The Pew Safe Credit Cards Project is engaged in a multi-faceted strategy that combines raising public awareness, building partnerships with industry and advocating policies that better protect consumers. The initiative will educate the public and policy makers by assessing data on the true cost of credit. Launched in 2007 in partnership with the Sandler Foundation, the Project is working to shape solutions that protect customers from unfair credit card practices and promote responsible management of debt.

The Safe Credit Card Standards and other project information is available at: www.pewtrusts.org/creditcards.