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Comptroller Dugan Urges Federal Reserve to Consider Rule Allowing Consumers to Opt Out of Higher Credit Card Rates

WASHINGTON — Comptroller of the Currency John C. Dugan said today that consumers should be given the opportunity to “opt out” of certain credit card rate increases and be given the alternative of paying off the card balance at the old rate.

In a speech to the Financial Services Roundtable, Mr. Dugan noted that the Federal Reserve is now considering a change to its Truth-in-Lending rules that would generally prohibit rate increases unless the cardholder receives 45 days prior notice. The notice would allow the consumer to avoid the rate increase by paying off the card balance or moving it to another card.

However, Mr. Dugan said, that provision might not provide a meaningful choice for some consumers, especially those for whom the rate hike was triggered by something unrelated to the account, such as a lower credit bureau score. Some consumers might have balances that are too large to pay off, and others might not be able to find a card company willing to roll over the balance.

“The practical reality is that the consumer would get stuck paying the higher rate on the full amount of his or her outstanding balance, because there would be no realistic alternative,” the Comptroller said.

“He or she could very well complain that the rate increase was totally unexpected and would undoubtedly believe that the higher rate was being applied ‘unfairly’ and ‘retroactively’ to balances the consumer accrued when the lower rate was in effect,” Mr. Dugan added. “In circumstances like these, I think the disgruntled consumer has a point.”

The Comptroller suggested that when consumers are notified that their rates will surge to a penalty rate – which can be as high as 30 percent or more – they be allowed to opt out, subject to several exceptions.

First, the opt-out would not be available if the increase resulted from payment default on that card, as opposed to other circumstances, such as a missed payment on another obligation. Second, the opt-out would not apply to rates that increase only because of the passage of time, as is the case when low initial rates expire after some predetermined period of time. Finally, the card issuer would not be obliged to allow the consumer to make new charges on the card at the old rate.

“But the opt-out would allow the consumer to keep the balance outstanding on the card

at the old rate, with a requirement to pay off that balance or roll it over to another card within a reasonable period," Mr. Dugan said.

The Comptroller said that if most cardholders exercised the right to opt out, fewer products would be marketed that offer zero or low interest rates initially and depend upon steep increases in rates as the primary means of making the card profitable.

"But the cost of foregoing such a pricing strategy, even though clearly valued by some consumers, might well be outweighed by eliminating one source of bitter consumer complaints in the area of so-called 'gotcha' or 'retroactive' pricing," he added.

Mr. Dugan noted in his speech that the primary focus of regulation has been on providing consumers, through mandated disclosures, with meaningful notice of the costs and terms of the card, while leaving lenders generally free to set costs and terms.

"The underlying theory of this approach to regulation is a familiar one: if consumers are provided adequate information about products, they will choose the ones they want and like best, and banks will compete to innovate to structure these products, without government interference, to best meet that demand," he said.

Although this paradigm has worked phenomenally well by many measures, it has also led to a swelling of sharp complaints in recent years about such aggressive practices as eye-popping penalty interest rates, "universal default" provisions that trigger the higher rates, and ever-increasing fees, Mr. Dugan said.

"My take on all this is that there is plainly a state of disequilibrium when it comes to consumer protection for credit cards, and the system needs fixing," the Comptroller added. Mr. Dugan said the Fed's rulemaking is a good place to address his proposal for a consumer opt-out, and the OCC will submit a comment letter making that recommendation.

Related Links:

- Remarks Before The Financial Services Roundtable (<http://www.occ.gov/ftp/release/2007-104a.pdf>)
- Comptroller of the Currency John C. Dugan (<http://www.occ.gov/dugan.htm>)

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