Need to know: New regulations for your debit and credit cards

Not all that long ago, adults' financial advice to young people was simple: "Learn how to write a check and balance a checking account."

Today, young people need to know about more than just checkbooks and paper statements. Online banking is extremely popular, and paper is all but obsolete—and that includes paper checks. Today, debit and credit cards are the rule, and consumers—especially young consumers—need to know about these tools and the rights and responsibilities that go along with them.

With recent changes in the regulations regarding debit cards and credit cards, it's a good time to learn about these forms of payment.

Debit cards

According to CreditCardGuide.com, a subsidiary of Bankrate Inc., in 2008 debit card purchases exceeded credit card purchases for the first time. This trend is expected to continue, which makes understanding debit cards and consumers' rights regarding debit cards all the more important.

But what do consumers need to know that they don't already know? It seems pretty straightforward: you enter a store, you swipe the card through the reader, you type in your PIN, and you take your bag of new stuff home. Well, that's just the beginning of a process that can prove to be your greatest convenience or your biggest problem, depending on how you handle it.

First, a definition is in order: A debit card is a card provided by a bank as a service that allows a point-of-sale transaction to replace cash and checks; transactions are deducted electronically from a cardholder's account. It works this way:

- The bank gives you a card linked to your bank account.
- The card can be used to buy things instead of using cash or writing a check or using a credit card.
- The bank receives information about purchases electronically and deducts the amount spent from the account at the time the purchase is made.

Debit cards are convenient and easy to use, but consumers have to be responsible and keep track of transactions to ensure they know how much money is available. Why is this so important? Consider this.

Suppose you buy a pack of gum at a convenience store for $1.57, and you use your debit card. Your bank is notified, and $1.57 is taken from your bank account. But you have only $1 in your account, and that $1.57 transaction just caused an overdraft in your account. (An *overdraft* occurs when you do not have enough money in your account to cover the cost of a transaction—whether it is a debit transaction, an ATM withdrawal, or a check.)

If you have overdraft protection and your bank allows the transaction to go through, the bank will charge you a fee—maybe as much as $34. Good grief—that pack of gum cost you $35.57! ($1.57 for the gum itself and $34 for the overdraft fee.) It had better be very, very long-lasting gum!

Each year more than 50 million Americans overdraw their checking accounts and pay nearly $24 billion in *overdraft fees*. The most common triggers of these fees are small debit card transactions such as the one described above. Debit card overdrafts are so prevalent that regulators were concerned that consumers did not understand the fee structure. As a result, new regulations were established to inform and protect consumers from incurring frequent and multiple fees when using a debit card.

Overdraft protection and the new rules

Banks can cover your overdrafts in one of two ways. Banks have "standard overdraft practices" that cover your transaction for a flat fee of between $20 and $35 each time you overdraw your account.

Your bank may also offer a line of credit or a link to your savings account to cover transactions that overdraw your account. Typically you would still pay a fee each time you overdraw your account, but these overdraft plans are likely to be less expensive than the standard overdraft practices.

Under new Federal Reserve Board rules, if you open an account after July 1, 2010, your bank cannot charge you overdraft fees for everyday debit card and ATM transactions unless you opt in (agree) to enrollment in that overdraft protection plan. To opt in, your bank must provide you a written notice explaining its overdraft services and fees. You must indicate on the form that you want the standard overdraft protection on ATM and debit card transactions, sign the form, and return it to your bank. If you don't opt in, your bank will typically decline everyday debit and ATM transactions when you don't have enough money in your account to cover them. So if you only have $1 in your account, you can't buy a pack of gum that costs $1.57. Although your transaction will be denied (and you will be gumless), you will not be charged an overdraft fee.

As of August 15, 2010, standard overdraft practices will not apply to your existing accounts (that is, everyday debit and ATM transactions) unless you actively opt in to the overdraft plan. Again, transactions that exceed the account balance typically will be declined, but you won't be charged any fees.

