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CRS Report for Congress

Credit Card Minimum Payments

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Summary

Revolving credit cards generally require a minimum payment for each statement period. The creditor uses a fixed percentage or formula to calculate each month's minimum dollar amount. Low minimum payment requirements have been challenged by consumer advocates as a contributing factor to the mounting credit card debt held by U.S. households as they raise the cost by extending the time it takes to pay off the credit. Guidelines on credit card lending, issued in January 2003 by four federal regulators of depository financial institutions, were critical of the general easing of minimum payment requirements by credit card issuers. The guidelines, issued because of safety and soundness concerns, communicated expectations of more prudent practices. In response, credit card issuers began adjusting their minimum payment formulas, raising the amount of the required monthly payment. Congress has focused on the need to increase consumer awareness of the financial jeopardy that can result from paying only the required minimum. The Bankruptcy Act of 2005 (P.L. 109-8, 119 *Stat*.23) requires the placement of a standardized minimum payment warning on every periodic statement. Several bills have been introduced in the 110th Congress that would enhance the disclosure to cardholders regarding minimum payments.

This report provides an overview of the issues and congressional action. It will be updated as events warrant.

Background

Although there is no absolute industry standard for credit card minimum payments, they are a ubiquitous requirement of revolving credit card[1] programs. The formulas used to calculate the monthly minimum payment can vary by issuer and type of account, but typically the payment is calculated as a percentage of the outstanding balance.[2] The

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[1] As opposed to charge cards which require the full balance to be paid each month.

[2] Some issuers may calculate the minimum payment as a percentage of the outstanding balance plus any finance charges, late fees, or other fees, issuers may use a flat fee, and others may use (continued...)

periodic statements received by the cardholder do not show the formula calculations. The statement instead presents the cardholder with the dollar amount of the minimum payment for that particular billing cycle.

In the 1970s, the average minimum payment was about 5% of the outstanding balance; by 2000, it was around 2%.[3] The decline in minimum payment requirements is usually attributed to competitive pressures in the credit card industry. Thousands of depository financial institutions offer bank cards to consumers. A downward trend in credit card interest rates, aggressive marketing efforts (by mail, phone, and Internet), and product innovations (such as the elimination of annual fees and creative balance transfer offers) have made it easier for consumers both to obtain credit cards and switch among issuers. Lower minimums, reward programs, and enhanced customer service are examples of practices used by card issuers to maintain customer loyalty. Easing minimum payment requirements can also be viewed as a technique (similar to new penalty fee structures and shortened grace periods) employed to maintain portfolio profitability by preserving outstanding balances.

Consumer advocates have long been concerned about the growth in credit card debt. Revolving consumer credit outstanding (which is made up primarily of credit card debt) totaled $238.6 billion at year end 1990. By year end 2000, the total had grown to $678.5 billion. From 2000 to 2007 consumer revolving debt increased an additional $260 billion plus, rising to $941.8 billion.[4] Consumer advocates argue that the aggressive marketing campaigns launched by credit card issuers in the 1990s contributed to an increased dependence on consumer credit. In this view, too many households are holding a level of debt that could easily cause major financial difficulties if the family experienced an unexpected occurrence such as an illness or job loss. Low minimum payment requirements can encourage consumers to take on more debt, and consistently paying the minimum greatly extends the time and cost of paying off that debt.

Policy Issues and Actions

Recently, both Congress and the federal regulators of depository financial institutions have questioned how well consumers understand the costs involved with using credit cards. Attention has been focused on the transparency of the terms and conditions applicable to cards. Minimum payment requirements have been part of the discussion. Federal regulatory guidance issued in 2003 dealt with safety and soundness issues raised

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[2] (...continued)
formulas that vary based on the APR (annual percentage rate).

[3] Testimony of Travis B. Plunkett, Legislative Director of the Consumer Federation of America, in U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, E*xamining the Current Legal and Regulatory Requirements and Industry Practices for Credit Card Issuers With Respect to Consumer Disclosures and Marketing Efforts*, hearings, 109th Cong. 1st sess., May17,2005, p.8, at [http://banking.senate.gov/index.cfm?Fuseaction=Hearings.Detail&hearing ID=154].

[4] Data (in current dollars) from Federal Reserve Statistical Release G.19, Consumer Credit, available at [http://www.federalreserve.gov/releases/g19/hist/cc_hist_sa.html] and [http://www.federalreserve.gov/releases/g19/current].

by credit card accounts management practices. The 2005 Bankruptcy Act and the subsequent proposed amendments to Federal Reserve Board of Governors's Regulation Z[5] addressed minimum payment disclosures. During the 110th Congress, improved disclosure of credit card terms and conditions (including revisions to minimum payment notices) has been the subject of oversight hearings and proposed legislation.

