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S. HRG. 109–543

REGULATORY REQUIREMENTS AND INDUSTRY PRACTICES OF CREDIT CARD ISSUERS

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

ON

EXAMINING THE CURRENT LEGAL AND REGULATORY REQUIREMENTS AND INDUSTRY PRACTICES FOR CREDIT CARD ISSUERS WITH RESPECT TO CONSUMER DISCLOSURES AND MARKETING EFFORTS

MAY 17, 2005

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

Available at: http://www.access.gpo.gov/congress/senate/senate05sh.html

U.S. GOVERNMENT PRINTING OFFICE

29–643 PDF WASHINGTON : 2006

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
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EXAMINING THE CURRENT LEGAL AND REGULATORY REQUIREMENTS AND INDUSTRY PRACTICES FOR CREDIT CARD ISSUERS WITH RESPECT TO CONSUMER DISCLOSURES AND MARKETING EFFORTS

TUESDAY, MAY 17, 2005

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:04 a.m., in room SD–538, Dirksen Senate Office Building, Senator Richard C. Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing will come to order.

The purpose of our hearing this morning is to examine current practices in the credit card industry. As part of this examination, we will consider the nature of the existing legal framework, that is the body of laws and regulations, which govern credit card issuer and consumer interaction. But looking back to our numerous hearings on the Fair Credit Reporting Act, it is clear that our credit markets are very competitive and very dynamic. Innovations on many fronts have greatly affected the cost and availability of credit. Constant change, however, has meant less consumer familiarity with the newly available credit products and terms.

Consumer financial literacy plays a key role in allowing consumers to keep pace with market developments. We need to continue to encourage consumer education on this front and, to this end, I look forward to receiving the Department of the Treasury's report on the state of financial literacy in this country. I believe this topic will merit further Committee consideration when this report is released this summer. In light of the significant changes in the marketplace, today's hearing is intended to give the Committee an opportunity to determine how well the rules are working to provide consumers the information necessary to make responsible credit-related decisions, as well as to give us a chance to observe the direction in which market forces are headed.

In the end, closely considering these matters is very important due to the unprecedented size and scope of this industry. Today, about 6,000 financial institutions have issued over 640 million credit cards to around 145 million Americans. The impact on the economy is obviously considerable. We look forward to hearing from our witnesses on this important subject.

I want to announce that we are going to have to move forward. We are going to have, beginning at 11:30, a series of stacked votes and then final passage of the transportation bill. So, I am going to try to move the panels, other than my two colleagues.

I want to welcome my colleagues. Senator Dole, do you have an opening statement?

Senator DOLE. Yes, I do, Mr. Chairman.

Chairman SHELBY. Go ahead.

STATEMENT OF SENATOR ELIZABETH DOLE

Senator DOLE. Mr. Chairman, a special welcome to my two colleagues who are with us this morning: Senator Feinstein and Senator Akaka.

During the proceedings surrounding the recently enacted bankruptcy bill, a number of issues surfaced related to the laws and regulations governing the credit card industry. I am glad that we waited to address these issues separately, so that we can give them the attention they deserve.

Credit cards have become indispensable financial instruments in today's society, and for good reason. They allow people to buy now and pay later, consolidating payments into a single monthly transaction. They facilitate payments over the phone and by way of the Internet. Credit cards provide a measure of safety, reducing the need to carry large amounts of cash and limiting a person's losses if a wallet or purse is lost or stolen. They also help to establish credit histories for consumers who have never before had access to credit. This, in turn, makes more likely the granting of loans for major purchases, including homes. For all of these reasons, the growth in credit card use has transformed the American financial services landscape.

There are dangers, however, that accompany this progress. Some of those people who are now able to acquire credit cards are not prepared to handle the responsibility that goes along with them. While Americans must take responsibility for their own finances, it is absolutely imperative that all Americans are equipped with the best, most clear information possible when making their decisions. This requires that credit card companies provide this information with utmost transparency.

There are already many well-intentioned laws that require credit card companies to fully disclose their policies on rates, payments, and terms of use. The tangible result of these laws, however, is often multiple pages of single-spaced typing and small-font lettering, filled with sophisticated, legal terminology. A magnifying glass and an attorney should not be necessary to understand the credit card user agreement.

Some lending companies are now providing consumers with a one-page summary of their disclosure information in a format similar to the nutritional information boxes on products in your local grocery store. And, Mr. Chairman, that brings back a lot of memories because that was a project I had the privilege of working on in the late 1960's. This clear, concise presentation is easy to read and simple to understand. We should work on legislation that will require those practices that allow consumers to quickly comprehend the benefits and risks associated with credit card use.

We must also continue to require that credit card companies provide full disclosure regarding fees, interest rates, minimum payments, and privacy statements. It is imperative that this information be presented in the most consumer-friendly was possible. This will benefit not only the consumers, but also the credit card companies. Credit issuers will reduce losses due to defaults and decrease the amount of customer service needed to guide consumers through problems that could be avoided with more comprehensible applications and monthly statements.

I want to thank you, Chairman Shelby, for holding this hearing, and I certainly want to thank our witnesses for giving us their time today to share their knowledge of the industry, and especially my colleagues in the Senate. Thank you.

Chairman SHELBY. We have with us two of our colleagues: Daniel Akaka, U.S. Senator from Hawaii, and Dianne Feinstein, U.S. Senator from California. Your written statements will be made part of the record. You proceed as you wish. Who wants to go first?

Senator FEINSTEIN. However you would like.

Chairman SHELBY. I will call on Dianne. Go ahead, Senator.

STATEMENT OF DIANNE FEINSTEIN
A U.S. SENATOR FROM THE STATE OF CALIFORNIA

Senator FEINSTEIN. Thank you very much, Mr. Chairman. Let me thank you, first of all, for keeping your promise. You said you would hold this hearing when the bankruptcy bill was on the floor, and you have held it, and I appreciate that very much.

Chairman SHELBY. I think, Senator Feinstein, as I told you on the floor when you were pushing the amendment, this was an important issue to hold a hearing on.

Senator FEINSTEIN. Thank you very much. And I also want to thank Senator Dole for her statement because I think she is right on, and I think she said it about as well as it can be said.

I sit on the Judiciary Committee. I participated in the markup of the bankruptcy bill. And the more we proceeded with amendments, the more it became apparent, at least to me, that the bankruptcy bill really heavily favored credit card companies and did nothing really to make clearer the responsibility of the person that used the credit card. And in my personal life, I have seen people really not understand the impact of the minimum payment on debt. And I think this is really where we are today.

The average American household now has about $7,300 of credit card debt. The number of bankruptcies has doubled since 1990. Many of these personal bankruptcies—not all, perhaps not even a majority, but many are from people who utilized credit cards. These cards are enormously attractive. I received two solicitations this past week. Interestingly enough, they were for renewal of credit cards that I did not have in the first place. So they were a bit disingenuous.

Unfortunately, individuals making the minimum payment are witnessing the ugly side of the miracle of compound interest. After 2 or 3 years, many find that the interest on the debt is such that they can never repay these cards with the minimum payment, and they do not know what to do about it, and it builds and builds, and they go into bankruptcy.

One study determined that 35 million people pay only the minimum on their credit cards. In a recent poll, 40 percent of respondents said they pay the minimum or slightly more. So, I suspect that most people would be surprised to know how quickly interest multiplies by only paying the minimum.

Take that average household debt of $7,300. In April, before the most recent Federal Reserve Board increase of the prime rate, the average credit card interest rate was 16.75 percent. If only the minimum payment of 2 percent is made on that average debt, it would take the individual 44 years and $23,373 to pay off that debt. And that is if the family does not spend another cent on their credit card, which is an unlikely assumption. In other words, the family will need to pay over $16,000 in interest to repay just $7,300 of principal.

For individuals or families with more than average debt, the pitfalls are even greater. Twenty thousand dollars of credit card debt at the average 16.75 percent interest rate will take 58 years and $65,415.28 to pay off if only the minimum payments are made.

Now, what is my point here? My point is I tried to figure out from the solicitations I got this past week what would happen if I only paid the minimum payment over a period of time. I could not figure it out. There is so much small print that I could not discern one thing from the other. And I strongly believe that individuals should be told, if they only make the minimum payment on their credit card, what it means over a period of time. They must know that really sometimes you cannot repay the principal of the debt just paying the 2-percent interest payment.

Yesterday, I introduced, as a bill, the amendment I made on the floor. Senator Akaka made an amendment. I voted for Senator Akaka's amendment. It went down. I made an amendment. That amendment was withdrawn. As part of the agreement that led to today's hearing I think it is important that this Committee consider transparency and disclosure to individuals who hold credit card debt.

I have a college degree. If I cannot figure it out, you can be sure that a number of other people cannot either.

So yesterday I introduced the Credit Card Minimum Payment Notification Act. This bill speaks directly to consumers who are not aware of the consequences of making only the minimum payments on their credit cards. And there will always be people who cannot afford to pay more than their minimum payment. But there are also a large number of consumers who can afford to pay more but feel comfortable making the minimum payment because they do not realize the consequences of so doing.

The bottom line is for many the 2-percent minimum payment is a financial trap, and I believe there should be a requirement to notify the individual of what that minimum payment means. Here is what my bill would do:

First, it would require credit card companies to add two items to each consumer's monthly credit card statement: One, a notice warning credit card holders that making only the minimum payment each month will increase the interest they pay and the amount of time it takes them to repay their debt; and, two, examples of the amount of time and money required to repay a credit

card debt if only the minimum payment is made; or if the consumer makes only minimum payments for 6 consecutive months, the amount of time and money required to repay the individual's specific credit card debt under the terms of their credit card agreement.

Second, the bill also requires a toll-free number be included on statements, and if the consumer makes only minimum payments for 6 consecutive months, they would receive a toll-free number to an accredited counseling service.

The disclosure requirements in this bill would only apply if the consumer has a minimum payment that is less than 10 percent of the debt on the card or if their balance is greater than $500. Otherwise, none of these disclosures would be required on their statement, and the reason for this is to try to be prudent and provide the least obligation for the credit card company.

These disclosures allow consumers to know exactly what it means for them to carry a balance and make only minimum payments so they can make informed decisions on credit card use and repayment.

Let me just end with a couple of examples of people:

An Ohio resident who tried for 6 years to pay off a $1,900 balance on her Discover card, sending the credit company a total of $3,492 in monthly payments from 1997 to 2003, yet her balance grew to $5,564.

A Virginia resident who had a Providian Visa bill increased to $5,357, even though they used the card for only $218 in purchases and made monthly payments totaling $3,058.

And an individual from my State, California, who actually worked a second job to keep up with the $2,000 in monthly payments she collectively sent to five banks to try to repay $25,000 in credit card debt. Even though she had not used the cards to buy anything more, her debt had doubled to $49,574 by the time she filed for bankruptcy last June.

Now, these stories are not unique, but this is the problem with the bankruptcy bill. It is making it easier for credit card companies to send out solicitations, but it does nothing to provide the kind of information that a minimum payer really should know when they make that minimum payment. So, I hope the Committee will remedy that.

Thank you very much.

Chairman SHELBY. Thank you, Senator Feinstein.

Senator Akaka.

STATEMENT OF DANIEL K. AKAKA
A U.S. SENATOR FROM THE STATE OF HAWAII

Senator AKAKA. Thank you very much, Mr. Chairman, Senator Dole, and Members of the Committee. I want to thank you very much for having this hearing and including me today. I also want to express my deep appreciation not only to you but also to Senator Sarbanes for working closely with me on a wide range of financial literacy-related issues, including credit card disclosures.

Mr. Chairman, revolving debt mostly comprised of credit card debt, has risen from $54 billion in January 1980 to more than $800 billion in March 2005. During all of 1980, only 287,570 consumers

filed for bankruptcy. In 2004, approximately 1.5 million consumers filed for bankruptcy, keeping pace with the 2003 record level.

Some of this increased activity can be explained by a ballooning in consumer debt burdens, particularly revolving debt, primarily made up of credit card debt. Credit card users and issuers have a lot of flexibility in settling minimum monthly payments. Competitive pressures and a desire to preserve outstanding balances have led to a general easing of minimum payments requirements in recent years.

The result has been extended repayment programs. Even with a doubling of minimum monthly payments from 2 to 4 percent by some of the country's largest credit card issuers, much of that payment continues to cover only interest and fees.

Meanwhile, other initiatives by large credit card issuers, such as reducing grace periods, will catch many consumers with late fees, which will trigger higher default interest rate charges.

It is imperative that we make consumers more aware of the long-term effects of their financial decisions, particularly in managing credit cards at early ages, particularly since credit card companies have been successful with aggressive campaigns targeted at college students. Universities and alumni associations across the country have entered into marketing agreements with credit card companies. More than 1,000 universities and colleges have affinity marketing relationships with credit card issuers. Affinity relationships are made as attractive as possible to credit card accountholders through the offering of various benefits and discounts for using the credit card with the affinity group receiving a percentage of the total charge volume from the credit card issuer. Thus, college students, many already burdened with student loans, are accumulating credit card debt. I appreciate all the work that Senator Dodd has done in order to address this situation.

While it is relatively easy to obtain credit, especially on college campuses, not enough is being done to ensure that credit is properly managed. Currently, credit card statements fail to include vital information that would allow individuals to make fully informed financial decisions. Additional disclosure is needed to ensure that individuals completely understand the implications of their credit card use and costs of only making the minimum payments as determined by credit card companies.

I have a long history of seeking to improve financial literacy in this country, primarily through expanding educational opportunities for students and adults. Beyond education, I also believe that consumers need to be made more aware of the long-term effects of their financial decisions, particularly in managing their credit card debt so that they can avoid financial pitfalls.

The bankruptcy reform law includes a requirement that credit card issuers provide information to consumers about the consequences of only making minimum monthly payments. However, this requirement fails to provide the detailed information on billing statements that consumers need to know to make informed decisions.

The bankruptcy law will allow credit card issuers a choice between disclosure statements. The first option included in the bankruptcy bill would require a standard minimum payment warning.

The generic warning would state that it would take 88 months to pay off a balance of $1,000 for bank card holders or 24 months to pay off a balance of $300 for retail card holders. This first option also includes a requirement that a toll-free number be established that would provide an estimate of the time it would take to pay off the customer's balance. The Federal Reserve Board would be required to establish the table that would estimate the approximate number of months it would take to pay off a variety of account balances.

There is a second option that the legislation permits. The second option allows the credit card user to provide a general minimum payment warning and provide a toll-free number that consumers could call for the actual number of months to repay the outstanding balance.

The options available under the bankruptcy reform law are woefully inadequate. They do not require issuers to provide their customers with the total amount that they would pay in interest and principal if they chose to pay off their balance at the minimum rate. Since the average household with debt carries a balance of approximately $10,000 to $12,000 in revolving debt, a warning based on a balance of $1,000 will not be helpful.

The minimum payment warning included in the first option estimates the costs of paying a balance off at the minimum payment. If a family has a credit card debt of $10,000 and the interest rate is a modest 12.4 percent, it would take more than 10 and a half years to pay off the balance while making minimum monthly payments of 4 percent.

Along with Senators Sarbanes, Schumer, Durbin, and Leahy, I introduced the Credit Card Minimum Payment Warning Act and subsequently offered it as an amendment to the bankruptcy bill. The legislation would make it very clear what costs consumers will incur if they make only minimum payments on their credit cards. If the Credit Card Minimum Payment Warning Act is enacted, the personalized information consumers would receive for their accounts would help them make informed choices about their payments toward reducing outstanding debt.

Our bill requires the minimum payment warning notification on monthly payments stating that making the minimum payment will increase the amount of interest that will be paid and extend the amount of time it will take to repay the outstanding balance.

The legislation also requires companies to inform consumers of how many years and months it would take to repay their entire balance if they make only minimum payments. In addition, the total costs in interest and principal if the consumer pays only the minimum payment would have to be disclosed. These provisions will make individuals much more aware of the true costs of their credit card debts.

The amendment also requires that credit card companies provide useful information so that people can develop strategies to free themselves of credit card debt. Consumers would have to be provided with the amount they need to pay to eliminate their outstanding balance within 36 months.

Finally, our bill would require that creditors establish a toll-free number so that consumers can access trustworthy credit coun-

selors. In order to ensure that consumers are referred to only trustworthy credit counseling organizations, these agencies would have to be approved by the Federal Trade Commission and the Federal Reserve Board as having met comprehensive quality standards. These standards are necessary because certain credit counseling agencies have abused the nonprofit, tax-exempt status and taken advantage of people seeking assistance in making their debts.

Many people believe, sometimes mistakenly, that they can place blind trust in nonprofit organizations and that their fees will be lower than those of other credit counseling organizations. We must provide consumers with detailed personalized information to assist them in making better informed choices about their credit card use and repayment. Our bill makes clear the adverse consequences of uninformed choices, such as making only minimum payments, and provides opportunities to locate assistance to better manage credit card debt.

In response to critics who believe that the Credit Card Minimum Payment Warning Act disclosures are not feasible, I, along with Senator Sarbanes and others, have asked the General Accountability Office to study the feasibility of requiring credit card issuers to disclose more information to consumers about the costs associated with making only the minimum monthly payment. I look forward to reviewing the GAO's conclusions.

Mr. Chairman, I look forward to working with you, Senator Sarbanes, and all the Members of the Committee to improve credit card disclosures so that they provide relevant and useful information that hopefully will bring about positive behavior change among consumers. Consumers with lower debt levels will be better able to establish savings plans that allow them to be in a better position to afford a home, pay for their child's education, or retire comfortably on their own terms.

Thank you again for including me in this hearing, Mr. Chairman. I apologize, but due to previous commitments, I must be excused. Thank you very much, Mr. Chairman.

Chairman SHELBY. Senator Feinstein and Senator Akaka, I just want to commend you for introducing your legislation, for persevering, because I agree with you that we need transparency to have an informed consumer. We are all consumers. We all, I think, basically benefit from the credit card industry, but only if we know what we are buying, what we are signing up to, and a lot of people do not. So, I want to thank you for your testimony, both of you here today, and your legislation.

Senator FEINSTEIN. Thank you very much.

Chairman SHELBY. Senator Johnson, do you have any comments for the Senators?

STATEMENT OF SENATOR TIM JOHNSON

Senator JOHNSON. No, I do not. I apologize for arriving late. We have competing things going on, including an energy markup that I am going to have to leave for. But I appreciate the work that Senators Akaka and Feinstein have done on this issue. I have an opening statement that I would like to make part of the record.

Chairman SHELBY. Without objection, in its entirety.

Senator JOHNSON. Thank you, Mr. Chairman.

Chairman SHELBY. Senator Dole, do you have any comments?

Senator DOLE. No.

Chairman SHELBY. We thank our colleagues for appearing here.

Senator FEINSTEIN. Thanks very much.

Senator AKAKA. Thank you very much, Mr. Chairman.

Chairman SHELBY. Thank you so much.

For our second panel, we have Edward Gramlich, Member of the Board of Governors of the Federal Reserve Board, and Ms. Julie Williams, Acting Comptroller, Office of the Comptroller of the Currency, if you will make your way up to the podium.

We welcome both of you here today. As regulators, you are on the firing line in this business. Your written testimonies will be made part of the record. Governor Gramlich, you may proceed as you wish.

STATEMENT OF EDWARD M. GRAMLICH, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. GRAMLICH. Thank you very much, Senator. I appreciate this opportunity to appear before the Committee to discuss consumer credit card accounts. The Board of Governors of the Federal Reserve System administers the Truth in Lending Act, which I will call TILA, the primary law governing disclosures for consumer credit including credit card accounts. This is all implemented by the Board's Regulation Z.

The last substantive revision to TILA's credit card provisions was in 1988, and since then, products and pricing have become much more complex. Competition has intensified over the years as advances in technology and the deregulation of rates and fees have combined to create new business models. As a result, consumers receive many offers for credit card accounts, some having terms that are low-priced at the outset but can become significantly higher-priced, for example, if penalty terms are triggered.

We, at the Board, recognize the challenges of implementing consumer protections that are effective and meaningful to the millions of consumers who use credit cards. In December 2004, the Board began a review of Regulation Z starting with an Advance Notice of Proposed Rulemaking on the rules for open-end or revolving credit such as general purpose credit cards. The goal of the Board's regulatory review is to improve the effectiveness and usefulness of TILA's disclosures and substantive protections given changes in the marketplace.

You have already noted that our written statement is submitted to the record, and that statement contains a much more detailed discussion of these issues than I am able to give this morning. My written testimony discusses in much more detail the Board's examination and enforcement process for institutions under its supervision and the importance of consumer education, which you referred to earlier, as a complement to consumer protection laws.

In the interest of time on the enforcement issue I will simply say that we have closely examined the credit card portfolios of the institutions we supervise for both safety and soundness and consumer compliance. Only 2 of the more than 900 institutions we supervise have substantial credit card portfolios, and have taken appropriate supervisory measures we believe to be warranted.

On the disclosure issue, the first question involves timing and format. For credit card accounts, disclosures of key terms must be provided with applications or solicitations using a highly structured table popularly known as the Schumer box. For open-end accounts of any kind, more detailed disclosures must also be provided before an account is opened and periodically at the end of each billing cycle. Disclosures are generally required when account terms change, although no disclosure is required when the triggering events for the change were previously spelled out in the account agreement. Other than the table provided with credit card applications, TILA's current disclosures have few format requirements such as type, size, or location.

Disclosures provided with credit card applications and at account opening describe how charges associated with the plan will be determined. Account-opening disclosures also explain consumers' rights and responsibilities in the case of unauthorized transactions or billing disputes. Disclosures on periodic statements reflect the activity of the account for the statement period. Transactions that occurred and any interest or fees imposed during the cycle must be identified on the statement, along with any time period a consumer may have to pay an outstanding balance and avoid additional charges.

TILA and Regulation Z's primary cost disclosures are the finance charge and the annual percentage rate called the APR. The finance charge is the cost of credit in dollars. It is broadly defined as any charge payable by the consumer or imposed by the creditor as a condition of, or incident to, an extension of credit and includes interest and certain other fees. Some fees that are not considered a condition of getting credit, late fees, for example, must also be disclosed as other charges. The APR disclosed in advertisements, with credit card account applications, and at account opening is the annualized periodic rate that would be applied to outstanding balances. There are two APRs disclosed on periodic statements. In addition to the periodic rate APR, creditors must also disclose an effective APR for the billing cycle, which must reflect certain finance charges imposed in addition to interest.

TILA also provides for creditor investigations of billing errors on all open-end credit plans. TILA also protects consumers against unauthorized use of a credit card and allows cardholders to assert against credit card issuers claims the cardholder may have against a merchant in a disputed transaction. TILA also prohibits card issuers from issuing unsolicited credit cards. Finally, TILA requires creditors to credit payments promptly and to refund credit balances after 6 months.

The Board's Advance Notice of Proposed Rulemaking asks a number of questions about the adequacy of Regulation Z's open-end rules and how the effectiveness of the disclosures might be improved, given changes that have occurred in the marketplace. Credit card accounts have become increasingly complex. In addressing concerns about information overload, the Board must ensure that the account disclosures are both fair and accurate without becoming so complex that they become less meaningful. Moreover, credit card agreements often provide that their terms are subject to change, including an increase in the APR, and this can create dif-

ficulties for some consumers who use the account for long-term financing. Accordingly, the Board will also consider ways to make the short-term nature of the account agreement more transparent in the disclosures.

We also believe that consumer testing should be used to test the effectiveness of any proposed revisions and anticipate publishing proposed revisions to Regulation Z in 2006.

Thank you very much.

Chairman SHELBY. Ms. Williams.

STATEMENT OF JULIE L. WILLIAMS
ACTING COMPTROLLER OF THE CURRENCY

Ms. WILLIAMS. Thank you. Chairman Shelby, Senator Dodd, and Senator Johnson, I appreciate the opportunity to appear before you today to discuss the Office of the Comptroller of the Currency's perspectives concerning the marketing and disclosure practices of the U.S. credit card industry. Given the importance of credit cards to consumers and the U.S. economy, this is a most timely hearing.

The OCC's supervision of the credit card operations of national banks includes safety and soundness fundamentals, compliance with consumer protection laws and regulations, and fair treatment of consumers. My written statement describes our activities in those respects in detail.

This morning, I would like to summarize four key points from that written testimony.

First, it is widely recognized that today's credit card industry is highly competitive and innovative. Credit card issuers have responded to increasing market competition with innovations in card products, marketing strategies, and account management practices. The primary goals of these product and marketing innovations have been to gain new customer relationships and related revenue growth, but in some instances an important secondary benefit has been expanded access to credit by consumers with traditionally limited choices.

Unfortunately, not all of the product and marketing innovations have had a uniformly beneficial impact, and the account management and marketing practices of credit card issuers have come in for criticism in recent years from both consumer protection and safety and soundness standpoints.

In recent years, the OCC has issued supervisory guidance alerting national banks to our concerns about credit card account management and loss allowance practices, secured credit cards, and credit card marketing practices. And, utilizing our general enforcement authority in combination with the prohibition on unfair and deceptive practices contained in the Federal Trade Commission Act, we have taken formal enforcement actions against several banks—actions that have required those banks to end unfair and abusive practices and make restitution to consumers totaling hundreds of millions of dollars.

However—and this is the second point I wish to emphasize—it is important to appreciate that the OCC does not have statutory authority to issue regulations defining particular credit card practices or disclosures by banks as unfair and deceptive under the Federal Trade Commission Act. Nor do we have the authority to

issue regulations setting standards for disclosures credit card issuers must make under the Truth in Lending Act. In both respects, that authority is vested exclusively in the Federal Reserve Board.

And, that brings me to my third point. The OCC took the unusual step last month of submitting a comment letter responding to the Board's Advance Notice of Proposed Rulemaking on Regulation Z's open-end credit rules implementing the Truth in Lending Act. My written statement describes the most important issues raised in our comment letter: The importance of consumer research and testing, the pitfalls of extensive prescriptive disclosure rules, and the importance of disclosure standards keeping apace of industry developments. We also made clear that if there are ways in which the OCC can support the Board's efforts in this area, we look forward to doing so.

Finally, my statement stresses that disclosure is at the heart of our system of consumer protection today. Lately, however, there has been much criticism of the state of credit card disclosures and marketing practices, and clearly there is room for improvement.

My statement highlights several areas where disclosure issues currently exist, and discusses the need to begin a serious reexamination of how we go about developing, designing, implementing, overseeing, and evaluating consumer disclosures for financial products and services. I urge that we take a new approach, premised on obtaining input through consumer testing, to learn what information consumers most want to know and how to most effectively convey it to them. Quick fixes without consumer input and issue-by-issue disclosure "patches" to information gaps ultimately are not in the best long-term interest of consumers.

The direction set by Congress and the experience of the Food and Drug Administration using input from consumers to develop the now well-recognized "Nutrition Facts" disclosure for food provides us with some valuable lessons on how to provide disclosures that are both understandable and useful to consumers. Why can't we apply these positive lessons to the design of disclosures for financial products? Why should consumers today get more effective disclosure when they buy a bag of potato chips than when they make substantial financial commitments for financial products and services?

In conclusion, Mr. Chairman, the OCC has addressed many of the recent changes in credit card practices through our examination and supervisory processes, enforcement actions where necessary, and supervisory guidance. But consumers also depend on high-quality, user-friendly disclosures to help guide them through the increasing complexities of the credit card marketplace. The Federal Reserve's review of Regulation Z disclosures holds promise in this regard, but I respectfully urge that we need to rethink our approach to disclosures generally, along the lines I have described. The benefits for consumers, for marketplace participants, and for our economy will be well worth it.

Let me again commend the Committee for its interest in these very important issues, and I look forward to your questions.

Chairman SHELBY. Governor, the Federal Reserve has been involved in this issue for a long time. What is going to change, in

other words, if it is not driven statutorily here by the Congress. What is required as far as from your viewpoint as to disclosure? It is obvious to me that as a consumer, one, there is not enough financial literacy in the country, we know that, that is a given; and second, to be an informed consumer. As Senator Feinstein said, my gosh, if you have to run through page after page with a microscope and interpret something, the average person will never do this, and it seems to me that it would be in the best interest of the banking industry to have informed consumers, in other words, to have good customers.

Mr. GRAMLICH. Senator, I think everybody agrees with the basic goals of having disclosure statements that are both informative and understandable, and they cover all the contingencies.

Chairman SHELBY. Understandable.

Mr. GRAMLICH. Understandable is key. The Fed has never been against that, by the way.

As Comptroller Williams said, one thing that we are thinking about, and we are planning to do, is to use consumer focus groups. That is a worthwhile innovation and we intend to pursue it.

Some of the disclosure statements that one gets—and they are packed with very small print and very complicated language—are the lenders' response to the statute. On every one of these statutes we give model disclosure forms, which are viewed as safe harbor, that is, you could use this and this would be adequate. But very often the lenders actually go beyond these safe harbor forms and give statements that cover various other legal contingencies. So that is an issue.

We will continue to give model forms.

Chairman SHELBY. Do you pretest these forms?

Mr. GRAMLICH. We will do this with the focus groups. We will be doing that this time.

Chairman SHELBY. The focus groups will not be just PhD's in economics, will it?

Mr. GRAMLICH. No.

Chairman SHELBY. I mean it will be people that——

Mr. GRAMLICH. People who borrow a lot.

Chairman SHELBY. Average Americans.

Mr. GRAMLICH. Average Americans, yes.

Chairman SHELBY. Okay.

Mr. GRAMLICH. All I can say is that we will try to make these relevant to the issues facing people and as meaningful and as informative as possible. But they do have to cover the various contingencies, and with credit cards, the instrument is so flexible that some people could make the minimum payment, some people could go above that, it is very hard to come up with examples that cover all the circumstances.

Chairman SHELBY. Ms. Williams alluded to the powers of the Federal Reserve.

Mr. GRAMLICH. The powers, yes, our massive powers.

Chairman SHELBY. Do you have enough statutory power to do what needs to be done as to create an informed consumer or do you need additional legislation?

Mr. GRAMLICH. Do what needs to be done to create an informed consumer? I do not know that anybody has enough statutory power

to do that. The financial education issue is massive. It is not only that people do not understand complicated credit terms, but it is also partly that the credit card companies, the lenders, are always a step ahead. They can create new instruments and so forth, and it takes the literacy sector, a while to catch up.

We have enough powers I think. I am not aware of any powers that we do not have. If I become aware, we will certainly let you know.

But we have to be I think a little humble about what we can do with financial literacy. It is just a massive job with this highly innovated financial sector we have. Even if our focus group were PhD's in economics, it would be hard for them to keep up with everything.

Chairman SHELBY. How would it be hard for the average consumer if it is shown on the credit card statement that you, in a block, if you pay the minimum payment you are just treading water or you are getting deeper in the water?

Mr. GRAMLICH. In the new bankruptcy bill there are two or three provisions for those that will be incorporated in our review of Regulation Z. Whether we have the additional disclosures that the two Senators previously recommended, one could question all of that. But the bankruptcy bill already has a minimum payment provision, and so that will be part of our regulation from now on.

Chairman SHELBY. Governor, do you believe that it is important for the consumer to know the terms of any agreement and what is going to happen to them if they do not pay up?

Mr. GRAMLICH. Absolutely.

Chairman SHELBY. The cost and everything that goes with it.

Mr. GRAMLICH. Absolutely.

Chairman SHELBY. And it should be up front?

Mr. GRAMLICH. Yes.

Chairman SHELBY. It should not be hidden, should not be in something you cannot find unless you are a real lawyer or something. Ms. Williams, you have a comment?

Ms. WILLIAMS. Let me just note that in an area that, Mr. Chairman, I know is of great interest to you, and that is privacy, that the agencies are now engaged in a process using focus groups, consumer interviews, and testing in developing what we hope will be a much-improved streamlined privacy notice. Based on just some of the preliminary ideas that I have seen, I can tell you it does not look anything like the stuff that consumers have been getting and throwing in their trash, unfortunately, for the last couple of years. It can be done, but it takes some time, patience, and working with people who are experts in consumer communications.

Chairman SHELBY. Is this an important area for the Federal Reserve, Governor?

Mr. GRAMLICH. Yes, absolutely.

