

Frederic S Mishkin: Credit card disclosures

Testimony of Mr Frederic S Mishkin, Member of the Board of Governors of the US Federal Reserve System, before the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, US House of Representatives, Washington DC, 7 June 2007.

The original speech, which contains various links to the documents mentioned, can be found on the US Federal Reserve System's website.

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Madam Chair Maloney, Ranking Member Gillmor, members of the Subcommittee, I appreciate the opportunity to discuss the Federal Reserve Board's May 23, 2007, proposal to revise the credit card disclosures required by current Truth in Lending Act (TILA) regulations. The Board's proposed revisions to Regulation Z, which implements TILA, also apply to other revolving credit accounts not secured by a residence. However, I will focus my remarks on credit cards, the subject of this hearing and by far the most common form of open-end accounts that are not home-secured.

Many more households have obtained credit cards since the Board last reviewed TILA regulations comprehensively in 1981. In the early 1980s, less than half of American families had at least one general purpose credit card (43 percent in 1983), and now close to three quarters have at least one (71 percent in 2004). The increase was sharpest among lower-income families. From 1983 to 2004, the share of families in the lowest income quintile that hold a credit card jumped from 11 percent to 37 percent. Not only are more consumers holding credit cards, consumers are using their cards more. Total charges on credit cards increased by about four times from 1991 to 2004 alone.¹

Growth in credit card use is explained in part by consumers switching from other forms of credit such as installment loans. Growth has also been enhanced by changes in consumer preferences related to the convenience and security of using card forms of payment rather than cash. Another substantial contributor has been the development of credit scoring and risk-based pricing, which has increased use of credit cards by consumers who traditionally lacked access because of poor or limited credit histories.

As credit cards have become more commonplace, they also have become more complicated. Even a relatively simple credit card account is more complex than the fixed-payment installment loan it may have replaced. Moreover, most credit cards can no longer be described as relatively simple. Once, a card may have allowed the user to make purchases or obtain cash advances and applied a single annual percentage rate, or APR, to each feature. Fees were limited to a fee for cash advances, an annual fee on the account, and perhaps a fee if the consumer paid late. Today, a card may also offer balance transfers and treat different classes of purchases and cash advances as different features, each with its own APR. These APRs adjust much more frequently to respond to changes in the market or to changes in a borrower's credit risk profile. The typical card no longer has an annual fee, but it has many other fees tied to a variety of features, or to requirements of the credit agreement, or to a growing number of optional services.

All of these developments have joined to produce the seeming paradox that credit cards are both widely used and widely criticized. The Board is keenly aware of concerns over the fairness and transparency of card marketing and account terms. There is, for example, a concern that issuers advertise low introductory rates while downplaying that these rates can increase sharply. Observers worry that the varied reasons that rates can increase, sometimes by a factor of two or three, are not made clear when the consumer applies for the card, starts to use it, or builds up a substantial balance. Further, there are concerns that issuers' methods of calculating interest, such as the ways they choose to allocate customers' payments to different balances, are confusing or not clearly disclosed. More broadly, the presence in the market of terms seemingly unfavorable to consumers appears to some to indicate that the market is not fully competitive.

¹ Board of Governors of the Federal Reserve System (2006), Report to the Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and their Effects on Consumer Debt and Insolvency (Washington: Board of Governors of the Federal Reserve System), tables 3 and 6.

The Board's goals and process

The goals of our proposed revisions to credit card disclosures are to aid consumer decisionmaking and improve competition. More effective disclosures make information about terms and pricing easier for consumers to obtain and understand. When that happens, individual consumers are less likely to fall into "traps for the unwary" and are more able to choose products that offer the best combination of features and pricing to meet their personal financial needs. Better dissemination of information about credit card terms and pricing also enhances competition among credit card issuers, which, in turn, helps generate products that consumers want.

To achieve these goals, the Board's proposal seeks to ensure that consumers receive key information about the costs of credit card transactions in ways they can understand, in formats they can use, and at times when it is most helpful. To help us craft a proposal to meet these specific objectives, we considered the traditional sources: public input we received in over 250 comment letters, available sources of data and information, and our own long experience implementing TILA. We also considered what consumers, themselves, had to say. As part of extensive consumer testing, we interviewed consumers individually about their use and understanding of different disclosures. Consumers told us what information they find useful when making credit decisions and what information they ignore. We learned which words and formats for presenting information promote understanding and which do not. These lessons are reflected in a myriad of preliminary judgments we have made about appropriate disclosure content, format, and timing.

