

# The 2009 Credit Card Act

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## How does it affect your business?

It is true that change is coming. It's also true that it has arrived. The Credit Card Act of 2009 has been signed into law. The internet is inundated with articles about how this Act will positively impact customers, but very little attention has been paid to how the Act negatively impacts already-struggling financial institutions.

### In This Issue

The Credit Card Act of 2009 was designed for the consumer, but its biggest impact will be to already-struggling financial institutions. We're breaking down the Act so you will be educated as to its affect on your business.

***Do you understand the impact on both your organization and your customer?***

***What will you do to replace lost revenue?***

***Do you have a plan in place?***

***Will you simply absorb the revenue loss or counter with new strategies or products?***

We believe the required changes are going to significantly impact income statements of all card issuers. Furthermore, to the extent that accounts and/or loan balances will be lost or additional charge-offs will occur; balance sheets will also be negatively affected. The legislation will make credit harder to get. Once obtained, it will cost more. Higher rates, new fees, and reduced (rewards) benefits will prevail. For credit card issuers, there will be increased costs due to the necessary system/technology changes to support the new regulations.

Provided below is Profit Technologies' review of the 2009 Credit Card Act. We have highlighted the changes and outlined the impact to both customers AND credit card issuers. The sections, organized by the Act's major sections, are:

- 1. Customer Protection**
- 2. Enhanced Customer Disclosures**
- 3. Protections of Young Consumers**
- 4. Gift Cards**

## Customer Protection

**45 days notice required prior to significant changes in credit card terms, including changes to the benefits or rewards. Note: this rule is effective 90 days after the enactment date of the Credit Card Act.**

- While most major issuers currently provide at least 45 days advance notice for changes in terms, this requirement could impact banks' ability to risk base re-price. Banks will likely charge higher rates overall with reduced limits to manage risk and some income will be lost through the inability to implement changes at the end of a cycle when an event has occurred.

**Credit card companies must apply payments to higher interest rate balances first.**

- This feature will significantly change the practice of offering promotional offers. Because banks will be required to allocate payments to the higher rate balances, interest income will be reduced though the extension of the promotional/teaser rates and balance transfer balances for the majority of customers that carry both promotional and non-promotional balances generated through retail activity.
- To offset this reduced income, in the future, banks will likely offer higher initial rates with very limited promotional offers on new accounts or balance transfers. Additionally, expect to see more use of balance transfer fees.
- While the frequency and type of promotional offers will change, it will still be a worthwhile tool in increasing balances and attracting accounts. It will simply require a more narrowly targeted approach in defining the target population to identify those customers that will be expected to eventually migrate to the normal rate after the promotion expires. Banks will need to do a better job of identifying prospective profitable customers through analytics.

**Retroactive rate increases are banned except when a cardholder is more than 60 days late in paying their bill.**

- This limitation will significantly reduce card companies' revenue and will prevent them from charging a price commensurate with the potential risk of charge-off in the earlier stages of delinquency. By the time a customer is 60 days delinquent, there is a very high likelihood of migration to charge-off. Raising the rate at this point is like "closing the barn door after the horses have escaped". Issuers will raise their overall rates to compensate for the lost revenue, and it is probable that most credit worthy customers will end up paying more for their credit. Whereas before, issuers could adjust rates based on customer performance and behavior, now it will be more "one size fits all" in terms of pricing.
- In the future, card companies will need to focus more on a prospective customers' credit quality and to price accordingly on the front end. This will be a major competitive issue, as the risk of pricing too high will be to lose accounts to competitors, and the risk of pricing too low will be to fail to price against risk exposure.

**Credit card issuers must review the cardholder's account 6 months after increasing the interest rate, and return the APR to the previous lower APR if the cardholder has since been on-time with payments.**

- While many major issuers already have some variation of this practice in place, there still are situations where over limit events are counted toward the allowed number of penalty occurrences, or otherwise influence keeping customers at the penalty rate.

- Interest income will be reduced as cure periods have been shortened. Some issuers previously require a 12 month minimum for cure.