Chairman SHELBY. Senator Dodd.

STATEMENT OF SENATOR CHRISTOPHER J. DODD

Senator DODD. Thank you, Mr. Chairman, and my apologies for being a few minutes late at the opening of the hearing this morning, but I want to thank you immensely for holding this hearing. I am aware my colleague from Maryland is doing pretty well this

morning, at least that is the good word, so I am sorry he is not here with us this morning. But thank you for doing this and to focus on this issue.

I do not know of another issue that we deal with in this Committee that affects as directly as many Americans as this issue does. I mean homeownership affects obviously millions, and certainly financial services, to a large degree, do generally speaking. But on credit cards specifically, this issue probably touches more people in our country than any other single issue, so I am very grateful to the Chairman for giving us some time this morning to talk about this, and inviting a very good group of witnesses to appear before us to share their thoughts about this issue.

I am going to take a couple of minutes, Mr. Chairman, just to share some opening comments, and get to some questions here.

Credit cards, as we all know, are one of the most successful and pervasive financial service products ever created and have undoubtedly improved access to credit, added significant measure of convenience to consumers. That needs to be stated at the outset. Those of us who have been critical about this are not suggesting that we should be eliminating the availability of the credit card industry at all. But to put it in perspective, just to give everyone an idea of how pervasive the credit card industry is and the staggering role that credit cards have in our country.

According to the Federal Reserve—and you may have shared some of these numbers before I arrived—there are 556.3 million Visa and Master Credit cards in circulation in 2003. Those credit cards, coupled with Discover and American Express products indicated today that at least 700 million resolving credit cards are currently in circulation. Approximately 145 million Americans have at least one credit card. The average credit card holder in the United States today has 4.8 credit cards. The total amount of credit card debt is over $800 billion. The total amount of credit extended to cardholders is over $4 trillion.

With this kind of market presence it is not surprising that the credit card management reported in May 2004 was the most profitable year ever for credit cards. With this tremendous success I believe comes significant responsibility, and I believe that the credit card industry is failing that test. Credit card issuers have now become the victims of their own success and are turning credit cards into nothing less than wallet-sized predatory loans. In a time when access to credit is the easiest and cheapest, credit card companies are making more money than ever. Credit card issuers are charging usurious rates and fees and engaging, in my view, in a very serious amount of abusive and deceptive practices, which I believe will have drastic long-term consequences on our country.

Credit card companies are charging consumers higher fees than ever before. In 1980, credit card fees alone raised $2.6 billion. In 2004, credit card fees raised over $24.4 billion. We have been told that the reason the credit card rates and fees are so high is that more and more consumers are failing to pay their debts, and as a result, issuers much charge higher rates and greater fees.

In fact, the opposite is true in our country. Consumer bankruptcies went down last year by nearly 3 percent, and default rates actually decreased last year. The truth of the matter is that this

is the best time in history to be in the credit card business. Last year, over 5 billion solicitations were sent to American homes, which is nearly twice as many as 8 years ago. Coupled with television and radio ads, intermittent signs, it is nearly impossible to turn on your television set or computer or simply walk down the street without being offered a credit card.

Despite the assertions that the credit card industry is struggling because of bad consumer behavior, credit card companies have more money than they know what to do with, and they are pumping out solicitations in search of new people to get in debt.

While normally competition lowers cost for consumers, the exact opposite is happening here. Credit card companies are finding more and more ways to effectively increase their income from rates and fees. Abusive practices such as misleading teaser rates which employ bait-and-switch tactics, hidden fees, penalties, and universal default provisions buried in the fine print are standard operating procedures in the credit card industry.

While my statement this morning will not touch on the entirety of my concerns for the credit card industry, I would like to highlight, Mr. Chairman, a couple of major abuses currently employed by the industry at large.

One of these abuses is called the universal default, which more accurately should be described as a predatory retroactive interest rate hike. This practice forces a credit card consumer in good standing, by the way, who is paying his or her credit card bills on time to have his or her interest rates retroactively jacked up to 25 to 30 percent because of some unknown irrelevant change in his or her spending patterns. The idea that a credit card company can charge an initial interest rate that would have been in the past outlawed as usurious and then double or triple that rate for any reason it so chooses, in my view is just plain wrong.

The industry refers to this practice as "risk-based pricing." They believe that when a consumer's credit score goes down they become riskier, and higher interest rates are levied on them. What is interesting to me is that I can find no evidence, either anecdotal or empirical, of when a consumer's credit improves, that a credit card company lowers the interest rate for that consumer. We should stop this practice completely in my view, or at least at a minimum make an increase rates prospective, not retroactive.

Another troubling development in the battle to signh up new consumers has been the aggressive way in which they have targeted people under the age of 21, particularly college students. Solicitations to this age group have become more intense for a variety of reasons. First, it is one of the few market segments which there are always new customers to go after every year. Twenty five to 30 percent of undergraduates are fresh faces entering their first year of college. Second, it is also an age group in which brand loyalty can be readily established. In fact, most people hold on to their first credit card for up to 15 years, which is probably the amount of time it takes them to dig out of the mountain of credit card debt they will incur in their teen years.

A staffer of mine recently opened his 7-year-old's mail, amazed to find a brand new American Express card. The new card came

as a result of, according to the offer, the elementary schooler's, "excellent credit history."

[Laughter.]

A brand new potential victim of the credit card industry. He is 7-years-old. What is next? Are we going to set up credit card kiosks in hospital maternity wards?

Credit card issuers target vulnerable young people in our society and extend them large amounts of credit with little if any consideration of whether or not there is a reasonable expectation of repayment. As a result, more and more young people are falling into a financial hole from which they are unable to escape. One of the fastest-growing segments of our population forced to declare bankruptcy is in this age group.

Mr. Chairman, I think we have an obligation to protect and educate our Nation's youth. This generation of American leaders, this younger generation deserves no less than the reining in of irresponsible practices of the credit card industry as many witnesses will mention.

I have introduced legislation designed to force credit card issuers to stop their more deceptive and abusive practices and alter the targeting of our most vulnerable customers. This legislation, the Credit Card Act, should be the first step I hope in restoring some common decency in the credit card industry.

I obviously look forward to the testimony we are going to hear this morning.

Let me just say, Mr. Chairman, the industry needs to wake up to this stuff. I mean they are a very important part of our financial services sector, but if you do not do this—it may not happen in this Congress, but it will happen. These pendulums swing. I have been around long enough to watch them. And if you pretend it is not going to happen, you are deluding yourself. These kinds of practices are just flat-out wrong, and they are unfair to people in this country.

We were not able to get them included as part of the bankruptcy bill. The bankruptcy bill talks about responsibility, and it has an important element, making sure that consumers are responsible. But responsibility goes both ways. You have to be responsible too, and you are not being responsible today when you engage in the practices that are costing so much money to so many people in this country who can least afford it.

My hope is that as a result of these hearings, Mr. Chairman, we might get some strong legislation to rein this in, or you are going to do great damage to an important instrument that many people need to use.

Let me ask our witnesses a couple of things. I was interested in your quote here, Dr. Gramlich, and you talked about that you have enough powers here, that you have the authority you claim you need. Yet, I have tried to find, when I worked on my legislation, to get data here, and I was amazed at how little data was available in terms of how many companies are, in fact, engaging in some of these practices? How many students are, in fact, being solicited? And I am not getting the information. It seems to me that the responsible Federal agencies, if you have the authority and you have

the power, why are we not getting better information from what is actually going on in the industry than seems to be available today?

Mr. GRAMLICH. Senator, I have to look into the data question. I mean we, like you, are aware that some of these practices are going on, but I cannot tell you now how prevalent it is, how many companies have these——

Senator DODD. Should we not know that? You know, just given the amount of involvement here, 700 million credit cards out there, 145 million Americans with them. We know what is going on in these rates, what is happening to some of these figures. Twenty five and 30 percent is not a rarity. It happens with great regularity. Why do we not know more?

Mr. GRAMLICH. The Board has purchased credit card information included in credit bureau data, and we are now processing the numbers, but I cannot go beyond that. But we can get you some information on exactly what we can get with our data and what we cannot get.

Senator DODD. It is not a lack of authority then, the Chairman's question to you, do you need additional legislative authority? You are telling us this morning that you have all the authority you need to get this data that we are talking about?

Mr. GRAMLICH. We have purchased credit bureau data. Whether we need more authority to get more data is something I cannot answer right now.

Senator DODD. Where does the credit card data come from?

Mr. GRAMLICH. It is from a credit bureaus. Let me check with our lawyers, and I will get you the information on it.

Senator DODD. I would also like to know whether or not the Fed has the authority on its own to collect this data.

Mr. GRAMLICH. Right.

Senator DODD. You collect data on a lot of areas in our economy.

Mr. GRAMLICH. Right.

Senator DODD. You agree with me, this is not a small issue, is it?

Mr. GRAMLICH. It is not a small issue.

Senator DODD. In fact, if my numbers are correct, are they correct about the number of credit cards out there?

Mr. GRAMLICH. They seem correct, yes.

Senator DODD. And the amount of debt, $800 billion by consumers?

Mr. GRAMLICH. Right.

Senator DODD. How much consumer debt is there out there overall today, about $2.1 trillion? Am I right on that number roughly, $2.1 trillion? So we are getting precariously close to half of all consumer debt is in this one area. I would like to know if you have any questions about whether or not you have the authority to gather this area of data. I would like to know about it immediately. I am sure the Chairman would as well, to determine whether or not we need to do anything.

Let me ask you as well, Ms. Williams, what about the OCC?

Ms. WILLIAMS. What we have is information that we could get on a bank-by-bank basis, Senator. The number of cards outstanding, the breakdown of the types of card programs that the banks have, and the number of accounts in particular programs are data that

we would probably be able to obtain, but we would have to go bank-by-bank to ask it.

Senator DODD. But that has not been done yet? We do not know, for instance, on these questions I raised here this morning?

Ms. WILLIAMS. With respect to the specific areas, Senator, that you asked about, we have not done that across the total spectrum of all of the credit card banks that we supervise.

Senator DODD. Do you agree with me it should be done?

Ms. WILLIAMS. I think that is useful information, sir.

Senator DODD. Thank you, Mr. Chairman.

Chairman SHELBY. Senator Carper.

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. Thanks, Mr. Chairman. To our witnesses, thank you for joining us today.

I do not have any statement that I would like to give, but just have a couple of questions that I would like to ask.

Last week, Ms. Williams, you were good enough to meet with me for a little while, and we talked about the matter of minimum payments on credit card balances that are due. I had expressed some interest in the last Congress, and seeing if we should amend bankruptcy legislation to change the minimum payments that are being required in the statements that were sent out to those of us who have credit cards. I was told at the time that there was work under way by the regulator, at least the regulator for national banks, to change through regulation, not through legislation, the minimum payments that are required of people who are paying their credit card bills every month.

First of all, let me just ask you to explain to us if you will why we did not need the legislation and what is taking place regulatorily? Who is covered, who is not?

Ms. WILLIAMS. Without answering the question about whether the legislation was needed or not, over 2 years ago, on an interagency basis, the banking agencies adopted account management guidance. The guidance was focused on a number of practices that we had noticed developing with credit card issuers, including the way that credit lines were being managed and situations where lines were being extended. There were issues about how certain fees were being accounted for. There were issues about negative amortization. And, there were issues about the minimum payments being required in connection with credit cards.

The concern that we had—and it is both a safety and soundness and a consumer protection concern—is that there should be a minimum payment that is sufficient to pay the interest, pay any fees and charges, and demonstrate some ability on the part of the customer to begin to pay down the principal.

So what we have been doing for the national banks that we supervise is, as part of our supervisory process, making sure that they get into compliance with this account management guidance. Some credit card issuers have particular customer segments that may have higher rates, where they cannot do it right away. It would be too precipitous, and so they are on plans right now which go through the end of this year. Some may go into January of next year because of systems conversion issues, things like that, to get

in full compliance with the account management guidance. What that will do is require, across the national banking segment of the credit card industry, that on the monthly cycle the consumer pays the interest, pays any fees and charges, and pays a minimal amount. We are looking for—and this is a rule of thumb—at least 1 percent of the principal to be reduced so that you do not see negative amortization, and you do see at least the beginning of some reduction in principal.

Senator CARPER. So if I owed $5,000 on my credit card. I had interest payment on that, I had fines on that, I would be expected to pay an amount of money in my minimum monthly payment that is consistent with the interest rate that is owed, any fees that are owed, and 1 percent of $5,000——

Ms. WILLIAMS. At a minimum.

Senator CARPER. —which I believe is what, $50?

Ms. WILLIAMS. The examples that we looked at, following up on our conversation, were if you had a $5,000 balance at 17 percent APR——

Senator CARPER. Let me say to my colleagues that what I had asked Ms. Williams be prepared to do was to say if a person did owe $5,000 and they were making a minimum payment of 1 percent of the principal on a monthly basis, 2 percent and I think 4 percent. I think I asked for those three.

Ms. WILLIAMS. I did 1 percent and 4 percent.

Senator CARPER. That is fine.

What we are looking for is how long does it take to pay it off.

Ms. WILLIAMS. If you are just doing the 1 percent, with $5,000 at 17 percent, it is going to take you about 22 years.

Senator CARPER. Say that one more time.

Ms. WILLIAMS. If you have a balance of $5,000 at 17 percent interest, assuming no late charges or over-limit fees and 1 percent reduction in principal, it will take you about 22 years to pay that off. If it is a 4 percent reduction in principal, it will take you a little over 10 years to pay it off.

Senator DODD. And how much more would you be paying on that $5,000?

Ms. WILLIAMS. I think I have that.

Senator DODD. Roughly.

Ms. WILLIAMS. You mean the total amount?

Senator DODD. At 1 percent, 22 years, 17 percent, no fees, let us just assume straight.

Ms. WILLIAMS. The total amount of interest paid then would be about $6,500.

Chairman SHELBY. On an initial debt of what?

Ms. WILLIAMS. That is the $5,000.

Chairman SHELBY. But what would the initial debt be?

Ms. WILLIAMS. It would be $5,000.

Chairman SHELBY. And you would pay how much interest?

Ms. WILLIAMS. Interest over that 22-year period that it takes to pay it down would be $6,524.

Senator CARPER. Could I ask you to just double-check that for the record?

Ms. WILLIAMS. Certainly.

Senator CARPER. Frankly, that seems a bit low, and it may be right, but if you could just double-check for the record and let us know.

Ms. WILLIAMS. Certainly.

Senator CARPER. Thinking out loud, that is a long time at the 1 percent rate to repay the loan. What I understand is that initially your inclination is to say maybe by the beginning of next year the minimum payment should be at least the 1 percent?

Ms. WILLIAMS. That is what we have looked at as a rule of thumb. There is not technically a regulation here, but that is the minimal amount that we would look for to begin to amortize the principal. A key issue here is that there are certain segments of certain credit card issuers' portfolios where it will be a challenge to make that adjustment, to pay the interest, any late fees or other charges, and to reduce the principal by just as little as 1 percent. That is why the phase-in is very important.

Senator CARPER. Talk about the phase-in. Phase in to, what is the next step?

Are we phasing in to 1 percent?

Ms. WILLIAMS. Phasing in to 1 percent, yes.

Senator CARPER. Pretty slow phase.

Ms. WILLIAMS. I think the participants in the next panel can speak to what they are doing to get a more rapid rate of amortizing the principal. Most of the credit card issuers that I am familiar with, when they are looking at their new accounts, are in compliance with the account management guidance. It is just that there are some existing accounts that have transition issues.

Mr. GRAMLICH. Senator, if I could say, first off we have done similar examination of our banks, and we only have two credit card banks now, but they are both in compliance with the standard that you just heard about.

The new bankruptcy bill will have how long it takes to repay the loan under specified conditions like this, so that information will be going out to consumers, and we are right now engaged in writing technical regulations on how that can best be done.

Senator CARPER. Is that going to be part of their statements?

Mr. GRAMLICH. That will be part of them, yes.

Senator CARPER. Is it going to be written in a way that ordinary people can read it and understand it?

Mr. GRAMLICH. We hope so.

Senator CARPER. That is real important.

Mr. GRAMLICH. Yes. The number is the number. If it takes 22 years, that will be right there.

Senator CARPER. Mr. Chairman, has my time expired? I think it has. Thanks you.

Chairman SHELBY. Thank you, Senator.

Senator Reed.

STATEMENT OF SENATOR JACK REED

Senator REED. Mr. Chairman, Senator Sarbanes has arrived. I would be happy to defer to him.

Senator SARBANES. Go ahead. You have been waiting.

Senator REED. Thank you. Thank you very much, Ms. Williams and Dr. Gramlich.

Ms. Williams, given the OCC's experience in supervising banks' lending risks in terms of safety and soundness, can you explain how banks determine the credit-worthiness of an 18-year-old college student, which is apparently one of their key targets?

Ms. WILLIAMS. Credit card issuers use a variety of models to try to assess the risk of certain populations that they will offer cards to. And, they can look at their experience with individuals that attend particular types of schools and individual schools as to what the credit performance has been. On that basis—and I urge you to ask the next panel for some more detail here—typically, when they offer a card to an entry level college student, for example, it is for a very relatively small amount, say, $500. They will hold that line and watch the performance of that particular card and will not increase the credit line unless and until there is demonstration of the ability of that particular cardholder to handle it.

Senator REED. How many issuers do that, Ms. Williams, I mean the banks that you supervise?

Ms. WILLIAMS. Offer credit cards to college students?

Senator REED. Not just offer credit cards to students, but actually do what you suggest is done in terms of a risk profile and relating it to the various schools which will probably relate it in some direction to income of families, and is there any responsibility for them to do that?

Ms. WILLIAMS. Starting with your last question first, I think there absolutely is a responsibility to determine, based on some risk evaluation, where they are offering the cards. I cannot speak to every single national bank credit card issuer. The large national bank credit card issuers that I do know offer college card programs do risk modeling, risk evaluation, and credit line control along the lines of what I described.

Senator REED. And as part of your supervisory responsibilities you review their procedures and policies?

Ms. WILLIAMS. Yes, we do.

Senator REED. And you essentially agreed with them that this is prudent.

Ms. WILLIAMS. We review whether they have appropriate risk evaluation techniques in place, yes, Senator.

Senator REED. Thank you. With the new bankruptcy law it is obviously much harder to discharge debt, but there is an area now of people who have already filed for bankruptcy who might be subject to solicitation by banks for credit cards, and these individuals in some respects, since they have been through the process, have less debt, but they cannot discharge the debt for another 8 years. Is this post-bankruptcy marketing process a potential risk for the banks because of the type of individuals that they would be targeting?

Ms. WILLIAMS. Two points on that, Senator. Again, I cannot speak to every single national bank that issues credit cards, but the major national bank credit card issuers are not involved in targeting those that are recently emerging from bankruptcy.

What they need to be doing is evaluating the risk profile of that customer segment and making a decision about whether it is a sound risk judgment to offer to that customer segment. If the experience they have indicates that segment, with appropriate controls

on the credit lines, is such that the risk is of a quantity that is appropriate for them to take on, then that would be a situation where they might do so.

Senator REED. Ms. Williams, I have been informed that the average cost of debt on credit cards is between $2,700 and $3,000, which would be difficult if the credit line was $500.

Ms. WILLIAMS. The average of?

Senator REED. The credit card debt of college students. This is Department of Education information, it suggests that the average is somewhere between $2,700 and $3,000.

Ms. WILLIAMS. I do not think that is how they start out. The point that I was trying to make—and I apologize if I was not clear—is that the way in which the cards are typically offered is with a limited credit line at the outset. It will be increased based upon the performance of the credit card holder.

Senator REED. Thank you, Mr. Chairman.

Chairman SHELBY. Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Mr. Chairman. First of all, I am sorry I was not here at the outset to hear Senator Akaka and Senator Feinstein. They have been very interested in this subject over a long period of time, as of course has Senator Dodd, who has taken a very strong leadership position on this issue.

Chairman Shelby, I want to express my appreciation to you for setting up a hearing which I think provides an opportunity to all interested parties to present their views to the Committee. It is obviously important that we do our business that way, and it has been done so again.

I am not going to take time for questions. I am going to make a few statements and then ask whether you see anything that was in the statement that is erroneous or you disagree with, because one of the problems we have is trying to understand what is going on out there. Of course, we are going to hear from a mixed panel here shortly, and I am anxious to move along so we have that opportunity, but you are the two prime regulators in this field, and it is important that we check it out against you.

Given the enormous importance of credit cards, it is estimated that 80 percent of all American families have at least one credit card. I mean if I put something out there that you say is wrong, tell me real quick so we can get back to the right figures. According to *Cardweb.com* American households have an average of 6 bank credit cards and 6 retail credit cards. I, along with others, think that individuals have to be responsible in how they use credit. The question is are they being ensnared or entrapped somehow or other, and being led into situations that they really cannot handle, and whether they have been led into those situations through misinformation or clever statements and so forth and so on, and what does that throw on the individual?

Only 40 percent of credit card customers, as I understand it, pay off their balance each month, and the industry is apparently one of the most profitable in the country.

Let me just briefly discuss a number of practices that have been brought to our attention and see whether you perceive them as, one, going on, and as abusive. First, overly aggressive and misleading direct mail solicitations to vulnerable populations, college students, on which Senator Dodd has taken such a keen interest, seniors on fixed incomes, even persons who have recently had their debts discharged in bankruptcy. We have these practices of offering offers for low- and fixed-rate credit cards which are in reality variable rate cards that can be adjusted upward every time the issuer sends out a change in terms notice.

It has also been alleged to us, and documented in certain instances, that issuers engage in bait-and-switch tactics to lure individuals with blemished credit by offering credit cards that have low interest, high credit line terms. Unfortunately, these individuals are then sent cards with terms different and less attractive than the card for which they applied. I have the feeling that they are just being manipulated here in a very skillful way as they become increasingly involved in these practices.

I know one answer is to say, well, they should not have a credit card. And as I said at the outset, I think people should be responsible, I feel that very strongly. On the other hand, I do think they are being lured into this thing.

A second practice is the imposition of excessive penalty fees. For instance, some issuers charge late fees as high as $39, double or triple the cardholder's interest rate if a payment is only a single day late, or in some instances even a few hours late. I am troubled because these fees do not appear to necessarily reflect the risk of default posed by a particular consumer, but are being used to extract larger profits in an increasingly concentrated and unregulated industry environment.

We have been told that penalty fees now represent 61 percent of all the fees paid to credit card issuers, just under $15 billion in 2004. When I turn to you, if you could specifically address that fact, I would appreciate it.

And then you do have these practices that contribute to late payments, eliminating the grace period, shortening billing cycles, varying the payment due date each month, establishing a cutoff time of 10 a.m. on the date that a payment is due. Presumably the mail comes in after 10 a.m. I do not know.

A third practice involves the utilization of so-called "universal default" clauses in card agreements. These clauses, which are often buried in the fine print of multipage credit card agreements, permit a credit card issuer to retroactively raise a consumer's interest rate for essentially any reason, even when the consumer has a perfect payment history with the issuing credit card company. While the name seems to suggest that the risk pricing is related to defaults of late payments to other creditors, the issuers also dramatically increase cardholder interest rates if there is a change in the FICO score, the cardholder takes on additional debt, or there are a certain number of inquiries into a consumer credit report.

And finally, is the failure of credit card issuers to disclose the cost of minimum payments to consumers, and that was being covered in the exchanges that took place and earlier here this morning. But I think it is fair to say most consumers are not fully aware

of the consequences of paying only the minimum monthly payment, and I commend Senators Feinstein and Akaka for the leadership they are taking on that.

Now, the OCC has put out an advisory, which I guess is a first step to identify unfair and deceptive marketing practices. I feel it is late in coming, but it may well be the beginning of what could be a very important initiative.

Of course, the Fed has undertaken a review of Regulation Z, which implements the Truth in Lending Act, the primary Federal law that regulates the credit card industry. In my own view, the disclosure requirements of that Act are inadequate, and if the Fed concludes it has the authority, I would hope they would revise Regulation Z to mandate that all disclosures are unambiguous, accurate, apply to the entire term of the contract, and provide consumers with necessary information to make informed choices.

Now, these are pretty egregious practices when you think about them, and their impact is obviously very substantial in terms of so deeply involving people in a very difficult circumstance which just preys on their mind, and in many instances can bring financial ruin. Am I overstating these practices? These practices go on, I take it. How would you respond to this?

Ms. WILLIAMS. Senator, let me lead off on that because you referred to the guidance that the OCC put out last fall on credit card marketing practices.

There are a variety of types of practices and approaches to disclosure, and you touched on a number of them in the statement that you just made, that are not necessarily illegal or prohibited under current law or current regulation, but that we felt were unacceptable for national banks. What we tried to do with that credit card marketing guidance is to identify those practices and to be very clear about the type of corrective actions that we wanted to see national banks undertake, and we are working with the banks as a supervisory matter to get improved disclosures. Some improvements have already occurred, and some are in the works. You may hear about some of them with your next panel.

We think it is critical that consumers get the information they need in order to make informed decisions, information about opening an account or decisions about their behavior that is going to affect the terms of their account. If they have gotten an introductory rate or if they have done a balance transfer, what circumstances are going to cause that rate to go up? What circumstances are going to result in a late payment fee? Exactly when does that money have to come in?

Or, take the case of so-called "up-to marketing," where there is marketing that goes out to a segment of potential customers and you see it displayed as "credit up to $5,000 or $10,000," but the issuer knows, because of the demographic analysis that they have done, that only a very small portion of those customers are actually going to qualify for that up-to amount. We said that was not appropriate. If issuers are doing an "up-to marketing" and they know the likely qualification criteria of the customers that are receiving the marketing, there needs to be good disclosure about the likelihood of whether the customer is going to get that up-to amount that is prominently featured.

So, I think a lot of what you just talked about goes to areas where there needs to be better disclosure and we need to figure out how to do it in a way that consumers can understand.

One of the concerns that I spoke about in my opening statement is that a lot of information is going to consumers, and these products in some cases are not simple. There are issues about thresholds of consumer literacy and the extent to which consumers are sophisticated about the features of the products, but there are also tremendous issues today about the kind of information that consumers are being given to disclose to them the key information about their financial products and services. We have to figure out a way to do that better. It is not working well, I agree with you.

Mr. GRAMLICH. Let me say a couple of things. First of all, I would like to align with Ms. Williams on the supervisory issue. As you know, the Fed does not have many credit card banks, only two. We also, along with FDIC, issued an advisory on unfair and deceptive practices. We warned our supervisees that it would be incorporated into our supervisory process, and we have done that. We also have broader authority in defining unfair and deceptive practices. Some of the practices you mentioned sounded like they were getting close. We are actually examining a number of them. It is a little harder to declare something unfair and deceptive across the board than if done by one bank. Let us say they are playing games with when the letters get in, are they postmarked in time and so forth, you can more easily do that with one bank than you can do it across the board.

But we are looking at a number of these practices, and as you mentioned, a number of them come up in Regulation Z and we are doing a very comprehensive review of that. We are proceeding as fast as we can, but there are many things to look at, 2006 is the target date. I think every one of the practices you mentioned is on the list of things we are looking at under Regulation Z.

Senator SARBANES. Do you all ever take your credit card statement and turn it over and read all the fine print on the back of it?

Mr. GRAMLICH. I am very sympathetic with the people who say they cannot do that.

Senator SARBANES. Well, I have tried it, and I reached the conclusion that the only way to solve this problem is to pay my credit card every month so I do not fall into any of the traps that are on the back page.

Mr. GRAMLICH. That is actually not a bad rule of thumb.

Senator SARBANES. They have you coming and going.

Mr. GRAMLICH. That is not a bad rule, the way you do it.

Senator SARBANES. I know, but a lot of people cannot do that.

Senator DODD. I went back, Mr. Chairman, just quickly doing the numbers here with a $5,000 debt at 2 percent, with 2 percent monthly payments, it will take 482 months. That is 40 years, to pay that off, and the interest paid would be $11,305 over that period of time.

At 1 percent minimum monthly payments at 17 percent interest, talking about both, you actually get negative amortization.

Ms. WILLIAMS. The figures I gave were assuming that the customer is paying the interest, that there are no fees and charges,

and that there is a 1 percent reduction in the principal. You definitely get a different figure if the customer does not pay the finance charge at all, but that was not the example that I was working through.

Senator DODD. The number that we talked about earlier, that is a pretty staggering number.

Chairman SHELBY. Thank you, Senator Dodd.

Senator DODD. Thank you.

Chairman SHELBY. Senator Bennett.

STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Thank you very much, Mr. Chairman.

We are a little schizophrenic in this country on this issue as we look at the various laws that have been passed. We have laws that say we must have truth in lending, we must have activities that discourage people from doing this. We get all upset when people market it, and then we pass the Equal Credit Opportunity Act that says we must make this device available to everybody regardless of their race, age, race, color, religion, national origin, sex, marital status, or receipt of income from public assistance. And that last phrase is code for people who are on welfare.

So on the one hand we say, gee, we cannot allow people to market these in such attractive fashion, and on the other hand the Congress says, and we must make sure they are available to people on welfare.

So what we come down to, I think, Ms. Williams, a phrase you said talking about information, do it in a way customers understand. And Senator Sarbanes cannot understand the back of his statement. I do not say that in a pejorative sense. I cannot understand the back of mine, and I do my best to pay mine off every month. I have discovered a problem. I pay it off now by wire transfer on the Internet and I try to do that as close to the due date as possible so I get the advantage of the money earning interest in my account before I put it on their account, and every once in a while I missed it by 24 or 48 hours, and then I get the finance charge and the late charge and all the rest of that. I should probably be a little more diligent in my own date planning.

The question is, for the two of you, do you feel you currently have enough tools as regulators to deal with the whole credit card phenomenon? We cannot do away with it as the Equal Credit Opportunity Act indicates. We have gone to great lengths in the Congress to make sure it is available to everybody. It may be a joke, but I am not sure that it is: Someone said "I am going to pay this bill with cash," and they were told, "Do you have any form of identification."

[Laughter.]

You cannot rent a car without a credit card. You cannot check into a hotel without a credit card. The old days of paying for everything with cash are now over, and if you try to do that you are considered quaint. My father, in his 90's, decided that to simplify his life he would pay for everything in cash so that he would not have to keep any other records or fuss with any other deadlines, and he was viewed as being quite backward and old-fashioned when he wanted to pay cash and he did not have a credit card in his pocket.

The question that we as the Congress have to ask you as the regulators is, do you feel, given your background and experience in this issue, that you need any action on the part of Congress? Are you looking for additional powers? Are you looking for clarification of your authority? Do you feel that the Congress has been derelict in withholding opportunities for regulation that you would like to have? Either one or both of you.

Ms. WILLIAMS. Senator, there is one tool that we do not have that at various times I have wished we did, and that is the ability to write rules defining unfair and deceptive practices for purposes of the Federal Trade Commission Act. We can implement the FTC Act. We can review individual situations on a case-by-case basis, and we have taken enforcement actions on a case-by-case basis, including in the credit card area. We do a lot with supervisory guidance, the guidance that Senator Sarbanes referred to, and we do a lot through our supervisory process, but we do not have rule-writing authority. Over the course of the last couple of years, there have been occasions where I have said to myself that I wish we had the ability to write rules under the FTC Act.

Senator BENNETT. Dr. Gramlich.

Mr. GRAMLICH. Senator, as I believe Chairman Shelby asked me earlier, I am not aware of any legal authority that we need. Now, I did promise Senator Dodd to write a description of the data, what data we can get on credit cards and on various abuses. It may be that we need more authority to get some of the data that the Senator wanted. That is something we just have to look into. I cannot answer that sitting here this morning. But in terms of general authority to deal with the issue, I do not think our main problem is lack of authority conferred by the Congress. I think the main problem is just it is very difficult to deal with some of these issues.

Senator BENNETT. If I may, Mr. Chairman, just a quick personal statement triggered by Senator Sarbanes' comment. I own a house in the State of Virginia where we live when we are not in Utah, and therefore I pay Virginia property taxes. And every year they have said you can pay your property taxes with a credit card if you want to, and then they have a list of the charges that are added to the credit card charges if you take advantage of that. And I look at that list of charges and I shudder, and I never use the credit card.