These new rules provide flexibility as well. If you opt in, you can cancel at any time. If you do not opt in immediately, you may choose to do so later. The new rules do not apply to checks or automatic bill payments that you may have set up to cover payments (for car insurance, cell phone service, etc.) Your bank may still automatically enroll you in their standard overdraft protection for these types of transactions. If you do not want the standard overdraft protection to apply to these types of transactions, you will have to speak with someone at your bank. You may or may not have the option to cancel the protection.

Credit cards

The consumer's next-favorite form of plastic is credit cards. And these are easy to use as well—until you realize that a bill comes every month and you have to pay for all the things you purchased. The most important thing to remember about credit cards is that, if you don't quickly pay for the things you buy, those things can end up costing much, much more than the original purchase price.

If you thought $35.57 was a high price to pay for a pack of gum, try this scenario. You use your credit card to buy a 12-pack of cola at the grocery store for $5.00. At the end of the month, you receive your credit card bill and discover that because you already owed a balance of $497 on your credit card that had a $500 credit limit, the $5.00 purchase pushed you over that limit, and your card has a $27 over-the-credit-limit fee. Wow—that 12-pack of cola cost you $32!

If that weren't enough, you don't have money in your bank account to pay off the entire credit card bill this month, so you make the minimum payment. You see that your interest rate on the card is 12.99%. At this pace it will take you three years to pay off the bill (assuming you make no additional purchases with the card), and you will have paid approximately $98 in interest over that period of time. You may think that $98 in interest over that period of time is exaggerated. It isn't.

Credit cards represent agreements between thousands of lenders—the institutions issuing the card—and millions of cardholders. Credit cards are used repeatedly to buy products or services and to borrow money on credit. Credit card companies charge *over-the-limit fees*, *late fees,* and *interest* on unpaid balances. So, with the volume of credit card use as high as it is, even small fees add up to big money. In 2007, credit card issuers imposed $18.1 billion in penalty fees on credit card holders—up more than 50 percent from 2003. Often, credit card holders fail to review the possible fees and charges when they sign up for the card and don't learn about these fees and the rate of interest until they make a mistake.

Over the years, several laws have been passed to protect consumers when using credit cards. The Truth in Lending Act of 1968 mandated disclosure of information about the cost (terms) of credit by requiring creditors to display both their *finance charges* and the *annual percentage rate* on forms they use. Updates to this law were made later, including the Fair Credit Billing Act of 1974 and the Fair Credit and Charge Card Disclosure Act of 1988. Most recently, the Credit Card Act of 2009 provides new credit card rules and amends previous acts with regulations prohibiting unfair credit card practices.

New rules regarding rates, fees, limits, and disclosures
Under the Credit Card Act of 2009, credit card companies may not increase the interest rate on your account for the first 12 months after the account is opened, with a few exceptions:

- If there is an *introductory rate*, it must be in place for at least six months. After that, the rate can revert to the "go-to" rate the company disclosed when the account was opened.
- If the card has a variable interest rate tied to an *index,* the card rate can increase when the index increases.
- If you are more than 60 days late in paying your bill, the interest rate can go up.
- If you are in a workout agreement—a type of debt management plan—and you don't make the payments as agreed, the interest rate can go up.

If the credit card company raises your rate after the first year, the new rate applies only to new charges made on the account. If there is a balance on the account, the old interest rate is applied to that balance.

Under the new regulations, you must tell the credit card company you want to allow transactions that will take you over the account *credit limit*. If you don't opt in, a transaction that would take you over the account limit will be denied. If you don't opt in and the credit card company still accepts a transaction that puts the account over the limit, you cannot be charged an over-the-limit fee.

In addition, if the credit card company requires an *annual fee* or an *application fee*, those fees may not total more than 25 percent of the initial credit limit on the account. For example, if the initial credit limit on the account is $1,000, the fees for the first year cannot be more than $250. This restriction does not apply to penalty fees, such as late fees.

