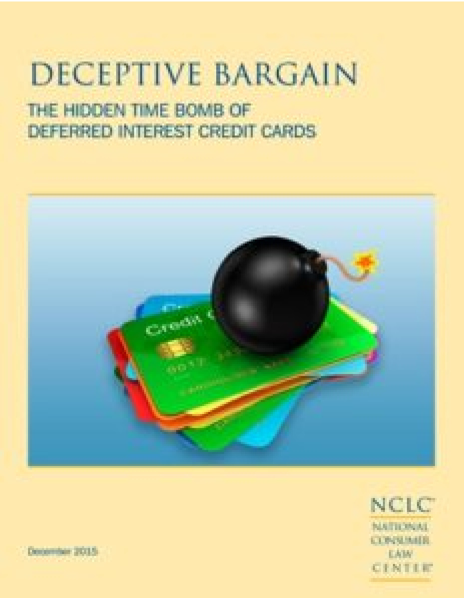
Deceptive Bargain: The Hidden Time Bomb of Deferred Interest Credit Cards

This National Consumer Law Center report reviews deferred interest credit card promotions, a deceptive practice that is growing. The practice should be banned due to its unfairness, especially as financially vulnerable consumers are most likely to fall prey to the trap.



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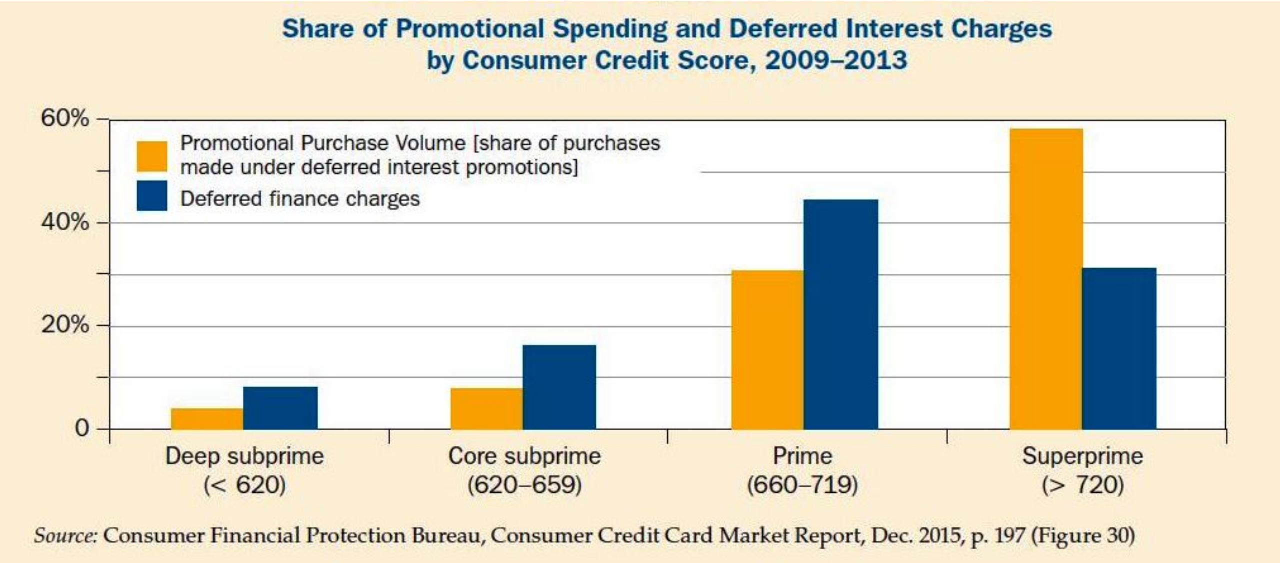
Executive Summary

"Deferred interest" promotions on credit cards are a trap for the unwary. They lure consumers with promises of "no interest" or "0% interest" for a promotional time period, but there is debt time bomb at the end: Consumers who don't pay off the entire balance before the promotional period ends will be charged interest retroactively back to the date that they bought the item, even on amounts that have been paid off. For example, if a consumer buys a $2,500 living room set on January 2, 2016 using a one-year 24% deferred interest plan, then pays off all but $100 by January 2, 2017, the lender will retro- actively charge nearly $400 interest on the entire $2,500 dating back one year.