This year I got my property tax and it said on the front you can call this 888-number and pay your property taxes by credit card, no mention of any fee, and no chart showing what the fee is. The previous chart said if the property tax is $1,000 the fee is such and such, if it is $2,000 the fee is such and such.

On the back it says, these are the ways you can pay, money order, check, so on, credit card, and repeated the 888-number. And then it said "a fee will be added." And I thought, well, they have stopped publishing the amount of the fee because those of us who read it decided we were not going to pay that, so now they say "a fee will be added" and they give no number. So, I am going to have to spend another 37 cent stamp and sent them a check because I am not going to use the convenience of my credit card. Interestingly, enough, I would like to put my property taxes on a credit card because then I earn points on the credit card, and the prop-

erty taxes would be a really big addition to my point total, and then I could bring my kids to Washington on the free airline trips that come from the points. But I am not going to do it because they have not disclosed the fees. So back to your comment, do it in a way the customers understand.

Thank you, Mr. Chairman.

Chairman SHELBY. Thank you, Senator.

Mr. GRAMLICH. Senator, if I could on that example. I think if this solicitation had come from a credit card company, those fees would have to be disclosed.

Senator BENNETT. Undoubtedly, yes, that is the difference.

Mr. GRAMLICH. So the problem here is that it comes from the tax authorities.

Senator BENNETT. The State of Virginia is trying to make a little extra money off of me.

Mr. GRAMLICH. Right.

Senator BENNETT. I am not going to let them do it.

[Laughter.]

Chairman SHELBY. Thank you, Senator Bennett.

Senator DODD. Mr. Chairman, could I just ask the follow-up question. I ask this not only of the Fed but also the OCC, to provide the Committee with a detailed account of what information you do receive and then what you would need to receive. I think that might be helpful.

Then I think the last response, Ms. Williams, to your question to Senator Bennett is an important one. And that is your ability to have any regulatory authority in this area, so it does not take an act of Congress to get in and say, not in this particular case but something like it, you have to do this. And instead of going through the gyrations of introducing bills, you actually could have the ability to get a handle on this issue. Mr. Chairman, I think it would be helpful. But I think if we had some idea of what they are able to get right now and what you would like to have, that would help.

Chairman SHELBY. That would be very helpful. Thank you, Senator Dodd.

I want to thank the panel. It has been very informative. I hope we will give you whatever authority you need. Thank you very much.

We are moving toward a vote as 12 o'clock so we are going to have some problems with our next panel, so we are going to limit you to—if you will come on up—4 minutes each to make your statements. Your written statements will be made part of the record and we are going to enforce the 4-minute rule. We have no choice.

On our third panel we have: Antony Jenkins, Executive Vice President, Consumer Value and Growth Markets/International Cards, Citi Cards; Travis Plunkett, Legislative Director, Consumer Federation of America; Louis Freeh, Senior Vice Chairman and General Counsel, MBNA, and we all know him as a former Director of the FBI; Robert Manning, Special Assistant to the Provost, Rochester Institute of Technology; Carter Franke, Executive Vice President of Marketing, JP Morgan Chase & Company; Edmund Mierzwinski, Consumer Program Director, U.S. Public Interest Research Group; Marge Connelly, Executive Vice President, Corporate

Relations and Governance, Capital One; and Linda Sherry, Editorial Director, Consumer Action.

I know you have waited all morning for this, but we have no control of the floor of the Senate, and we have a problem, so we are going to enforce the 4-minute rule.

Mr. Jenkins, we will start with you. Remember the 4-minute rule. We are going to enforce it. We will have to. Your written testimony will be made part of the record. Again, I want to reemphasize that. If you have some points to make make them fast because we do not want you to have to come back here. Thank you a lot.

Mr. Jenkins.

STATEMENT OF ANTONY JENKINS

EXECUTIVE VICE PRESIDENT, CITI CARDS

Mr. JENKINS. Good morning, Chairman Shelby and Members of the Senate Banking Committee. My name is Antony Jenkins, and I am an Executive Vice President at Citi Cards. I appreciate the opportunity to speak before you today to discuss the credit card industry, Citi Cards, and especially our customer relationships.

Citi Cards is one of the leading providers of credit cards in the United States with close to 80 million customers and 119 million accounts. Consumers spend roughly $229 billion annually through our credit cards. This constitutes about 2 percent of the Nation's gross domestic product. Citi Cards employs nearly 35,000 people in 30 geographic locations around the country and we offer a variety of credit card products and services.

We recognize that customer satisfaction is critical to success in the highly competitive credit card marketplace. A lost customer is difficult and expensive to replace. At Citi Cards, we work hard to maintain customer loyalty through marketing and other business practices. Our research tells us that customer satisfaction is high. Furthermore, we are committed to continually improving the customers' experience, and I will now describe some of our initiatives in this area.

We recognize that an educated customer will be a more satisfied customer. Accordingly, we take great care to provide customer education in our communications. Also, I am proud to mention that Citigroup and the Citigroup Foundation recently announced a 10-year global commitment of $200 million toward financial education.

We use direct mail solicitations to find most of our new customers. Our selection process includes careful credit bureau screening for bankruptcy filings, delinquent and written off accounts, and other credit problems. To this selection process we then apply additional criteria using our own internal scoring models before we grant credit to new customers.

To conduct our credit card business in the safe and sound manner mandated by bank regulation, we use risk-based pricing to contain and manage the inherent risk of making unsecured and open-ended credit card loans. The goal of our solicitations is to assure no surprises for our customers. In this spirit, we redesigned our solicitation letters to tell consumers in more detail that their account terms could change and to describe the types of credit bureau information about them that could cause us to reprice their accounts.

Today, we reserve the right to adjust a customer's interest rate automatically for only three events, all of which involve the customer's relationship with us. These events are: The failure to make a payment to us when due; exceeding the credit line; or making a payment to us that is not honored. I should note though that most of our customers make their payments on time and stay within their credit limits.

In the past, our cardholder agreements gave us the right to increase a customer's interest rate automatically in the event of the customer's delinquency with another creditor, which is commonly referred to as "universal default." This is no longer the case. Now before we increase a customer's rate due to a delinquency with another creditor, we provide prior notice to the customer explaining why the rate is being increased, and we give the customer the right to opt-out of that increase. Customers who opt out may continue to use the card with the existing rate until the card expires. When the card expires no new charges are allowed. However, customers may continue to pay off their balance using the existing rate and payment terms.

As another initiative to improve the customer's experience, we completely rewrote, reformatted, and simplified our credit card agreements. In doing so, we added on the first page a section entitled "Facts About Rates and Fees." This section highlights and summarizes critical pricing information in a single place, much like the nutrition labels found on food products. This section also includes a description of the reasons we may decide to change rates and fees.

We are also changing our minimum payment formula to ensure that all customers who regularly pay only the minimum due will pay off their debt in a reasonable period. This will increase the minimum due for some of our customers, although I should emphasize that the vast majority of Citi Cards customers pay more than the minimum. We are developing strategies to mitigate the impact of this increase for customers in hardship situations. We believe that in the long-run the new formula will save our customers money by accelerating the payments of outstanding debt and lowering their total interest payments.

Thank you very much.

Chairman SHELBY. Thank you. I hate to cut you off.

Mr. Plunkett.

STATEMENT OF TRAVIS PLUNKETT
LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA

Mr. PLUNKETT. Chairman Shelby and Members of the Committee, I applaud you for calling this important hearing on credit card industry practices. Perhaps no industry in America is more deserving of such oversight.

According to the U.S. Better Business Bureau, credit card abuses are the third most common source of all consumer complaints after cellular phone services and new car dealers.

I would like to make five brief points about the current marketing, lending, and pricing practices of the credit card industry. First, credit card companies are expanding efforts to market and

extend credit at a time when Americans have become more cautious in taking on credit card debt. It is conventional wisdom to attribute the growth of revolving debt to just over $800 billion solely to insatiable consumer demand for credit cards, or to consumer irresponsibility as we have heard today, or to a lack of consumer financial literacy as we have heard today.

In fact, our analysis shows that—and we have looked at credit card lending patterns over the last 15 years—aggressive and even reckless lending by issuers has played a huge role in pushing credit card debt to record levels. A couple of facts here. Since 1997, the extension of credit by issuers has increased more than twice as fast as credit card debt taken on by consumers. The amount of credit made available by issuers now exceeds an astonishing $4.3 trillion or just over $38,000 a household.

Meanwhile, the number of solicitations mailed by issuers has increased by more than five-fold since 1990 to 5.23 billion, or 47 per household.

Second point: Creditors have targeted some of this credit at the least sophisticated, highest risk, and lowest income families, who have taken on fairly high debt burdens relative to their incomes and have suffered disproportionate financial harm. We have heard a lot about that already. I will reemphasize the point. It is not just college students, it is also older Americans, minorities, and those with blemished credit histories. This approach has led to fairly high industry losses and record profits, which is not as paradoxical as it seems. The industry now loans money to riskier customers who are more likely to carry a balance and more likely to pay penalty fees and interest rates, but the industry charges them far more, generating extraordinary profits.

We have heard about their profits this year. The credit card industry is the most profitable by far in the banking sector, earning a return on assets that is three times greater than for commercial banks overall. One of the major reasons for this astonishing profitability are a number of new and very costly fees and interest rates. We have heard about universal default, and retroactive interest rate increases. I do not know of another industry in the country that can charge you more, that can increase the price on what they have sold you after you have bought it.

We have not talked about what is often called "sticky interest rates." According to Federal Reserve data we have looked at, credit card interest rates during the last few years dropped by only a third as much as the prime interest rate did, indicating that consumers still, even in a lower interest environment, are paying too much in interest rates. This is big money for issuers. We have heard about fee income over the last few years. We looked at fee income charged just to consumers, not to merchants, in 2003, and found that every card-holding household paid an average of $830 for fees and for interest. That is a great deal of money.

In response to this concern, we often hear from credit card issuers, well, we are just pursuing risk-based pricing. We are charging households that are higher risk, higher rates. Issuers justify these practices that way.

I will close here and just say that we have extensive testimony on why this pricing is not risk-based. In fact, it looks to us to have all the tell-tale signs of being predatory.

Chairman SHELBY. Thank you.

Judge Freeh.

STATEMENT OF LOUIS J. FREEH
SENIOR VICE CHAIRMAN AND GENERAL COUNSEL, MBNA

Mr. FREEH. Thank you, Mr. Chairman. It is my pleasure here to represent MBNA today, and a pleasure to be before the Committee. I will make just four very brief points.

I do join with the panel members also in thanking the Committee for this hearing. It is a very important hearing on a very major industry in our country.

As someone I think mentioned, there are 6,600 issuers in the United States, and with all industries of that scale, the vast majority of lenders in the country do grant credit responsibly, and that the vast majority of the users of that industry act very responsibly. That does not mean we should not focus on the exceptions, but we should make sure that we are not looking at the exceptions to the exclusion of what the norm is. I think this is an industry that is heavily regulated and that is working very well.

The four brief points I would like to make, first, with respect to student marketing, we make every effort at MBNA to ensure that credit card offers are not sent to anyone under 18 years of age. We also have very unique relationships. We have affinity relationships with over 700 colleges and universities. All of our marketing with respect to students has to be approved by the university, by the alumni directors, and we have a huge reputational as well as business interest, in making sure that the lending is responsible.

One fact you may be interested in with respect to our student marketing, more than 90 percent of the credit cards we issue through colleges and universities go to alumni, parents, and staff, not students. We impose a very low credit line for student accounts. The average credit line for students is about $700. We stop authorization immediately if they trigger over the limit restrictions, and call them up if we detect a problem. We have a very strong and we think beneficial system for making sure that they use credit responsibly. We have a lot of credit card literacy education that we do with them. That is part of the program that we are very proud of.

With respect to repricing, before we lend money to customers, of course, we must borrow funds, so the ability to reprice, to do it reasonably and responsibly, pursuant to regulation, is essential for the health of this marketplace. We manage the environment by using the affinity model to differentiate our products. We increase an APR for only one of two reasons, either our costs have increased or the consumer's credit-worthiness indicates a higher risk than was established at the initial pricing.

We do not practice universal default, we never have. We do not automatically reprice a customer's account without notice solely because he or she may have missed or been late on a payment to some other creditor. Absent a specified default on an MBNA account, we do not reprice, and we always allow our customers in

that situation to just say no, which means they can reject the reprice by default, pay off the balance at the old rate, and if they do not use the card again, that account is closed.

With respect to minimum payments, very briefly, less than one-quarter of 1 percent of our customers pay minimum payments consistently. It is a very small fraction which is why I talked before about the perspective with respect to focusing only on the exceptions at the expense of the norm.

Consistent with the OCC guidance, MBNA has agreed to and is now establishing the 1 percent plus interest plus late fee calculation. I know there has been a lot of discussion about——

Thank you very much, Senator. I am a trained lawyer, I know when to stop.

[Laughter.]

Chairman SHELBY. Dr. Manning.

STATEMENT OF ROBERT D. MANNING
UNIVERSITY PROFESSOR AND SPECIAL ASSISTANT
TO THE PROVOST, ROCHESTER INSTITUTE OF TECHNOLOGY

Mr. MANNING. Thank you, Chairman Shelby and Members of the Committee. I certainly appreciate the opportunity to participate in this long overdue hearing on credit card policies. Please bear in mind I typically teach 4-hour seminars, so each minute is basically 1 hour of information.

Chairman SHELBY. You would be here by yourself.

[Laughter.]

Mr. MANNING. In framing my remarks and my written testimony, the focus has been on the deregulation of financial services, and I want to make a few brief points that particularly impact on current trends in both marketing and the financial impact of consumer credit and credit card today.

In particular, what we have seen is a dramatic shift in the transformation of the industry, the consolidation, conglomeration, such as the union of wholesale and retail banking and insurance corporations, as well as the bifurcation, the emergence of both first-tier banks as well as second-tier banks, which has particular implications to the emergence of sub-prime credit cards.

What I think is most important is we have seen a shift from banking underwriting standards that were risk averse from our community-based bankers where the best client was somebody who could repay the loan in a timely fashion.

What we have seen over the last 20 years is that given our understanding of the tremendous profitability of credit cards, there has been an enormous transformation and shift from wholesale to retail banking with particular attention to credit cards. It is unambiguous, the data is irrefutable that the tremendous expansion and increase of credit card interest rates and fees has precipitated an unprecedented growth of consumer bankruptcies, to the point that we have seen an unprecedented historical phenomenon where in the late 1990's we saw an inverse relationship; that is, as unemployment went down, bankruptcy rates went up, jumping to a high of 1.6 million.

What this has done is put greater pressure then in this new deregulated environment where the best client is somebody who could

never pay off their debts. What we have seen and what I have had most experience with is the marketing of new groups of potential clients, the college students, where 10 years ago—actually 15 years ago when I first studied the marketing to college students—we saw that the first entree was the student who had one foot in the door, the college senior or junior. And it was very rare in the early 1990's to see college students with more than $3,000 or $4,000 in debt. Today, what we have seen is actually a race to the bottom where over 80 percent of college students who are going to get a credit card have it by the time they have taken their first midterm exam. What we have seen now is the whole new redefinition of the starving student, which credit cards are jokingly referred to as yuppie food stamps.

At the same token, the rise of bankruptcy and the withdrawal of many banks from the central cities has seen a rise of the most egregious credit card policies, and that is sub-prime credit cards, particularly marketed to people who have recently gone through bankruptcy. These are cards with typically less than $300 lines of credit that have fees that will account for as much as 80 percent of the outstanding line of credit.

I want to conclude by stating then that we have heard some references about technological innovation here in the United States, but based on my experience in my research in other parts of the world, the United States actually lags tremendously through Western Europe and other parts of the world, and, in fact, it is a shame to see where we are in terms of smart-card technology and identity fraud protections and the role of Government in protecting consumers in terms of the kinds of credit card policy abuses that we are discussing today.

Thank you.

Chairman SHELBY. I know you did not have 2 hours or 4 hours, but we do appreciate your contribution.

Ms. Franke.

STATEMENT OF CARTER FRANKE
CHIEF MARKETING OFFICER, CHASE BANK U.S.A., N.A.

Ms. FRANKE. Mr. Chairman, Members of the Committee, good morning. My name is Carter Franke, and I am the chief marketing officer of Chase Card Services, a division of Chase Bank U.S.A.

Today, I sit here as a representative of the more than 16,000 Chase employees around the country who support our credit card services division. Our customers are primarily those that fall in what we call the "super-prime" and "prime" categories—the most responsible and the most knowledgeable credit users in the country. We operate in a highly competitive industry, one where many customers can easily vote with their feet. Our customers in particular have many choices in the marketplace today, and competition is good for consumers.

Today's credit cards are issued, as we said, to consumers with exceptionally good credit histories, and as a result, our business model is built upon consumers making their payments regularly and on time. All of our pricing decisions are based on sound economic analysis. However, unsecured credit lending is a shared responsibility between the lender and the borrower. Our goal is to

provide problem-free access to the credit lines that we offer and to achieve the highest level of customer satisfaction possible.

During 2003 and 2004, Chase invested approximately $107 million working with partners across the Nation to voluntarily fund responsible credit counseling services, create online financial education, and credit and debt management tools. At Chase, we value our customers. A missed payment on a non-Chase card does not drive automatic repricing of any Chase account.

We also realize that in the vast majority of cases, a late payment on a Chase card is not a sign of increased risk but of timing—a vacation or other realities of our very busy lives. For that reason, a late payment will not result in a price increase for over 90 percent of Chase customers.

A small segment of our customers do have a change in creditworthiness from time to time, which we deal with fairly and responsibly. If a customer's overall credit profile deteriorates materially and, thus, exposes us to an increased risk of nonpayment, economic considerations may cause us to raise the interest rate.

In these cases, and in accordance with all of the applicable laws, we provide the customer an opt-out option. This enables the customer to reject our change in terms, close their account, and pay off the balance under their existing terms. Once closed, the interest rate on a Chase account that is paid according to its terms will not be changed.

Mr. Chairman, we understand that our business may seem complicated and even at times unfriendly. I hope this information I have provided today has offered you some substantive insights into our practices and an understanding of our true commitment to fairness for all customers. At times we are faced with difficult decisions relative to individual card members and their accounts, and when reviewed on an isolated basis, these may seem inappropriate. Our decisions are designed to permit the vast majority of our customers to continue to receive the best possible rates, service, and access to the benefits credit cards provide.

We look forward to working with you and with Members of the Committee to answer your questions and address your concerns. Thank you.

Chairman SHELBY. Thank you.

Mr. Mierzwinski.

STATEMENT OF EDMUND MIERZWINSKI
CONSUMER PROGRAM DIRECTOR,
U.S. PUBLIC INTEREST RESEARCH GROUP

Mr. MIERZWINSKI. Thank you, Senator Shelby, Senator Dodd, Members of the Committee. On behalf of the Public Interest Research Groups, it is a privilege to be here for this very important hearing.

You have heard from the industry that there are 6,000 credit card issuers. There are only 10 that matter. The industry is extremely concentrated. Those 10 have two-thirds of the cards, two-thirds of the receivables. Those are the 10 the Committee should concentrate on.

In terms of getting data from those companies, you should ask the regulators why they cannot improve call report reporting.

Those are the forms banks provide so that we can learn more—provide to the regulator so that we can learn more about how much they are making in fees more easily and compare the companies better.

When you have a highly concentrated industry or everybody already has too many cards, even though the companies are extremely profitable, as we have heard—it is the most profitable form of banking. The only way you can make more money and achieve the corporate profit goals that downtown wants, you have to either get customers from others, which means deceiving them or offering them more expensive products. You have to reach out to new constituencies such as college students or previous bankrupts. Or you have to charge your own customers more money to make more money on them. And that is the reason we see all of these unfair practices.

We have a website that describes what consumers can do. It is called *truthaboutcredit.org*. Consumers can download a fact sheet about how to solve the credit card road map of credit card hazards. We also care a great deal about college students because we were founded years ago by college students, so we have our own credit card brochures, charge it to the max MegaDebt credit card. With our own brochures, we can find out more.

But the real problem here is that a credit card agreement is a license to steal. A credit card agreement allows companies to change terms at any time for any reason, including no reason. That is unbelievable. That is outrageous. That needs to be changed.

Chairman SHELBY. Is that the only situation in the banking industry you know about?

Mr. MIERZWINSKI. I think that might be the only situation anywhere, Senator, where the contract is so one-sided that it can be changed at any time for any reason, including no reason. The consumer virtually has no rights except to try to get another card.

The second problem, of course, is their use of mandatory predispute binding arbitration to limit a consumer's rights to enforce their rights in court.

So we know that these problems that have been described exist because of preemption theory. With the Marquette decision and the Smiley decision limiting the authority of States to regulate interest or fees, the industry has consolidated in a few States, and the OCC has claimed that the industry is virtually unregulated by the States. Yet, the States have attempted to enforce the laws against the credit card companies.

Just this January, Capital One was sued by the Minnesota Attorney General. Other States have filed because their fixed rates are not really fixed. Many States have sued the sub-prime lender Cross Country Bank for its very deceptive and unfair practices in debt collection. In 2002, 28 States settled a case with Citibank; 28 States and Puerto Rico settled a case in 2002 with First USA as well. And, of course, the OCC did go after one big bank, Providian, in 2000, but only after the tiny San Francisco district attorney and the California Attorney General showed the way.

The consumer groups jointly have a long list of recommendations to you that we have all endorsed. It is all in all of our testimony.

Most of our recommendations are incorporated in Senator Akaka's and Senator Dodd's bills.

Thank you.

Chairman SHELBY. Thank you.

Ms. CONNELLY.

STATEMENT OF MARGE CONNELLY
EXECUTIVE VICE PRESIDENT,
CAPITAL ONE FINANCIAL CORPORATION

Ms. CONNELLY. Good afternoon, Chairman Shelby and Members of the Committee. My name is Marge Connelly, and on behalf of Capital One, I also want to thank the Committee for holding these hearings. And at the outset, I do want to acknowledge that we do hear the criticisms and concerns, and we are very sensitive to them.

But without diminishing the challenges associated with those concerns, I do urge the Committee to really look broadly at how this industry has evolved over the past 30 years. As we have noted, today more than three-quarters of American families rely on credit cards on a daily basis, and these cards enable almost $2 trillion in transactions every year. So that in and of itself is really a remarkable success story, but there is really much more to this evolution than just volume. In my testimony, I have included a chart, which please feel free to take a look at, but it just reflects the change in interest rates. There are a couple. There is one there. It just reflects the changes in annual percentage rates, the interest rate, and annual fees that are charged to consumers.

And as you can see, back in 1987 we really had a one-size-fits-all kind of environment, and virtually all customers were paying this, 19.8 percent, $20 annual fee, regardless of what kind of risk that they have. Now, that has changed significantly. Long-term rates as low as 5 percent are now available for some of the lowest-risk customers, and on average, consumers are paying in the range of 13 or 14 percent. And in most cases, there are no annual fees.

So, based on a study that was cited in a 2003 report from the Information Policy Institute, this trend has saved consumers about $30 billion per year. So we think that is, again, another great part of the evolution of the industry, but we also can note that access to credit cards has also been increased significantly. And that means that more consumers can take advantage of the benefits that this product offers. They can handle emergencies better. They are safer when shopping because they do not need to carry cash. And as has been noted, they can make purchases, like online transactions, like reserving a hotel room, renting a car, that otherwise they would find incredibly difficult, if not literally impossible to make.

Now, these two positive trends—reduced price and increased access—have really been driven by intense competition and improvements in credit risk. These two drivers, though, have increased the complexity and the variations of the products offered. And they have led to an increased use of fees and risk-based pricing so that we can better align product terms with risk. And this is necessary in order to avoid the kind of subsidization that you could see from past years.

I will say that we do not use universal default as part of our risk-based pricing policy, but we do indeed find the need to take actions if there is evidence of risky behavior on our accounts.

I think the question, though, is really is this industry really adequate serving its customers? I would say that we believe that for the most part it is, but we do acknowledge that it is a more complex environment, it is more difficult for consumers to fully understand the structure of some of the products. And although we think things like the Schumer box have really taken us a big step forward, a lot has changed and there are a lot of terms that are now incredibly important to consumers that are not included in that disclosure regime. We actually have a second exhibit that we have brought with us that I am happy to chat about during our questioning that is our submission to the Fed's advanced regulatory notice. And we think it is a pretty big step forward in terms of trying to really portray all of the very important information and to do so in a way that we think is uniform, can be easily compared by customers, and is actually done in language that we think is very clear and easy for customers to understand.

So, again, I want to thank you for holding this hearing. I want to say that at Capital One we are committed to reearning our customers' business every single day. Thank you.

Chairman SHELBY. Thank you.

Ms. Sherry.

STATEMENT OF LINDA SHERRY
EDITORIAL DIRECTOR, CONSUMER ACTION

Ms. SHERRY. Thank you. Chairman Shelby and Members of the Committee, my name is Linda Sherry of Consumer Action. Thank you for your leadership on this important issue.

Consumer Action for more than 20 years has been conducting surveys of credit card rate fees and conditions, and our survey has become a barometer of industry practices. When we survey, we call as consumers. This gives us the insight into what people face when they shop for credit cards. In our experience, getting accurate information from credit card companies is difficult and exasperating. Application lines are staffed by salespeople who pressure callers to apply but who often cannot give even the most basic facts that are available under the Credit Card Disclosure Act.

Consumer Action receives many complaints from credit card customers about unfair practices. Penalty rates and universal default rate hikes top this list. Penalty rates are much higher interest rates triggered when you pay late, even one time. We found penalty rates as high as 29.99 in 2004 when the prime rate was at 4 percent. This year, the highest one we found is 35 percent.

Customers who contact Consumer Action about universal default report being hit by retroactive default rates that were double and triple their old rates. It is outrageous that the credit card companies claim that they are merely protecting themselves from risk when they hike interest rates. We challenged the industry to explain how a new car loan or a one-day-late payment makes a customer so much more risky that it justifies tripling their rate.

An increased number of card issuers employ universal default policies. Our 2004 survey found that 44 percent of the surveyed

banks, which include the top 10 banks, by the way, use universal default. When you are turned down for credit the law, requires that you get a letter explaining why. But if you are hit with a universal default repricing, you do not learn about it until you open your next statement.

A Bastrop, Texas, woman told us: The city AT&T Universal card just raised our interest rate from 12.9 to 28.74 because of a late payment they found listed on my husband's credit report to another credit card company. Our payments to AT&T have been on time.

Late payments result in higher penalty rates with 85 percent of the issuers surveyed in 2004, with average penalty rates of 22.91. Of these issuers, 31 percent said a penalty rate could be triggered by just one late payment.

A Topeka, Kansas, house painter complained: Chase raised my interest rate from 9 to over 27 percent and told me it was because I had two 30-day past due payments last year. His statements showed one payment was posted 2 days late and the other 7 days late.

A decade ago, the average late fee was $13. The average late fee surveyed last year was $27.45, with three major banks charging up to $39.

Tiered late fees, a new trend tied to the outstanding balance, penalizes people with smaller balances than those with higher ones. The number of issuers with tiered late fees jumped from 20 percent in 2003 to 48 percent in 2004.

We have found that 58 percent of surveyed issuers even have a cutoff time on the due date. If you are even 5 minutes late, you might have to pay a late fee of up to $39.

Banks must begin to consider postmarks—and thank you for your leadership on this, Senator Dodd—before they assess late fees. We have heard from consumers who allowed 7 days to post a payment, yet they were still charged a late fee. If those are the rules, no one can hope to comply.

This is a follow-the-leader industry. When one issuer adopts an anticonsumer practice, others quickly follow. We can only conclude that the industry is attempting to fundamentally redefine its business model to shift the risk from lending from itself onto the backs of its unwitting customers.

Thank you for your diligence in investigating these practices, and please support all legislation, such as Senator Dodd's thoughtful legislation, that will help end these unfair anticonsumer practices.

Thank you.

Chairman SHELBY. I appreciate all of the hurried-up testimony here today. I have a number of questions I am going to submit for the record because this is a very important hearing.

I do not believe myself there is any room anywhere in America to exploit anybody, and we should not do this. If that is true, 35 percent interest is—if that were true—that is astounding. Why, the short-loan people, loan sharks, would be proud of you if you would do that because they would soon be out of business. I hope this is not true.

On an unrelated subject in a sense, but related very much to the credit card industry, I have a statement and a question. On a different thing, I would like to emphasize to our witnesses here from

the credit card industry the important role that you could play in the very troubling growth of Internet child pornography, because major credit cards are the easiest and quickest method of payment on the Internet for commercial transactions. Many child pornography websites use universally recognized credit cards to ensure the largest possible customer base. According to the International Center for Missing and Exploited Children and the U.S. and international law enforcement, the size and scope of this worldwide problem is huge and is growing rapidly.

Because of the large demand and tremendous profitability of this crime, this content is also becoming more explicit, and the child victims of these crimes are increasingly younger each year. I know in your industry there has already been some effort by the International Center for Missing and Exploited Children and various law enforcement agencies to work with many of the financial institutions to find ways to help increase detection and reporting of child pornography, and I commend these efforts. And I know, Judge Freeh, you as former FBI Director, you understand all this well. But it is something that this industry could really do something good on.

Senator Dodd.

Senator DODD. Mr. Chairman, we have about a minute left, or less than that, for these votes on the floor. What I would like to do is submit some questions in writing, if we could. It is going to be difficult to get back here. But let me just make the point I made a while ago, and that is—and I appreciate the industry standpoint here, I am not suggesting that all credit card companies do all the same things. But if you do not take a leadership position on this stuff and get it straightened out, there should probably be some regulatory moves made anyway. But, nonetheless, the pendulum moves. I have seen it over my years. And people who sit back and assume they can do it—we watched it in the savings and loan industry. We have watched it in other areas. And it is building and it is building, and I would strongly urge you to engage in a lot of self-discipline within the industry on some of these practices, and do not play follow the leader. I think it is a good analogy. Too often that is the case because no one seems to be saying anything, and no one is doing anything about it, so why not continue doing it or why not try the practice yourself?

Mr. Chairman, I would hope that we might look at some legislation that would give some authority to our respective agencies here so that some additional steps could be taken to find out exactly what is going on out there. Part of the difficulty is we are relying on solid information, but an awful lot of it is not coming from the industry itself.

So, I thank you all for being here.

Chairman SHELBY. Thank you.

Senator Carper.

Senator CARPER. To each of our witnesses, thank you for being here today, and thank you for sharing your comments with all of us. I apologize that you have had to truncate your remarks, and I really regret that we do not have the opportunity to ask questions of each of you.

A comment or two, if I could. I heard during the course of several of your testimonies policies which I think are meritorious, commendable, and what I wish we had the opportunity to go back into to put a spotlight on some of those—I will call them "white-hat policies." There are a couple of ways to get the kind of behavior we want, whether it is financial services entities or others. We can criticize those who perform badly, or we could put a spotlight and positive reinforce the good behavior. And I tend to be the guy who likes to positively reinforce good behavior. For those of you that are doing the right thing for the right reasons, I salute you. And I would like to find a way for us to put a spotlight on those good policies so we can encourage others who are not following those kinds of policies to begin to adopt them.

Again, we appreciate your being here today, and thank you for bearing with me. Mr. Chairman, when you and I are the Majority Leader of the U.S. Senate, we will not have these votes to disrupt our hearings in this Committee and inconvenience these people.

Thank you.

Chairman SHELBY. Thank you, Senator Carper.

Dr. Manning, maybe we can get you back sometime and give you 4 hours, but not 4 days or 4 months.

[Laughter.]

We thank all of you, and I appreciate your being here today, and I hope you understand our predicament on the floor of the Senate. We are late now.

The hearing is adjourned.

[Whereupon, at 12:28 p.m., the hearing was adjourned.]

[Prepared statements and response to written questions supplied for the record follow:]

PREPARED STATEMENT OF SENATOR TIM JOHNSON

Thank you, Mr. Chairman, for calling today's oversight hearing on the credit card industry, in particular the regulation and industry practices with respect to consumer disclosures and marketing. I am interested in today's hearing given the significant impact the credit card industry has on consumers and our national economy.

