Client Alert

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CFPB Releases Second CARD Act Report

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On December 3, 2015, the Consumer Financial Protection Bureau ("CFPB" or "Bureau") released its second biennial report on the consumer credit card market ("Report"), as required by the Credit Card Accountability Responsibility and Disclosure Act ("CARD Act").[1] The Report outlines the results of the CFPB's most recent study of the credit card market, which included a public request for information in March 2015 and other input from industry and consumer groups. The Report updates the results from the CFPB's 2013 study and report ("2013 Report"), and explores other aspects of the credit card market.

The Bureau's outlook on the credit card market overall was quite positive. In a speech at the Consumer Federation of America's annual Financial Services Conference that was timed with the release of the Report, CFPB Director Richard Cordray stated that the Report shows that the CARD Act has not reduced consumer access to credit and, instead, has "had a positive impact on consumers and industry alike across the marketplace." Director Cordray also said that the CARD Act helped consumers avoid $16 billion in "gotcha" credit card fees.

This alert highlights several key findings in the Report, including findings related to the cost and availability of credit, deferred interest products, rewards programs, debt collection and product innovation.

COST AND AVAILABILITY OF CREDIT

The Report concludes that the cost of credit to consumers across all risk bands remains stable at the levels reported in the 2013 Report. Specifically, the Report states that consumer fees are significantly lower in proportion to balances as compared to pre-CARD Act levels for consumers in all credit score ranges and that consumers now pay less in fees overall, and less in fees relative to their balances, as compared to pre-CARD Act levels.

Moreover, in terms of the cost of credit cards for consumers, the Report concludes that elimination or reduction of many fees consumers previously paid on the "back end" (*e.g.*, late payment fees and overlimit fees) has lowered overall consumer costs. Specifically, the Report states that "consumers would have paid an additional $16 billion in such fees from the beginning of 2011 through the end of 2014" if issuers had continued to charge fees at the levels commonplace before the CARD Act was implemented.[2] The Report further concludes that the incidence of late fees is relatively unchanged since the 2013 Report and that overlimit fees are "essentially extinct."[3] The Report further states that, today, the costs of consumer credit cards are "more predictable and transparent."[4] However, looking at the average purchase annual percentage rate ("APR") tells a different story: the average

[1] Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734; *see also* 15 U.S.C. § 1616(a).
[2] *See* Report at 10, 66, 69.
[3] *Id.* at 12.
[4] *Id.* at 10.

purchase APR has increased to 15.87 percent from 14.23 percent since the implementation of the CARD Act.[5] And while "back end" fees may have decreased, other fees, including annual fees, have increased substantially.[6]

With respect to credit availability, contrary to other data, the Report concludes that credit cards are now available to more consumers than before the CARD Act was implemented, stating that new account volume has grown every year since implementation of the CARD Act.[7] Industry data shows, however, that new account volume is down across all risk bands since the implementation of the CARD Act, with decreases significantly more prominent in the lower risk bands.[8] Moreover, industry data shows that total account volume is down in all but the super-prime risk band.[9]

The Report also concludes that consumers with lower credit scores have more general purpose credit lines, on average, than they did previously.[10] Again, industry data indicates otherwise: the average credit lines for consumers across all risk bands for new and existing accounts are down substantially since the implementation of the CARD Act.[11]

Although issuers need to price accounts based on credit risk because the higher likelihood of default makes subprime lending more expensive, the CFPB expressed concern about subprime credit card issuers. Specifically, the Report found that cards offered by subprime issuers were "significantly more expensive than their mass market counterparts."[12] The Report suggests that such subprime issuers charge consumers greater fees and interest, emphasizing the origination and maintenance fees that the issuers charge on relatively small credit lines to mitigate some of the risk of lending to consumers with lower credit scores. The Report suggests that this strategy could make it more difficult for consumers to pay down any principal balance, ultimately increasing interest due to the issuer, even though issuers may not otherwise be able to afford to offer credit to consumers with low credit scores without these fees. The Report also indicates that subprime issuers use longer and more complex credit card agreements than other issuers, despite the fact that their consumers tend to have a lower level of formal education.

The Report also raises a concern related to variable interest rates, stating that consumers who may be accumulating credit card debt now, during a period of historically low interest rates, could be caught off guard when interest rates eventually increase and their credit card interest rates rise and begin to apply to both new and existing high principal balances. It is worth noting, however, that historically low interest rates were not viewed as causal in the Report's discussion of the impact of the CARD Act on the cost of credit.