The two leading providers of deferred interest credit cards are Synchrony Bank (formerly known as G.E. Capital) and Citibank. Both lenders offer deferred interest credit card plans through retailers, such as Walmart, Sears, J.C. Penny, Macy's, Best Buy, Home Depot, and Staples, where the cards are used to sell big-ticket items such as electronics or appliances. One third of large retailers surveyed by the website CardHub offer these plans. PayPal also offers deferred interest credit financing through PayPal Credit (formerly BillMeLater), which it promotes through online retailers that offer PayPal as a payment option. More troubling, both Synchrony and Citibank offer deferred interest credit cards through healthcare providers to pay for dental and medical bills, often for optional procedures. Synchrony's credit card, called CareCredit, has been the subject of enforcement by the Consumer Financial Protection Bureau (CFPB) and the New York Attorney General.

Pitfalls of deferred interest plans include:

- **Inherent deception** Many consumers do not understand that they can be charged interest retroactively for the entire deferred interest period if they do not pay off the balance by the end of the period. The complexity of these plans makes it almost impossible to formulate a short, simple disclosure necessary to prevent consumers from being deceived.
- **"Life Happens"** Even consumers who do understand the nature of deferred interest plans can get trapped. Consumers may expect to be able to pay the balance in full by the end of the promotional period, but for a variety of reasons (such as job loss or other financial emergency) find that they cannot. Or, consumers may forget or miscalculate the critical date for payoff, especially if the end of the promotional period does not coincide with the payment due date for that month.
- **High APRs** Deferred interest credit cards typically carry very high interest rates, with an average of 24% and as high as 29.99%. These rates can be almost twice as much as the APR for a mainstream, prime credit card. To illustrate the impact of deferred interest, we have provided a link to an online calculator provided by the Finance Buff that compares the costs of a deferred interest plan to a mainstream credit card when the entire balance is not paid off by the end of the promotional period.
- **Balloon interest charges and interest on interest** For consumers hit with deferred interest, those charges come in one big lump sum at the expiration of the promotional period. Interest charges that might have been manageable in small pieces can result in the outstanding balance on a card increasing dramatically. Consumers who cannot pay off that huge interest charge at once then start paying interest on the back interest.
- **Impact on the most vulnerable** A Consumer Financial Protection Bureau (CFPB) study found that for consumers with subprime credit scores – who are more likely to be financially vulnerable – over 40% were unable to pay off the balance by the end of the deferred interest period. These consumers were likely socked with lump sum retro- active interest charges. While most of the consumers who used deferred interest plans were able to pay off the balances without paying interest, the consumers who benefited the most were superprime consumers. Thus, better-off consumers get the benefit of interest-free financing, while credit card lenders make their profits off of financially constrained consumers.



- **Minimum payments don't pay off the balance** Lenders generally set the minimum payment as less than the amount that would pay off the balance during the deferred interest period. Thus, consumers who make only the minimum payment – often thinking they are doing what they need to do to avoid interest – will inevitably be hit with retroactively assessed interest at the end of the deferred interest period.
- **Difficulty allocating payments to successfully avoid retroactive interest** If a consumer makes additional purchases that either do not have deferred interest or have different promotional periods, problems can arise with allocating payments to ensure that the deferred interest balance is paid off. Payment allocation is extremely complex and fraught with pitfalls, and it can be nearly impossible to pay off a deferred interest balance while minimizing interest charges.

Deferred interest promotions are one of the biggest abuses that remain after the passage of the Credit Card, Accountability, Responsibility and Disclosures (CARD) Act of 2009. In fact, the Federal Reserve Board actually banned these plans in 2009 because of their deceptive nature, but then reversed itself. While the Credit CARD Act does not explicitly ban deferred interest, these promotions technically violate two provisions of the Credit CARD Act. However, the Federal Reserve carved out an exception, asserting that Congress intended to preserve these plans.

As one of the few tricks and traps left after the Credit CARD Act, the use of deferred interest promotions is growing. These promotions are inherently unfair, as their profits depend on trapping consumers either by confusion or because the consumer cannot pay due to financial problems, thus imposing a huge lump sum retroactive interest charge on those least able to handle it.

Recommendation

The simplest, most effective, and best step that the CFPB could take to protect consumers from the trap of deferred interest is to ban these promotions.