The judgments required were not always clear-cut. Frankly, it is sometimes difficult to determine which transaction terms are most important because consumers use credit cards in many different ways. It is also difficult to determine how much information about those terms is enough; what information should be highlighted, and what should be disclosed less prominently; what information should be disclosed early on in the transaction, and what can be reserved for later. The Board also must balance a rule's specificity, which makes disclosures more consistent and reduces the risk of non-compliance, with its flexibility, which reduces operational burdens and ensures that disclosures can be adapted to changes in credit products and practices. In addition, the Board tried to ensure that creditor compliance and operational burdens are justified by the expected benefits to consumers and competition, and to reduce existing burdens if they are not warranted.

Developing effective credit card disclosures is particularly challenging because of the complicated and dynamic nature of the product. First, explaining the effective cost of credit before the consumer uses the card is difficult because key elements affecting the cost, such as whether the consumer will pay off balances regularly or carry balances that incur finance charges, are unknown. So TILA requires disclosures that provide consumers several terms that, together, determine the effective cost of credit: the periodic rate and nominal APR, other charges such as fixed and minimum fees, the grace period, and the balance calculation method. Clearly and simply explaining what these terms mean and how collectively they determine the cost of credit is difficult. Second, effectively disclosing credit card pricing becomes more difficult as credit card pricing grows more complex with the spread of risk-based pricing and penalty pricing and the "unbundling" of the price of a credit card into many different types of rates and fees. Clearly explaining costs contingent on future events that might seem remote when disclosures are made and promoting awareness of the total cost – not just component costs – pose additional challenges. Third, credit card pricing and features will continue to change, which means that we must try to craft disclosure requirements that work today and as products change.

The Board's proposal

Taking all of this into account, the Board has developed a comprehensive proposal to revise Regulation Z that includes the following specific elements:

- Advertisements of introductory rates would more clearly disclose the eventual higher rates and how soon they would be imposed;
- Advertisements of "fixed" rates would be restricted to rates that are truly not subject to change, either for a clearly disclosed period or for the life of the plan;
- The "Schumer box" required with credit card solicitations and applications would be updated to more effectively present information about rates and fees. As can be seen in the attached model form, the most critical rate and fee information would be presented in the box; rates and fees would be separated into two sections; and graphic techniques such as minimum

font size, judicious bolding, and vertical alignment of key numbers would make it easier to read and use;

- Summary tables similar to the Schumer box would accompany the lengthy, complex credit agreements that consumers receive both when they first open an account and would also be provided, later, when account terms are amended. A model of this new disclosure is attached;
- The penalty rate and penalty fees would be highlighted in the Schumer box and the account-opening summary table; and a reminder of late payment penalties would appear on every periodic statement;
- A consumer would be sent notice forty-five days before a penalty rate was imposed or the rate was increased for other reasons;
- The cumulative cost of fees would be highlighted every month, as can be seen in the attached model of a periodic statement. Fees charged in the last cycle would be grouped together on the statement in a prominent location and totaled for the cycle and year-to-date;
- The periodic statement's "effective APR," another way of disclosing the total cost of credit, is the subject of two alternative proposals. Under one, the effective APR could be revised to make it simpler for creditors to compute and potentially easier for consumers to understand. Under the other, if continued consumer testing, the public comments and the Board's analysis indicate that the effective APR does not have a meaningful benefit, then it could be eliminated, as the statute authorizes;
- Consumers would be warned on the periodic statement about the higher cost of making only minimum payments, and creditors would be provided incentives to give consumers a more precise estimate of the time to repay the balance and to place that estimate on the periodic statement rather than make it available by telephone; and
- Creditors would receive clearer guidance as to what charges must be disclosed, when, and how, along with increased flexibility to disclose charges at times and by methods more convenient to the creditor and consumer alike.