DEFERRED INTEREST PRODUCTS

The Report was critical of deferred interest promotional financing products, despite the popularity of these products. Specifically, the Bureau found that deferred interest products are "the most glaring exception" to the

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[5] *See* American Bankers Association comment letter (dated May 18, 2015) at 4.
[6] *Id*. at 5.
[7] Report at 88-89.
[8] *See* American Bankers Association comment letter at 3.
[9] *Id*.
[10] Report at 13-14; *see also id.* at 39.
[11] *See* American Bankers Association comment letter at 4.
[12] Report at 11; *see also id.* at 63 ("Consumers of subprime specialist products, however, face a significantly different fee burden.").

general post-CARD Act trend toward upfront credit card pricing.[13] While the Report acknowledges that consumers who make all of their payments in a timely manner can often avoid paying any interest on a purchase through a deferred interest financing plan, the Report indicates that consumers who are most likely to be unsuccessful in taking advantage of the promotional program tend to be those consumers with the lowest credit scores.

Notwithstanding the required Regulation Z disclosures applicable to deferred interest, the Report cites a lack of transparency as it relates to the "back end" cost of these products, particularly because the payoff rates "have declined slightly in recent years."[14] Additionally, the Report expresses concern that consumers who have a regular balance and a promotional balance on the same account may be confused about the terms of their repayment because they are less likely to pay off their promotional balances in full during the promotional period than consumers who have only a promotional balance on the account, and accounts with promotions that are not paid in full during the promotional period may experience significantly higher delinquency rates after the promotion ends than accounts that are paid in full during the promotion.[15]

REWARDS PROGRAMS

While acknowledging the increasing popularity and diversity of rewards programs, especially on general purpose credit cards, the Report identifies a handful of areas of potential concern relating to rewards programs. The Report identifies "[t]he number of different disclosures associated with rewards cards, and the timing of when consumers receive them or have access to them" as a key area of potential concern as it relates to cards with rewards features.[16] Without commenting on the absolute number of complaints related to rewards programs, the Report states that sign-up bonuses represent "an exceptional area of concern for consumers because they were the largest single driver of complaints to the Bureau regarding rewards credit cards."[17]

The Report also identifies concerns related to the blurring of marketing and disclosures; non-specificity of terms (particularly with respect to an issuer's right to change consumers' ability to earn or redeem rewards, as well as the right to "revalue" the rewards themselves); expiration and forfeiture; complexity, restrictions, and incentives; third-party involvement; and the difficulty of determining and comparing the actual value of rewards under different programs.

These areas of potential concern were informed by a series of focus groups that the Bureau engaged to discuss credit card rewards; however, the Bureau acknowledged the limitations of such groups, given the limited number of consumers involved.

DEBT COLLECTION

The Report states that the "conduct of debt collectors can present substantial risk to consumers," and adds that the CFPB received more than 88,000 complaints from consumers about debt collection in 2014, one in seven of which pertained to credit card debt collection.[18] As part of its study of credit card debt collection, the Bureau

[13] Prepared Remarks of CFPB Director Richard Cordray at the Consumer Federation of America (Dec. 3, 2015), http://www.consumerfinance.gov/newsroom/prepared-remarks-of-cfpb-director-richard-cordray-at-the-consumer-federation-of-america/.
[14] Report at 16; *see also id.* at 165.
[15] *Id.* at 17; *see also id.* at 125-26, 132, 151-52.
[16] *Id.* at 229.
[17] *Id.* at 230.
[18] *Id.* at 237.

surveyed a number of large credit card issuers in order to better understand their approach to credit card debt collection and recovery. According to the Report, the survey evinced varying practices among issuers during the initial delinquency in-house collection, as well as variations between issuers' practices of selling debts to debt buyers and using third-party debt collectors. The Report notes that overseeing multiple third-party debt collectors on numerous delinquent and/or charged-off accounts can be a difficult prospect for issuers, who continue to bear responsibility for ensuring that the debt collectors use only fair debt collection practices in accordance with state and federal laws. The Bureau also studied the quality of representations and warranties made in debt sale and purchase agreements to ascertain whether the parties to such agreements warranted that the seller retains title to the accounts, has complied with all relevant consumer laws, and affirms the accuracy and completeness of the information the debt buyer is purchasing.[19]

PRODUCT INNOVATION

As is required by the CARD Act, the Report describes the impact of product innovations. The Report focuses on security innovations and mobile payments. As it relates to security innovations, the Report discusses the progress of the Europay, MasterCard and Visa ("EMV") chip card implementation, as well as various tokenization initiatives across the payments industry. The Report also discusses the impact of mobile payments on the way consumers interact with their credit cards and consumers' behavior more broadly; for example, by enabling consumers to easily comparison shop on their phones, save time by ordering products before entering a store, or check account balances before making purchases.

CONCLUSION

The Report describes at length the benefits that have accrued to consumers in the years since the CARD Act was enacted. Nonetheless, the Bureau seems poised to act on key areas that could have a significant impact on consumers and the market generally, which potentially include debt collection, deferred interest offerings, and rewards programs.

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[19] Report at 259.

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