After the first year, credit card companies must notify you 45 days before making any significant changes to the *terms* of an account, such as increasing interest rates or changing certain fees, such as annual fees, *cash advance* fees, and late fees. If a credit card company is going to change the terms of your account, it must give you the option of canceling the card before certain fee increases take effect. If you take advantage of this option, the credit card company may close your account and increase the monthly payment, subject to certain limitations. The company may require you to pay off the balance on the account in five years or may double the minimum payment, resulting in faster repayment than under the existing terms of the account. The credit card company does not have to send consumers a 45-day advance notice under certain conditions, similar to those in effect during the first year.

The new regulations also address credit card consumers under the age of 21. If you are under 21, you must demonstrate that you have the ability to make payments: you must have income or you must have a cosigner—someone who will be responsible for payments if you are unable to make payments. A cardholder under 21 who has a cosigner and wants to increase the credit limit on the account may only do so if the cosigner agrees to the increase. The new rules also prohibit credit card companies from offering tangible inducements, such as t-shirts, mugs, and caps, for opening a credit card account while soliciting near a college campus; moreover, the laws prohibit credit card companies from soliciting within 1,000 feet of a college campus.

Credit card companies are now required to provide additional information on the billing statement. The statement must include the length of time it would take the consumer to pay off the balance if making only the minimum payment. The statement must also include the payment a consumer must make each month to pay off the balance in three years. The information on the statement should look something like the table below.

<table>
<tr><td colspan="3">New balance</td><td colspan="3">$5,000.00</td></tr>
<tr><td colspan="3">Minimum payment due</td><td colspan="3">$100.00</td></tr>
<tr><td colspan="3">APR</td><td colspan="3">14.4%</td></tr>
<tr><td colspan="6">Late Payment Warning: If we do not receive your minimum payment by the date listed above, you may have to pay a $35 late fee and your APRs may be increased up to the Penalty APR of 28.99%</td></tr>
<tr><td colspan="6">Minimum Payment Warning: If you make only the minimum payment each period, you will pay more in interest and it will take you longer to pay off your balance. For example:</td></tr>
<tr><td colspan="2">If you make no additional purchases using this card and each month you pay…</td><td colspan="2">You will pay off the balance shown on this statement in about…</td><td colspan="2">And you will end up paying an estimated total in interest of…</td></tr>
<tr><td colspan="2">Only the minimum payment</td><td colspan="2">23 years</td><td colspan="2">$6,537</td></tr>
<tr><td colspan="2">$172</td><td colspan="2">3 years</td><td colspan="2">$1,188 (savings of $5,349)</td></tr>
</table>

Changes to billing and payments
Under the new rules, credit card companies must mail or deliver credit card bills to you at least 21 days before payment is due. In addition,

- The due date must be the same date each month.
- The cutoff time cannot be earlier than 5:00 p.m. on the due date.
- If the payment due date falls on a weekend or a holiday when the company does not process payments, you have until the following business day to pay. So if the due date is on a Sunday, the cardholder has until 5:00 p.m. on the Monday to make the payment.

If you make more than the minimum payment on a credit card balance, the credit card company must apply the excess amount to the balance with the highest rate, with one exception. If you made a purchase under a deferred interest plan (for example, “no interest if paid in full by December 2013”), the credit card company may let you choose to apply the extra amounts to the deferred interest balance before other balances. Otherwise, for two billing cycles prior to the end of the deferred interest period, the credit card company must apply your entire payment to the deferred interest rate balance first.

Finally, the new regulations eliminate two-cycle (double-cycle billing). This means that credit card companies may not impose interest charges on balances in the current billing cycle.

Conclusion

Although the new regulations regarding debit cards and the Credit Card Act of 2009 are the most recent attempt to protect consumers, the best consumer protection is to know your rights and your responsibilities. You need to read the fine print, ask questions, and gather information before signing any financial agreement—whether it is related to opening a bank account, using a credit card, or investing in the stock market.

This article is slightly abridged from an article written by Mary Suiter and Jeannette Bennett of the Federal Bank of St. Louis for the fall 2010 edition of Inside the Vault, *the St. Louis Fed’s newsletter for teachers.*

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