We are committed to providing the public a meaningful opportunity to evaluate and comment on these and other elements of the proposal, most of which are detailed in Appendix I. The Board has posted to its web site a lengthy report of its consumer testing, which forms the basis for major elements of the proposal, and has explained the reasons for the proposal in some detail in over 300 pages of "supplementary information." The public has four months to submit comment letters, which the Board expects will contain many useful responses and suggestions.

I want to say more about two elements of the proposal that we expect will elicit vigorous comment. The first is the proposed new notification requirement when rates are raised. With some exceptions, the current regulation requires that notice be mailed fifteen days before a rate increase takes effect. The Board is concerned that this notice can leave consumers too little time to react and possibly to shop for alternative sources of credit or pay off the existing credit card balance under existing terms. Further, one of the current exceptions to the fifteen-day notice requirement is for rate increases that are penalties (for example, for exceeding the credit limit). The Board believes that consumers will not necessarily anticipate penalty-based rate increases when the penalty was disclosed in credit agreements they received months, or even years, earlier. Thus, the Board has proposed to lengthen the notice period for a rate increase to forty-five days and require advance notification of penalty-based rate increases as well. In practice, consumers would have the benefit of more than a month to pursue their options, and creditors would forego collecting some interest revenue. The Board wants to receive comments addressing whether the costs are justified by the benefits.

The two alternative proposals concerning the effective APR on the periodic statement also are expected to elicit vigorous comment. The effective APR reflects the cost of interest and certain other finance charges imposed during the statement period. As an example, a cash advance carries an effective APR that reflects both interest assessed on the balance in the billing period and any fee charged by the creditor for the cash advance. The effective APR can be quite high, often much higher than the nominal APR, in part because it amortizes the cost of credit, including fees, over one month. Although consumer groups argue that the resulting "sticker shock" helps consumers make better credit shopping and account management decisions, creditors argue that it confuses consumers and misleads them to think the cost of credit is higher than it is.

Consumer testing conducted for the Board suggests that many consumers have a limited understanding, if any, of the effective APR, but it also suggests that clearer presentation of the disclosure can improve understanding. Thus, the proposal seeks to present the effective APR more clearly to consumers with more straightforward terminology and better formatting that promotes understanding. In addition, the proposal seeks to improve consumer understanding and reduce creditor uncertainty by specifying more clearly than the present regulation which fees are to be included in the effective APR. However, because of inherent limitations of the calculation – such as the need to assume the repayment period – and continued concern that adequate consumer understanding may be difficult to achieve, the Board is also seeking comment on an alternative proposal to eliminate the disclosure. When evaluating these two alternatives, and any others the public comments might suggest, the Board will consider the comments as well as the results of additional consumer testing.

Conclusion

Madam Chair, in closing, let me emphasize the Federal Reserve's commitment to ensuring that consumers get key information about credit card terms in ways they can understand, in formats they can use, and at times when it is most helpful. We appreciate efforts in the Congress and among consumer groups and the credit card industry to ensure that disclosure practices are in line with the needs of consumers. As my testimony this morning indicates, more complex pricing and continuous change in the marketplace make the task of writing rules for effective disclosure challenging. Nevertheless, the combination of extensive review, substantial public input, and systematic consumer testing has enabled us to propose changes that we believe will further the original goals of the Truth in Lending Act to promote economic stability and competition through the informed use of credit. I look forward to our continuing efforts in this regard, and I am happy to address any questions you might have.

Appendix I

Summary of proposed changes to the Federal Reserve Board's Regulation Z

The following summary is organized according to the major disclosures required under Regulation Z. For more information, see the Federal Register notice the Board approved on May 23, 2007.

Advertisements

Regulation Z requires that advertisements that contain certain information about the cost of a loan disclose additional information to give the consumer a fuller picture of the cost. The regulation also requires that terms advertised actually be available.

Advertising discounted rates. Under a proposal that would implement a Bankruptcy Act requirement, creditors that advertise a discounted initial annual percentage rate (APR) in connection with an application or solicitation would have to place the term "introductory" or "intro" near each mention of that rate. Close to the first mention, creditors would disclose prominently the introductory rate's duration and the higher rate that would apply afterwards. Creditors would also disclose, in the "Schumer box," the conditions under which consumers could lose the discount prematurely (e.g., if the consumer pays late).