When this Committee considered the reauthorization of the Fair Credit Reporting Act and during recent floor debate on the bankruptcy reform legislation, we had preliminary discussions about consumer notices, risk-based pricing, and interest rates. I look forward to taking a careful look at these issues in detail again today. My hope is that today's hearing will not only be useful to the Committee in its oversight role, but also that the hearing will provide useful information to the regulators, industry, and consumer groups on where improvements can be made.

I would guess there are very few individuals in this hearing room that do not have at least one credit card in their pocket. The credit card has become an important tool that so many American families depend on for day-to-day living. Like any other contractual agreement, it is vital that consumers know the rules of that contract and that both the consumer and company play by those rules. That is why the regulation of consumer notices and industry implementation of such notices are so important.

I must say that simply sending out notice after notice is probably not the most effective way to disclose the most important information to consumers. Frankly, we need to do a better job of making sure consumers are not flooded with notices they do not read, let alone understand.

Just last week, I learned that in my home state of South Dakota, the Student Federation, representing thousands of students at our public universities, highlighted the need for more financial literacy, especially among students. As more and more young people enter the economy as adult consumers, we need to ensure they have the knowledge necessary to manage their finances responsibly. Just recently, along with several of my colleagues, I signed a letter seeking funding for the Excellence in Economic Education program. This competitive grant program aims to teach young people the importance of economic and financial literacy. I am hopeful that with funding for this program, along with financial literacy efforts by the regulators, industry, and consumer groups, we can start our young people along the road to sound personal financial management. The more knowledgeable consumers are about their finances, the fewer social and economic problems our Nation and our economy will face.

I understand the difficult balance that must be achieved between providing consumers with clarity and completeness of information when it comes to notices that allow consumers to make informed decisions about their personal finances. That is why I am hopeful that the financial regulators, along with industry and consumer groups, can come together and establish guidelines for notices that do not overburden companies or consumers.

Another issue is that some have criticized the industry for is risk-based pricing. We had debate about this issue when Congress reauthorized the expiring provisions of FCRA and when we considered the bankruptcy reform legislation. One of the hallmarks of our credit system in the United States is that it opens economic opportunities for consumers with limited or less than perfect credit histories. When Congress reauthorized FCRA, we ensured that millions of Americans continued to have access to affordable credit under a uniform national standard that included significant new consumer protections. Access to affordable credit allows many American families to build or restore their credit history which will help to lower their cost of credit. At the same time, access to credit gives consumers another tool to help manage their day-to-day finances.

A study of the consumer credit marketplace shows the growth of credit card access over the last 30 years, and the results are striking. In 1970, only 2 percent of families in the lowest income bracket had a credit card. In 2001, that number stood at 38 percent. In the highest bracket, the 33 percent of households that had at least one credit card in 1970 had risen to 95 percent.

Even more striking are the statistics related to access to credit by race. Between 1983 and 2001, the number of white families who held credit cards increased by 69 percent. During the same period, the number of Hispanic families increased by 85 percent, and the number of African-American families increased by 137 percent.

Credit cards, which often carry higher interest rates than other types of nonrevolving lines of credit, have seen significant decreases in cost. The study attributes these decreases largely to the competition in the market and to prescreening, which is made possible on a large-scale basis by FCRA. For example,

in 1990, only 6 percent of all credit card balances paid interest rates under 16.5 percent. By 2002, 15 percent of all card balances paid rates below 5.5 percent, and 71 percent of all credit card balances carried interest rates under 16.5 percent. In 1990, while more than 93 percent of all credit card balances paid interest rates over 16.5 percent, that number had plummeted to 29 percent in 2002.

While some of these interest rate declines may be due to the interest rate environment, much surely has to do with companies' ability to differentiate risk among borrowers and to price credit accordingly. Credit scoring models have increased in their predictive power and one result is increasingly competitive cost of credit.

Consumers must have clear information on an ongoing basis to help manage their credit. At the same time, companies should not have undue restrictions on their ability to price credit based on risk. The ability to price credit based on risk allows companies to manage their financial risk in a safe and sound manner.

I hope the industry, regulators, and consumer groups will work together on ways to improve consumer awareness without causing unintended consequences that would limit consumer choice or ability to obtain credit. And, I hope the industry will continue to work in a constructive manner to find innovative ways to provide consumers with timely and useful disclosures. It is good for the public and good for business to have informed consumers using credit responsibly.

Thank you, Mr. Chairman, and I look forward to today's testimony.

PREPARED STATEMENT OF SENATOR CHRISTOPHER J. DODD

I would like to thank Chairman Shelby and Ranking Member Sarbanes for holding this important hearing on an issue which impacts tens of millions of Americans. This Committee continues to focus on issues which have such a direct impact on so many in our nation. I believe that the subject matter of the hearing today—credit card issuer practices—touches the lives of more Americans than any other issue within this Committee's jurisdiction.

I would also like to thank the witnesses for appearing before the Committee today. It is my hope that this will not be the last hearing on this subject matter and the input from the witnesses today is much needed and greatly appreciated.

Credit cards are one of the most successful and pervasive financial services products ever created, and have undoubtedly improved access to credit and added a significant measure of convenience to consumers.

Just to give an idea of the staggering role that credit cards have in the United States, according to the Federal Reserve, there were 556.3 million Visa and Mastercard credit cards in circulation in 2003. Those cards coupled with Discover and American Express products indicate that today at least 700 million revolving credit cards are currently in circulation.

Approximately 145 million Americans have at least one credit card. The average cardholder has 4.8 credit cards. The total amount of credit card debt is over $800 billion, while the total amount of credit extended to cardholders is over $4 trillion dollars.

With this kind of market presence, it is not surprising that Credit Card Management reported in May that 2004 was the most profitable year ever for credit cards.

With this tremendous success, I believe, comes significant responsibility. And I believe that the credit card industry is failing that test.

Credit card issuers have now become the victims of their own success and are turning credit cards into nothing less than wallet-size predatory loans.

In a time when access to credit is the easiest and cheapest, credit card companies are making more money than ever, credit cards issuers are charging usurious rates and fees and engaging in a series of abusive and deceptive practices which I believe will have drastic long term consequences on our Nation.

Credit card companies are charging consumers higher fees than ever before. In 1980, credit card fees alone raised $2.6 billion. In 2004, credit card fees raised over $24.4 billion.

We have been told that the reason that credit card rates and fees are so high is that more and more consumers are failing to pay their debts, and as a result, issuers must charge higher rates and greater fees.

In fact, the opposite is the truth. Consumer bankruptcies went down last year by nearly 3 percent. And default rates actually decreased last year.

The truth of the matter is that this is the best time in history to be in the credit card business. Last year, over 5 billion solicitations were sent to American homes last year, which is nearly twice as many as only 8 years ago. Coupled with television ads, radio ads, internet ads and advertising signs, it is nearly impossible to

turn on your TV or computer or simply walk down the street without being offered a credit card.

Despite the assertions that the credit industry is struggling because of bad consumer behavior, credit card companies have more money than they know what to do with and they are pumping out solicitations in the search for new people to get in debt.

And while normally competition lowers costs for consumers, the exact opposite is happening.

Credit card companies are finding more and more ways to effectively increase their income from rates and fees. Abusive practices such as misleading teaser rates which employ bait-and-switch tactics, hidden fees and penalties, and universal defaults provisions buried in the fine print, are standard operating procedures in the credit card industry today.

And while my statement this morning will not touch on the entirety of my concerns with the credit card industry, I would like to highlight a couple of major abuses currently employeed by the credit card industry.

One of these abuses is the so called "Universal Default" or which should more accurately described as a predatory retroactive interest rate hike. This practice forces a credit card consumer in good standing, who is paying his credit card bills on time, to have his interest rates retroactively jacked up to 25 percent or 30 percent because of some unknown irrelevant change in his spending patterns. The idea that a credit card company can charge an initial interest rate that would have in the past been outlawed as usurious, and then double or triple that rate for any reason it so chooses is just plain wrong.

The industry refers to this practice as "risk-based" pricing. They believe that when a consumer's credit score goes down, they become "riskier" and higher interest rates are levied on them. What is interesting to me is that I can find no evidence, either anecdotal or empirical of when a consumer's credit score improves, a credit card company lowering an interest rate for a consumer.

We should stop this practice completely or at a minimum make any increase in interest rates prospective and not retroactive.

Another troubling development in the battle to sign up new customers, has been the aggressive way in which they have targeted people under the age of 21, particularly college students.

Solicitations to this age group have become more intense for a variety of reasons. First, it is one of the few market segments in which there are always new customers to go after; every year, 25 to 30 percent of undergraduates are fresh faces entering their first year of college. Second, it is also an age group in which brand loyalty can be readily established. In fact, most people hold on to their first credit card for up to 15 years, which is probably the amount of time it takes them to dig out of the mountain of credit card debt they incurred while in their teens.

A staffer of mine recently opened his 7 year old son's mail—amazed to find a brand new American Express card. The new card came as a result of, according to the offer, the elementary schooler's "excellent credit history." A brand new potential victim of the credit card industry. He is 7 years old. What's next? Are they going to set up credit card kiosks in hospital maternity wards?

Credit card issuers target vulnerable young people in our society and extend them large amounts of credit with little if any consideration to whether or not there is a reasonable expectation of repayment. As a result, more and more young people are falling into a financial hole from which they are unable to escape. One of the fastest growing segments of the population forced to declare bankruptcy is this agegroup.

We have an obligation to protect and educate our Nation's youth. The next generation of American leaders deserve no less than the reigning in of the irresponsible practices of the credit card industry.

As many of the witnesses will mention, I have introduced legislation designed to force credit card issuers to stop their more deceptive and abusive practices and alter the targeting of our most vulnerable consumers. This legislation, the Credit CARD Act, should be the first step is restoring some common decency in the credit card industry.

I look forward to the testimony today, particularly from the regulators of the credit card industry—I must confess I do not know a great deal about the regulatory and enforcement activities of those that regulate this industry.

What concerns me is that I fear that my lack of knowledge about what the regulators dois because they do not do enough to protect consumers from the predatory practices of the credit card industry. I look forward to working with them to accomplish the goal of improving consumer protection in the area of credit cards.

Record fees, record abuses, record profits. And a record number of Americans are being taken advantage of.

I would like to again thank our witness for appearing before the Committee today.

PREPARED STATEMENT OF SENATOR WAYNE ALLARD

I would like to thank Chairman Shelby for holding this hearing to examine the current legal and regulatory framework governing credit card issuers and business practices in the credit card industry.

Six hundred thousand credit card issuers exist in the market today, and nearly 145 million Americans use credit cards.

The consumer credit system has provided Americans access to financing when they need it most. Of course, it is essential that consumers are responsible with their use of credit cards, and are well aware of the interest rates, fees, limits and other terms of the accounts.

As a proponent of meaningful disclosure, however, I believe there is a balance to strike when it comes to giving the consumer information about their credit terms and agreements without becoming so overwhelming as to be rendered meaningless.

I look forward to hearing from the regulators and industry today on what changes might be needed in order to improve the current framework for the ultimate protection of consumers. Thank you to our witnesses for agreeing to appear before the Committee. I look forward to your testimony.

PREPARED STATEMENT OF SENATOR DEBBIE STABENOW

Thank you, Mr. Chairman. I want to welcome both Senator Feinstein and Senator Akaka to today's hearing.

They are both champions of financial literacy and consumer rights and they will add significantly to our discussions on the subject of credit cards and consumer debt.

It is quite fitting that we are taking some time to discuss this issue again. On the heels of Congress' decision to pass the bankruptcy bill—a bill that was supported by a broad bipartisan group of legislators—it is important for us to continue our focus on how we can improve the disclosures that banks and credit card companies make to their costumers.

However, we should continue to move forward on increasing financial literacy.

Many would agree that education is the silver bullet for us in so many areas and that is certainly true when it comes to our personal financial health. I look forward to seeing the Treasury Department's upcoming report on financial literacy, but we already know that Congress and the President are not investing the kind of money in this effort necessary to be successful.

I strongly supported the establishment of a national uniform standard for our credit system—one that would ensure greater consumer access to and control over credit information that would provide enhanced protections against identity theft, and, establish a groundbreaking new role for the Federal Government in financial literacy and education promotion.

I was pleased to sponsor Title V—the Financial Literacy component of the FCRA legislation that we passed more than a year ago.

Because of this Title, there is now a national financial literacy commission charged with developing a national strategy on financial literacy, setting up a one-stop consumer website and 800 number, and guaranteeing that we streamline and coordinate our Government's financial literacy efforts.

I also authored an FCRA provision that requires the FTC to study common financial transactions that are not generally reported to credit reporting agencies and recommend ways to encourage the reporting of these transactions. This is important because it will help the Government and credit reporting agencies develop better ways to measure the creditworthiness of lower-income, working families.

I also want to say that I believe that one thing that has made our economy more robust over the past 20 years has been the increasing access that people have to credit.

I am committed to ensuring that people have access to credit and I am going to continuing working to ensure the heath of our consumer credit markets.

For one, I am concerned about taking a heavy handed approach to oversight that may lead to the regulation of interest rates and fees that ultimately limit the ability of banks to extend credit to higher risk consumers.

That being said, it is important that we make sure that credit cards companies are treating people fairly.

It disturbs me that there are reports that some companies are increasingly trapping unwitting consumers in a labyrinth of late fees and rising interest rates.

We must consider the issue of fair play. People can act rationally only when they have all the information that they need to make a decision. Senator Akaka has introduced a bill that would provide additional information to consumers, information that consumer advocates are adamant will help consumers understand the high costs of holding credit card debt.

I supported his amendment on this issue when it was offered to the bankruptcy bill because I believe that reasonable disclosures can help bridge the gap between available information about how our credit cards work and the need to make informed decisions.

Also, I continue to be concerned about credit card marketing to our college aged kids.

The marketing to our students is not necessarily a bad thing. Credit cards used by students can be very beneficial. They can provide students with an opportunity to learn to manage money. And, they can offer students an opportunity to build good credit ratings.

However, this is not always what happens. Indeed, we are seeing numerous incidents where the ultimate result is that the students end up racking up thousands of dollars of debt.

That is why I support Senator Dodd's efforts to ensure that if a credit card company wants to issue a credit card to a student under the age of 21, the student must have the ability to repay his or her debts, must attend a credit counseling course, or must identify an individual—presumably a parent—who is willing to accept joint liability for the credit card balances. This is both common sense and good underwriting.

While we have done a significant amount of work to improve disclosures and transparency there is always room for improvement. I believe the Committee, however, should be careful that we do not unintentionally restrict credit to vulnerable segments of our population when considering our options.

Mr. Chairman, thank you again for calling this hearing and I look forward to hearing from our witnesses today.

PREPARED STATEMENT OF DIANNE FEINSTEIN

A U.S. SENATOR FROM THE STATE OF CALIFORNIA

MAY 17, 2005

Thank you, Chairman Shelby and Ranking Member Sarbanes for scheduling this hearing. I believe that it is important that we explore the issue of consumer credit card debt.

Today, 144 million Americans utilize credit cards and charge more debt on those cards than ever before. (Frontline, "The Secret History of the Credit Card," November 2004.) In 1990, Americans charged $338 billion on credit cards. By 2003, that number had risen to $1.5 trillion. (*Carddata.com.*)

Many Americans now own multiple credit cards. In 2003, 841 million bank-issued credit cards were in circulation in the United States. (*CardWeb.com.*) That number becomes nearly 1.4 billion credit cards, when cards issued by stores and oil companies are factored in. (HSN Consultants.) That is an average of 5 credit cards per person.

The proliferation of credit cards can be traced, in part, to a dramatic increase in credit card solicitation. In 1993, credit card companies sent 1.52 billion solicitations to American homes; in 2001, they sent over 5 billion. (*Mail Monitor*, a service of BAIGlobal, Inc. See also Consumer Federation of America, Press Release, "Credit Card Issuers Aggressively Expand Marketing and Lines Of Credit On Eve Of New Bankruptcy Restrictions," February 27, 2001.)

As one would expect, the increase in credit cards has also yielded an increase in credit card debt. Individuals get six, seven, or eight different credit cards, pay only the minimum payment required, and many end up drowning in debt. That happens in case after case.

Since 1990, the debt that Americans carry on credit cards has more than tripled, going from about $238 billion in 1990 to $755 billion in 2004. (Testimony of Tamara Draut, Director of the Economic Opportunity Program, Demos, Before The Sub-

committee on Financial Institutions and Consumer Credit Regarding Financial Services Issues: A Consumer's Perspective, September 15, 2004.)

As a result, the average American household now has about $7,300 of credit card debt. (Federal Reserve, Release G. 19, "Consumer Credit.")

As has been discussed in this Congress, the number of personal bankruptcies has doubled since 1990. (Testimony of Tamara Draut, Director of the Economic Opportunity Program, Demos, Before The Subcommittee on Financial Institutions and Consumer Credit Regarding Financial Services Issues: A Consumer's Perspective, September 15, 2004) Many of these personal bankruptcies are people who utilize credit cards. These cards are enormously attractive. However, these individual credit card holders receive no information on the impact of compounding interest. They pay just the minimum payment. They pay it for 1 year, 2 years—they make additional purchases, they get another card, and another, and another.

Unfortunately, these individuals making the minimum payment are witnessing the ugly side of the "Miracle of Compound Interest." After 2 or 3 years, many find that the interest on the debt is such that they can never repay these cards, and do not know what to do about it.

Statistics vary about the number of individuals who make only the minimum payments. One study determined that 35 million pay only the minimum on their credit cards. (Frontline, "The Secret History of the Credit Card," November 2004.) In a recent poll, 40 percent of respondents said that they pay the minimum or slightly more. (Cambridge Consumer Credit Index Poll, March 2005.) What is certain is that many Americans pay only the minimum, and that paying only the minimum has harsh financial consequences.

I suspect that most people would be surprised to know how much interest can pile up when paying the minimum. Take the average household, with $7,300 of credit card debt, and the average credit card interest rate, which in April, before the most recent Federal Reserve Board increase of the prime rate, was 16.75 percent. (*Carddata.com.*) If only the 2 percent minimum payment is made, it will take them 44 years and $23,373.90 to pay off the card. (All calculations from CardTrak at *Cardweb.com.*) And that is if the family does not spend another cent on their credit cards—an unlikely assumption. In other words, the family will need to pay over $16,000 in interest to repay just $7,300 of principal.

For individuals or families with more than average debt, the pitfalls are even greater. Twenty thousand dollars of credit card debt at the average 16.75 percent interest rate will take an 58 years and $65,415.28 to pay off if only the minimum payments are made.

And 16.25 percent is only the average interest rate. The prime rate, despite recent increases, remains relatively low—at 6 percent. However, interest rates around 20 percent are not uncommon. In fact, among the 10 banks that are the largest issuers of credit cards, the top interest rates on credit cards are between 23 and 31 percent—and that does not factor in various penalties and fees. (*Cardweb.com.*) When penalty interest rates are factored in, the highest rates are 41 percent. (*Carddata.com.*) In 1990, the highest interest rate—even with penalties, was 22 percent, a little more than half of what they are today. (*Carddata.com.*)

Even if we assume only a 20 percent interest rate, a family that has the average debt of $7,300 at a 20 percent interest rate and makes the minimum payments will need an incredible 76 years and $41,884 to pay off that initial $7,300 of debt. That is $34,584 in interest payments—more than 4 times the original debt. And these examples are far from extreme.

Moreover, these are not merely statistics, but are reflective of very real situations for many people. On March 6, *The Washington Post* ran a headline story on its front page, entitled "Credit Card Penalties, Fees Bury Debtors." I would recommend this article to my colleagues, because it illustrates part of the problem—that credit card companies, aggressively marketing their products, end up charging outrageous interest and fees to their customers. I ask that the article be included in the record. The article highlighted the following stories:

- Ohio resident, Ruth Owens tried for 6 years to pay off a $1,900 balance on her Discover card, sending the credit company a total of $3,492 in monthly payments from 1997 to 2003. Yet her balance grew to $5,564.28,
- Virginia resident Josephine McCarthy's Providian Visa bill increased to $5,357 in 2 years, even though McCarthy has used the card for only $218.16 in purchases and has made monthly payments totaling $3,058.
- Special-education teacher Fatemeh Hosseini, from my state of California, worked a second job to keep up with the $2,000 in monthly payments she collectively sent to five banks to try to pay $25,000 in credit card debt. Even though she had not used the cards to buy anything more, her debt had nearly doubled to $49,574 by the time she filed for bankruptcy last June.

Unfortunately, these stories are not unique.

Part of the problem goes back to changes made in the credit card industry. For a long time, most banks required their customers to pay 5 percent of their credit card balance every month. That was before Andrew Kahr, a credit card industry consultant, got involved. Mr. Kahr realized that if customers were able to pay less, they would borrow more, and he convinced his clients that they should reduce the minimum payment to just 2 percent. (Frontline, "The Secret History of the Credit Card," November 2004.)

The PBS program "Frontline," ran a program in November of last year titled "The Secret History of the Credit Card" that examined the rapid growth of the credit card industry and included an interview with Mr. Kahr.

Mr. Kahr's innovation has been a windfall for the credit card industry. If consumers are paying a lower percentage of their balance as the minimum payment, the credit card companies will make more money over time. In fact, many in the industry refer to individuals who pay their credit card bills in full as "deadbeats," because they are less profitable than individuals who carry large balances, who are known as "revolvers." (Frontline, "The Secret History of the Credit Card," November 2004.)

And Mr. Kahr's own research showed that just making the minimum payment eased consumers' anxiety about carrying large amounts of credit card debt—they believe they are still being financially prudent. (Frontline, "The Secret History of the Credit Card," November 2004.)

The bill I am proposing speaks directly to those types of consumers. There will always be people who cannot afford to pay more than their minimum payments. But, there are also a large number of consumers who can afford to pay more but feel comfortable paying the minimum payment because they do not realize the consequences of doing so.

Now, I am certainly not trying to demonize credit cards or the credit card industry. Credit cards are an important part of everyday life. However, I do think that people should understand the dangers of paying only their monthly minimums. In this way individuals will be able to act responsibly.

Mr. Chairman, it is not necessarily that people do not understand the basics of interest. Most of us just do not realize how fast it compounds or how important it is to do the math to find out what it means to pay a minimum requirement.

The bottom line is that for many consumers, the 2 percent minimum payment is a financial trap.

The Credit Card Minimum Payment Notification Act is designed to ensure that people are not caught in this trap through lack of information. The bill tracks the language of the amendment originally proposed to the bankruptcy bill that was cosponsored by Senator Kyl, Senator Brownback, and myself.

Let me tell you exactly what this bill would do. It would require credit card companies to add two items to each consumer's monthly credit card statement:

One, a notice warning credit card holders that making only the minimum payment each month will increase the interest they pay and the amount of time it takes to repay their debt; and two, examples of the amount of time and money required to repay a credit card debt if only minimum payments are made; or if the consumer makes only minimum payments for 6-consecutive months, the amount of time and money required to repay the individual's specific credit card debt, under the terms of their credit card agreement.

The bill would also require that a toll free number be included on statements that consumers can call to get an estimate of the time and money required to repay their balance, if only minimum payments are made.

And, if the consumer makes only minimum payments for 6-consecutive months, they will receive a toll free number to an accredited credit counseling service.

The disclosure requirements in this bill would only apply if the consumer has a minimum payment that is less than 10 percent of the debt on the credit card, or if their balance is greater than $500. Otherwise, none of these disclosures would be required on their statement.

The language of this bill comes from a California law, the "California Credit Card Payment Warning Act," passed in 2001. Unfortunately, in 2002, this California law was struck down in U.S. District Court as being preempted by the 1968 Truth in Lending Act. The Truth in Lending Act was enacted in part because Congress found that, "The informed use of credit results from an awareness of the cost of thereof by consumers." Consequently, this bill would amend the Truth in Lending Act, and would also further its core purpose.

These disclosures allow consumers to know exactly what it means for them to carry a balance and only make minimum payments, so they can make informed decisions on credit card use and repayment.

The disclosure required by this bill is straightforward—how much it will cost to pay off the debt if only minimum payments are made, and how long it will take do it. As for expense, my staff tells me that on the website *Cardweb.com,* there is a free interest calculator that does these calculations in under a second. Moreover, I am told that banks make these calculations internally to determine credit risk. The expense would be minimal.

Percentage rates and balances are constantly changing and each month, the credit card companies are able to assess the minimum payment, late fees, over-the-limit fees, and finance charges for millions of accounts.

If the credit card companies can put in their bills what the minimum monthly payment is, they can certainly figure out how to disclose to their customers how much it might cost them if they stick to that minimum payment.

The credit card industry is the most profitable sector of banking, and last year it made $30 billion in profits. (*Carddata.com.*) MBNA's profits alone last year were one-and-a-half times that of McDonald's. Citibank was more profitable than Microsoft and Wal-mart. (Frontline, "The Secret History of the Credit Card," November 2004.) I do not think they should have any trouble implementing the requirements of this bill.

I believe that this is extraordinarily important and that it will minimize bankruptcies. With companies charging very substantial interest rates, they have an obligation to let the credit card holder know what those minimum payments really mean. I have people close to me I have watched, with six or seven credit cards, and it is impossible for them, over the next 10 or 15 years, to pay off the debt if they continue making just minimum payments.

We now have a bankruptcy bill that has passed into law. I continue to believe that a bill requiring a limited but meaningful disclosure by credit cards companies is a necessary accompaniment. I think you will have people who are more cautious, which I believe is good for the bankruptcy courts in terms of reducing their caseloads, and also good for American consumers.

The credit card debt problem facing our Nation is significant. I believe that this bill is an important step in providing individuals with the information needed to act responsibly, and it does so with a minimal burden on the industry.

PREPARED STATEMENT OF DANIEL K. AKAKA

A. U.S. SENATOR FROM THE STATE OF HAWAII

Thank you Mr. Chairman, I appreciate your including me in this hearing today. I also want to express my deep appreciation to Senator Sarbanes for working closely with me on a wide range of financial literacy related issues, including credit card disclosures.

Mr. Chairman, revolving debt, mostly comprised of credit card debt, has risen from $54 billion in January 1980 to more than $800 billion in March 2005. During all of 1980, only 287,570 consumers filed for bankruptcy. In 2004, approximately 1.5 million consumers filed for bankruptcy, keeping pace with 2003's record level.

Some of this increased activity can be explained by a ballooning in consumer debt burdens, particularly revolving debt, primarily made up of credit card debt. Credit card issuers have a lot of flexibility in setting minimum monthly payments. Competitive pressures and a desire to preserve outstanding balances have led to a general easing of minimum payment requirements in recent years. The result has been extended repayment programs. Even with the doubling of minimum monthly payments from 2 to 4 percent by some of the country's largest credit card issuers, much of that payment continues to cover only interest and fees. Meanwhile, other initiatives by large credit card issuers, such as reducing grace periods, will catch many consumers with late fees which will trigger higher default interest rate charges.

It is imperative that we make consumers more aware of the long-term effects of their financial decisions, particularly in managing credit card debt. Obtaining credit has become easier. Students are offered credit cards at earlier ages, particularly since credit card companies have been successful with aggressive campaigns targeted at college students. Universities and alumni associations across the country have entered into marketing agreements with credit card companies. More than 1,000 universities and colleges have affinity marketing relationships with credit card issuers. Affinity relationships are made as attractive as possible to credit card account holders through the offering of various benefits and discounts for using the credit card, with the affinity group receiving a percentage of the total charge volume from the credit card issuer. Thus, college students, many already burdened with stu-

dent loans, are accumulating credit card debt. I appreciate all of the work that Senator Dodd has done in order to address this situation.

While it is relatively easy to obtain credit, especially on college campuses, not enough is being done to ensure that credit is properly managed. Currently, credit card statements fail to include vital information that would allow individuals to make fully informed financial decisions. Additional disclosure is needed to ensure that individuals completely understand the implications of their credit card use and the costs of only making the minimum payments as determined by credit card companies.

I have a long history of seeking to improve financial literacy in this country, primarily through expanding educational opportunities for students and adults. Beyond education, I also believe that consumers need to be made more aware of the long-term effects of their financial decisions, particularly in managing their credit card debt, so that they can avoid financial pitfalls.

The Bankruptcy Reform law includes a requirement that credit card issuers provide information to consumers about the consequences of only making the minimum monthly payment. However, this requirement fails to provide the detailed information on billing statements that consumers need to know to make informed decisions. The bankruptcy law will allow credit card issuers a choice between disclosure statements. The first option included in the bankruptcy bill would require a standard "Minimum Payment Warning." The generic warning would state that it would take 88 months to pay off a balance of $1,000 for bank card holders or 24 months to pay off a balance of $300 for retail card holders. This first option also includes a requirement that a toll-free number be established that would provide an estimate of the time it would take to pay off the customer's balance. The Federal Reserve Board would be required to establish the table that would estimate the approximate number of months it would take to pay off a variety of account balances.

There is a second option that the legislation permits. The second option allows the credit card issuer to provide a general minimum payment warning and provide a toll-free number that consumers could call for the actual number of months to repay the outstanding balance.

The options available under the Bankruptcy Reform law are woefully inadequate. They do not require issuers to provide their customers with the total amount they would pay in interest and principal if they chose to pay off their balance at the minimum rate. Since the average household with debt carries a balance of approximately $10,000 to $12,000 in revolving debt, a warning based on a balance of $1,000 will not be helpful. The minimum payment warning included in the first option underestimates the costs of paying a balance off at the minimum payment. If a family has a credit card debt of $10,000, and the interest rate is a modest 12.4 percent, it would take more than 10 and a half years to pay off the balance while making minimum monthly payments of 4 percent.

Along with Senators Sarbanes, Schumer, Durbin, and Leahy, I introduced the Credit Card Minimum Payment Warning Act and subsequently offered it as an amendment to the bankruptcy bill. The legislation would make it very clear what costs consumers will incur if they make only the minimum payments on their credit cards. If the Credit Card Minimum Payment Warning Act is enacted, the personalized information consumers would receive for their accounts would help them make informed choices about their payments toward reducing outstanding debt.

Our bill requires that a minimum payment warning notification on monthly statements stating that making the minimum payment will increase the amount of interest that will be paid and extend the amount of time it will take to repay the outstanding balance. The legislation also requires companies to inform consumers of how many years and months it will take to repay their entire balance if they make only the minimum payments. In addition, the total cost in interest and principal, if the consumer pays only the minimum payment, would have to be disclosed. These provisions will make individuals much more aware of the true costs of their credit card debts. The bill also requires that credit card companies provide useful information so that people can develop strategies to free themselves of credit card debt. Consumers would have to be provided with the amount they need to pay to eliminate their outstanding balance within 36 months.

Finally, our bill would require that creditors establish a toll-free number so that consumers can access trustworthy credit counselors. In order to ensure that consumers are referred to only trustworthy credit counseling organizations, these agencies would have to be approved by the Federal Trade Commission and the Federal Reserve Board as having met comprehensive quality standards. These standards are necessary because certain credit counseling agencies have abused their nonprofit, tax-exempt status and taken advantage of people seeking assistance in managing their debts. Many people believe, sometimes mistakenly, that they can place blind

trust in nonprofit organizations and that their fees will be lower than those of other credit counseling organizations.

We must provide consumers with detailed personalized information to assist them in making better informed choices about their credit card use and repayment. Our bill makes clear the adverse consequences of uninformed choices, such as making only minimum payments, and provides opportunities to locate assistance to better manage credit card debt.

In response to critics who believe that the Credit Card Minimum Payment Warning Act disclosures are not feasible, I, along with Senator Sarbanes, have asked the General Accountability Office to study the feasibility of requiring credit card issuers to disclose more information to consumers about the cost association with making only the minimum monthly payment. I look forward to reviewing the GAO's conclusions.

Mr. Chairman, I look forward to working with you, Senator Sarbanes, and all of the Members of the Committee, to improve credit card disclosures so that they provide relevant and useful information that hopefully will bring about positive behavior change among consumers. Consumers with lower debt levels will be better able to establish savings plans that allow them to be in a better position to afford a home, pay for their child's education, or retire comfortably on their own terms.

Thank you again for including me in this important hearing, Mr. Chairman.

