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Fed proposes rules to limit credit card fees

By Tamara Holmes

CreditCards.com

Credit cardholders who have complained about rising interest rates and fees in recent months may be getting a break, thanks to a proposed rule released Wednesday by the Federal Reserve, which would set limits on penalty fees and require card issuers to reconsider past interest rate increases.

"The rule would prevent credit card issuers from charging large penalty fees for small missteps by consumers and would require issuers to re-evaluate rate increases imposed since the beginning of last year," said Federal Reserve Gov. Elizabeth A. Duke in a statement.

As part of the Credit CARD Act of 2009, card issuers must ensure that penalty fees imposed for account violations are "reasonable and proportional" to the violation. The rule proposed by the Federal Reserve Wednesday provides guidelines for doing so, and would go into effect on Aug. 22, 2010. The types of fees covered by the rule include late payment fees, returned payment fees and over-limit fees. Those not covered by the rule include balance transfer fees, cash advance fees, foreign transaction fees and annual fees.

Under the proposed rule:

- **Penalty fees could not exceed the violation.** Card issuers would not be able to charge consumers a fee that was larger than the dollar amount of the infraction. In other words, if a cardholder was late making a $15 minimum payment, the penalty fee could be no higher than $15. In the case of large dollar amounts, penalty fees could not exceed 5 percent of the dollar amount, so a consumer who exceeded his credit limit by $500 could be subject to no more than a $25 fee. Penalty fees imposed on credit cardholders for such infractions as paying late and going over the limit have been rising for years. A 2006 report by the Government Accountability Office found that penalty fees rose from an average of $13 in 1995 to $30 in 2005. More recently, Chicago-based market research firm Mintel Comperemedia found that the average late payment and over-limit fees were $37 and $36 respectfully.
- **Multiple penalty fees cannot be charged for the same offense.** Cardholders who violate account terms cannot have more than one penalty imposed upon them. For example, a card issuer might charge a cardholder a late fee, as well as a returned payment fee if a check bounced. Under the new rule, only one penalty fee could be applied to the violation.
- **Inactivity fees would be banned.** One of the most widely criticized practices of charging cardholders an inactivity fee for failing to make new purchases within a certain period of time would be prohibited under the new rules.

The Federal Reserve also addressed interest rates that have risen dramatically for many cardholders in the months before much of the Credit Card Act went into effect Feb. 22. The rule would require credit card issuers to let cardholders know the reasons their rates have increased. Also, issuers who increased rates since Jan. 1, 2009, would have to re-evaluate their decision to see whether the reasons for the increase have changed. If they have, card issuers would have to consider reducing the rate.

Consumer groups hail rules

The ruling was received favorably by consumer groups.

"The recent Federal Reserve ruling related to credit card fees is yet another positive protection for consumers," says Gail Cunningham, a spokeswoman for the National Foundation for Credit Counseling, based in Silver Spring, Md. "Large penalty fees have often pushed consumers into a financial situation from which they could not recover. Requiring fees to be proportionate to the offense is a common-sense ruling that is long overdue, and one that consumers will undoubtedly welcome."

The ban on inactivity fees would be a huge win for consumers, says Kathleen Day, a spokeswoman for the Durham, N.C.-based Center for Responsible Lending. "If you don't want to spend money, [card issuers] were making you spend money on fees," Day says. "A ban on inactivity fees is a step in the right direction."

However, financial experts say consumers must still be diligent about understanding their credit card agreements so they can avoid penalty fees altogether. "Even though these protections shield consumers from abusive practices, it is nonetheless incumbent on the consumer to become aware of and familiar with the provisions, and remain fully engaged with their finances, thus using the new laws to their advantage," Cunningham says.

The limits on fees are good, but consumers should strive for paying no fees, says **Dorothy Guzek**, a counselor with Farmington Hills, Mich.-based **GreenPath Debt Solutions**. That means consumers should make a point of opening and reading their statements and if they don't understand why they're being hit with certain charges, they should call their credit card issuers to find out how they can avoid them.

"Every fee that consumers pay is principle they're not paying so it's going to take them longer to be debt-free if they're paying high interest or late fees or over-the-limit fees," **Guzek** says.

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