Advertising "fixed" rates. Consumer testing indicated that many consumers believe that a rate advertised as "fixed" will not change and do not understand that "fixed" may only mean that the rate does not vary based on changes in an index or formula. Under the proposal, an advertisement may refer to a rate as "fixed" only if the advertisement specifies a period during which the rate cannot increase for any reason (and the agreement does not give the creditor the right to increase it during that period), or if the rate will not increase while the plan is open.

Advertising minimum payments. Consumers commonly are offered the option to finance the purchase of goods or services (such as appliances or furniture) by establishing an open-end credit plan, which

may or may not be accessed by a credit card. These offers often advertise monthly minimum payments associated with the purchase. Under the proposal, advertisements stating a minimum monthly payment for an open-end credit plan to finance the purchase of goods or services must state, as prominently as the minimum payment, the time it would take to pay the balance and the total amount the consumer would pay if the consumer made only minimum payments.

Credit card applications and solicitations; the “Schumer box”

Under Regulation Z, credit card issuers are required to provide information about key costs and terms with their applications and solicitations in the form of a table often referred to as the "Schumer box." The table is intended to help consumers focus on the most important terms when comparing offers and deciding whether to apply for a credit card account. A model of the proposed new Schumer box is attached.

Format. Consumer testing showed that the basic format of the Schumer box, the vertical presentation of information in a tabular format with headings on the left-hand side, is quite effective. Testing also suggested, however, that reorganizing the information, adding certain new information, and removing other information would make the box more effective in disclosing today's more complex pricing of credit cards. The proposed new Schumer box reflects these lessons. For example, consistent with testing findings, it separates the box into two parts, "interest rates and interest charges" and "fees." In the first part, it presents each major type of APR, such as a cash advance APR and a penalty APR, in a separate row instead of grouping them under the single heading "other APRs." The fee section divides fees into major categories, such as transaction fees and penalty fees; today these fees may appear below the box, where testing confirms consumers do not readily notice them. Cross-references between the interest and fees sections were found to help ensure that consumers understand that both types of costs can apply to the same transaction. The proposed new Schumer box also incorporates graphic techniques such as a minimum font size of ten points, judicious bolding of text, and vertical alignment of key numbers. Other changes to the content and format of the Schumer box are discussed below.

Rates based on creditworthiness. A creditor may disclose at solicitation a range of APRs or several discrete APRs because it will determine a particular applicant's rate based on an evaluation of creditworthiness. The proposal would require the creditor to disclose in simple terms, tested with consumers, that the rate the applicant receives would be based on the applicant's creditworthiness.

Adjustable rates. Currently, if an application or solicitation offers a variable APR, the creditor must disclose inside the Schumer box the index or formula and the margin used to determine the rate. Additional details, such as how often the rate may change, must be disclosed outside the box. Consumer testing indicated that few consumers use details such as the index and margin when shopping for a card and, moreover, that consumers may be distracted or confused by such details. Under the proposal, information about variable APRs would be reduced to a single phrase indicating the APR varies "with the market," along with a reference to the type of index, such as "Prime." Details about the rate's determination would continue to be disclosed to consumers at account opening.

Fees. Participants in consumer testing often did not notice fees if they were disclosed outside the Schumer box, as is common today. The proposal requires card issuers to disclose inside the box the most common penalty fees, namely, fees for paying late, exceeding a credit limit, or making a payment that is returned. The fee disclosure must also refer the consumer to the penalty rate if, for example, paying late could also trigger the penalty rate. The most common transaction fees, such as cash advance fees and balance transfer fees, also would be disclosed inside the box.

Penalty pricing. The proposal would make several improvements to the Schumer box to increase consumers' understanding of default, or penalty, pricing. Currently, credit card issuers must disclose inside the box the APR that will apply in the event of the consumer's default. However, they must disclose the actions that may trigger the penalty APR outside the box, where, according to consumer testing, this information often goes unnoticed. Under the proposal, therefore, card issuers would be required to include inside the box the specific triggers of a penalty APR – such as paying late on the account. Creditors would also disclose the rate that will apply, the balances to which the penalty rate will apply, and the circumstances under which the penalty rate will expire or, if true, the fact that the penalty rate could apply indefinitely. The proposal would require card issuers to use the term "penalty APR" because testing demonstrated that some consumers misinterpret the term "default rate."

