Viewpoint

THE CONSUMERS UNION PERSPECTIVE

Rights that credit-card users deserve now

More than 5 billion credit-card offers bombarded Americans last year, burying them in paper and, in many cases, debt. Families who carry a credit-card balance now owe, on average, $9,312.

Credit cards come with a cost far higher to consumers than the price of the items they buy. High fees, short grace periods, late fees for payments that were mailed on time but delivered late, and penalties when the consumer has missed a payment on a different card are driving credit-card debt to record levels (see the report on page 12). Consumers Union (publisher of CONSUMER REPORTS), the Consumer Federation of America, Consumer Action, the U.S. Public Interest Research Group, the Center for Responsible Lending, and the National Consumer Law Center have called for Congress to enact a variety of strong reforms. Consumers Union believes the following measures are essential:

- Congress should cap interest rates on credit cards at no more than the prime interest rate plus 10 percent. Now, penalty rates can go as high as 35 percent, about 28 points over mid-August's prime rate.
- The first page of every month's bill should state how long it will take and how much it will cost—interest included—to pay off the balance at the minimum payment. A consumer who owes $5,000 on a credit card at an annual percentage rate of 16 percent, and who makes a requested 2 percent minimum payment each month, will need almost 36 years to pay off the balance and will rack up $9,329 in interest.
- The number and types of fees should be restricted to make it easier for consumers to compare cards. Congress should also require that fees be closely related to the actual costs to the card issuer, so that fees don't drive up the true cost of the credit to the consumer.
- Card companies shouldn't be allowed to add new terms and pile on increases after the consumer has signed on. Card companies that raise the interest rate should not be allowed to apply the higher rate to existing balances, that is, money already borrowed at a lower rate. Ads and applications for cards with artificially low "teaser" rates should clearly explain what the higher rate will be once the low rate ends.
- Card companies should be prohibited from increasing the periodic interest rate because a cardholder missed a payment to a different creditor or because his or her credit score changed.
- Credit-card companies should be required to evaluate each consumer's ability to repay before issuing a credit card. Cards that encourage unrealistically high balances keep consumers on a debt treadmill. Aggressive marketing to, and high credit limits for, young people can mar their futures by ruining their credit records early in life.
- Practices that trigger unnecessary fees, such as setting short grace periods and failing to count a payment from the date of the postmark, should be banned. Consumers should be guaranteed 30 days to pay and shouldn't have to pay a late fee if the envelope is postmarked on time.
- Congress should clarify that both state and federal laws and agencies can simultaneously protect credit-card consumers. A regulation of the federal Office of the Comptroller of the Currency asserts that states may not enforce most of their own consumer-protection laws against national banks. Since national banks issue the vast majority of credit cards, this OCC rule stymies state consumer protection.

Consumers deserve a fair deal. Consumers Union believes it is long past time for Congress to improve credit-card contracts for consumers. For more information, go to Consumers Union's new Web site, YourWallet.org.

then & now extreme remote control

If in 1956 you'd had enough of Arthur Godfrey's ukulele but were reluctant to leave your easy chair, a remote control was just what you needed.

The most novel was the wireless Zenith Flash-Matic Tuning, at left. By aiming the beam at photocells in the picture frame of a compatible Zenith TV, you could turn the set on and off and change stations. The photocells' sensitivity could even be fine-tuned to work with an ordinary flashlight.

Now if you're far from home but have Internet access, the Slingbox, at right, lets you view the shows you receive at home (see First Look on page 24). And at the risk of annoying those you left behind as they watch TV, you can even change channels. Imagine the possibilities.

CR INVESTIGATES

CREDIT  CA

They really *are* out to get you

Ruth Owens' troubles began when she stopped using her Discover card. The Cleveland woman, who was on Social Security disability, had just passed her $1,900 balance limit.

Over the next six years, she made $3,492 in payments but never reduced her debt. Discover charged fees and finance charges that used up all her payments and ballooned her balance to $5,564. In 2003, the card company sued Owens, asserting that she breached the card contract by failing to make minimum monthly payments. "After paying my monthly utilities there is no money left," Owens pleaded in court papers. "If my situation was different, I would pay." Cleveland municipal court judge Robert Triozzi ruled that Owens had paid enough, declaring that she had been prey to "the plaintiff's unreasonable, unconscionable, and unjust business practices."