PREPARED STATEMENT OF EDWARD M. GRAMLICH

MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MAY 17, 2005

Chairman Shelby, Senator Sarbanes, and Members of the Committee, I appreciate the opportunity to appear today to discuss consumer credit card accounts. The Board of Governors of the Federal Reserve System administers the Truth in Lending Act (TILA). Enacted in 1968, TILA is the primary Federal law governing disclosures for consumer credit, including credit card accounts. It is implemented in the Board's Regulation Z.

TILA has distinct rules for two categories of consumer credit: Open-end (revolving) credit plans, such as credit card accounts and other lines of credit; and closed-end (installment) transactions, such as auto loans and home-purchase loans. Amendments targeting specific loan products or practices have been added over TILA's nearly 40-year history and the Act was substantially revised by the Truth in Lending Simplification and Reform Act of 1980.

TILA's purpose is to assure a meaningful disclosure of credit terms so that consumers can compare more readily the various credit terms available and avoid the uninformed use of credit. TILA fulfills this purpose by requiring the uniform disclosure of costs and other terms to consumers. TILA is also intended to protect consumers against inaccurate and unfair credit billing and credit card practices, which the Act seeks to accomplish through procedural and substantive protections, including special rules for cardholders.

Regulation Z review. Regulation Z and its staff commentary have been reviewed and updated almost continuously, but not comprehensively since 1980. In December 2004, the Board began a comprehensive review of Regulation Z, starting with the publication of an Advance Notice of Proposed Rulemaking (ANPR) on the rules for open-end credit that is not home-secured, such as general-purpose credit cards.[1] The goal of the review is to improve the effectiveness and usefulness of open-end disclosures and substantive protections. The public comment period recently closed, and the Board's staff will be carefully reviewing the comment letters as they consider possible changes to the regulations. We also believe that consumer testing should be used to test the effectiveness of any proposed revisions, and anticipate publishing proposed revisions to Regulation Z in 2006.

We recognize the hard work that is ahead. The landscape of credit card lending has changed since TILA's disclosure rules for credit card accounts were first put in place. Products and pricing are complex. Credit card accounts can be used for purchases, cash advances, and balance transfers, and each means of access may carry different rates. Promotional rates and deferred interest plans for limited time periods are commonly layered onto these basic features. However, under some credit card agreements, paying late or exceeding a credit limit may trigger significant fees

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[1] The Board's Advance Notice of Proposed Rulemaking for Regulation Z can be found at: *www.Federalreserve.gov/boarddocs/press/bcreg/2004/20041203.*

and a penalty rate that is applied to the entire outstanding balance, and may trigger higher rates on other credit card accounts. Moreover, the amount of consumers' payments, how creditors allocate those payments to outstanding balances, and how the balances are calculated all affect consumers' overall cost of credit under open-end plans.

The question is, of course, how might the Board revise its rules under TILA in a way that will enable consumers to more effectively use disclosures about the key financial elements of a particular credit card over the life of the account? Simplifying the content of disclosures may be one way; finding ways to enhance consumers' ability to notice and understand disclosures may be another. Reviewing the adequacy of TILA's substantive protections is a third, and the ANPR asks questions about each of these areas. As the Regulation Z review proceeds, the Board will be grappling with the challenge of issuing clear and simple rules for creditors that both provide consumers with key information about complicated products (while avoiding so-called "information overload") and provide consumers adequate substantive protections, consistent with TILA. For example, TILA contains procedures for resolving billing errors on open-end accounts, prohibits the unsolicited issuance of credit cards, and limits consumers' liability when a credit card is lost or stolen.

To assist the Committee in its deliberations, I will provide an overview of TILA's rules affecting open-end credit plans, focusing on rules for credit card accounts. I will discuss some of the major issues raised in the ANPR, and commenters' views on these issues. I will also address compliance and enforcement issues, along with the role of consumer education in improving consumers' informed use of credit.

Disclosures for Open-end Credit Plans

TILA disclosures for open-end plans are provided to consumers:

- On or with credit card applications and solicitations, such as applications sent by direct mail.
- At account opening.
- Throughout the account relationship, such as on periodic statements of account activity and when the account terms change.

Content. Generally, the disclosures provided with credit card applications, at account-opening and on periodic statements, address the same aspects of the plan; that is, in each case consumers receive information about rates, fees, and grace periods to pay balances without incurring finance charges. The level of detail differs, however.

Disclosures received with a direct-mail credit card account application are intended to provide a snapshot to help the consumer decide whether or not to apply for the credit card account. For example, revolving open-end accounts involve calculating a balance against which a rate is applied. The method for calculating that balance may differ from creditor to creditor, however. Under TILA, identifying a balance calculation method by title, such as the "average daily balance method (including new purchases)," is sufficient at application. Account-opening disclosures are more detailed and complex, however, in part because the account-opening disclosures required under TILA are typically incorporated into the account agreement. The periodic statement discloses information specific to the statement cycle. In the case of balance calculation methods, the disclosure is typically identical to the account-opening disclosure.

Creditors must also tell consumers about their rights and responsibilities under the Fair Credit Billing Act, a 1974 amendment to TILA that I will discuss later, which governs the process for resolving billing disputes. In addition to explaining these rights in the account-opening disclosures, creditors must send reminders throughout the account relationship. Under TILA, a detailed explanation must be sent about once a year; typically, creditors instead send an abbreviated reminder on the reverse side of each periodic statement, as permitted by Regulation Z.

Format. Generally, disclosures must be in writing and presented in a "clear and conspicuous" manner. For credit card application disclosures, the "clear and conspicuous" standard is interpreted to mean that application disclosures must be "readily noticeable." Disclosures that are printed in a twelve-point type size have a safe harbor in the regulation under this standard.

Disclosures for direct-mail credit card account applications have the most regimented format requirements. The disclosures must be presented in a table with headings substantially similar to those published in the Board's model forms. Regulation Z's sole type-size requirement also applies to direct-mail application disclosures; the annual percentage rate for purchases must be in at least eighteen-point type size. Format requirements for credit card account applications available to the general public (take-one's) are quite flexible. At the card issuer's option, take-one

disclosures may be in the form required for direct-mail applications, an abbreviated narrative, or a simple statement that costs are involved that provides information about where details can be obtained.

Compared to application disclosures, account-opening and periodic statement disclosures are governed by few specific format requirements. Except in the context of recently enacted amendments to TILA contained in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (2005 Bankruptcy Act), disclosures need not be presented in any particular order, nor is there any detailed guidance on the "clear and conspicuous" standard other than a requirement that the terms "finance charge" and "annual percentage rate" must be more conspicuous than any other term.

The 2005 Bankruptcy Act contains several amendments to TILA, three of which are particularly relevant here. The act generally requires creditors to provide on the front page of periodic statements a warning about the effects of making minimum payments and a standardized example of the time it would take to pay off an assumed balance if the consumer makes only the minimum payment, along with a toll-free telephone number that consumers can use to obtain estimates of how long it would take to pay off their actual account balance. In addition, the Act provides that if a temporary rate is offered on solicitations and applications, or promotional materials that accompany them, the term "introductory" must be "immediately proximate" to each listing of the temporary rate. The expiration date and the rate that will apply when the introductory rate expires must be "closely proximate" to the first listing of the introductory rate in promotional materials. Under the Act, the Board must issue guidance regarding a "clear and conspicuous" standard applicable only to these minimum payment and introductory rate disclosures, including model disclosures.

The Board has published model forms and clauses to ease compliance for many of TILA's disclosure requirements. Creditors are not required to use these forms or clauses, but creditors that use them properly are deemed to be in compliance with the regulation regarding these disclosures. The Board has published model forms for direct-mail credit card account application disclosures, but there are no model forms illustrating account-opening or periodic statement disclosures.

Regulation Z review. Considering how consumers' use of open-end credit, and credit cards in particular, has grown, and the increased diversity in credit products and pricing, the Board's ANPR asked a number of detailed questions about how to improve the effectiveness and usefulness of TILA's open-end disclosures, including how to address concerns about "information overload." The Board also invited comment on how the format of disclosures might be improved, and whether additional model disclosures would be helpful. The Board announced its intent to use focus groups and other research to test the effectiveness of any new disclosures.

In general, commenters representing both consumers and industry believe that the regimented format requirements for TILA's credit card account application disclosures have proven useful to consumers, although a variety of suggestions were made to add or delete specific disclosure requirements. Many, however, noted that typical account-opening disclosures are lengthy and complex, and suggested that the effectiveness of account-opening disclosures could be improved if key terms were summarized in a standardized format, perhaps in the same format as TILA's direct-mail application disclosure. These suggestions are consistent with the views of some members of the Board's Consumer Advisory Council, who advise the Board on consumer financial services matters. Industry commenters support the Board's intention to use focus groups or other consumer research tools to test the effectiveness of any proposed revisions.

To combat "information overload," many commenters asked the Board to emphasize only the most important information consumers need at the time the disclosure is given. They asked the Board to avoid rules that require the repetitive delivery of complex information, not all of which is essential to comparison shopping for credit cards, such as a lengthy explanation of the creditor's method of calculating balances that is now required at account-opening and on periodic statements. Commenters suggested that the Board would more effectively promote comparison shopping by focusing on essential terms in a simplified way. They believe some information could also be provided to consumers through educational, nonregulatory methods. Taken together, this approach could lead to simpler disclosures that consumers might be more inclined to read and understand.

Truth in Lending's Cost Disclosures for Open-end Credit Plans

As I have indicated, TILA is designed to provide consumers with information about the costs and terms of a particular form of credit, to enable consumers to

make comparisons among creditors or different credit programs, or to determine whether they should obtain credit at all.

Finance charges and other charges. Creditors offering open-end credit must disclose fees that are "finance charges" and "other charges" that are part of the credit plan. A "finance charge" is broadly defined as any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor, as an incident to or a condition of the extension of credit. Interest, cash advance fees, and balance transfer fees are examples of finance charges. Fees that are not incident to the extension of credit, but are significant charges imposed as part of an open-end plan must also be disclosed as "other charges." Late payment fees, application fees, and recurring periodic membership fees that are payable whether or not the consumer uses the credit plan (annual fees) are examples of other charges.

Annual percentage rate. Under TILA, the finance charge is also expressed as an annualized rate, called the Annual Percentage Rate, or APR. Interestingly, within the Truth in Lending structure, the term represents three distinct calculations, one under TILA's rules for closed-end credit and two under the rules for open-end credit.

For closed-end (installment) credit, the APR includes interest and finance charges other than interest, such as points or origination fees on mortgage loans. Thus, the APR on closed-end transactions can be somewhat higher than the interest rate identified in the loan agreement, whenever other fees are present in the finance charge.

APR's for open-end credit are calculated differently. Interest is the only component of the APR that can be disclosed on credit card solicitations and applications, account-opening disclosures, and advertisements for open-end plans. This is because the actual cost of credit to the consumer is unknown when these disclosures are provided, since the amount and timing of advances and the imposition of fees generally are in the consumer's control.

Periodic statements must also disclose an "effective" or "historic" APR that reflects interest as well as finance charges other than interest, such as a cash advance fee, that were imposed during the past billing cycle. Because noninterest finance charges are amortized over one billing cycle for purposes of disclosing the effective APR, such fees can result in a high, double-digit (or sometimes triple-digit) effective APR on periodic statements. To avoid a skewed APR that could possibly mislead consumers, nonrecurring loan fees, points, or similar finance charges related to the opening, renewing, or continuing of an open-end account are currently excluded from the effective APR that is disclosed for a particular billing cycle, under Regulation Z and the Board's official staff commentary.

Regulation Z Review. A major focus of the Board's Regulation Z review is how to disclose more effectively the cost of open-end credit. For the industry as a whole, the types of fees charged on open-end consumer credit accounts have grown in number and variety. To the extent these fees are not specifically addressed in TILA or Regulation Z, creditors are sometimes unsure whether the fee should be disclosed under TILA as a "finance charge" or an "other charge," or not disclosed under TILA at all. The Board asked for comment in the ANPR on how to provide more certainty in classifying fees, and whether consumers would benefit from other disclosures that address the cost of credit, such as how creditors allocate payments.

Commenters provided a variety of views. Some suggested that creditors should disclose only interest as the "finance charge" and simply identify all other fees and charges. Others suggested that all fees associated with an open-end plan should be disclosed as the "finance charge." Above all, to mitigate the risks and potential liability for noncompliance, creditors seek clear rules that allow them to classify, with confidence, fees as a "finance charge" or an "other charge" under TILA, or as fees that are disclosed pursuant to the credit agreement or State law. Under the statute, a creditor's failure to comply with TILA could trigger a private right of action by consumers and administrative sanctions by the Federal agency designated in TILA to enforce its provisions with regard to that creditor.

One of the Board's most difficult challenges in the Regulation Z review is to address the adequacy of periodic statement APR's. TILA mandates the disclosure of the effective APR on periodic statements, but its utility has been controversial. Consumer advocates believe it is a key disclosure that is helpful, and provides "shock value" to consumers when fees cause the APR to spike for the billing cycle. Commenters representing industry argued that the effective APR is not meaningful, confuses consumers, and is difficult to explain. They said the disclosure distorts the true cost of credit because fees are amortized over one billing cycle—typically 30 days—when the credit may be repaid over several months. Several commenters urged the Board to include in the effective APR calculation only charges that are based on the amount and duration of credit (interest). In response to the Board's ANPR, some commenters believe the effective APR might be more effectively understood if a disclosure on the periodic statement provided additional context.

Comments received on the merits of requiring creditors to disclose payment allocation methods illustrate the competing interests in improving the overall effectiveness of cost disclosures. Some commenters believe any additional disclosure about payment allocation methods would be excessive and that many card issuers already make such disclosures. Others believe such a disclosure could be helpful to consumers but worry that descriptions might be overly detailed; some asked the Board to publish model disclosures to ensure clarity and uniformity.

Rate increases. Credit card account agreements typically allow card issuers to change interest rates and other fees during the life of the account. Agreements spell out with specificity some potential changes, such as that the rate will increase if the consumer pays late. Credit card agreements also more generally reserve the right to increase rates, fees, or other terms.

The statute does not address changes in terms to open-end plans. Regulation Z, however, requires additional disclosures for some changes. The general rule is that 15 days' advance notice is required to increase the interest rate (or other finance charge) or an annual fee. However, advance notice is not required in all cases. A notice is required, but not in advance, if the interest rate increases due to a consumer's default or delinquency. And if the creditor specifies in advance the circumstances under which an increase to the finance charge or an annual fee will occur, no change-in-terms notice is required when those circumstances are met before the change is made. This is the case, for example, when the agreement specifies that the interest rate will increase if the consumer pays late. Under Regulation Z, because the card issuer has specified when rates will increase in the account agreement, the creditor need not provide advance notice of the rate increase; the new rate will appear on the periodic statement for the cycle in which the increase occurs.

Regulation Z review. The ANPR asked how consumers were informed about rate increases or other changed terms to credit card accounts, and whether the current rules were adequate to allow consumers to make timely decisions about how to manage their accounts.

Comments were sharply divided on this issue. Some consumers believe there is not enough advance notice for changes in terms, and believe a much longer time period is needed to find alternative credit sources. Creditors generally believe the current rules are adequate. The 15 days' advance notice is sufficient, they stated, because change-in-term notices are typically sent with periodic statements, which means as a practical matter consumers receive about a month's notice before the new term becomes effective. Creditors noted that many States require at least 30 days' advance notice and allow consumers to "opt-out" of the new terms by closing the account and paying the outstanding balance under the former terms. For rate (and other) changes not involving a consumer's default, a number of creditors support a thirty-day notice rule and a few support a consumer "opt-out" right under Regulation Z.

Where triggering events are set forth in the account agreement, creditors believe there is no need to provide additional notice when the event occurs; they are not changing a term, they stated, but merely enforcing the agreement. Some suggested this is a case where consumer education is the best solution, and that perhaps Board-published model forms would result in uniformity and greater consumer understanding. Consumers and consumer groups agreed that change-in-term policies should be more prominently displayed, including in the credit card application disclosures.

Procedures and Substantive Protections

TILA and Regulation Z provide protections to consumers when a lost or stolen credit card is used (unauthorized use), when the consumer believes a charge on a billing statement is in error (billing error), and when a purchase is made with a credit card and the consumer cannot resolve with the merchant honoring the card a dispute about the quality of goods or services (claim or defense). The Fair Credit Billing Act was enacted, in part, to provide a procedure for resolving disputes between cardholders and merchants who honor credit cards, and to allocate to card issuers some responsibility for providing relief to the consumer if the merchant fails to accommodate the cardholder.

In general, these protections allow the consumer to avoid paying the disputed amount while the card issuer investigates the matter. The card issuer cannot assess any finance charge on the disputed amount or report the amount as delinquent until the investigation is completed.

Depending on the facts, a dispute could trigger one or more of the protections discussed below. The applicability of a protection can hinge on timing (when the cardholder notifies the card issuer about the problem), the outstanding balance (how much of the sale price remains unpaid at the time the cardholder notifies the card

issuer), and receipt of the good or services (nothing was delivered, or something was delivered but did not meet the cardholder's expectations).

Unauthorized use of a credit card. A cardholder cannot be held liable for more than $50 for the unauthorized use of a card. State law or other applicable law determines whether the cardholder "authorized" the use of the card. There are no specific timing or procedural requirements to trigger this protection (other than notifying the card issuer). An unauthorized charge may also be raised as a billing error or a claim or defense.

Billing error. The billing error provisions contain the strictest timing and procedural requirements of TILA's substantive protections for open-end plans. For example, the consumer's claim must be in writing and sent to the address specifically designated for this purpose. The consumer triggers the billing error rules by notifying the creditor about the dispute. The notice must be received, and creditors must respond, within a set time period. If asserted in a timely manner, a billing error can be asserted even if the consumer previously paid the charge in full.

Claim or defense for a credit card purchase. Cardholders may assert against the card issuer any claim or defense they could assert against the merchant. Cardholders trigger the rule by notifying the card issuer that they have been unable to resolve a dispute with a merchant about a sales transaction where a credit card was used. There is no specific time period within which the cardholder must give notice or the card issuer must respond. However, the cardholder must try to resolve the matter with the merchant before involving the card issuer. Unlike the billing error provision, this remedy is available only if the cardholder has an unpaid balance on the disputed purchase at the time notice is given.

Under TILA, the claim or defense remedy cannot be used to assert tort claims (for example, product liability) against the card issuer. Also, the remedy is available only for sales exceeding $50 and for sales that occur in the State the cardholder has designated as his address or within 100 miles of that address.

Unsolicited issuance. Credit cards may be issued to consumers only upon request. Nevertheless, credit cards may be issued to cardholders in renewal of, or substitution for, a previously accepted card (including supplemental cards for the existing account).

Regulation Z Review. The Board's ANPR asked whether there was a need to revise the regulations' provisions implementing TILA's substantive protections, for example, whether the rules need to be updated to address particular types of accounts or practices or to address technological changes. To illustrate, TILA requires creditors to credit payments on open-end plans on the day the payment is received. Regulation Z permits creditors to set reasonable cut-off hours, which must be disclosed to consumers. The ANPR solicited comment on payment process systems, where mail delivery and electronic payments may be continuous 24 hours a day, 7 days a week, and whether further guidance was needed on what constitutes a "reasonable" cut-off hour.

Most industry commenters stated that cut-off hours vary among creditors due to a number of internal and external factors, and asked that creditors' flexibility in processing payments be maintained. The Board also received suggestions for standardizing cut-off hours in ranges, such as between 3 p.m. and 5 p.m. for mail delivery and 6 p.m. and 8 p.m. for electronic payments.

Consumers and some consumer groups suggested that payments be credited as of the date payments are received regardless of the time. They asked the Board to consider rules that would provide greater certainty to consumers with regard to determining when the payment is received, because creditors more frequently than in the past exercise their right under the account agreement to impose late fees when a payment is not received by the due date. Moreover, consumer groups stated, many credit card agreements allow creditors to increase rates when the creditor learns the cardholder was late on another account even if the cardholder makes timely payments to the creditor.

Supervision and Enforcement

As part of the bank supervision process, the Federal Reserve enforces safe and sound banking practices and compliance with Federal banking laws, including the Truth in Lending rules, with respect to the approximately 915 State-chartered banks that are members of the Federal Reserve System. Other regulators enforce these rules with respect to other institutions. For the vast majority of State member banks, credit card lending is not a significant activity. In fact, of the banks supervised by the Federal Reserve, the issuance of credit cards is the principal business activity of only two of these banks.

In January 2003, the Federal Reserve, along with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift

Supervision, issued interagency guidance on credit card account management practices. Federal Reserve supervisory staff have applied the principles of this guidance through constructive discussions with bank management about individual institutions' portfolio management practices. In the limited instances where formal or informal enforcement actions have proven necessary to ensure sound management of an institution's credit card portfolio, the Federal Reserve has appropriately exercised this authority.

The Board also investigates consumer complaints against State member banks and forwards complaints it receives involving other creditors to the appropriate enforcement agencies. In 2004, the Board received approximately 5,100 consumer complaints. Of this number, approximately 2,300, or 45 percent, were against State member banks, while about 2,800, or 55 percent, were against other creditors not under the Board's supervisory authority and were forwarded to the appropriate agencies.

About 39 percent of the 2,300 complaints against State member banks processed by the Board were complaints about credit cards. The data show that complainants' main concerns were about interest rates and terms, penalty charges and fees such as late fees, over-the-limit fees, and annual fees. In addition, consumers were concerned that their credit information was incorrectly reported to consumer reporting agencies. By way of comparison, industry estimates suggest there are more than 600 million credit cards in consumers' hands and annual domestic transactions involving credit cards exceed $1 trillion.

Role for Consumer Financial Education

This detailed description of the issues of concern in our review of Regulation Z is illustrative of both the complexity of and the growth in today's consumer credit markets. Technology has significantly changed consumers' payment options, with the credit card becoming an accepted payment medium for virtually any consumer good or service. In addition, credit scoring models, the mathematical formulations lenders use to predict credit risk, have enabled creditors to price credit more efficiently, and charge rates of interest commensurate with a consumer's repayment risk. This technology has contributed to the expansion of the subprime market, which has significantly increased access to credit for consumers who, more than likely, would have been denied credit in the past.

As a result, concerns surrounding consumer protection relate as much to issues of fair pricing practices as they do to fair access to credit. In addition, as the industry has become more competitive on interest rate pricing, it has adopted more complex fee structures that, if triggered, affect a consumer's overall cost associated with the credit card.

The use of disclosure rules as a consumer protection strategy is predicated on the assumption that consumers have an understanding of consumer credit and personal financial management principles. By dictating disclosure requirements, regulators and lawmakers rely on consumers to be familiar with basic financial principles and to be able to evaluate personal financial scenarios and options, once they have access to pertinent financial information. Indeed, this is the fundamental premise of our free market system, in which information increases market efficiency. In recent years, however, there has been an increase in concern that consumers' level of financial literacy has not kept pace with the increasingly complex consumer financial marketplace and the expansion of financial service providers and products.

Lenders, regulators, and consumer and community advocacy groups have agreed that there is an increased need for consumer financial education, and have pointed to a variety of factors, including record personal bankruptcy filings, high consumer debt levels, and low personal savings rates, to support this assertion. Financial education could encourage consumers to focus on their credit contracts in addition to the TILA disclosures, which highlight the key terms of the contract. Toward this end, many public and private initiatives have been undertaken at both the local and national level to highlight the importance of financial education.

As you know, Congress has established the Financial Literacy and Education Commission and the Financial and Economic Literacy Caucus—further demonstration of the degree of interest and concern in helping consumers obtain the knowledge they need to effectively manage their personal finances. The Federal Reserve System has also been active in promoting consumer financial education, and is an active participant in initiatives to further policy, research, and collaboration in this area.

In closing, I would like to note that disclosure and financial education work in tandem in the interest of consumer protection, and I believe that it is important to continue to focus our collective attention on both fronts.

PREPARED STATEMENT OF JULIE L. WILLIAMS

ACTING COMPTROLLER OF THE CURRENCY

MAY 17, 2005

Introduction

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, I appreciate this opportunity to appear before you today to discuss the Office of the Comptroller of the Currency's (OCC) perspectives concerning credit card disclosures. The OCC's supervision of the credit card operations of national banks includes safety and soundness fundamentals, compliance with consumer protection laws and regulations, and fair treatment of consumers.

In addition to our ongoing supervision of these institutions, and our processing of numerous consumer inquiries and complaints relating to credit cards, we have taken a number of steps—in the form of enforcement actions and preventive supervisory guidance—to address safety and soundness and consumer protection issues that have arisen in connection with the credit card products offered by national banks. It is important to note, however, that the OCC does not have express statutory authority to issue *regulations* that would define particular credit card practices by banks as unfair or deceptive under the FTC Act, or regulations governing specific credit card disclosures under the Truth in Lending Act. Authority to issue regulations in both those areas has been granted exclusively to the Federal Reserve Board.

The credit card industry is highly competitive, and card issuers have responded to increasing market competition with innovations in card products, marketing strategies, and account management practices. The primary goals of these product and marketing innovations have been to gain new customer relationships and related revenue growth, but in some instances an important secondary benefit has been expanded access to credit by consumers with traditionally limited choices. Unfortunately, not all of the product and marketing innovations have had a uniformly beneficial impact, and the marketing practices of credit card issuers in particular have come in for pointed criticism in recent years.

Regulatory concerns arise when these developments carry costs and risks that are detrimental to consumers and to the safe and sound operations of the credit card issuing bank. They also arise when disclosures intended to enable consumer understanding of the costs and terms of their credit agreements fail to effectively inform consumers about aspects of the credit relationship that are most important to them *and* impose unnecessary burdens on the credit card issuers required to provide the disclosures.

My statement discusses the need to begin a serious reexamination of the processes we have followed historically for developing, designing, implementing, overseeing, and evaluating consumer disclosures for financial products and services. I urge that we take a new approach. Credit card disclosures would be a fine place to start.

In my statement, I also describe the OCC's current program for supervising credit card issuers, enforcement actions we have taken to address practices we viewed as egregious, and guidance we have issued to flag practices that concern us and prevent problems from developing in the future.

Finally, I discuss the recent initiative by the Federal Reserve Board to review disclosure requirements for credit card issuers under the Truth in Lending Act (TILA). The OCC is in a somewhat anomalous position when it comes to credit card disclosures required under TILA, for, while we supervise many of the credit card issuers, we are not authorized to participate in writing the rules under TILA governing their consumer disclosures. Thus, last month, the OCC took the out-of-the ordinary step of submitting a comment letter responding to the Board's Advance Notice of Proposed Rulemaking on Regulation Z's open-end credit rules implementing TILA. My statement describes the most important issues raised in our comment letter.

The Need for a New Approach to Developing Consumer Disclosures

In evaluating the current state of disclosures for consumer financial products and services—which I think we can all agree leave substantial room for improvement—and where we should go in the future, it is useful to consider the process we have followed in developing these disclosures. For several decades, disclosures for consumer financial products have been developed by implementation of statutory requirements that typically specify particular content of information to be provided to consumers. These specific requirements have cumulated over the years. And usually, the regulatory agencies charged with drafting the rules to implement those requirements are given short deadlines to finish their work. These approaches may not always have produced or sustained the positive consumer protection results that

Congress intended, and thus a fundamental change in our approach to consumer disclosure laws and regulations may be called for.

Compared to the processes we have used to develop consumer financial disclosures, a very different approach was used by Congress and the Food and Drug Administration in the development of the "Nutrition Facts" box that is possibly the most prevalent and frequently used consumer disclosure in the marketplace today. The clear and concise labeling of food nutrition content has not only enabled consumers to find products with the nutritional characteristics they're seeking, but it also has influenced food producers to develop products that consumers want. By this measure, the food nutrition disclosures have been effective and useful to consumers, whereas I doubt that we would make a similar statement about many of our current disclosures for consumer financial products. I describe these issues in more detail below in connection with the discussion of the Federal Reserve Board's review of TILA requirements for open-end credit.

The effort that led to the FDA's nutrition labeling began with a clear statement by Congress of the objective the FDA was charged to accomplish. While Congress did specify certain nutrition facts to be disclosed, it also provided the FDA with the flexibility to delete or add to these requirements in the interest of assisting consumers in "maintaining healthy dietary practices." It left to the FDA's discretion the design and format of the nutrition label.

Based on the direction and goals set out by Congress, the FDA took several years, in an effort that involved intensive research not only by nutritionists, but also by experts who polled focus groups to elicit ideas on the kind of information consumers thought was most useful, experimented with dozens of different formats, and tested those formats with target consumer audiences to determine what actually worked. The "Nutrition Facts" box disclosure was the result of painstaking laboratory and fieldwork, notably including extensive input by consumers.

Rather than mandating the precise elements of disclosures, the approach used by Congress with regard to food nutrition labeling was to articulate the goals to be achieved through a particular consumer protection disclosure regime. Congress could follow this model in legislation affecting disclosures for consumer financial products and services, and direct regulators on the *key goals and objectives* Congress wants particular consumer disclosures to achieve. Applying the FDA model to these consumer disclosures means that Congress would also look for opportunities to require, and provide adequate time for, regulators to include consumer testing as an integral part of the rulemaking processes.

Quick fixes without consumer input, and issue-by-issue disclosure "patches" to information gaps, ultimately are not in the long-term best interests of consumers. Before bank regulators issue any new consumer disclosure rules and regulations, we should undertake—or be directed by statute to undertake—thorough consumer testing to discover what information consumers most want to know about in connection with a particular product and how most effectively to communicate that information to them. And any new process for developing consumer disclosures for financial products also needs to take into account both the burden and costs on the industry associated with implementing any new standards, together with the effectiveness of those disclosures.

We have some important choices to make, and this hearing provides an excellent opportunity to initiate a discussion about those choices. We can continue with the current approach to credit card disclosures—indeed, consumer compliance disclosures generally—of critiquing particular practices and gaps in information and then requiring disclosures to address those particular concerns on a piecemeal basis. Or we can, and I hope we will, recognize that a fundamentally different approach is called for. The results, I believe, will be well worth it for consumers and the financial services industry as a whole.

OCC Supervision of Credit Card Issuers

The OCC's comments on these issues are strongly influenced by our experience as the supervisor of many credit card issuers, as well as by the information about consumer confusion and complaints that we obtain through the OCC's Customer Assistance Group. National banks supervised by the OCC issue a substantial percentage of the credit cards held by U.S. consumers. (The Board of Governors of the Federal Reserve System (Board) and the Federal Deposit Insurance Corporation also supervise major credit card issuers.) The OCC's supervision of these institutions reflects a comprehensive approach that is designed to ensure safe and sound operations that comply with applicable laws and regulations and treat customers fairly. This approach enables the OCC to supervise the operations of individual banks, to address emerging risks and other issues on an institution-by-institution or broader basis, and, where necessary, to require correction of consumer abuse or safety and

soundness problems that we may find. There are four primary tools that we use to accomplish these objectives: Examinations, complaint processing, supervisory guidance, and enforcement actions.

Examinations of Credit Card Operations in National Banks

The OCC conducts comprehensive examinations of the business of national banks, including their credit card operations, and OCC examinations monitor whether credit card lending is being conducted in a safe and sound manner and in compliance with consumer protection laws and regulations. The OCC has a corps of compliance specialists, including retail and credit card lending specialists, located throughout the United States, who conduct these examinations of national banks' credit card operations.

The largest national banks, which include many of the major credit card issuers, have on-site examination teams continuously supervising all aspects of the banks' operations. The supervisory time and attention devoted to credit card banks and operations is directly related to their level of complexity, the credit spectrum served, and the risks presented. Thus, our regulatory scrutiny of high risk and complex credit card issuers that are not the largest banks is rigorous, and more frequent than that contemplated by the general 12- to 18-month examination schedule for other banks.

The OCC's supervision of credit card issuers is based on our assessment of the line of business and the market overall. Examiners assigned to the largest and most complex, highest risk operations typically have many years of specialized experience with credit card products.

Our supervision evaluates whether credit card issuers are operating in a safe and sound manner, and we consider consumer compliance, information technology, and capital markets aspects in the overall safety and soundness assessment of the bank. We seek to determine if risks that the bank has assumed are acceptable, and that the risks are appropriately identified, measured, monitored, and controlled.