Creditors can use the term "default" to refer to one late payment, but consumers sometimes understand "default" to imply a more serious breach, or to mean something else entirely.

Payment allocation/loss of grace period. The proposal would add a new disclosure to the Schumer box about the effect on credit costs of creditors' payment allocation methods. It is common for a creditor to allocate payments first to low-rate balances such as promotional balance transfers. Consumers who make purchases at a higher rate will not be able to take advantage of any "grace period" on the higher-rate purchases until they pay off the entire lower-rate balance transfer, which they may not have intended to do until the promotional rate expired. Consumer testing indicated that consumers are often confused about this aspect of balance transfer offers; testing also indicated that a disclosure that is short and simple while accurate and complete is challenging to achieve. The proposal seeks to balance these objectives in a new disclosure that alerts consumers that they will pay interest on their purchases until they pay the transferred balance in full.

Subprime accounts. Subprime credit cards, cards offered to consumers with low credit scores or with credit problems, sometimes have substantial fees associated with opening the account. Typically, these fees are billed to consumers on the first periodic statement, and can substantially reduce the amount of credit available to the consumer. For example, the initial fees on an account with a credit limit of \$250 may reduce the available credit to less than \$100. Consumers have complained that they were not aware that so little credit would be available to them. To address this concern, the proposal would require a card issuer offering a low credit limit and high initial fees or security deposits (25 percent or more of the minimum credit limit) to include in the Schumer box the amount of available credit the consumer would have after paying the fees or security deposit, assuming the consumer received the minimum credit limit.

Account-opening disclosures

Regulation Z requires creditors to disclose rates, charges, and related terms such as grace period and balance calculation method before the first transaction on the account. Consumers' rights and responsibilities in the case of unauthorized use or billing disputes must also be explained. Currently, Regulation Z imposes few format requirements on these disclosures and creditors typically integrate them with the cardholder agreement, which is usually dense and long.

Account-opening summary table. The proposal requires creditors to include a table summarizing the most important terms in an easy-to-follow format, substantially similar to the Schumer box the consumer typically would have seen with the application. An example of this new table is attached.

Fees. Under the current rules, a creditor must disclose any fee that is a "finance charge" or "other charge" in the written account-opening disclosures and generally has no obligation to disclose it again, unless the charge is increased. New fees added to the plan after account opening must be disclosed before they take effect and later if they increase. (Of course, after a fee is charged, it must appear on the periodic statement; disclosure at that stage is discussed later.) Creditors have sometimes had difficulty determining whether a particular fee is properly classified as a "finance charge" or "other charge," or as neither of these. Although the regulation and commentary give specific guidance, sometimes new services develop before the guidance can be updated. When that happens, creditors can find it difficult to determine if the fee for the service must be disclosed in writing at account opening (or before the fee takes effect, if a service is added later). This uncertainty can pose legal risks for creditors that act in good faith to comply with the law, and it can lead to inconsistent disclosure to consumers.

Moreover, it is not clear that consumers benefit from requiring creditors to disclose every potential fee in writing and at account opening. It may be months, and possibly years, until the consumer requests the service for which the fee is imposed. Furthermore, the consumer may request the service by telephone for speed and convenience, and not expect to have to wait for a written disclosure before the transaction can be completed.

The proposal seeks to address these potential limitations of the present rule while taking into account the Truth in Lending Act's (TILA) requirement to disclose plan-related charges before they are

imposed. Accordingly, under the proposal, the rules would be revised to² specify precisely the charges that creditors must disclose in writing at account opening (interest, minimum charges, transaction fees, annual fees, and penalty fees such as for paying late), which would be listed in the summary table referred to above; and (2) permit creditors to disclose other charges, typically fees for optional services that may be used infrequently, orally or in writing before the consumer agrees to or becomes obligated to pay the charge. To prevent abuse of this flexibility, the proposal requires that an oral disclosure be clear and conspicuous, and that it be given when the consumer would likely notice it.