Getting trapped in the jaws of credit-card debt has become alarmingly easy. Thanks to cozy relationships that have developed over the years among lawmakers, federal regulators, and credit-card issuers, few consumer protections are left. There have been no limits on interest rates for years, so a temptingly low 1.9 percent APR can morph into double-digit territory at the whim of the credit-card company. Or it can climb beyond 30 percent when a consumer does nothing worse than sign up for a new card, inquire about a car loan, or make a single late payment to *any* creditor.

As for fees, anything goes. You can receive a $39 spanking for going over the limit, paying late, or paying less than the minimum, for balance transfers and cash advances, and foreign currency transactions. Credit cards have turned into "nothing less than wallet-sized predatory loans," observed Sen. Christopher Dodd, D-Conn., during a congressional hearing earlier this year.

The effects on Americans' finances are showing. Average card debt per household with at least one credit card topped $9,300 in 2004. That's more than triple the average in 1990. Consumer bankruptcies have skyrocketed from 287,463 in 1980, the dawn of card-industry deregulation, to just over 1.5 million in 2004. Credit-card fees and finance charges are much more difficult to repay for families with other money problems, say medical bills or a job loss. "It is the rising cost of the plastic itself that is tipping hundreds of thousands of families over the edge," says Elizabeth Warren, a Harvard law professor and bankruptcy expert.

Nessa Feddis, senior federal counsel at the American Bankers Association, is not totally sympathetic. "It isn't just medical expenses that can cause the trouble," she says. "It's that nice handbag they charged, that kind of spending." Penalty fees are needed, she adds, as "deterrents to bad behavior."

CR Quick Take

Credit cards have become much more treacherous for consumers. Card issuers have:

- **Imposed interest rates in excess of 30 percent on customers whose only offense might be a late payment to another creditor.**
- **Battered cardholders with fees and penalties that now often hit $39.**
- **Reduced grace periods when new purchases are free of interest.**
- **Lobbied successfully to weaken protections for cardholders.**

There are measures that consumers can take, however, to protect themselves from fees, finance charges, and credit-card debt. See What You Can Do on page 15.

In 2003 those deterrents, along with fees for cash advances, exceeded the after-tax profits of the entire credit-card industry just two years earlier. Card issuers have been experiencing record profits since 2000 and saw them top $30 billion in 2004. A wave of mergers has ensued, consolidating power in the hands of a few players who set take-it or leave-it terms for consumers. Prior to 1978 the top 50 issuers represented 50 percent of the credit-card market, but by mid-2005 only five companies, American Express, Bank of America, Citigroup, JPMorgan Chase, and MBNA, controlled 65 percent of the market. "The impending marriage of MBNA and Bank of America will further narrow the circle of big players; consumers can expect to be squeezed even harder by rising rates and fees," warns Robert D. Manning, professor of finance at Rochester Institute of Technology and author of "Credit Card Nation."

Don't think you are off the hook if you are among the 45 percent of cardholders who pay balances in full each month. As interest rates rise, card issuers are seeking ways to eke out income from you as well. "You may have to pay fees to receive what used to be free year-end summary statements," Manning says. "You may be switched to penalty interest rates on cards if you don't use them frequently, and in general you're likely to see a steady decline in the value of reward programs, such as cards that offer frequent-flyer miles or cash rebates as perks." (See CR Money, on page 53.)

Warren adds, "This is not a case of a few piranhas swimming amidst a sea of big benign fish. The deregulation of this

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industry has made the waters treacherous for all consumers." Here are the most significant dangers, along with advice on how to minimize them.

RATES THAT AREN'T REAL

More than one rate. Unwary consumers can easily wind up with an interest rate that Tony Soprano would charge. Take a recent solicitation for a Chase Visa Platinum card. In giant type, it trumpeted a 0 percent fixed introductory annual percentage rate on purchases and balance transfers for up to 15 months and a 7.99 percent fixed rate thereafter.

Sounds good, but a fixed rate means only that the credit-card company has to give at least 15 days' written notice before it changes. In smaller print on an accompanying page, you learn: "We reserve the right to change the terms (including the APRs) at any time for any reason."

The 35 percent trap. Most card issuers impose a penalty rate if you pay your bill late or exceed your card's credit limit. Currently, it averages 24.23 percent. But according to a survey conducted last spring by Consumer Action, a San Francisco-based advocacy group, about 45 percent of card issuers also have so-called universal default policies. The companies monitor your credit report and kick up your rates if they believe your behavior with other creditors signals that you've become a greater credit risk.