To make this determination, examiners review the fundamentals such as the reasonableness of the business model and strategic planning, the effectiveness of the bank's controls, financial strength, and compliance with laws, regulations, and relevant supervisory guidance. They also assess the adequacy of policies and procedures through reviews of various functions including marketing and pricing, underwriting, account management, collections, and loss mitigation. In addition, examiners review the bank's use of credit scoring and other models, and, as warranted, bring in quantitative specialists to assess model development and validation. Throughout the supervisory process, examiners routinely make recommendations for improvement, formally and informally. Examiners also advise banks about issues that pose undue credit, compliance, transaction, or reputation risk.

Based on our supervisory experience, we can say that the vast majority of the credit card issuers supervised by the OCC are focused on operating responsibly and in a safe and sound manner, and that they strive to balance their business objectives with customer needs. However, because the credit card market is a highly competitive and, arguably, saturated market, issuers can sometimes implement changes to their products, programs, or practices before fully addressing all of the implications of those changes.

The OCC can address deficiencies in the credit card operations of national banks as a part of our supervisory process. National banks have changed their practices to address specific concerns we raised, including by suspending or withdrawing certain products, repricing initiatives, and line increase programs when they have not been supported by appropriate business analyses and controls, and by modifying procedures affecting the assessment of penalty fees and the posting and allocation of payments.

OCC Consumer Complaint Process

Our Customer Assistance Group (CAG) provides assistance to customers of national banks and their subsidiaries, fielding inquiries and complaints from these customers—many of which relate to credit card products. This complaint processing activity not only helps to resolve individual problems and educate consumers about their financial relationships, in many cases, but, it also leads to resolution of the complaints by the bank and secures monetary compensation or other relief for customers who may not have a more convenient means for having their grievances addressed.

Consumer complaint data can be used by examiners in the field to identify risks affecting particular institutions that should be reviewed as part of the supervisory process. The data also can be used to identify systemic problems—at a particular

bank or in a particular segment of the industry—that warrant enforcement action, or supervisory guidance to address emerging problems.

OCC Enforcement Actions Addressing Unfair and Deceptive Credit Card Practices

The OCC also can address significant problems involving individual credit card issuers through formal enforcement actions. The OCC has authority to address unsafe and unsound practices and to compel compliance with any law, rule, or regulation, including the Truth in Lending Act, the Fair Credit Reporting Act, and the Equal Credit Opportunity Act—the principal Federal statutes that provide specific protections for credit card applicants and borrowers. This authority allows the OCC to require a national bank to cease and desist unsafe or unsound practices or actions that violate consumer protection laws. Further, the OCC may seek restitution for affected consumers in these and other appropriate cases, and assess civil money penalties against banks and their "institution-affiliated parties."

Since 2000, the OCC also has used its general enforcement authority, in combination with the prohibition in the Federal Trade Commission Act (FTC Act) against unfair or deceptive acts or practices, in a number of enforcement actions involving credit card lending. It should not be overlooked that the OCC's use of Section 5 of the FTC Act in this respect was groundbreaking, was initially greeted with skepticism, but is now the uniform position of all the Federal bank regulatory agencies—although it has yet to be employed by any other banking agency to gain relief for consumers in a public enforcement action. Our enforcement actions, described below, have provided hundreds of millions of dollars in restitution to consumers harmed by unfair or deceptive credit card practices, and have required the reformation of a variety of practices. For example:

- Providian National Bank, Tilton, New Hampshire (consent order—June 28, 2000). We required the bank to provide not less than $300 million in restitution for deceptive marketing of credit cards and ancillary products, to cease engaging in misleading and deceptive marketing practices, and to take appropriate measures to prevent such practices in the future.
- Net 1st National Bank, Boca Raton, Florida (consent order—September 25, 2000). We required the bank to discontinue its misleading and deceptive advertising of credit cards and to take appropriate measures to prevent the recurrence of such advertising.
- Direct Merchants Credit Card Bank, N.A., Scottsdale, Arizona (consent order—May 3, 2001). We required the bank to provide restitution of approximately $3.2 million for deceptive credit card marketing, to discontinue its misleading and deceptive marketing practices, and to make substantial changes in marketing practices.
- First National Bank of Marin, Las Vegas, Nevada (consent order—December 3, 2001). We required the bank to provide restitution of at least $4 million for misleading and deceptive credit card marketing, to discontinue its misleading and deceptive advertising practices, and to make substantial changes in its marketing practices and consumer disclosures.
- First National Bank, Ft. Pierre, South Dakota (formal agreement—July 18, 2002). We required the bank to discontinue its misleading and deceptive advertising practices, and to take appropriate actions to prevent deceptive advertising concerning credit lines and the amount of initial available credit.
- First National Bank in Brookings, Brookings, South Dakota (consent order—January 17, 2003). We required the bank to provide restitution of at least $6 million for deceptive credit card marketing practices, to obtain prior OCC approval for marketing subprime credit cards to noncustomers, to cease engaging in misleading and deceptive advertising, and to take other actions.
- Household Bank (SB), National Association, Las Vegas, Nevada (formal agreement—March 25, 2003). We required the bank to provide restitution for deceptive practices in connection with private label credit cards, resulting in a pay out of more than $6 million to date, and to make appropriate improvements in its compliance program.
- First Consumers National Bank, Beaverton, Oregon (formal agreement—July 31, 2003). We required the bank to make restitution of approximately $1.9 million for deceptive credit card practices.
- First National Bank of Marin, Las Vegas, Nevada (consent order—May 24, 2004). We required the bank to make at least $10 million in restitution for consumers harmed by unfair practices, and prohibited the bank from offering secured credit cards in which the security deposit is charged to the consumer's credit card account.

It is vital to note, however, that the OCC does *not* have express statutory authority to issue *regulations* specific to credit card disclosure practices. For example, the

OCC is not granted authority to define unfair or deceptive acts or practices by banks under the FTC Act through regulations. That authority is vested exclusively in the Board. Similarly, Congress has vested the Board with exclusive authority under the Truth in Lending Act to issue regulations governing disclosure practices by *all* credit card issuers.

Nevertheless, through enforcement actions and supervisory guidance, the OCC has sshould fill in the gaps and address circumstances in which existing regulations may not provide specific standards for creditors in making disclosures and in avoiding unfair and deceptive practices. As described in more detail below, additional regulatory standards issued by the Board using its rulemaking authority are needed to address this uncertainty and lack of uniform compliance standards on a comprehensive basis.

Recent OCC Supervisory Guidance on Credit Card Practices

An integral component of OCC supervisory activities is the issuance of guidance to national banks on emerging and systemic risks. We use joint agency issuances and the OCC's advisory letter process to alert national banks to practices that pose consumer protection or safety and soundness risks, and give guidance on how to address these risks and prevent problems from arising. We follow up on how banks are responding to issues flagged in guidance through our supervisory processes.

In the past few years, for example, we have issued a number of supervisory guidelines related to credit card lending, including: [1]

- Credit Card Lending: Account Management and Loss Allowance Guidance (Jan. 3, 2003)
- OCC Advisory Letter 2004–4, Secured Credit Cards (April 28, 2004)
- OCC Advisory Letter 2004–10, Credit Card Practices (Sept. 14, 2004)

The following sections discuss this recent guidance.

Account Management and Loss Allowance Practices

In January 2003, the Federal bank and thrift regulatory agencies issued guidance to address concerns with credit card account management practices. The interagency guidance, *Account Management and Loss Allowance Guidance,* addressed five key areas: Credit line management, overlimit practices, minimum payment and negative amortization, workout and forbearance practices, and income recognition and loss allowance practices. The issues covered by the guidance first surfaced in the subprime credit card market, but follow-up examinations identified similar concerns involving several prime credit card lenders.

It may be useful to describe the highlights of these issues in greater detail. Through the examination process, examiners identified concerns with practices for assigning the initial credit lines to borrowers and increasing existing credit lines, particularly for credit card lenders with subprime portfolios. In some instances, borrower credit lines were increased, seemingly for purposes of increasing the size of the loan portfolios, but without the proper underwriting analysis to support the increases. Some borrowers were unable to make their payments after their credit lines were increased. The result was an increase in delinquencies and losses. The guidance describes the agencies' expectations for banks when they establish initial credit lines for customers and when they increase those credit lines.

Examiners also observed loan workout and loan forbearance practices varied widely, and in some instances raised safety and soundness concerns. These workout programs, whereby lenders typically lower interest rates and stop assessing fees, were often not effective in enabling consumers to repay the amounts owed. In particular, some workout programs had extended repayment periods with modest reduction on the interest rates being charged. To address this issue, the agencies reminded the industry that workout programs should be structured to maximize principal reduction and required that repayment periods for workout programs not exceed 60 months. In order to meet the timeline requirement for repayment for workout accounts, it is our observation that credit card lenders have lowered interest rates on those accounts, fostering more effective workout programs.

Examiners also identified weaknesses in income recognition and loss allowance practices. Because of the revolving nature of the credit card product and low minimum payment requirements, a portion of the interest and fees due were being added to the balances and recognized as income. The agencies' guidance reiterated the principle that generally accepted accounting practices require that loss allow-

[1] In March, 2002, the OCC also issued Advisory Letter 2002–3, Guidance on Unfair or Deceptive Acts or Practices, which includes guidance on avoiding these practices in connection with credit card products.

ances be established for any uncollectible finance charges and fees. The agencies also directed credit card lenders to ensure that loss allowance methodologies covered the probable losses in high-risk segments of portfolios, such as workout and overlimit accounts. Based on our observations, the industry responded quickly to this guidance and increased their loss allowances where needed.

Overlimit practices, where a borrower exceeds the credit limit on the account, raise both safety and soundness and consumer fairness concerns. Examiners observed that credit card accounts had been allowed to remain in overlimit status for prolonged periods with recurring monthly overlimit fees. Negative amortization occurred in accounts where the minimum payment was insufficient to cover the finance charges and other fees imposed, including overlimit fees, and consequently the principal balance increased. To prevent prolonged periods of negative amortization, the guidance directed banks to strengthen overlimit management practices to ensure timely repayment of the amounts that exceed the credit limits. We believe the industry has responded positively to this guidance by restricting the approval of transactions that exceed credit limits and limiting the number of overlimit fees assessed when repayment of the overlimit amount became extended.

Finally, over the past several years, examiners observed declining minimum payment requirements for credit card accounts. During the same period, credit lines, account balances, and fees all have increased. As a result, borrowers who make only minimum payments have been unable to meaningfully reduce their credit card balances. From a safety-and-soundness standpoint, reductions in minimum payment requirements can enable borrowers to finance debts beyond their real ability to repay, thus increasing credit risk to the bank. Liberalized payment terms also increased the potential for consumers to accumulate unmanageable debt loads, and raised their vulnerability to default in cases of even moderate cashflow disruptions. The guidance required banks to address these issues through a systematic reevaluation of payment requirements and fee assessment practices.

From the OCC's perspective, the implementation of this guidance by national banks has been satisfactory, but is not complete. Most national banks addressed the credit-line management, workout program, and loss allowance practices immediately. Issues pertaining to overlimit practices, minimum payments, and negative amortization are taking longer because they require changes to customer account agreements and operating systems. Also, we recognized the need for changes to be phased-in carefully for certain customer segments, in order to enable those customers to adjust to changed repayment expectations. All of the large national bank credit card lenders have submitted plans to address outstanding issues related to overlimit practices, prolonged negative amortization, and required minimum payment amounts for those remaining customer segments. Necessary changes have been and are in the process of being phased-in during 2005, with implementation largely completed by year-end, and the OCC is carefully monitoring the phase-in of these changes.

Secured Credit Cards

The OCC also has issued supervisory guidance that focuses on discrete issues affecting credit card products, such as our guidance on secured credit cards. Secured credit card programs entail a borrower pledging collateral as security for the credit. The borrowers who receive these cards typically are individuals with limited or blemished credit histories who cannot qualify for an unsecured card. In some respects, these products can benefit these consumers by allowing them to establish or improve their credit histories. Traditionally, secured credit cards have required that borrowers pledge funds in a deposit account as security for the amounts borrowed under the credit card account. In the event of default, the deposited funds may be used to help satisfy the debt.

In recent years, however, some issuers began to offer secured credit cards that did not require the consumer to pledge separate funds in a deposit account as collateral in order to open the credit card account. Instead, the security deposit for the account would be charged to the credit card itself upon issuance. This newer practice resulted in a substantial decrease in the amount of credit that was available for use by the consumer when the account was opened. Unsecured credit card products also have been offered with similar disadvantages, except that account opening fees, rather than a security deposit, are charged to the account and consume the nominal credit line assigned by the issuer.

These developments in secured credit card programs—in combination with marketing programs, targeted at subprime borrowers, that often did not adequately explain the structure or its likely consequences—meant consumers were misled about the amount of initial available credit, the utility of the card for routine transactions, and the cost of the card. Truth in Lending disclosures generally do not provide infor-

mation to consumers about credit limits and initial available credit. Moreover, while account opening disclosures prescribed by Regulation Z require, if applicable, a general disclosure pertaining to security interests, there is no such requirement for credit card solicitations or advertisements. Thus, these rules omit disclosure of key information that would provide consumers, at a decision point, a full understanding of a secured credit card product's cost and terms. They also offer little guidance to lenders that may have wished to present such information in a comprehensible manner.

The OCC took enforcement actions involving this type of secured credit card for violating the FTC Act's prohibition against unfair or deceptive practices. We reviewed marketing materials and found significant omissions of material information about the likely effect that charging security deposits and fees to the account would have on the low credit line that was typically extended, and about the consequent impairment of available credit and card utility. These omissions were accompanied by potentially misleading representations concerning possible uses of the card, such as helping consumers to "be prepared for emergencies." While these marketing practices generally *complied* with the specific credit cost disclosure requirements of TILA and Regulation Z, the OCC determined that they constituted *deceptive* practices under the FTC Act. The OCC's enforcement actions required both changes in the issuers' practices and monetary reimbursement to consumers.

We also reviewed whether the practice of charging substantial security deposits and fees to a credit card account and severely reducing the initial credit availability could also be found to be *unfair* within the meaning of the FTC Act. Evidence available to us indicated that consumers were materially harmed by these practices when the product received by most consumers fails to provide the card utility and credit availability for which consumers have applied and incurred substantial costs. Based on this review, the OCC concluded that this practice posed considerable compliance risks under the FTC Act.

To address these concerns, the OCC issued Advisory Letter 2004–4, "Secured Credit Cards." The advisory directs national banks *not to offer* secured credit card products in which security deposits (and fees) are charged to the credit card account, if that practice will substantially reduce the available credit and the utility of the card. The OCC also advised that national banks should not offer *unsecured* credit cards that present similar concerns as a result of initial fees charged to the card.

Shortly after the OCC issued its advisory, we took enforcement action against a national bank offering this type of secured credit card product that required the bank to reimburse affected consumers and to cease offering products in which the security deposit is charged to the consumer's credit card account. As a result of our enforcement actions, advisory letter, and supervisory suasion, we believe that the significant supervisory concerns we had relating to secured credit card products offered by national banks have been addressed.

Other Credit Card Practices

Other credit card practices, involving marketing and changes in terms, also have been the focus of OCC supervisory guidance recently because of our concern that they could expose national banks to material compliance and reputation risks. The OCC recently issued Advisory Letter 2004–10 to advise national banks concerning the risks that these practices may violate the prohibition in the FTC Act against unfair or deceptive practices. These practices include:

- Catching a consumer's attention in advertising materials with promotional rates, commonly called "teaser rates," but not clearly disclosing significant restrictions on the applicability of those rates;
- Advertising credit limits "up to" a maximum dollar amount, when that credit limit is, in fact, seldom extended; and
- Increasing a consumer's rate or other fees when the circumstances triggering the increase, or the creditor's right to implement that increase, have not been disclosed fully or prominently.

Teaser rate marketing. A common marketing technique used in credit card solicitations involves "teaser rates." Frequently, teaser rates are used in promotions seeking to induce new and existing customers to transfer balances from other credit cards. The promotional rate, almost always highlighted prominently in the marketing materials, is usually in effect for a limited period after the account is opened or the relevant balance is transferred. Other important limitations on the availability of the promotional rate, or on the consumer's ability to take advantage of that rate, often apply—although they may *not* be disclosed prominently. For instance, the lower, promotional rate may apply only to balances that are transferred, and a higher rate would apply to purchases and other credit transactions during the

promotional period. Frequently, a consumer's payments during the promotional period are applied first to the transferred balance, and only after this low-rate balance is paid off will payments be applied to balances that are accruing interest at a higher rate. There also may be other costs, such as balance transfer fees, that affect whether the consumer will benefit from accepting a promotional rate offer.

In some circumstances, consumers can lower their credit costs when they transfer balances to a new account with an introductory rate. The costs and limitations on these rates and accounts, by themselves, are not unlawful or inappropriate—provided the consumer has a full appreciation of the terms of the transaction. Problems arise when consumers accept offers without knowing the true terms. This, in turn, can lead to increased complaints and increased exposure to claims of "bait-and-switch," particularly when the consumer accepts these terms without knowing the circumstances in which the creditor can change the terms, including unilaterally.

The Federal Reserve Board's Regulation Z governs many aspects of promotional rate offers. Direct mail credit card solicitations must display prominently in a tabular format each APR that will apply to purchases and balance transfers. However, Regulation Z currently does not restrict the ability of a creditor to highlight only the teaser rate in other materials included in the mailing without noting any limitations on the offer (or to do so only in fine print).[2] Further, Regulation Z requires no disclosure of the order in which payments will be applied to various balances. Finally, while balance transfer fees must be disclosed in solicitations, they are not required to be disclosed in a "prominent location," even in solicitations expressly offering the consumer a promotional rate on a balance transfer.

The OCC's AL 2004–10 provides guidance on how to "fill in the gaps" in these rules for the responsible use of promotional rate advertising. The guidance advises national banks to disclose fully and prominently the categories of balances or charges to which the promotional rate will *not* apply. The advisory also states that a national bank should not fail to disclose fully and prominently other material limitations, such as the time period the rate will be in effect and any circumstances that could shorten the promotional rate period, and related costs. Moreover, if applicable, a national bank should disclose fully and prominently that payments will be applied first to promotional rate balances.

Marketing based on maximum credit limits. Another marketing practice that we have been monitoring concerns promotions based on the highest attainable credit limit—such as "you have been preapproved for credit up to $5,000." We became concerned when we observed that this marketing might be targeting consumers with impaired or limited credit history, and enticing them to accept a credit card based on an illusory "firm offer" of a specific amount of credit. Instead of receiving the credit line that is promoted, these consumers may instead receive a "default credit line" (the minimum credit line) that is significantly lower than the maximum. All too often in marketing of this type, the possibility that a significantly lower credit line may be extended is either not disclosed or disclosed only in fine print or in an obscure location. When high initial fees are charged to the card in relation to the credit line extended, consumers who accept the offer will end up with little initial available credit and little card utility.

The OCC has taken enforcement action in three matters involving, at least in part, marketing to subprime borrowers of credit cards with limits "up to" a specified amount. These enforcement actions involved products and marketing techniques like those described above: Most applicants received a default credit line substantially less than the "up to" amount featured in the promotion, and security deposits or fees consumed substantially all of the default credit line, leaving the consumer with little or no available credit at account opening. For example, in one program, almost 98 percent of credit card applicants received the default line, rather than the theoretical maximum credit line that was promoted. These enforcement actions resulted in consent orders or formal agreements containing detailed provisions to prevent misleading or deceptive marketing materials, and restitution for consumers injured by the bank's marketing practices.

We also addressed "up-to" marketing in AL 2004–10. Even disclosures that may technically comply with Regulation Z remain subject to the FTC Act if they are unfair or deceptive. It may be difficult to assess, however, when practices cross the line into unfairness or deception in a given case. For practices in this gray area, we determined that guidance was needed to prevent consumer confusion and assist national banks in avoiding compliance and reputation risks.

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[2] We note that the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 amends the Truth in Lending Act in several respects to address disclosures affecting credit card accounts, including disclosures related to "introductory rates," minimum payment disclosures, and payment due dates if the creditor may impose a late payment fee.

The advisory states three general guidelines for managing risks and avoiding unfair or deceptive practices in these promotions. First, we advised national banks not to target consumers who have limited or poor credit histories with solicitations for credit cards advertising a maximum credit limit far greater than most applicants are likely to receive. Second, we advised national banks to fully and prominently disclose the amount of the default credit line and the possibility that the consumer will receive it, if it is likely that consumers will receive substantially lower default credit lines. Finally, we advised national banks not to promote cards on the basis of card utility if the initial available credit most consumers receive is unlikely to allow those uses.

Repricing practices and changes in terms. Coincident with the marketing of credit cards based on high credit limits and low introductory interest rates, many credit card issuers have turned to measures such as penalty pricing, rather than relying solely on the up-front interest rate, to manage risk. For instance, many credit card issuers raise the interest rate on a credit card for consumers who do not make timely payments to the issuer, or even to *another* creditor. Card issuers may also raise the interest rate on a credit card to address other indicators of increased credit risk, such as the consumer's increased use of credit or failure to make more than the minimum monthly payment. Some card issuers raise the cost of credit in other ways, such as shortening due dates for payments and increasing cash advance, over-the-limit, late payment, or similar fees. These changes in terms have been the object of significant public attention—and criticism—recently, and are the source of many consumer complaints the OCC has received.

It is important to note that Federal law, including the Truth in Lending Act, does not restrict the ability of creditors to include in their credit card agreements provisions permitting penalty interest rates, other changes in interest rates, or other changes in the terms of the account. However, while penalty rates are required by Regulation Z to be disclosed in solicitations, the manner of disclosure may not effectively alert customers to these terms. For example, except in certain transactions, the disclosure of when penalty rates will apply is not required to be included in the "Schumer box" disclosures, and need not be as detailed as the explanation later provided in the initial account disclosures. Moreover, Regulation Z rules contain anomalies: In contrast to sometimes detailed disclosures provided to consumers about a credit card's costs, Regulation Z does *not* require a disclosure that a creditor has reserved the right to change, unilaterally, these costs and any other credit terms.

The OCC addressed the compliance and reputation risks that accompany change in terms practices in AL 2004–10. We made clear that to avoid consumer misunderstanding and complaints of unfairness, national banks must do more than merely comply with the technical requirements in Regulation Z. The OCC guidance states that national banks should disclose, fully and prominently in promotional materials, the specific circumstances under which the card agreement permits the bank to increase the consumer's APR, fees, or other costs (such as for late payment to another creditor). Additionally, if national banks reserve the right to change the APR, fees, or other credit terms for any reason at the bank's discretion, the OCC advisory provides that this fact should be disclosed fully and prominently in both marketing materials and account agreements.

The OCC advisory does not restrict the ability of a bank to base initial credit pricing decisions, and subsequent changes to pricing, on risk factors. Indeed, default pricing and other changes in terms can be appropriate ways to manage credit risk in credit card accounts and, as noted above, the Truth in Lending Act does not prohibit these actions. But, because of the heightened risks of unfair and deceptive practices involving repricing, we believe that national banks should always fully and prominently disclose this material information before a consumer commits to a credit card contract.

To assist banks in implementing our guidance, we have been reviewing direct marketing materials and credit agreements from eleven national banks with credit card operations, including the largest issuers, to compare how their disclosures on promotional rates and changes in terms conform to the standards in our advisory letter. In general, we found that most of the banks surveyed disclosed restrictions on teaser rates and the possibility of changes in credit terms, but that the prominence and completeness of these disclosures could be improved. The materials we reviewed also generally did a good job of telling the consumer what constitutes a "default" that *will* give rise to higher default pricing. However, the materials typically did not warn the consumer about the other types of circumstances—short of "default"—under which the terms *may* change. We have provided feedback to the banks we surveyed, and we are working with them now on addressing the issues we identified. In responding to the OCC's supervisory guidance, some banks have also been considering whether to make additional improvements to their marketing

and account management procedures to address issues related to change in terms practices. These initiatives are commendable.

Regulation Z Review

The OCC supervises the credit card operations of national banks through comprehensive examinations, complaint resolution, supervisory guidance, and enforcement actions. However, there are limitations on the extent to which the OCC can ensure effective disclosures, and otherwise protect credit card customers of national banks, through these actions. For example, as noted above, the OCC has not been granted rulemaking authority to address unfair and deceptive practices by banks under the FTC Act, nor to adopt regulations under the Truth in Lending Act. Therefore, we encourage and endorse the Federal Reserve Board's recent undertaking to review disclosure issues relating to *all* consumer credit card issuers under Regulation Z under TILA.

As this hearing itself demonstrates, the past few years have witnessed increasing public concern about the effectiveness of consumer disclosures, especially in the credit card industry. These increased concerns coincide with—and possibly reflect—significant changes in the way credit card accounts are marketed and managed by card issuers. The Board's initiative is a particularly timely effort. It provides an important opportunity to address recent industry developments and related issues addressed in the bankruptcy reform legislation, to resolve anomalies that have arisen in Regulation Z, and to remedy sources of consumer confusion and misunderstanding.

The OCC has a strong interest in the issues that are being addressed in this review. I have discussed my concerns about the limitations and effectiveness of Regulation Z disclosures, industry burden, and the lack of uniform standards affecting credit card issuers, in a number of forums, and last month, the OCC took the unusual step of submitting a comment letter responding to the Board's Advance Notice of Proposed Rulemaking on Regulation Z's open-end credit rules. In addition to pointing out a number of specific anomalies and other issues that we believe should be considered in the Board's review of Regulation Z, our comment letter discussed three general themes that may be relevant to the review.

Consumer Research and Testing

The first general theme relates to consumer research and testing. As noted above, the OCC believes that consumer testing should precede regulators' issuing new consumer disclosure rules. Therefore, we applaud the Board's plans to use consumer focus groups and other research in developing proposed revisions to the Regulation Z disclosure rules and the related model forms. We urge the Board to employ both qualitative and quantitative consumer testing to ensure that Regulation Z's requirements maximize the effectiveness of consumer disclosures for credit cards.

Our letter pointed to the development of the Food and Drug Administration's (FDA's) "Nutrition Facts" label as illustrative of the consumer research needed to produce a highly effective disclosure document. Precedents for thorough consumer testing also exist elsewhere in the financial services world. The Financial Services Authority (FSA) in the United Kingdom used extensive testing in developing revised disclosure requirements for a variety of financial products, and the OCC, the Board, and several other Federal agencies are currently engaged in a multiphase consumer testing project related to financial institution privacy notices. The agencies have issued an Advance Notice of Proposed Rulemaking with respect to the privacy notices rules, and hope to follow it with a proposal for a new, streamlined approach to privacy notices that reflects the results of that consumer testing.

The results of the earlier FDA and FSA studies are instructive as to what we might expect to find from consumer testing on credit card disclosures. In particular, those studies indicate that we should expect effective disclosures to:

- Focus on key information that is central to the consumer's decisionmaking (with supplementary information provided separately in a fair and clear manner);
- Ensure that this key information is highlighted in such a way that consumers will notice it and understand its significance;
- Employ a standardized disclosure format that consumers can readily navigate; and
- Use simple language and an otherwise user-friendly manner of disclosure.

Prescriptive Disclosure Rules

A second general theme of our comment letter relates to a particular approach to consumer disclosure requirements: Detailed, prescriptive rules specifying (among other things) the content of information to be provided to consumers. Regulation Z and countless other consumer protection rules in the financial services arena have

relied predominantly on this approach for decades. While this approach has been effective, to a certain extent, in informing consumers about many of the most important features of their credit card accounts, it also carries significant potential adverse consequences that should not be ignored as the Board revisits Regulation Z. These include:

- The risk of information overload, as well as the risk that important information will be obscured by the cumulative volume of required specific disclosures;
- The risk of over-inclusion of information that may not be material for the particular product (or target market), as well as the risk of under-inclusion of the information consumers most need about a particular credit card product; and
- The risk that any set of specific requirements will not be flexible enough to adapt to or reflect the inevitable changes in credit products and industry practices over time.

All of these risks may imperil the effectiveness of disclosure rules. Moreover, they raise the possibility that the consumer benefit is insufficient to justify the significant burdens that these detailed disclosure rules place on creditors. Accordingly, we urged the Board to consider, as it conducts its review of Regulation Z, whether this approach is best suited to consumer and industry needs in today's rapidly evolving consumer credit markets.

Industry Developments

The third general theme of our comment letter relates to the need to ensure that credit disclosure rules keep pace with the evolution of credit products and industry practices. For example, as mentioned above, one source of an increasing number of consumer complaints is the exercise by creditors of change-in-terms provisions to reprice credit card accounts, and the information that consumers receive about those practices. Typically, a credit card agreement provides that the interest rate on the account may increase upon the occurrence of a "default" (as that term is defined in the particular credit card agreement). Card agreements also typically provide for a general reservation of rights to the issuer that permits it, unilaterally, to change any term in the agreement, including the interest rate and fees, and the method of allocating payments, and thereby increase the consumer's costs.

We believe it is important that lenders retain the right to close, reprice, and/or limit further credit advances on accounts due to factors such as fluctuations in the interest rate environment, adjustments in business strategy, market developments, or an increased credit risk associated with an individual consumer or similarly situated groups of consumers. At the same time, customers need to know the circumstances under which their rates will be, or may be, changed. Absent effective disclosure of this information, particular changes in terms may be not only unexpected, but also perceived by the customer to be unfair, such as the application of a penalty rate to *existing* balances, rather than to only new transactions. Understandably, consumer confusion and concern about these matters are heightened when an interest rate increase on an account is not tied to an increase in general interest rates or to deterioration in the borrower's performance with the particular credit card.

Amendments to Regulation Z could address some of this confusion and concern. Although matters relating to repricing may well be more important to consumers than other information that is currently disclosed in a prominent or conspicuous manner (for example, balance computation methods), Regulation Z currently addresses the various ways in which an account may be repriced in very different—and perhaps anomalous—ways. For example, the Schumer box disclosure requirements do not treat all repricing mechanisms the same:

- *Variable Rates.* Specific disclosure is required of the fact that the rate may vary and an explanation of how the rate will be determined, as well as detailed rules about the actual numerical rate that is disclosed.
- *Promotional Rates.* Specific disclosure of the promotional rate and a large print disclosure of the rate that will apply after expiration of the promotional rate is required, but no disclosure is required of the different circumstances under which the promotional rate will be or may be terminated.
- *Penalty Rates.* Specific disclosure of the increased penalty rate that may apply upon the occurrence of one or more specific events is required, but the disclosure of those events is not required to be particularly detailed, or necessarily prominent, and no disclosure of the duration of the penalty rate is required.
- *Reservation of Rights.* No disclosure is required of the issuer's reservation of a unilateral right to increase the interest rate, fees, or any other terms of the account.

We urged that one objective of the Board's review should be to find the most effective way to ensure that consumers understand how material terms may change. We suggested that an approach to explore is the possibility of an integrated description of potential changes of pricing and other terms, regardless of the cause or source, that would permit consumers to understand and readily compare this aspect of different credit offers. This type of description could also include disclosure, for example, of whether pricing changes would apply retroactively to existing balances, and whether and how consumers may be able to "opt out" of the changed terms. In addition, the disclosure anomalies described above should be carefully reviewed—for example, the absence of any disclosure requirement with respect to unilateral reservations of rights (even for accounts advertised as "fixed rate" accounts) in contrast with detailed requirements relating to standard variable rate accounts (as well as certain required disclosures for promotional and penalty rates). We also encouraged the Board to address the adequacy of current requirements relating to penalty rates (especially in light of the rise of cross-default provisions commonly referred to as "universal default" clauses) and promotional rates.

We noted in our letter a number of other areas in which, similarly, the Board should review Regulation Z to determine whether new technologies, marketing strategies, or account management practices warrant changes to existing disclosure requirements or other consumer protections. These issues point to the general challenge in the pending review of credit card rules—how to build flexibility into Regulation Z so it will not be outpaced by rapidly evolving market practices. Without this flexibility, regulators—and industry, for that matter—will continue to need to "fill in the gaps" to ensure that consumers have the information they need to understand the terms of their credit card accounts.