Periodic statements

Once an account has been opened, creditors are required to provide periodic statements reflecting the account activity for each billing cycle, typically monthly. The statement must identify each transaction on the account, such as a purchase or cash advance. It must also identify each "finance charge" (using that term) and other charges imposed as part of the plan during the cycle. And it must identify the periodic rate(s) and corresponding annual percentage rate(s), also known as the nominal APR, that applied during the last cycle. If finance charges were imposed in the form of fees (e.g., a cash advance fee), as well as (or instead of) monthly interest, then the statement must disclose an effective APR reflecting the *total* finance charge, with limited exceptions. Under amendments to TILA made by the Bankruptcy Act that are implemented in this proposal, creditors must also disclose information about the cost of paying late or making only the minimum payment due. A model of the periodic statement that reflects the revisions discussed below is attached.

Transactions. As the regulation currently permits, transactions are often presented in chronological order and not by transaction type. Participants in consumer testing found it easier to read and use statements where similar types of transactions are grouped together. Accordingly, the proposal requires creditors to group similar transactions together by type, such as purchases, cash advances, and balance transfers.

Fee and interest charges. The proposal contains a number of revisions to the periodic statement to improve consumers' awareness and understanding of charges they have incurred in the form of fees or interest. Consumer testing indicated that consumers have difficulty understanding the term "finance charge." They are more likely to conceive of their charges as "interest," the charge that results from applying a rate to a balance, and "fees," such as a cash advance fee or a late payment fee. Consumer testing also indicated that many consumers more easily compute the number and amount of fees when the fees are itemized and grouped together. Participants noticed fees and interest charges more readily when they were located near the transactions. Also, many participants more quickly and accurately determined the total charges for the billing cycle when a total fee amount for the cycle was disclosed, as well as the total interest.

These findings led the Board to propose four changes to fee disclosures on the periodic statement. First, creditors would no longer have to label charges as "finance charges;" they would instead classify charges as "fees" or "interest." Second, creditors would be required to group all charges together in a discrete place on the statement under the headings "fees" and "interest charges." Third, these charges would appear near the transaction items. Fourth, creditors would disclose the total fees and total interest imposed for the cycle, and the totals for the year to-date.

The effective APR. The effective APR disclosed on periodic statements reflects the cost of interest and certain other finance charges imposed during the statement period. For example, for a cash advance, the effective APR reflects both interest assessed on the balance in the statement period and any fee assessed for the advance. The effective APR can be quite high, often much higher than the nominal APR, in part because it amortizes the cost of credit, including fees, over one month. Although consumer groups argue that the resulting "sticker shock" helps consumers make better credit shopping and account management decisions, creditors argue that it confuses consumers and misleads them to think the cost of credit is higher than it is.

² Card issuers must establish and maintain their own toll-free telephone numbers to provide the repayment estimates, except that depository institutions having assets of \$250 million or less may rely for two years on a number the Board is required to establish and maintain for them, and non-depository creditors may rely on a number the FTC is required to establish and maintain for them.

Consumer testing suggests that many consumers have a limited understanding, if any, of the effective APR, but it also suggests that clearer presentation of the disclosure can improve understanding. Thus, the proposal seeks to present the effective APR more clearly to consumers, giving it an intuitive label of "fee inclusive APR" and placing it next to other, related information such as the interest and fees it includes. In addition, the proposal seeks to improve consumer understanding and reduce creditor uncertainty by specifying more clearly than the present regulation which fees are to be included in the effective APR. However, because of inherent limitations of the disclosure (such as the need to assume the repayment period) and continued concern that an adequate level of consumer understanding may be difficult to achieve, the Board is also seeking comment on an alternative proposal to eliminate the disclosure. When evaluating these alternatives and any others the public comments suggest, the Board will consider the public comments as well as additional consumer testing the Board plans to conduct.

Late payments. The Bankruptcy Act requires creditors to disclose the payment due date (or if different, the date after which a late-payment fee may be imposed) along with the amount of the late-payment fee. The proposal implements this requirement and adds a requirement to disclose the penalty APR that could be triggered by a late payment. Creditors would be required to disclose the penalty fee and rate close to the due date. If the creditor uses an early cut-off time on the payment due date, the time would also have to be disclosed near the date.