Declining credit scores and late payments on any accounts reported to credit bureaus were the most common universal default triggers, but about 24 percent of card issuers said that simply inquiring about a car loan or mortgage could trigger such a rate hike; 33 percent said getting a new credit card could do so. Tracey Mills, a spokeswoman for the American Bankers Association, defends default rates, saying that they are "part of risk-based pricing, which means that you earn the interest rate you receive."

Penalty rates, which Consumer Action's survey found had already risen as high as 35 percent last spring, may then be applied not just to new charges but also to existing balances. Consumer activists argue that it's unfair to apply higher rates to balances retroactively. "I know of no other industry that is allowed to increase the price of a product once it is purchased," says Travis Plunkett, legislative director of the Consumer Federation of America. Chase, Citibank, and MBNA are among card issuers that have announced their intention to give cardholders advance notice of penalty rate hikes and allow them to "opt out" of paying the

RATE HIKE NO. 1

WHO Melanie Mills
WHERE Medford, Ore.
WHAT HAPPENED Mills was outraged when MBNA informed her that the rate on a card she uses for her Internet business, Medford Books, would rise from 8.9 percent to 19.99 percent. She says that after inquiring, she learned the hike was a result of increased use of her available credit. "Well, duh," Mills says. "It's a business card. I used it at the annual gift show to place several orders for products for resale. That's why I opened the account to begin with." She has since closed the account and is repaying the remaining $11,624 balance at her original rate.

closeup

THE 10 MOST CONSUMER-FRIENDLY CREDIT CARDS

CardWeb.com, a leading source of data on the credit-card industry, analyzed 10,200 card offers to identify those with the lowest cost in a group that provided the best terms based on CR's criteria. None of the 10 cards has a universal default clause, two-cycle billing, or balance transfer fees, all of which can jack up finance charges. All cards have a grace period of at least 25 days and have no annual fees. The information is current as of Aug. 1, 2005. An "f" indicates that the card has a fixed rate; "v," a variable rate. Rates are the lowest offered to customers who meet issuers' credit-score standards. The "go-to APR" takes effect at the end of the promotional period.

Card	Issuing bank	Intro APR	Go-to APR	Cash advance fee	Late-payment fee	Over-limit fee	Currency-exchange fee	Phone number
Platinum MasterCard	Town North	none	v 7.99%	2%	$15	$15	none	877-866-2265
Visa Platinum	First Tennessee	f 3.90%	v 8.40	3	35	35	3%	800-234-2840
Visa Gold	Pulaski	f 0.00	f 8.50	none	35	29	none	800-217-7715
Visa Platinum Rewards	Simmons First National	none	f 8.95	3	29	29	2	877-245-1234
Target Visa	Target National	none	f 9.90	3	35	none	1	877-474-8378
Visa Platinum	BB&T	f 1.90	f 9.90	3	35	29	2	800-476-4228
Platinum MasterCard	Franklin Templeton Bank & Trust	none	v 9.99	3	29	29	2	800-238-2761
Visa Platinum	RBC Centura	f 2.90	v 9.99	3.50	29	29	1	800-236-8872
Visa Platinum	Commerce	f 2.99	v 10.49	none	none	none	2	888-751-9000
Visa Platinum	Zions	none	v 11.50	2	29	29	1	800-789-8800

Source: CardWeb.com.

ILLUSTRATION BY JIM FRAZIER PHOTO BY JULIE COBURN higher rates on existing balances.

And one rate hike can lead to another. That's what happened to Ann Craig, who ran her credit-card balances close to the limits to make ends meet after her husband's South Carolina consulting business went into a post-9/11 slump. Though Craig says she always made on-time monthly payments, the noose tightened when her First USA credit card raised her 9.99 percent interest rate to 22.99 percent in one month. In the wake of that increase, she says, rates on her other cards shot up above 20 percent. She doesn't think that she can get credit at lower rates, so right now she is stuck. "People who are trying really hard to manage their debts are being outrageously penalized," she says.