Conclusion

Credit card terms, marketing, and account management practices have been changing over the past several years in response to intense market competition. These changes have significant implications for safety and soundness and consumer protection. The OCC has addressed many of these concerns through its supervision of national bank credit card operations, its enforcement actions, and its supervisory guidance.

However, given the tremendous volume of credit card solicitations in the market today, we remain concerned that consumers are not always provided information that will be effective in helping them to sort through these offers and to understand the benefits *and* material limitations of the various products being marketed. The Board's review of the credit card rules in Regulation Z holds promise for a disclosure regime that is more effective for consumers.

More importantly, we need to rethink our current approach to credit card disclosures—indeed, consumer compliance disclosures generally—of critiquing information practices affecting particular issues and then pushing for correction on a piecemeal basis. We can, and I hope we will, recognize that fundamental changes to our approach are needed. It will take time to achieve, but the results, I believe, will be well worth it for consumers, complementary to a competitive market, *and* less burdensome for lenders.

Once again, Mr. Chairman, thank you for the opportunity to present the OCC's views on these matters.

PREPARED STATEMENT OF ANTONY JENKINS

EXECUTIVE VICE PRESIDENT, CITI CARDS

MAY 17, 2005

Good morning, Chairman Shelby, Ranking Member Sarbanes, and Members of the Senate Banking Committee. My name is Antony Jenkins and I am an Executive Vice President at Citi Cards. I appreciate the opportunity to speak before you today to discuss the credit card industry, Citi Cards, and our customer relationships. Our customers are our most valuable asset and we constantly monitor customer satisfaction and loyalty to make sure we are serving their evolving needs.

Overview of Citi Cards

"Citi Cards" is the brand that Citigroup uses to identify our MasterCard, Visa, and private label credit card business in the United States and Canada. In my testimony today, I generally will be focusing on our MasterCard and Visa business in the United States.

Citi Cards is one of the leading providers of credit cards in the United States with close to 80 million customers and 119 million accounts. Consumers spend roughly $229 billion annually through our credit cards, which constitutes about 2 percent of the nation's Gross Domestic Product (GDP). Citi Cards employs nearly 35,000 people in 30 geographic locations around the country.

We offer a variety of products and services to meet consumers' diverse needs and preferences. These include a wide array of general-purpose cards where customers can earn rewards or receive cash back. Our rewards programs offer consumers a range of options, including airline miles, gift certificates to major retail stores and restaurants, and electronics. Examples include the Citi AAdvantage card, the longest running airline rewards program in the marketplace today, and our new ThankYou Network rewards program that offers consumers a broad selection of rewards for their everyday purchases.

The Credit Card Industry

THE BENEFITS OF CREDIT CARDS TO CONSUMERS AND THE ECONOMY

Consumer spending is a key component of the U.S. economy, accounting for a significant portion of the nation's GDP. The credit card industry facilitates 17 percent of all consumer spending, or the equivalent of $1.7 trillion. Consumers' use of credit cards is instrumental to businesses of every size. The use of electronic credit card payment systems for a significant portion of all store purchases speeds and organizes payments to merchants throughout the country.

Credit cards have become an integral part of the everyday lives of consumers, and strong competition in the credit card industry has given consumers lower interest rates, enhanced services, and a wide variety of choices.

Credit cards are the payment method of choice for many consumers. They are also the primary means to purchase goods and services through e-commerce in the United States and around the globe. Eighty percent of U.S. households have credit cards, and consumers often choose to carry more than one card for the flexibility and choice that comes with differing card features and rewards.

Credit cards provide consumers with a fast and efficient means of payment for many types of purchases. They are secure, convenient, and easy to use. They allow consumers to purchase airline tickets, rent cars, make hotel reservations, and shop on the Internet from the comfort of their homes and offices. Credit cards are also instrumental in establishing a credit history, which plays an essential role in a consumer's ability to make large purchases such as a home or automobile, get a job, or even open a bank account.

Credit cards offer customers the flexibility to adjust their monthly payments to reflect their preferences and monthly cashflow situation. Some customers choose to pay their cards off in full each month, basically using their cards exclusively as a convenient way to make purchases and pay their bills. Other customers choose to revolve their credit and adjust the amount they pay each month according to their monthly household budgets. Most Citi Cards customers make their credit card payments on time. The vast majority of our customers pay more than the minimum due.

Credit cards provide unique protection features and services not found in other forms of payment. In our case, we believe protecting our customers is fundamental to our business. All of our cards provide security features against fraud and identity theft. Citi Cards and most other issuers also have zero liability policies for unauthorized charges on a customer's card to supplement the already strong protections of current law against liability for unauthorized charges.

CREDIT CARD INDUSTRY LENDING MODEL

The lending model for credit cards is unique. The loans we provide are unsecured and open-ended, and there are significant operational, funding, and other costs associated with maintaining the infrastructure that allows consumers to use credit cards anywhere, at any time. There are many elements that determine the level of profitability for a company, and well-run companies make profits because of careful management of the risks involved.

LEGAL AND REGULATORY FRAMEWORK

The credit card industry is heavily regulated.[1] The bulk of these regulations were put in place during the 1960's and 1970's, and they have been continuously updated

[1] The many laws and regulations that apply to the credit card industry include: (a) the Truth in Lending Act and the Federal Reserve's implementing Regulation Z; (b) the Fair Credit Reporting Act; (c) the Equal Credit Opportunity Act; (d) the Gramm-Leach-Bliley Act, including

Continued

to keep pace with industry changes. For example, the Truth in Lending Act (TILA) was amended in 1988 by the Fair Credit and Charge Card Disclosure Act to add the now well-known "Schumer box" to credit card solicitation disclosures. During the 1980's and 1990's, TILA's implementing Regulation Z was periodically amended with new fee and interest rate disclosures and other requirements for both traditional direct mail and newer Internet marketing channels. Even as we meet today, the Federal Reserve Board is analyzing responses to its recent Advance Notice of Proposed Rulemaking representing a comprehensive review of Regulation Z's open-end credit provisions, and the Board is preparing to issue regulations pursuant to TILA amendments enacted as part of last month's bankruptcy reform legislation. These amendments require new disclosures regarding the effect of making minimum payments, enhanced "introductory rate" disclosure requirements, new Internet disclosure rules, and other new disclosures.

In addition, the bank regulatory agencies have taken a series of new actions regarding unfair and deceptive acts and practices. In 2002, for example, the Office of the Comptroller of the Currency (OCC) issued guidance to national banks cautioning that practices can be found unfair or deceptive despite technical compliance with applicable TILA and Regulation Z requirements. Last year, the OCC augmented this letter with specific guidance on various credit card practices, including the marketing of "up-to" credit limits, promotional rate marketing, and repricing of accounts and other changes in credit card terms. These advisory letters have supplemented well-publicized OCC enforcement actions.

All U.S. card issuers are subject to Federal or State regulatory agency oversight. Citi Cards' two card issuers are both national banks that are subject to regulation, examination, and supervision by the OCC. We meet formally with the OCC to review the types and trends of customer complaints that its national Customer Assistance Group receives about the banks it regulates, including Citi Cards. Like other banks, we undergo regularly scheduled, extensive consumer compliance and Community Reinvestment Act (CRA) examinations. We also have full-time on-site OCC examiners who constantly review our practices and policies.

Citi Cards and Our Customers

Our Goals for Our Customers

In a highly competitive marketplace in which consumers have numerous payment card choices, we recognize that customer satisfaction is a driver of business revenue and that a lost customer is difficult and expensive to replace. We therefore constantly work to meet consumer demand and maintain customer loyalty. We strive to be responsive to our customers' needs and concerns.

We recognize that an educated customer will be a more satisfied customer. Accordingly, we take great care to make sure that we provide access to consumer education in our communications. We reach out to educate our customers in a variety of ways. For example, our "Use Credit Wisely" program helps our customers learn to enjoy the flexibility and convenience of our credit cards without a resulting burden. Our websites (*www.usecreditwisely.com* and *www.students.usecreditwisely.com*) have important information for students and other consumers, including rules for using credit responsibly, tips for gaining financial control, credit education tests, a glossary of important credit-related terms, and tips to prevent identity theft.

Financial education is an integral part of the work we do every day and a major focus of our effort to make a difference in the communities where we live and work. Recently, Citigroup and the Citigroup Foundation announced a 10-year global commitment of $200 million toward financial education and, as part of this commitment, Citigroup announced the formation of the Office of Financial Education.

Reaching New Customers

Credit Availability

We strive to make credit available to consumers as their needs change throughout their lives. One of the ways new entrants to the credit market begin to build a credit history is with their first credit card. We reach out to groups that are new to credit, such as college students and recent graduates, for whom a credit card relationship offers a necessary payment tool, security, and means for them to build a positive credit history.

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the Federal banking agencies' and FTC's privacy and information security regulations; (e) the unfair or deceptive practices provisions of the Federal Trade Commission Act; (f) the Fair Debt Collection Practices Act; (g) the Telemarketing and Consumer Fraud and Abuse Protection Act; (h) the Telephone Consumer Protection Act; (i) the Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 (the CAN-SPAM Act); and (j) the Community Reinvestment Act.

With new entrants to the credit market, we normally start the customer with a credit line tailored to his or her individual circumstances. These new customers, just like our general customer population, must demonstrate that they can manage their credit responsibly before we will increase their credit line. Our experience with college students has shown that they compare favorably with our general customer population in terms of credit management.

New Customer Solicitations

We use direct mail to find the majority of our new customers. We mail prescreened offers (which are sometimes referred to as "preapproved offers") to consumers who have been selected to receive the offer. This selection process includes credit bureau screening for bankruptcy filings, delinquent and written-off accounts above certain amounts, debt levels above certain amounts, and other credit problems. The selection process also includes the use of our internal credit scoring model in order to apply more sophisticated credit criteria before the offer is mailed. When the consumer responds to the prescreened offer, we then review his or her actual credit bureau report and apply the same credit bureau and modeling criteria that we did in the selection process to make sure that the consumer is still creditworthy.

We also mail offers to consumers without prescreening. When a consumer responds to this type of offer, we review the consumer's credit bureau report and apply basically the same credit bureau and credit score modeling criteria that we use for our prescreened offers.

Recent Revisions to Our Solicitation Materials

Our goal is to assure "no surprises" for our customers and to continually improve upon our practices. In reaching new customers, this means that all of our written materials must describe our products clearly, accurately, and fairly.

Citi Cards recently redesigned our solicitation letters to assure "no surprises" for our new customers. In doing so, we also made sure that our new letters were consistent with the OCC Advisory Letter of September 14, 2004, which requires national bank credit card issuers to review specified credit card marketing and account management practices.

While we have always disclosed our right to reprice accounts, we took the Advisory Letter as an opportunity to review our disclosure practices. As a result, we now tell consumers in more detail at the time of solicitation that their account terms could change. We specify that information in the consumer's credit bureau report—such as failure to make a payment to another creditor when due, amounts owed to other creditors, number of credit accounts outstanding, or the number of credit inquiries—could cause us to reprice the account. This is to help educate consumers about how we use credit bureau information. Moreover, we tell them that our right to change the terms of our accounts with them based on credit bureau report information is subject to their right to prior notice and their right to opt out of the change.

In addition, we now repeat on page one of our solicitations selected disclosure information about the terms of credit that previously appeared only on the second page in the large print Regulation Z "Schumer box." For example, if a promotional rate applies to balance transfers and there is a balance transfer fee, that fee information from the Schumer box is now repeated on page one of the solicitation.

OUR RELATIONSHIP WITH OUR EXISTING CUSTOMERS

Products and Services

Our goal is to make sure our customers know how to use their card and all of the services available to them. New customers receive a directory of services with their credit card. The directory of services is tailored to each of our individual credit products so that it can explain all the benefits of the card to the new customer. These benefits include the opportunity for the customer to request that a photo be put on the front of his or her card for added security, as well as the other security features that apply to our cards, such as Citi Identity Theft Solutions. We let them know how to reach us, both by phone and online, so that they can take advantage of the benefits that their card offers. We also have a welcome kit that we send to new customers to make them aware of an array of products and services that are available.

Customer Satisfaction

We conduct research on an ongoing basis to understand existing and prospective customer needs and wants. This research helps us identify and recommend products, services, and processes that satisfy marketplace desires and improve the customer experience.

Our call center associates receive extensive classroom training prior to handling customer contacts. This includes specialized modules around key "soft skill" attributes such as courtesy, empathy, tone, listening skills, proactive service, and the importance of the customer experience.

We also work very closely with our customers who advise us that they are having financial difficulties. We offer various options to these customers, such as reducing minimum payments, reducing interest rates, waiving fees going forward, or crediting back fees that have already been billed. In addition, we work with nonprofit consumer credit counseling agencies and support customer debt management plans.

Risk-Based Pricing Policies

Because credit card loans are unsecured and open-ended, it is important that we are able to employ various methods of recognizing and mitigating risk. Constraints on risk-based pricing would lead to less access to credit for those in need, higher prices for all consumers, and a less competitive marketplace.

The best indicator as to whether an individual will repay a loan is his or her payment behavior with us and other lenders. Pricing loans for risk is a fair and equitable method of compensating lenders for making loans that carry a higher possibility of default. It is also consistent with the regulatory and business goal of assuring that we conduct our business in a safe and sound manner.

If we see indications that a customer is taking on too much debt, has missed or is late on payments with another creditor, or is otherwise mishandling his or her personal finances, it is not unreasonable, as an unsecured lender, to determine that this behavior poses an increased risk. In the interest of all of our customers and the safety and soundness of our banks, we adjust a customer's rate to compensate for that increased risk.

In the past, our agreements with our cardholders provided that a delinquency with another creditor (referred to as an "off-us" delinquency) gave us the right to automatically increase a customer's interest rate. Now, before we increase a customer's rate due to an off-us delinquency, we provide prior notice to the customer explaining why his or her rate is being increased and give the customer the right to opt out of that increase. If the customer opts out, he or she may continue to use the card with the existing rate until the card expires. When the card expires, no new charges are allowed. However, customers may continue to pay off their balance using the existing rate and payment terms. The events that allow us to automatically increase the interest rates are now limited to three types of behavior that relate to a customer's relationship with us: failure to make a payment to us when due; exceeding the credit line; or making a payment to us that is not honored.

New Change in Terms and Opt Out Notice

We also recently redesigned our change in terms and opt out notice. Our newly rewritten and reformatted notice is shorter, more concise, and uses white space and bold headers to ensure that key messages stand out. To highlight to our customers that they can opt out of a change in terms, we added the words "Right to Opt Out" to the title of the notice and the paragraph heading. Finally, we added a toll-free telephone number as an alternative opt out method.

This right to advance notice and opt out affords significant protections for customers. For example, if we notify a customer that his or her interest rate will be increased due to adverse information in a credit bureau report, the specific reasons for the proposed repricing (for example, failure to make payments to another creditor when due) are included in the advance notice, and the advance notice names the credit bureau providing the information so the customer may challenge the report if he or she thinks the information is inaccurate.

Redesigned Customer Agreements

In a continuous effort to improve our customer communications, a few months ago we completely rewrote, reformatted, and simplified our credit card agreements. Then we added on the first page a section entitled "Facts About Rates and Fees" that summarizes critical card pricing information in a single place, much like the nutritional labels found on food products. We emphasize this pricing information by bolding key words and phrases so that it will be more useful to our customers. This "Facts About Rates and Fees" section also includes a description of the reasons we may use to change the rates and fees associated with their account.

Anti-Fraud Initiatives

Citi Cards is committed to protecting our customers from fraud and identity theft and we are continuously developing new programs to deal with these problems. We were the first card issuer to have a photo identification on the credit card in 1992. More recently, in 2003, we created the Identification Theft Solutions program with

an internally staffed unit dedicated to handling identification theft cases for our customers even if the identification theft relates to another of their cards that we did not issue. This year we announced a new collaboration with the National District Attorneys Association where we work with State and local prosecutors nationwide to develop new strategies for the arrest and prosecution of identity thieves. Similarly, for our Internet channel, we rolled out a program to stop "phishers" from spoofing our customers who use the Internet. We created a special security box that appears on the top of all emails sent by us to Citi customers—known as the "Email Security Zone," and we provide dedicated Internet security specialists to help customers with questions about suspicious emails and other security issues.

New Minimum Monthly Payment Formula

This year we are changing our minimum payment formula to ensure that every customer who pays only the minimum monthly payment pays off his or her debt in a reasonable period. Under this new schedule, a customer's minimum payment requirement covers interest, late fees, and 1 percent of the balance due. This formula was adopted to meet the OCC's recent requirement for positive amortization of credit card debt on an individual customer basis. It will increase the minimum monthly payment due for some of our customers, and in some instances dramatically for those whose accounts are at higher interest rates. Although we recognize that, in the short-run, some customers could be financially strained meeting these higher monthly payments, we believe that over the longer-term the new minimum payment policy will be a net positive for customers as it will accelerate their payment of outstanding debt, and over time it will result in lower total interest payments. In the meantime, we are developing strategies to mitigate the impact of increased monthly payments for customers in hardship situations.

The newly enacted Bankruptcy Abuse Prevention and Consumer Protection Act amends TILA to require creditors to disclose on the front of each billing statement an example showing the time it would take to repay a sample balance if a customer is making minimum payments only. As an alternative under the new law, if a creditor maintains a toll free telephone number that provides customers with the actual number of months it would take to repay the customer's balance, that creditor is not required to provide the sample on the billing statement.

We are currently looking at ways that we could provide this actual information to customers in a manner that will not confuse or mislead them but that will instead be beneficial. We hope to use this requirement to provide information that is a useful, accurate, and effective planning tool for our customers who may desire it.

Thank you again for the opportunity to appear before this Committee. I would be pleased to answer any questions you may have.

Consumer Federation of America

TESTIMONY OF

TRAVIS B. PLUNKETT,
LEGISLATIVE DIRECTOR

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
OF THE
UNITED STATES SENATE

"EXAMINING THE CURRENT LEGAL AND REGULATORY REQUIREMENTS AND INDUSTRY PRACTICES FOR CREDIT CARD ISSUERS WITH RESPECT TO CONSUMER DISCLOSURES AND MARKETING EFFORTS"

MAY 17, 2005

Introduction

Mr. Chairman, Senator Sarbanes, and Members of the Committee, my name is Travis Plunkett and I am the legislative director of the Consumer Federation of America.[1] I appreciate the opportunity to offer CFA's comments on current credit card industry practices, as well as legal and regulatory requirements.

Given the dramatic changes that have occurred in the credit card industry in recent years – and the negative impact that some of these changes have had on consumers – perhaps no industry in America is more deserving of oversight by Congress. The U.S. Better Business Bureau reported more than 17,000 complaints about credit cards in 2004, the third highest source of consumer complaints after cellular phone services and new car dealers. There is clearly a need to examine many questionable practices in the industry including marketing, credit extension, the terms and conditions of credit card contracts and rising fees and interest rates. We applaud you for calling this important oversight hearing and look forward to working with you to make this industry more consumer-friendly.

I will begin my remarks with an examination of recent credit card lending practices. We find that credit card issuers are expanding efforts to market and extend credit much faster than Americans are taking on new credit card debt. This credit expansion has had a disproportionately negative effect on the least sophisticated, highest risk and lowest income households. It has also resulted in both relatively high losses for the industry and record profits. That is because the industry has been very aggressive in implementing a number of new – and extremely costly – fees and interest rates.

I conclude that these new pricing policies cannot be justified by stating that creditors are simply leveling higher charges for consumers who represent higher financial risks. In fact, some of these new fee and interest rate policies appear to be predatory -- charging what the market will bear while ignoring the harmful impact this pricing has on many Americans. I will close by making a number of legislative and regulatory recommendations that should eliminate abusive pricing in the industry and empower consumers to make better credit decisions.

A. AS CONSUMERS EXCERCISE MORE CAUTION IN TAKING ON NEW DEBT, ISSUERS CONTINUE TO EXPAND MARKETING AND AVAILABLE CREDIT

It is conventional wisdom that consumer demand has fueled the growth of revolving debt to just over $801 billion.[2] However, a careful analysis of lending patterns by credit card companies shows that aggressive and even reckless lending by issuers has played a huge role

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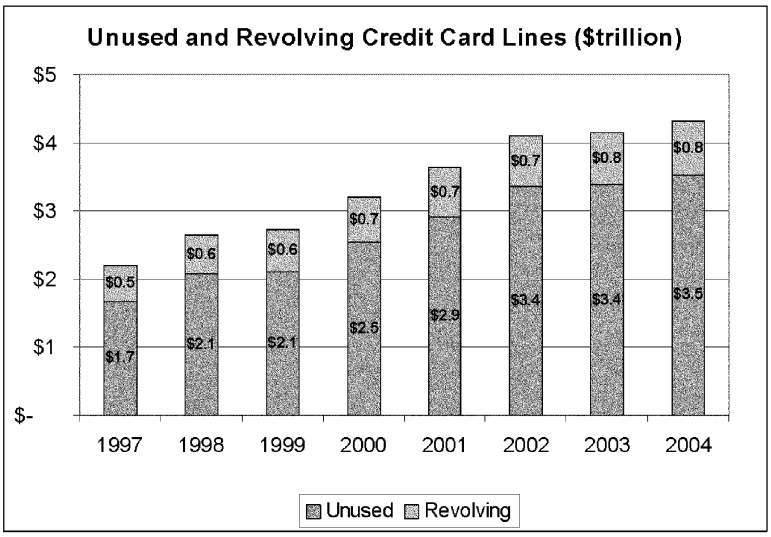
[1] The **Consumer Federation of America** is a nonprofit association of over 280 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through research, advocacy and education.

[2] Federal Reserve Board, Consumer Credit Outstanding. Although this figure is often used as a proxy for credit card debt, most experts believe that outstanding credit card debt is slightly lower. First, approximately 5 percent of consumer revolving credit is not on credit cards. Second, between 4 to 9 percent of the debt does not truly revolve. It is repaid to the credit card issuer before the next billing cycle starts. Taking these two factors into account, outstanding credit card debt is likely to be between $688.4 billion and $728.5 billion.

in pushing credit card debt to record levels. Since 1997, creditor marketing and credit extension has increased more than twice as fast as credit card debt taken on by consumers.[3] Moreover, when consumers become more cautious in taking on new debt, as they have in recent years, issuers often sharply increase their marketing and credit in an attempt to entice reluctant consumers to exercise riskier behavior. That is why there is a growing credit "gap" between creditor supply and consumer demand.



The total amount of credit made available by issuers now exceeds an astonishing $4.3 trillion dollars.[4] The average amount of credit available per household is over $38,700.[5] Of that amount, only 18 percent has been taken on as debt by consumers. According to figures from Veribanc Inc., there were more than $3.5 trillion in unused credit card lines in the fiscal quarter ending in December 2004. Between December 1999 and December 2004, revolving debt grew by 30.9 percent, but unused credit card lines made available by creditors grew by 67.0 percent – or twice as fast.[6] As a result, revolving consumer credit has declined as a

[3] Veribanc, Inc. and Federal Reserve Consumer Credit Outstanding. According to Federal Reserve figures, consumer revolving debt grew by 50.2 percent from $530 billion in December 1997 to $796 billion in 2004. According to Veribanc, unused lines of credit grew at more than double the rate consumers increased their use of credit card lines, growing from $1.7 trillion in 1997 to $3.5 trillion in 2004.
[4] Veribanc, Inc. and Federal Reserve Consumer Credit Outstanding.
[5] There are 111 million households in the U.S., U.S. Census Bureau, "America's Families and Living Arrangements: 2003," November 2004, at 2.
[6] Veribanc, Inc. and Federal Reserve Consumer Credit Outstanding.

share of total outstanding credit lines from 22.3 percent of total credit lines to just above 18.0 percent of total credit lines.[7]

A similar trend is evident when examining the consumer response to massive increases in marketing by creditors. The most significant form of marketing for creditors remains solicitation by mail. Over half of credit cards held by consumers are the result of mail solicitation.[8]

	Solicitations (billions)	Response Rate
1990	1.1	2.1%
1991	0.99	2.4%
1992	0.92	2.8%
1993	1.5	2.2%
1994	2.5	1.6%
1995	2.7	1.4%
1996	2.38	1.4%
1997	3.01	1.3%
1998	3.44	1.2%
1999	2.54	1.0%
2000	3.54	0.6%
2001	5.01	0.6%
2002	4.89	0.5%
2003	4.29	0.6%
2004	5.23	0.4%

Issuers have increased the number of solicitations mailed more than five-fold since 1990, from 1.1 billion to a record 5.23 billion in 2004, or just over 47 per household. Wealthier families receive the highest number of credit card mailings, but low-income families are more likely to open the solicitations they receive.[9] The table at right indicates that issuer interest in marketing credit cards has grown much faster than consumer interest in accepting new cards. The consumer response rate to mail solicitations has declined more than five-fold from 2.1 percent in 1990 to .4 percent in 2004. This means that for every 250 solicitations consumers receive, they reject 249. The tiny response rate demonstrates that the vast majority of consumers are being responsible when offered unsolicited credit.

The huge increase in mail marketing despite a plummeting response rate is yet more evidence that credit cards are highly profitable. In a normal business, declining consumer demand would result in reduced product marketing.

Issuers also spend extremely large sums on many other forms of marketing and advertising, through television, telemarketing, the Internet, radio, print and even outdoor billboards. *Nielsen Monitor* reported that credit card companies were among the top advertisers nationally and the fastest growing segment of purchased advertising in 2004, with credit card television advertising growing to $1.7 billion in 2004, a $438 million and 32.4 percent increase over 2003.[10] These figures are before the fourth largest credit card issuer, MBNA, started its first national advertising campaign during the 2005 Super Bowl.[11]

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[7] CFA calculation based on Veribanc, Inc. and Federal Reserve Consumer Credit Outstanding.

[8] Vertis Inc. press release, "Financial Direct Mail Readers Interested in Credit Card Offers," January 25, 2005; "Card Marketing 101," *CardTrack*, September 2002.

[9] Kidane, Amdetsion and Sandip Mukerji, Howard University School of Business, "Characteristics of Consumers Targeted and Neglected by Credit Card Companies," *Financial Services Review*, Vol. 13, No. 3, 2004 at 186.

[10] Nielsen Monitor, "U.S. Advertising Spending Rose 6.3 percent in 2004, Nielseon Monitor-Plus Reports," March 1, 2005.

[11] Sidel, Robin, "Card Issuer MBNA lets the Public Take a Peek at Its Hand," *Wall Street Journal*, January 20, 2005 at C1.

Issuers also promote and advertise their cards by establishing significant networks of co-branded affinity relationships, which offer credit cards with the logo and affiliation of a sports team, university, association or non-profit. Credit card companies gain access to mailing lists, marketing the credit card branded with the group's logo directly to the group's membership. Organizations are paid a bounty for each account that is opened as well as revenue from any open balances on the affinity cards. Once a consumer relationship is established with the affinity card, the credit card issuers can market other lending products including student loans, home equity loans or auto loans to their affinity card customers.[12]

B. ISSUERS TARGET THE LEAST SOPHISTICATED AND RISKIEST HOUSEHOLDS AND ENCOURAGE THEM TO RUN UP UNSUSTAINABLE LEVELS OF DEBT

The growth of revolving debt in this country to over $800 billion[13] has obviously not affected all Americans equally. The extraordinary expansion of the credit card industry in the 1990s was fueled by the marketing of credit cards to populations that had not had widespread access to mainstream credit, including lower and moderate income households, consumers with seriously blemished credit histories, college students, older Americans and minorities.

In a practice widely known as risk-based pricing, creditors charged riskier consumers more to cover potential losses, usually in the form of higher interest rates. To make the assumption of debt more attractive to these households – and to entice them into carrying debt for longer periods – creditors lowered minimum payment balances from around five percent of principal to just over two percent. As a result, an estimated eighty percent of all households now have at least one card.[14] Moreover, vulnerable households shoulder a disproportionate share of the debt burden relative to their incomes. In other words, "democratization of credit" has had serious negative consequences for many Americans, putting them one unexpected financial emergency away from bankruptcy.

Lower Income and Minority Households

While the share of higher income families carrying credit card debt declined between 1998 and 2001, more lower and moderate income families were taking on debt.[15] The share of homeowners with credit card debt declined (probably due to a large increase in "cash out" refinancings that were used to pay down credit card debt), but the number of renters with debt increased. While fewer white families accumulated credit card debt, more minority

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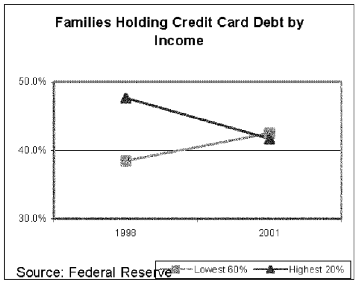
[12] Sidel, Robin, "Card Issuer MBNA lets the Public Take a Peek at Its Hand," *Wall Street Journal*, January 20, 2005 at C1.
[13] Federal Reserve Consumer Credit Outstanding.
[14] Cardweb.com
[15] Aizcorbe, Ana M., Arthur B. Kennickell and Kevin B. Moore, "Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances," *Federal Reserve Bulletin*, January 2003 at 22-23 Table 11. The percentage of families earning the lowest 60 percent of income grew by 10.5 percent from 38.5 percent of these families in 1998 to 42.5 percent of the lowest earning families in 2001. The share of families with credit card balances earning the top 20 percent of incomes fell by 12.6 percent from 47.7 percent of top earning families in 1998 to 41.7 percent of these families in 2001.

households did.[16] Moreover, although minority households are less likely to have credit cards than white families, they are more likely to have credit card debt.[17] The amount of credit card debt held by minority households has also increased compared to white households.[18]

Credit card debt also consumes a significant portion of lower income families' income. A 2004 Gallup poll found that families with credit card debt earning under $20,000 a year owed 14.3 percent of their income in credit card debts, those earning between $20,000 and $29,999 owed 13.3 percent and those earning between $30,000 and $39,999 owed 11.0 percent. Compare this to the 2.3 percent of their income owed by families earning over $100,000.[19] The increase in credit card debt has contributed to alarmingly high overall levels of debt for many of these lower and moderate income families. More than one-quarter of the lowest income families spent over 40 percent of their income on debt repayment in 2001.[20] The proportion of lower income families falling behind on their debts is also increasing.[21]



Younger and Older Americans

Starting in the early 1990's, credit card issuers targeted massive marketing efforts at college campuses throughout the country, resulting in a sharp growth of credit card debt among college-age and younger Americans. CFA and Dr. Robert Manning were among the first to document the serious consequences of this trend.[22] Since Dr. Manning's report for CFA in 1999, this issue has been the subject of much public and media scrutiny. One of the

[16] Aizcorbe, Kennickell and Moore, 2003 at 24.

[17] Draut, Tamara, Director of the Economic Opportunity Program Demos, Testimony Before the House Banking Committee Subcommittee on Financial Institutions and Consumer Credit, September 15, 2004, at 6. Although African American and Latino families are less likely to have credit cards than white families (59 percent, 53 percent and 82 percent of these families have credit cards respectively), they are more likely to be carrying debt than white families. Just over half (51 percent) of white families reported having debt in 2001, compared to 84 percent of African American families and 75 percent of Latino families.

[18] Aizcorbe, Kennickell and Moore, 2003 at 22, Table 11.

[19] Gallup Poll News Service, "Average American Owes $2,900 in Credit Card Debt," April 16, 2004.

[20] Aizcorbe, Kennickell and Moore 2003 at 29, Table 14. In 2001, more than one in four (27.0 percent) families in the lowest income quintile spent more than 40 percent of their income on debt payments, compared to less than one in six (16.0 percent) of families in the second lowest income quintile and one in nine (11.0 percent) of all families who spend 40 percent or more of their income on debt payments.

[21] Aizcorbe, Kennickell and Moore 2003 at 29, Table 14. A larger share of lower-income families is behind on their debt in 2001 than a decade earlier. In 2001, about one in fifteen of all households (7.0 percent) were at least 60-days behind on at least one debt payment according to the Federal Reserve. In comparison, more than one in eight (13.4 percent) of households in the lowest income quintile and one in nine households (11.7 percent) in the second lowest income quintile were 60-days or more behind on a debt payment.