Minimum payments. The proposal implements a requirement of the Bankruptcy Act that card issuers warn their customers on the periodic statement about the higher cost of making only minimum payments, give a hypothetical example of the time to repay a balance with minimum payments, and refer the customer to a toll-free telephone number for an estimate of the time to repay the current balance if paying only the minimum.¹ In testing conducted by the Board and in separate testing conducted by the U.S. Government Accountability Office (GAO), participants who typically carry credit card balances found an estimated repayment period based on terms that apply to their own account more useful than a hypothetical example. Accordingly, the proposal gives card issuers incentives to provide a more precise estimate of the time to repay and to place this estimate on the periodic statement. The incentives include exemptions from the requirements to maintain a toll-free telephone number and disclose the warning and hypothetical example.

Changes in consumer's interest rate and other account terms

Regulation Z requires creditors to provide advance written notice of some changes to the terms of an open-end plan. When notices are required, they must be sent fifteen days before the effective date of the change. Creditors need not notify consumers before they increase a rate for default or delinquency, or as a penalty for other conduct if the credit agreement specifically provides for an increase.

Timing. Allowing creditors to mail a notice fifteen days before increasing the cost of credit can leave consumers too little time to receive the notice, shop for alternative credit, and possibly pay off the existing credit card account. Accordingly, the Board is proposing to require sending a notice at least forty-five days before the effective date of the change, which would give consumers over a month to pursue their options.

Penalty rates. Credit agreements sometimes define defaults that trigger rate increases quite broadly, and often provide that the increased rate will apply to all existing balances, including balances with low promotional rates. Months, or years, after receiving the credit agreement, a consumer may no longer remember that certain behaviors will trigger a rate increase and, therefore, may be surprised to learn, after the fact, that the rate has increased. Thus, the proposal would require a creditor to send a notice forty-five days before increasing the consumer's rate for default or delinquency or as a penalty for other conduct, to give the consumer time to shop for alternative credit sources and possibly pay off the account. The proposal does not limit actions creditors may take to mitigate risk, such as lowering the credit limit or suspending credit privileges.

Format. Change-in-terms disclosures, like account-opening disclosures, are commonly interspersed with other disclosures and written in small print and dense prose. Consumer testing indicates that many consumers set the documents containing these disclosures aside without reading them. Under the proposal, creditors must highlight critical changes in a summary table. Creditors that enclose their notices with periodic statements must place this table on the periodic statement above the transactions list, where consumer testing suggests consumers are most likely to notice it.

Checks that access a credit card account

Many credit card issuers provide accountholders with checks that can be used to obtain cash, pay the outstanding balance on another account, or purchase goods and services directly from merchants. The solicitation letter accompanying the checks may emphasize a low introductory APR for these checks. The proposed revisions would require creditors to disclose other rates and fees that will apply if the checks are used, rather than simply suggest the consumer review the disclosures provided at account opening. To ensure the disclosures are conspicuous, creditors would be required to place the rates and fees in a table on the same page as the checks.

Right to dispute billing errors

The Board also has proposed several revisions to substantive and procedural protections TILA provides consumers. Four proposed revisions, in particular, would clarify Regulation Z in ways that strengthen consumers' rights to dispute billing errors on credit cards and other forms of revolving credit. First, if a creditor determined that no error occurred, the proposal would make clear that the creditor may not impose finance charges or other charges until the grace period (if any) in the credit agreement has elapsed. Second, if a creditor credited a borrower's account for a disputed transaction, the proposal would make clear that the creditor may not reverse the credit after two billing cycles or ninety days, whichever period is shorter; this clarification is meant to ensure finality. Third, the proposal would make clear that the right to dispute billing errors covers check transactions that access open-end accounts. Fourth, the proposal would make clear that the right to dispute errors applies to purchases of goods or services made using a third-party payment intermediary, such as a person-to-person Internet payment service.

Attachments

G-10 (C)

Applications and solicitations sample (credit cards)

G-17 (B)

Account-opening sample

G-18 (H)

Periodic statement form