**Interest rate cannot be increased within the first 12 months, and promotional rates must have a minimum 6-month duration.**

- Except for penalty pricing situations, most major issuers do not customarily re-price accounts within the first 12 months, (although some may do so after six months) so this rule may not have a significant negative impact.
- While many issuers do not offer promotional rates less than 6 months, for those that do, it will be more important than ever to identify eligible accounts based on the expectation that the promotional balance will eventually migrate to the contractual rate.

**The practice of universal default and double-cycle billing are no longer allowed.**

- While some issuers have moved to performance-based pricing using their own customer's behavior history and relationship information, the restriction on universal default will reduce many issuer's interest income. Banks are likely to charge higher interest rates from the beginning if penalty pricing for increased risk is more difficult.
- The restriction on double-cycle billing will have relatively little impact, as most major issuers have already discontinued double-cycle billing.

**Over credit limit fees are prohibited unless consumers agree to allow transactions to go through instead of being denied. Only one over-the-limit fee is allowed per billing cycle.**

- While at first this may appear to have a significant impact on fee income, it may not have as much of an impact as many may think. The requirement is to obtain "in advance" the cardholder's agreement that over limit situations can occur and that fees can be assessed when they do. We believe that most customers will likely agree to the terms, wanting this additional flexibility.
- Banks will be less likely to allow customers to go over limit if there is limited compensation for the increased risk. Additionally, the technology costs required for the advance notice may force banks to deny all over limit transactions.

**Bills must be sent out no later than 21 days before the due date.**

- This restriction will reduce interest revenue and increase funding costs for issuers that currently apply a 20 day payment due date for transactors. More time given to transactors to pay will mean fewer missed payments and lower revolve rates. It will also reduce late fee revenue for the same reason.
- This requirement is likely to drive additional technology expense for re-tooling to support specific time tables. Issuers may force cardholders into electronic notifications and statements to avoid issues and cost. We might see a monthly fee for customers that require paper statements to off-set the cost of critical delivery cycles.

**Payments must be credited as on-time if the payment is received by 5 p.m. on the due date.**

- We do not believe this restriction will have a major revenue impact on issuers. Some customers who in the past have sent payments in at the last minute have been affected by early (e.g., 2pm) cut-offs. It is these customers who have been most vocal and to whose outcry Congress is responding. Nevertheless, with the multiple payment channels now available to the vast majority of customers (internet, pay by phone, auto-pay), only a few customers are now affected by payment

cutoff times earlier than 5 p.m. If there are any impacts, they will be reductions in late fee income and increased operating expenses due to the cost of processing activity in a more limited payment receipt window.

**No fees are permitted for making credit card payments online, by mail, or over the phone, unless you make a last-minute payment over the phone and your bill is due the same or next day.**

- Because this is not a major source of revenue for issuers, there will likely be little revenue lost. Similar to the 5 p.m. cutoff restriction, we believe this is primarily an emotional issue that Congress decided to respond to, understanding that few customers would actually be affected. In fact, we would suspect that most payment calls are now made either on the payment date or the day before, when customers suddenly realize that their payment won't arrive on time if mailed.

**The term “fixed rate” may only be used to refer to an annual percentage rate or interest rate that will not change or vary for any reason over the period specified clearly in the terms of the account.**

- This change will limit issuers flexibility to change (via re-disclosures) to a variable rate product if they find themselves in a rising rate environment. This change will likely lead to higher pricing across the board as issuers will be locked into the rate if they use the term “fixed”.

**Payments must be due on the same date each month.**

- This restriction will likely exacerbate the requirement for a 21-day lead time between the date that statements are mailed and the payment due date. It is not clear how this will be implemented by major processors, particularly with consideration for holidays and weekends. However, if the payment date has to be the same every month, and each month there must be at least 21 days between the statement mailing and the payment date, there will likely be, on average, more than the required 21 days to payment. The further back in the cycle the payment due date is set the fewer customers will miss the payment date and thereby be subject to interest and late fees, resulting in additional loss of revenue for issuers. This regulation will impact variable due date strategies as customers will have the same payment due date regardless if they are a transactor or revolver.
- This restriction will likely generate an increase in expenses for a one-time system change.