Regulatory Guidance

In January 2003, four federal regulators of depository financial institutions[6] jointly issued interagency guidance on credit card lending.[7] The guidelines stated that recent examinations of financial institutions by the regulators found credit card account management practices that raised safety and soundness concerns. The guidelines described the concerns and the corrective changes for practices deemed inadequate or imprudent. The guidelines also recognized that the time required to implement changes could vary among individual credit card issuing institutions.

A section of the January 2003 guidelines dealt with minimum payment requirements. The agencies recognized a pattern of general easing of these requirements in recent years, noting that new formulas can have the effect of delaying principal payment. Of particular concern were accounts experiencing "negative amortization," a situation where the monthly minimum payments consistently fall short of even covering all of the finance charges and fees, and that therefore the outstanding balance continues to grow. The situation can be exacerbated by programmatic, recurring over-limit fees and other charges. The regulators view these fees as inappropriate if they are primarily intended to increase recorded income for the lender rather than as a tool to enhance the borrowers' (cardholder) performance or their access to credit. Liberal repayment programs can increase credit risk, mask portfolio quality, and compound or protract consumer debt. The account management changes expected by the federal regulators included minimum payment requirements that would effectively amortize the current balance over a reasonable period of time.

Since the guidelines were issued, a number of large issuers of bank credit cards (including Bank of America, Citibank, MBNA, and JPMorgan Chase) have begun increasing their minimum payment requirements. The average minimum payment is expected to rise to about 4%. The following example shows what a difference an increase from 2% to 4% could mean to a cardholder. A cardholder with a $10,000 balance in a payment program with a 2% minimum and a 16% interest rate would need more than 40

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[5] The Federal Reserve's Regulation Z implements the consumer protections in the Truth in Lending Act (P.L. 90-321, 15 U.S.C. 1601*et. seg*, 82 *Stat*. 146) requiring uniform methods for computing the cost of credit and for disclosing credit terms.

[6] Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and the Office of Thrift Supervision.

[7] The Federal Reserve Board, "FFIEC Agencies Issue Guidance on Credit Card Account Management and Loss Allowance Practices," joint press release, January 8, 2003, at [http://www.federalreserve.gov/boarddocs/press/bcreg/2003/20030108/default.htm].

years to pay off the balance and pay a total of $19,329 in interest. The same cardholder with a 4% minimum would need about 14 years and pay a total of $4,931 in interest.[8]

2005 Bankruptcy Act

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (P.L. 109-8, 119 *Stat*. 23) was enacted in April of 2005. Section 1301 of P.L. 109-8 provided for new disclosures for minimum payments. This section amends the Truth in Lending Act (P.L. 90-321, 15 U.S.C. 1601 *et.seg*, 82 *Stat*. 146) that is implemented by the Federal Reserve Board of Governor's Regulation Z. New generic disclosures would be required on the front of each periodic statement received by a credit cardholder. The information must include a warning that indicates paying only the required minimum will increase both the total interest paid and the time it takes to repay. A hypothetical example of these consequences must be presented. Finally, a toll-free number where the cardholder can find an estimate of the time it would take to repay their individual account balance will be included. The Federal Reserve is directed to prepare a table in order to standardize the information provided to cardholders using the toll-free phone resource.

The Federal Reserve sought public comment on how the Board should implement the minimum payment provisions and other amendments made by P.L. 109-8 to the Truth in Lending Act. The Federal Reserve requested data or comment on specific issues presented in a series of questions.[9] The issues reflected the potential problems raised by alternative approaches to estimating repayment periods, assumptions used in various calculations, the different terms and conditions connected to the variety of credit card programs offered by depository financial institutions, and the need for clear and conspicuous disclosures. Questions also explored providing personalized notices on periodic statements.

On May 23, 2007, the Federal Reserve issued a proposed rule amending Regulation Z.[10] The proposed revisions include minimum payment disclosures for credit card issuers required by the 2005 Bankruptcy Act. The Board's proposal would require issuers to provide, in each periodic statement, a warning statement about the effects of making only minimum payments, a hypothetical example, and a toll-free number to call for an estimate of the time it would take a cardholder to repay their individual account balance. A credit card issuer may choose to establish a toll-free number that provides cardholders with the actual number of months it would take to repay their outstanding account balance as opposed to an estimate. Those issuers would not be required to include a hypothetical example on periodic statements. In addition, credit card issuers could chose to provide the actual repayment information on the periodic statement. Issuers that choose this method of disclosure would not be required to provide a warning statement, a hypothetical example, or a toll-free number. Finally, the Board proposed guidance on how to calculate generic repayment estimates as an more useful alternative to issuing a table. The

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[8] Mara Der Hovanesian, "Tough Love For Debtors," *Business Week*, April 25, 2005, p. 99.