Balance-transfer switcheroo. To woo customers away from competitors, card issuers offer teaser rates as low as 0 percent for introductory periods that might last as long as 15 months. If you can transfer a balance on a high-rate card to one with a low rate, such offers can be useful tools. But they come at a high cost. Any payments you make typically are applied first to the lowest rate balance. So while the credit-card company uses your payment to quickly pay off that 0 percent transfer balance, you are piling up interest on purchases at, say, 18 percent.

Think you'll just transfer balances and not make any purchases? Not so fast. Some card issuers have attached strings to their offers. For example, at one point Providian required that customers take cash advances to earn the 0 percent rate.

RATE HIKE NO. 2

WHO Jeff Creason
WHERE Las Cruces, N.M.
WHAT HAPPENED Creason is among 50 consumers who have registered complaints with Consumer Action in the past 12 months about late-fee policies. He was charged a $35 late fee for a payment he says Household Bank did not post until two weeks after he mailed it. Within two months, his interest rate also jumped from 20.9 percent to 27.24 percent. "I'm tired of the fees, the rate increases, and the hassle of having to track payments constantly to make sure they're recording them on time, so I'm just going to pay off the balance and cancel my card," Creason says.

PHOTO BY KEN STINNETT

FEES AND MORE FEES

For tardiness. Since 1996, when a court ruling eliminated caps on card fees, the average fee for making a late payment has more than doubled, with 4 of the top 10 issuers now charging $39. More than half of cardholders pay late fees at least once a year, and it's getting easier than ever to trigger them. Card issuers are systematically mailing statements closer to the due date, giving customers less turnaround time. At least a third of issuers in Consumer Action's survey set a cutoff time on the due date, ranging from noon local time to 9 p.m. Eastern time. Generally, payments processed after that are recorded as late.

"We've heard from consumers who have been recorded as late for payments they've mailed over a week in advance of the due date, so they suspect issuers are deliberately delaying processing payments simply to generate late-fee revenue," says Joe Ridout of Consumer Action, which is among advocacy groups lobbying to require card companies to follow the practice of the IRS and accept a postmarked date as proof of on-time payments. "This claim, that card issuers are holding on to payments in order to get fees, is not industry practice, and it doesn't make business sense," says Mills of the ABA. She adds that consumers who suspect their issuer of such tactics can choose among 6,000 other cards.

For going over the limit. Rather than rejecting charges that exceed your credit limit, issuers today often let them go through but then charge a hefty penalty, which averages around $30. When cardholders are hit with penalty rates and other fees, finance charges alone can subject them to over-limit fees month after month, creating a never-ending spiral of debt. Other fees to watch: For balance transfers, you pay 2 percent to 3 percent of the amount transferred, with a cap of $50 to $75 for each transfer you make. And for cash advances, you pay 2 percent to 4 percent of the amount you take.

TRICKY BILLING

The minimum-payment trap. Over the years, card issuers have lowered the required minimum payment from the previous standard of 5 percent of outstanding balances to 2 percent. Consumers might not realize that by paying the minimum, they're barely making a dent in principal. If fees and penalty interest rates are triggered, they could end up owing more than they ever charged.

Indeed, in a North Carolina bankruptcy proceeding last year, Capital One itemized how much of the dollar amounts it said it was owed by 18 cardholders represented principal rather than finance charges. It turned out that on average, interest and fees consisted of more than half of total amounts owed.

Concern about the effect of reduced minimum payments prompted federal regulators to issue guidelines this year calling for card issuers to increase their minimum payment requirements enough to cover finance charges and fees during the billing cycle, and reduce some portion of principal too.

Issuers have until the end of 2006 to phase in higher minimums, but some already have changed their formulas. Citibank now requires minimums to cover 1 percent of the balance plus late fees and finance charges while, at press time, Bank of America requires a minimum equal to fees and finance charges plus $10 per month.

Interest on day one. Card companies have been gradually reducing grace periods, the time during which transactions don't accrue interest. And more and more cards come packaged with a mechanism called double-cycle interest, which allows you to avoid credit-card charges only if you have paid the last two balances in full.

Another twist, called residual interest, recently adopted by American Express, works like this: You get a bill with a $1,000 balance on Nov. 1 and mail in your check so that it arrives by the due date, say, 25 days later. On Nov. 2, however, you charge $500. Before Amex's change, you paid no finance charge on the $500. Now Amex charges interest on the purchase until it receives your $1,000.