## **Enhanced Consumer Disclosures**

- Clear disclosures on how long it would take to pay off a credit card balance if a cardholder makes only the minimum payment each month.
- Clear disclosures on the total cost in interest and principal payments if a cardholder makes only the minimum payment each month.
- Late payment deadlines and postmark dates are required to be clearly shown and disclosed to cardholders.
- If the financial institution has branches that take payments, the date on which the payment is made at the branch will be considered the date on which the payment is made for purposes of determining whether a late fee or charge may be imposed.
- Lenders are required to post their credit card agreements on the internet.

In general, the changes covered under “Enhanced Customer Disclosures” will likely reduce interest and fees incomes as customers better understand the “cost” of credit. Additionally, the changes will result in initially higher disclosure costs as credit card issuers adjust to the new requirements.

The requirement that issuers post their terms on the internet may put many industry participants at a competitive disadvantage, as any strategies requiring disclosure will be immediately available to other issuers for review and consideration.

## Protection of Young Consumers

- Credit cards cannot be issued to people under the age of 21 unless they have an adult co-signer or show proof that they have the means to repay the debt (proof of reasonable income).
- College students will be required to receive permission from parents or guardians in order to increase credit limit on joint accounts they hold with those adults.
- People under the age of 21 will now be protected from pre-screened credit card offers unless they specifically opt-in for offers.
- Credit Card companies are not allowed to offer college students any tangible items to induce participation in open-end loans if the offer is made on or near the campus, or at a sponsored event.

In general, the changes covered under “Protection of Young Consumers” will likely reduce total loans, interest income, fees and potentially new accounts. The changes will make it more difficult for young card holders to grow into loyal mature cardholders and to establish credit in their own name. Additionally, the changes will likely increase sales of re-loadable debit cards for young people to use. Thus, the industry could see a re-allocation of income from interest income to debit card fees.

## Gift Cards

**Gift cards are now required to remain active for at least five years from the day of their activation.**

- This will have a short term impact on income as current issued cards expire and the 5-year window is expanded. Issuers will have use of funds longer, but cannot report income until much later and will have to carry the liability for a longer period.
- “Breakage” on cards may increase as customer behavior may change. Customers will feel less pressure to immediately use their cards and they will have longer expiration dates. As a result, the potential to misplace or lose the card will increase.
- We expect to see higher costs in tracking card usage and dormancy over the extended 5 year period.

**Dormancy or inactivity fees must be clearly disclosed to gift card buyers.**

- Dormancy or inactivity fees on gift cards can no longer be imposed unless there has been no activity in a 12-month period. Dormancy fees during years 2-5 should be at a level that substantially eliminates major portions of balances on the average card. The changes will reduce the liability level on balance sheet and exchanges future income, via breakage, for current fee income.

**If the gift card expires after 5 years, the terms of expiration needs to be clearly disclosed to gift card buyers.**

## Other Observations

- Section 149 of the Act discusses how “reasonable” penalty (late and other) fees may be set, and suggests future comment and possible rules defining what constitutes “reasonable” fees. This could take aim at high late and over limit fees (e.g., \$39) and possibly place restrictions on the levels of these fees.
- Section 501 of the Act requires completion of a study on interchange fees within six months. Interchange is a significant portion of issuer profit. Changes to regulations impacting interchange would likely increase pressures on issuers already struggling for survival.
- Section 506 of the Act requires a review (within 9 months) of credit card practices for credit extended to small businesses. This may cause additional negative impacts on issuer revenues. Small business cards have traditionally been exempt from so-called “consumer legislation”, thereby allowing more flexibility in optimizing revenue with this group of customers.
- Additionally, the Credit Card Act of 2009 requires various government organizations to undertake a number of additional studies which may lead to additional regulations.

## Summary:

Due to the more restrictive regulatory changes, we believe it will become increasingly important to use a targeted approach to identify customers for specific interest rates, fees, and promotions/rewards. Profit Technologies can be your partner to ensure you are leveraging the rules, making the right changes, optimizing your system settings, and targeting the right customers. Give us a call. We can help ensure that these changes do not negatively impact the performance of your credit card portfolio.