[9] Federal Reserve press release October 11, 2005, at [http://www.federalreserve.gov/boarddocs/press/bcreg/2005/20051011/default.htm].

[10] The proposed rule can be found at [http://www.federalreserve.gov/newsevents/press/bcreg/20070523.htm].

guidance can facilitate the use of automated systems to provide the required disclosures; the guidance can also be used to generate a table. Cardholders using the toll-free number would be prompted to input information about their outstanding balance and the APR applicable to their account. Additional guidance was proposed on how to calculate customized or actual repayment disclosures to encourage issuers to provide these disclosures to cardholders.

110th Congress

Congress has continued to use its oversight role to actively monitor the advances, changes, and growth of the credit card industry. During the first session of the 110th Congress, oversight hearings were held by both Senate and House Committees[11] to examine the terms and conditions of credit card programs as well as the marketing, billing, and disclosure practices of the credit card industry. Minimum payment requirements were included in the discussion.

There was general agreement expressed during the hearings that consumers need to be better informed and educated on the benefits and drawbacks of credit cards and the terms and conditions of these financial products. Consumer advocates continue to support mandatory personalized minimum payment disclosure notices. Industry representatives support the option of providing customized information and expressed concern over the potential costs involved with providing personalized notices.

Legislation (including three bills in the House and two in the Senate) that would enhance the minimum payment disclosures required in the cardholder's periodic statement has been introduced in the 110th Congress.

- The Credit Card Accountability, Responsibility, and Disclosure Act of 2007 (H.R. 1461) was introduced on March 9, 2007, by Representative Mark Udall, and cosponsored by 40 other members to date, and was referred to the House Committee on Financial Services. Section 201 of the bill addresses minimum payment disclosures. The legislation would mandate a personalized notice providing repayment information that would apply to the cardholder's outstanding balance. The information would include the minimum monthly payment as both a dollar figure and as a percentage of the outstanding balance.

- The Credit Card Repayment Act of 2007 (H.R. 1510) was introduced on March 13, 2007, by Representative David E. Price, and cosponsored by

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[11] The following is a list, in chronological order, of the hearings held:
January 25, 2007, *Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry and Their Impact on Consumers*, Senate Committee on Banking, Housing, and Urban Affairs; March 7, 2007, *Credit Card Practices: Fees, Interest Rates, and Grace Periods*, Permanent Subcommittee on Investigations of the Senate Committee on Homeland Security and Governmental Affairs; April 26, 2007, *Credit Card Practices: Current Consumer and Regulatory Issues*, Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services; and June 7, 2007, *Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives*, Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services.

15 other members to date, and was referred to the House Committee on Financial Services. This bill would require a customized notice providing information to cardholders about paying off their outstanding balances using the minimum rate. The notice would include the total time to pay off the balance as well as the total cost.

- The Credit Protection Act of 2007 (H.R. 3421) was introduced August 3, 2007, by Representative Nita M. Lowey and was referred to the House Committee on Financial Services. Section 3 of the bill would require the cardholder's minimum monthly payment to be presented as both a dollar figure and as a percentage of the outstanding balance. The disclosure would include information on the total time to pay off the balance as well as the total cost.

- The Credit Card Minimum Payment Warning Act of 2007 (S. 1176) was introduced on April 20, 2007, by Senator Daniel K. Akaka and was referred to the Senate Committee on Banking, Housing, and Urban Affairs. Section 2 of the bill would require the disclosure of the number of years and months it would take to pay the cardholder's outstanding balance if only the minimum monthly payment was made. The total cost to the cardholder would be separated into interest and principal.

- The Credit Card Minimum Payment Notification Act of 2008 (S. 2542) was introduced on January 22, 2008, by Senator Dianne Feinstein and was referred to the Senate Committee on Banking, Housing, and Urban Affairs. Section 2 of the bill would require the card issuer to choose among several minimum payment disclosure options. The options include hypothetical examples, individualized information estimating the time and cost of paying the outstanding balance, and a toll-free number to obtain individualized information. None of the bills have been reported from committee.