LITTLE HELP

Where can consumers turn for relief? Not necessarily to the courts. About 45% of credit-card companies force customers to submit disputes to arbitration instead.

Regulators aren't likely to be of much use either. The card industry has an unusual degree of sway over its regulators, says Ed Mierzwinski of U.S. Public Interest Research Group. Card issuers can choose to be chartered as state banks, which are supervised by the Federal Reserve or the Federal Deposit Insurance Corp., or to be nationally chartered, putting them under the Office of the Comptroller of the Currency (OCC) or the Office of Thrift Supervision.

The overwhelming majority of issuers now are overseen by the OCC, whose operations are funded by the card industry itself. "The OCC has a much greater incentive to be accommodating to card issuers because the banks always have the option of switching to another regulatory body if they don't like OCC policies," Mierzwinski says.

The MAJORITY of card issuers are overseen by an agency funded by the industry.

State attorneys general, who have long been aggressive in fighting abusive card-industry practices, were pushed aside last year when the OCC imposed rules asserting that it had sole legal authority to enact and enforce consumer protection regulations for national banks and their state-licensed operating subsidiaries. "Simply put, the OCC rules will eliminate 50 cops from the beat," testified Roy Cooper, North Carolina's attorney general, before a congressional committee last year. Cooper said OCC officials, in their efforts to entice federal thrifts and state banks to become OCC regulated, behave like basketball coaches trying to recruit players. As a selling point, they tout rules aimed at preempting any role for states in consumer protection. Kevin Mukri, an OCC spokesman, says that such a charge is "ridiculous." He adds, "We have high standards of consumer protection at the national level."

Some of those consumer cops are pressing ahead despite the OCC's attempt to preempt. In December 2004, Minnesota's attorney general, Mike Hatch, filed a suit against Capital One, saying it used false, deceptive, and misleading TV ads, direct-mail solicitations, and customer-service telephone scripts to market credit cards with "low" and "fixed" rates that supposedly wouldn't rise, unlike those of their competitors' who were portrayed in TV ads as plundering barbarians. Yet a clause in the card agreement allowed Capital One to change interest rates for any reason. The case is still pending, and when asked for comment, Capitol One said it believes it has complied fully with the law.

For now, the greatest power that consumers have is in their own hands. Melanie Mills, whose credit-card rate was raised to a nosebleed level, has filed complaints about card-industry tactics with federal regulators. "As a citizen," Mills says, "the only power I have is to withdraw my business from these companies and encourage friends, family, and business partners to do the same."

whatyoucando

HOW TO WIN AT CREDIT CARDS

Choose well. Hunt for cards with consumer-friendly policies. The table on page 13 lists bank cards with interest rates and fees at the low end of the spectrum. Also consider cards issued by credit unions. A July 2005 study by the Woodstock Institute, a nonprofit economic development policy group, found that cards issued by credit unions had much lower fees and penalty APRs. To find a credit union for which you might be eligible, visit the Credit Union National Association Web site at *www.creditunion.coop* or call 800-358-5710.

Scope out the offer. Scan the Schumer box, named for Sen. Charles Schumer, D-N.Y., who sponsored a law mandating disclosure of all rates in a type size that customers can read. Pay attention to notices you receive from your card issuer. If you use your card after receiving them, you may be tacitly agreeing to new terms, even if you claim you never saw the notice.

Negotiate better terms. If your card issuer hits you with a late fee or a rate hike, ask for a waiver. The better your credit score, the more leverage you have, says Scott Bilker, author of "Talk Your Way Out of Credit Card Debt." "Even if your score is a little below average, you're still going to spend money and they would rather have it be on their card than a competitor's," he says. If you can't get a better deal now, you can improve your credit score over time by making on-time payments and by not increasing your balance. You can ask for a lower rate later.

Pay on time. Mail your payment as soon as you receive your bill or set up direct online payment arrangements with each card issuer, suggests Curtis Arnold, founder of CardRatings.com. "Even when you're paying electronically," he says, "some issuers may take two or three days to post payment to your account, so it's wise to go online to authorize your payment at least that far in advance of the due date to play it safe."

Complain. First register a complaint with your state attorney general. (Contact information is available at *www.naag.org*.) Also lodge a complaint with the Office of the Comptroller of the Currency, at *www.occ.gov* or 800-613-6743. If the OCC doesn't regulate the card issuer, it will help you find the agency that does.