[22] Manning, Robert, "Credit Cards on Campus: Costs and Consequences of Student Debt," June 8, 1999. CFA press release available at: http://www.consumerfed.org/ccstudent.pdf

few Congressional oversight hearings of the credit card industry in recent years was conducted by this committee and focused on financial literacy among college students and the extension of credit cards on campus.[23]

And yet, Americans under 35 years-of-age continue to show more signs of trouble managing credit card debt than any other age group. The amount of credit card debt held by students graduating from college more than doubled to $3,262 between the mid-1990s and 2004.[24] Americans under 35 are less likely to pay off their credit card balances every month than average Americans,[25] are paying more for debt obligations than in the past and are increasingly likely to pay more than 40 percent of their incomes on credit card debt.[26] Not surprisingly, more young Americans are declaring bankruptcy than in the past.[27] Moreover, there is increasing evidence that issuers are now targeting high school students with credit card offers.[28] They are also marketing branded debit cards to adolescents, in part to encourage these young consumers to use similarly branded credit cards when they are older.[29]

The growth of credit card debt among older households is also troubling. Although these households were long thought to be the most frugal and resistant to consumer debt, changing economic conditions – especially declining pension and investment income coupled with rising health care and prescription costs – have made credit card debt a more serious financial issue for older Americans. Between 1992 and 2001, Americans over age 65 saw their credit card debt nearly double from $2,143 to more than $4,000.[30] The number of seniors filing for bankruptcy more than tripled from 1991 to 2001.[31] Other warning signs are also evident. The proportion of income spent to pay off debts by households headed by individuals 65 to

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[23] Hearing of the Senate Committee on Banking, Housing and Urban Affairs on "The Importance of Financial Literacy Among College Students," September 5, 2002. Witness testimony and other hearing documents available at: http://banking.senate.gov/02_09hrg/090502/index.htm

[24] Trigaux, Robert, "Generation Broke: New Grads Bear Heavy Load," *St. Petersburg Times*, November 22, 2004.

[25] Draut, Tamara, Director of Demos Economic Opportunity Program, Testimony Before the House Banking Committee Subcommittee on Financial Institutions and Consumer Credit, September 15, 2004, at 8. More than half (55 percent) of Americans carry revolving balances compared to 71 percent of borrowers aged 25-34.

[26] *Ibid.* at 4-5. In 1992, about one in thirteen (7.9 percent) Americans aged 25-34 had debt greater than 40 percent of their income; by 2001, about one in eight (13.3 percent) had these high debt burdens.

[27] Sullivan, Theresa A., Deborah Thorne and Elizabeth Warren, "Young, Old, and In Between: Who Files for Bankruptcy?" *Norton Bankruptcy Law Advisor*, Iss. No. 9A, September 2001.

[28] Mayer, Caroline E., "Girls Go From Hello Kitty To Hello Debit Card; Brand's Power Tapped to Reach Youth," *The Washington Post*, October 3, 2004.

[29] *See* Ludden, Jennifer, "Credit Card Companies Target Kids," *All Things Considered*, National Public Radio, February 6, 2005.

[30] Demos, "Retiring in the Red," January 19, 2004 at 3.

[31] Sullivan, Theresa A., Deborah Thorne and Elizabeth Warren, "Young, Old, and In Between: Who Files for Bankruptcy?" *Norton Bankruptcy Law Advisor*, Iss. No. 9A, September 2001, at 5. The number of older Americans declaring bankruptcy during this period rose from 23,890 to 82,207.

74 years of age has risen steadily over the past decade,[32] while about one in seven senior households paid more than 40 percent of their income towards their debts in 2001.[33]

Seniors have fewer credit cards than other age groups and are more likely to pay their credit cards in full every month, but a greater proportion also have lower incomes.[34] This means that credit card debt has a more severe impact on this age group. For example, credit card debt can threaten older homeowners, who stand to lose their home – and their most significant hedge against poverty – if they use home equity to pay off credit card debt.

The Downsizing of Minimum Payments

As credit card issuers dramatically expanded their marketing and extension of credit in the 1990s, they lowered monthly minimum payment amounts. By reducing the minimum payment, issuers could offer more credit, encourage consumers to take on more debt, and ensure that consumers would take far longer to pay off their debts, thus making them more profitable for the industry.[35] Monthly minimum payment rates were reduced from around 5 percent of principal owed in the 1970s to just over 2 percent by the turn of the century.[36] Currently, 19 million credit card borrowers make only the minimum payments.[37]

However, paying only the minimum on credit cards can increase the length of time the debt is carried and significantly add to the interest cost of the credit card loan. Current Acting Comptroller of the Currency Julie Williams has noted that reduced minimum payments "dig borrowers into an ever deeper hole, requiring increasingly more difficult measures" for consumers to get out of debt.[38] CFA has concluded that reduced minimum payments were a significant cause of increasing bankruptcies in the last decade.[39]

One way to alert consumers to the consequences of paying off credit card balances at the minimum rate is to offer each consumer a personalized notice on the billing statement about how long it would take to pay off the balance at the minimum rate, and what would be the total costs in interest and principal. That is what Senators Akaka, Durbin, Schumer and

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[32] Aizcorbe, Kennickell and Moore 2003 at 28, Table 14. According to the Federal Reserve Survey of Consumer Finances, the median debt services ratio of households aged 65-74 grew by 54 percent from 9.8 percent in 1992 to 15.1 percent in 2001 and the debt services ratio for households 75 and older grew 169 percent from 2.6 percent to 7.0 percent in 2001.

[33] *Ibid.* 13.9 percent of households aged 65-74 and 14.3 percent of households aged 75 and over spent more than 40 percent of their income on debt service.

[34] Hanway, Steve, Gallup News Organization, "Do Credit Card Habits Improve with Age?" May 18, 2004. Nearly half (48 percent) of households over 65 years old have incomes below $30,000, compared to 16 percent of those aged 30-49 and 18 percent or those aged 50-64.

[35] Interview with Andrew Kahr, credit card industry consultant, "The Secret History of the Credit Card," *Frontline*, November 2004.

[36] Kim, Jane J., "Minimums Due on Credit Cards are on the Increase," *Wall Street Journal*, March 24, 2005.

[37] Der Hovanesian, Mara "Tough Love for Debtors," *Business Week*, April 25, 2005.

[38] OCC, Remarks by Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel before the Risk Management Association's Retail Risk Management Conference on Regulatory Concerns about Certain Retail banking Practices, Chicago, June 3, 2003, in "Speeches and Congressional Testimony," *OCC Quarterly Journal*, Vol. 22, No. 3, September 2003 at 107.

[39] Consumer Federation of America, "Consumer Restraint Pressures Lenders to Reduce Credit Card Marketing and Credit Extension," January 18, 2000.

Sarbanes have proposed in S. 393. Such a personalized disclosure is, unfortunately, not included in recently enacted bankruptcy legislation, which requires consumers to call a toll-free number to get information about how long it would take to pay off their balances.[40] No specific information would be offered on the total cost of paying at the minimum rate. This bankruptcy law requirement will likely have no impact on the millions of consumers paying at or near the minimum rate who will not call a toll-free phone number.

One positive development regarding credit card minimum payments is that recent regulatory guidance issued by federal banking regulators in January 2003 directed credit card lenders to set minimum payments that "amortize the current balance over a reasonable period of time" and noted that prolonged negative amortization would be subject to bank examiner criticism.[41] These regulatory changes will not be fully phased in until the end of 2006.[42] Many major credit cards began increasing their minimum payment requirements in 2005, including Bank of America, Citibank, Discover and JPMorganChase,[43] in some cases to as high as 4 percent.[44]

It is essential that issuers phase in these higher minimum payments gradually to prevent households that have been reliably paying at such low rates from being pushed into delinquency or default. One effective way to phase in higher minimum payments would be for banking regulators to require issuers to provide consumers with prominent disclosure well before higher payments are required, and to then require that higher minimum payments be assessed only on new debts, not outstanding debts.

The Office of the Comptroller of the Currency (OCC) has warned banks that increasing minimum payments may need to be accompanied by a reduction in Annual Percentage Rates (APRs) or eliminating fees to ensure that cardholders can actually reduce their balances and not just tread water with higher minimum bills.[45] Rising APRs and other increasing prices – such as energy costs – are leaving many consumers with less flexibility in their budgets. Even before the industry began to raise its minimum payments, consumers were increasingly worried about making their minimum credit card payments. Gallup found that the number of cardholders worried about being able to make their minimum payments had increased from 2002 to 2004.[46]

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[40] Section 1301, S. 256, Public Law 109-8.

[41] Joint Press release of Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency and Office of Thrift Supervision, "FFIEC Agencies Issue Guidance on Credit Card Account Management and Loss Allowance Practices," January 8, 2003, see attached "account Management and Loss Allowance Guidance" at 3.

[42] Day, Kathleen and Caroline E. Mayer, "Credit Card Penalties, Fees Bury Debtors," *Washington Post*, March 6, 2005.

[43] American Financial Services Association, "Credit Card Minimum Payments Going Up," *Spotlight on Financial Services*, April 2005.

[44] Warnick, Melody, "Credit Card Minimum Payments Doubling," *Bankrate.com*, May 3, 2005. Citibank and Bank of America have announced they are doubling their minimum payment requirements from 2 percent to 4 percent of the balance.

[45] Der Hovanesian, Mara "Tough Love for Debtors," *Business Week*, April 25, 2005.

[46] Gallup Poll News Service, "Average American Owes $2,900 in Credit Card Debt," April 16, 2004.

Targeting Consumers in Financial Distress

Nothing illustrates the perverse incentives of the credit card market better than the marketing of cards to consumers on the brink of bankruptcy, or to those just discharged from it. Several major issuers market high-cost, "subprime" cards to those with blemished credit histories. This population of cardholders can be profitable for the industry. Credit card industry consultant Andrew Kahr estimates that average subprime consumers will make two or three late payments a year, that the industry can generate fees from each of those tardy payments, and that these fees that can greatly exceed the interest payments on the small lines of credit themselves.[47]

Subprime consumers haven't just encountered high-cost offers of credit, but deceptive marketing practices as well. In 2000, Providian was required to pay more than $300 million in restitution to its subprime cardholders for unfair and deceptive practices.[48] More recently, Cross Country Bank, the subprime and secured credit card issuer that has been investigated by state and federal regulators for misleading consumers about the terms of its subprime credit card accounts and engaging in abusive collection practices, advertised on late night and daytime television when more unemployed potential subprime customers are most likely to be watching television.[49]

Consumers exiting bankruptcy are often swamped with offers at prime terms – low interest rates and without annual fees.[50] Many bankruptcy attorneys believe these offers are being made because consumers leaving bankruptcy court cannot erase their debts for another six years. Under the new bankruptcy legislation, consumers will not be able to wipe away any credit card debts for eight years. Some categories of credit card debt will not be "dischargeable" at all, no matter how long the consumer waits.[51]

C. AS ISSUERS HAVE DRAMATICALLY EXPANDED THEIR MARKETING AND CREDIT EXTENSION THEY HAVE EXPERIENCED HISTORICALLY HIGH LOSSES AND BROUGHT IN RECORD PROFITS

Although credit card obligations, late payments and delinquencies have declined in the past two or three years, they are still higher than they were before the marketing expansion accelerated. Credit card charge-offs, the percentage of the value of credit card loans removed from the books (net of recoveries), or "written off," have been persistently high for the past decade. Since the end of 1995, credit card charge-offs have only been below 4 percent for one quarter, and during the most recent economic downturn charge-offs reached a two-decade high.[52] However, charge-off rates have also moderated recently and were below 5.1 percent for the entirety of 2004, and below 5.0 percent for first two quarters of 2005.

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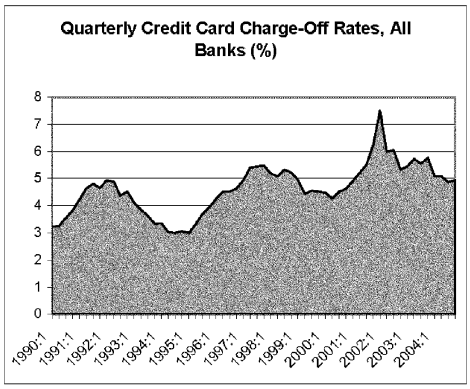
[47] Interview with Andrew Kahr, credit card industry consultant, "The Secret History of the Credit Card," *Frontline*, November 2004.
[48] OCC, Statement of Comptroller of the Currency John D. Hawke J., June 28, 2000.
[49] Pacelle, Mitchell, "Pushing Plastic," *Wall Street Journal*, November 5, 2004.
[50] Mayer, Caroline E., "Bankrupt and Swamped with Credit Offers," *Washington Post*, April 15, 2005.
[51] *Ibid.*
[52] Federal Reserve Board, Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks, available at http://www.federalreserve.gov/releases/chargeoff/.

Despite these losses, the credit card industry is typically the most profitable in the banking sector, earning a return on assets since 1995 that is three times greater than that for commercial banks overall.[53] The return on assets for credit card companies has grown every year since 1988, by a total of 80 percent.[54] In 2004, the credit card industry had its most profitable year since 1988.[55] The industry earned $30.2 billion in profits, up from $20.5 billion in 2000.[56]

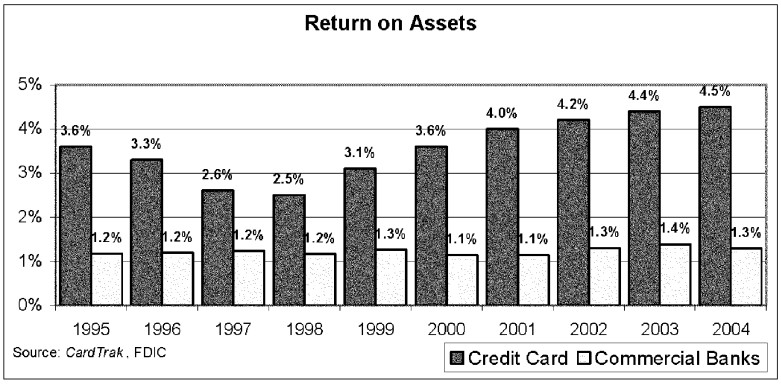
According to credit card industry consultant Andrew Kahr, the basic profitability of the credit card industry is tied to those who carry revolving debt. Borrowers who pay off their balances in full and on time each month do not earn profits for the industry.[57] With revolving debt nearly quadrupling since 1990, credit card companies' profitability should remain strong. About 90 million Americans do not pay off their cards each month,[58] and of those about 19 million usually make only the minimum payment.[59] Currently, less than one fifth of credit card debt is repaid every month. In December 2004, the payment rate for cardholders was 17.4 percent of total outstanding debt according to Moody's and the fourth quarter 2004 repayment rate was 16.7 percent, up from 15.5 percent in the fourth quarter of 2003.[60]



Second, credit card issuers earn a significant piece of their revenues from penalty fees alone. In 2004, issuers collected $14.8 billion in penalty fees, or 10.9 percent of revenue, up

[53] "Card Profits 04," *CardTrak*, January 24, 2005; "Banner Year," *CardTrak*, February 2004; FDIC, *FDIC Quarterly Banking Profile*, Fourth Quarter 2004 at 5, Table I-A; FDIC, *FDIC Quarterly Banking Profile*, Fourth Quarter 2000 at 4, Table I-A. Commercial banks average return on assets between 1995 and 2004 was 1.23 percent, about one third as large as the credit card industry average return on assets of 3.58 percent over the same period.
[54] "Card Profits 04," *CardTrak*, January 24, 2005. The industry's return on assets grew from 2.5 percent in 1998 to 4.5 percent in 2004.
[55] "Card Profits 04," *CardTrak*, January 24, 2005.
[56] "Banner Year," *CardTrak*, February 2004.
[57] Interview with Andrew Kahr, credit card industry consultant, "The Secret History of the Credit Card," *Frontline*, November 2004.
[58] Gallup 2004; McGeehan, Patrick, "The Plastic Trap," *New York Times*, November 21, 2004. CFA calculation based on Gallup 2004 poll results and number of cardholding Americans.
[59] Der Hovanesian, Mara "Tough Love for Debtors," *Business Week*, April 25, 2005.
[60] American Financial Services Association, "Across-the-Boards Decline in Delinquencies," *Spotlight on Financial Services*," April 2005.

from $10.7 billion and 9 percent of revenue in 2002.[61] Credit card analyst R.K. Hammer Investment Bankers predict that card issuers will focus on "re-pricing" their products in 2005, especially increasing late fees, over-limit fees, and utilizing universal default provisions to trigger higher penalty interest rates to increase income for the issuers.[62]



The new bankruptcy legislation recently enacted by Congress could further improve the bottom line for credit card companies. By preventing some consumers from eliminating their credit card debts, various estimates show that credit card companies could recover an additional $3 billion to $40 billion annually from households in bankruptcy.[63]

D. ISSUERS HAVE PURSUED ABUSIVE INTEREST RATE AND FEE POLICIES THAT HAVE A HARMFUL IMPACT ON MANY HOUSEHOLDS

In recent years, credit card companies have become far more aggressive in implementing questionable fees and interest rate practices. The upshot of these practices is that penalty interest rates, high and accumulating fees and interest on fees can push consumers with high debts over the financial brink into bankruptcy.[64] In fact, consumers in debt trouble sometimes owe as much or more in fees and penalty interest charges as in principal. Consumers also have to worry that an older industry practice – "sticky" interest rates that shoot up fast but decline much more slowly – will threaten their financial stability as interest rates increase.

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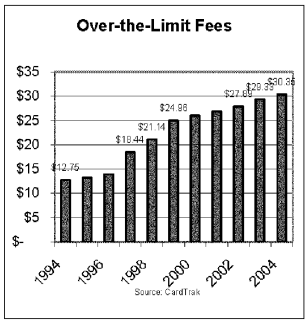
[61] Day, Kathleen and Caroline E. Mayer, "Credit Card Penalties, Fees Bury Debtors," *Washington Post*, March 6, 2005.
[62] "Card Profits 04," *CardTrak*, January 24, 2005.
[63] Heller, Michelle, "Gauging the Bottom-Line Effects of Bankruptcy Bill," *American Banker*, April 15, 2005.
[64] Day, Kathleen and Caroline E. Mayer, "Credit Card Penalties, Fees Bury Debtors," *Washington Post*, March 6, 2005.

High fees and interest rates can push consumers into negative amortization, where the principal on their credit card debt continues to rise despite making payments. Negative amortization in effect traps credit card borrowers on a debt treadmill that keeps moving faster. Although they are making regular payments, their debts continue to mount. In 2004, a Cleveland judge ruled against Discover Card's efforts to collect debts from a cardholder whose balance nearly tripled from $1,900 to $5,564 without making additional purchases because of fees and penalties, including $1,158 in over-the limit fees alone.



In another case, a bankruptcy court in North Carolina ordered a credit card company to itemize the claims it files in chapter 13 bankruptcy cases.[65] In its findings in support of the Order, the bankruptcy judge listed claims filed in eighteen separate cases broken down between principal and interest and fees. On average, interest and fees consisted of more than half (57 percent) of the total amounts listed in the claims. In one case, the card company filed a claim in the amount of $943.58, of which $199.63 was listed as principal and $743.95 was listed as interest and fees. In another case, a claim of $1,011.97 consisted of $273.33 in principal and $738.64 in interest and fees. It is almost certain that pre-bankruptcy payments in these cases had more than paid off the real charges made by the consumers.[66]

Penalty Fees

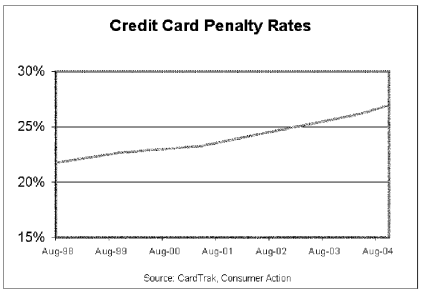
Traditionally, penalty fees were designed to deter irresponsible cardholder behavior, but in recent years these fees have become primarily a revenue enhancer for credit card issuers. Late fees, for example, have been steadily rising over the past half-decade. In 1996, a Supreme Court decision prohibited states from setting limits on the fees credit card companies could charge their cardholders. Prior to this court ruling, credit card late fees were commonly around five to ten dollars, but have risen sharply since the decision.[67] According to figures from the Consumer Action Annual Credit Card Surveys, late fees have increased from an average of $20.80 in 1999 to $32.86 in 2004.[68] More than half of cardholders pay late fees at least once a year, according to *CardTrak*.[69] Late fee charges have gotten so high that they can easily exceed monthly payments for consumers paying low minimum balances.[70]

Credit card issuers used to reject transactions that exceeded a cardholder's credit limit, but it has become common for issuers to accept the transaction and then apply an over-

[65] *In re* Blair, No. 02-1140 (Bankr. W.D.N.C. filed Feb. 10, 2004)
[66] National Consumer Law Center, "Responsible Consumers Driven into Default," February 22, 2005.
[67] Bergman, Lowell and David Rummel, "Secret History of the Credit Card," *Frontline*, November 2004.
[68] CFA analysis of Consumer Action's Annual Credit Card Surveys 1999 – 2004.
[69] "Late Fee Bug," *CardTrak*, May 17, 2002.
[70] "The Ugly Issuer," *Credit Card Management*, September 2004.

limit fee on cardholders who exceed their credit limits.[71] These fees are often applied by issuers in addition to a higher "penalty" interest rate charge for exceeding the credit limit or carrying a high balance.[72] These monthly fees are charged every month a consumer carries a credit balance higher than their credit limit. Between 1994 and 2004, over-limit fees have more than doubled, from $12.75 to $30.35. This fee has increased an average of $1.09 a year since 1999.[73] Critics of this practice argue that issuers should not assess a penalty fee when they can simply enforce the credit limit if they wish to prevent consumers from exceeding it.

Penalty Interest Rates



The majority of credit card issuers also increase interest rates for credit card account holders who pay their bills late, even by a few hours. In 2004, Consumer Action found that 85 percent of issuers charged penalty rates for late payments on their cards.[74] Between 1998 and 2004, penalty rates rose by nearly a fifth, from an average of 21.79 percent to 26.87 percent, according to figures from *CardTrak* and Consumer Action. Some consumers with low-rate cards could have their interest rates double over night for being late on one payment to their credit card.[75]

Retroactive Application of Penalty Rates

Most issuers also apply penalty interest rates retroactively to prior purchases. This has the effect of increasing the price on purchases already made (but not paid off).[76] Some cards even apply penalty rates to debts that were already paid at a lower rate.[77] There is simply no legal or economic justification for assessing a penalty interest rate to an existing balance. I know of no other industry in the country that is allowed to increase the price of a product once it is purchased. Issuers have already assessed a consumer's risk of not repaying the loan and presumably offered an interest rate based on that risk. Issuers should be required to allow a consumer to pay off his or her existing balance at that interest rate.

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[71] *Ibid.*
[72] Bergman, Lowell and David Rummel, "Secret History of the Credit Card," *Frontline*, November 2004.
[73] "Over-Limit Fees," *CardTrak*, February 2, 2005.
[74] Consumer Action, *Annual Credit Card Survey 2004*.
[75] Bergman, Lowell and David Rummel, "Secret History of the Credit Card," *Frontline*, November 2004.
[76] Draut, Tamara, Director of the Economic Opportunity Program Demos, Testimony Before the House Banking Committee Subcommittee on Financial Institutions and Consumer Credit, September 15, 2004, at 16-17.
[77] McGeehan, Patrick, "The Plastic Trap," *New York Times*, November 21, 2004. Discover disclosed to its customers that it had changed the terms of its interest rates from a low of zero to 19.99 percent for a single late payment, but it applied that rate increase for late payments from 11 months prior to the disclosure of the changing interest rate terms.

Universal Default

Universal default clauses in credit card contracts allow credit card companies to raise interest rates on debtors who have problems with other creditors or whose credit score declines. The increases are triggered not just by late mortgage or credit card payment to other lenders but also to other creditors, like utilities or book clubs.[78]

In 2004, the OCC sent an advisory letter to the institutions it oversees covering credit card marketing practices the OCC "regards as unacceptable," including failing to disclose the conditions for imposing unilateral cost increases for cardholders. However, disclosure will not help consumers avoid a practice that many consumers find inequitable when most major issuers pursue this practice. It is fundamentally unfair to impose a penalty interest rate on a consumer who has not made a late payment or defaulted on an obligation, especially when this rate increase is applied retroactively. Another concern with using credit reports to trigger a penalty rate is the problems with inaccuracies in credit scoring and credit reporting that CFA and other organizations have documented.[79]

Although credit card issuers contend that interest rate penalties that increase because of universal default are related to the credit risk of the borrower, the application of these punitive rate hikes seems to belie that contention. One late payment can result in significant increases in interest rates, although there is little to no evidence that a single late payment to one creditor increases the likelihood of default to all creditors. Moreover, the increase in fee burdens and punitive interest rate hikes may have similar or greater impacts on borrowers' ability to repay than modest problems with another creditor.

Interest Rates Stay Higher than the Cost of Funds Would Indicate

Although interest rates have been at historical lows over the past six years, credit card issuers' rates have not passed the cost savings completely through to their customers.[80] As a result, the "spread" between the credit card issuers' cost of funds and the interest rates charged to cardholders have tended to benefit the credit card companies regardless of the direction of the interest rate changes. According to Federal Reserve data, the prime rate fell by 4.5 percentage points from 8.75 percent in February 2000 to 4.25 percent in November 2002, but credit card interest rates fell by only 1.52 percentage points from 14.30 percent to 12.78 percent over the same period – about a third the decline of the prime rate.[81] When prime rates began to rise, credit card rates rose faster than the prime rate increases. Between November 2002 and February 2005, the prime rate rose by 1.25 percent and credit card interest rates rose by 1.35 percent, even more than the increase in the prime rate. The spread

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[78] Burt, Bill, "Pay One Bill Late, Get Punished by Many," *Bankrate.com*, January 20, 2004.

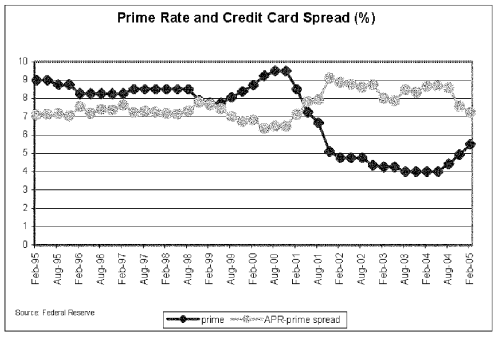
[79] Consumer Federation of America and National Credit Reporting Association, Credit Score Accuracy and Implications for Consumers, December 17, 2002. CFA and NCRA reviewed over 500,000 credit files and found that 29 percent of consumers have credit scores that differ by at least 50 points between the credit bureaus.

[80] "The Ugly Issuer," *Credit Card Management*, September 2004.

[81] Federal Reserve Bank Prime Loan Rate Changes: Historical Dates of Changes and Rates, H15 Selected Interest Rate Data Series, available at the St. Louis Federal Reserve http://research.stlouisfed.org/fred2/series/PRIME/downloaddata; Federal Reserve Consumer Credit Data, Terms of Credit, G19, available at http://www.federalreserve.gov/releases/g19/hist/cc_hist_tc.txt.

between credit card APRs and the prime rate rose when the prime rate declined. Between 1995 and 2000 the spread between credit card rates and the prime rate hovered around 7 percent, but after the prime rate began to fall the spread rose to over 9 percent and only fell below 8 percent once between November 2001 and August 2004.

The changing interest rate environment will primarily impact credit card debt carried on variable rate credit cards. Variable rate cards first appeared on the market in 1991.[82] Over the past six years, it appears that the distribution of credit cards between variable and fixed rates is somewhat related to the interest rate picture. As interest rates increase, issuers tend to switch consumers over to variable rate cards. *CardTrak* reported in November 2004 that more than half (55 percent) of credit card debt was carried on variable interest rate cards, up from three years earlier when rates were declining and card issuers were shifting to fixed rate products.[83] By March 2005, *CardTrak* was reporting that 65 percent of credit card balances were carried on cards with variable rates.[84] This trend means that more consumers will be extremely vulnerable to rising interest rates.



Increases in Credit Card Fees and Interest Rates Significantly Affect Consumer Debt

Although industry-wide figures are not yet available for 2004, penalty fees and interest made up more than three-quarters of credit card issuers' revenues throughout 2002 and 2003. Credit card issuers earned $65.4 billion in interest and $7.7 billion in penalty fees in 2003 or 75.7 percent of the total $96.5 billion in revenue.[85] In 2002, penalty fees and interest made up 76.8 percent of the industry's $97.1 billion in revenues. For the approximately 88 million credit cardholding households, penalty fees and interest on their credit card debt cost an average of $830 in 2003.[86]

Credit Card Issuers Reduce Assistance to Consumers Entering Credit Counseling

Credit card lenders have not only helped push many families into debt trouble in recent years with irresponsible and abusive lending, fee and interest policies; issuers have also reduced the assistance they offer to consumers in debt trouble who seek credit counseling as

[82] "Card Rates," *CardTrak*, September 17, 2001.
[83] "5% Prime," *CardTrak*, November 10, 2004.
[84] "Prime Impact," *CardTrak*, March 23, 2005.
[85] Daly, James J., "Smooth Sailing," *Credit Card Management*, May 2004 at 31.
[86] CFA calculation from Daly, James J. 2004 and Census Bureau figures.

an alternative to bankruptcy. According to a study by the National Consumer Law Center and Consumer Federation of America, five of 13 major credit card issuers increased the interest rates they offered to consumers in credit counseling between 1999 and 2003. [87] Currently, only two major credit card issuers (Wells Fargo and American Express) completely waive all interest charges for consumers in credit counseling. The majority of other major credit card companies charge interest in credit counseling above 9 percent, with issuers like Capital One, General Electric and Discover charging rates of 15 percent or more. Additionally, all major issuers have sharply reduced "fair share" funding to legitimate credit counseling agencies in the last five years.

E. ISSUER "RISK-BASED" PRICING OFTEN LOOKS MORE LIKE PREDATORY PRICING

Credit card issuers often claim that their interest rate and fee policies are justifiable because they are necessary to compensate for the increased financial risk of lending to borrowers with blemished or limited credit histories. It is clearly true that borrowers who pay their balance every month are receiving a valuable service at no cost. It is quite possible, in fact, that riskier borrowers who revolve their debt and pay higher interest rates and fees are subsidizing the cost of services that these non-revolvers receive. However, the key question is whether interest rates and fees charged to riskier consumers are fair and can be legitimately related to the actual financial risk incurred by creditors. There is increasing evidence that the answer to this question is "no." It is becoming ever more apparent that many of the most abusive fees and interest rates are assessed simply because it is what the market will bear.

- **The amount of fees and penalty interest rates do not appear to be proportional to the risk or cost incurred by issuers.** For many years, issuers have justified "sticky" interest rates that rise far faster than they decline by stating that these higher interest rates were necessary to compensate for increased risk. As issuers have increased the number and amount of fees and penalty interest rates they charge, it seems that higher baseline interest rates alone are not sufficient anymore to compensate for risk. As stated above, there is very little evidence that relatively modest problems, like one or two late payments, significantly increase a consumer's chances of default. It would appear to be impossible to justify hitting a consumer with a reasonably good credit history with a late payment fee of $35 and a default interest rate of 29 percent on prior purchases, in addition to the finance charge the consumer would already pay on a fairly high interest rate, such as 17 percent.

- **A rational market would lead lenders to limit their risk by limiting credit available to consumers with riskier credit records or histories, instead of increasing this risk by charging consumers who may be in significant financial trouble significantly more money.** Allowing higher-risk profile consumers to continue borrowing at a more expensive, higher rate does not limit consumers' risk of default, it increases it. If the cardholders are indeed higher-risk, lenders would limit their exposure by cutting off new purchases, preventing balances from increasing and helping to keep the cardholder out of default. But credit card issuers are not cutting

[87] National Consumer Law Center, Consumer Federation of America, "Credit Counseling in Crisis," April 2003.

off the credit, freezing the credit limit or closing the accounts of cardholders that the issuers deem increased risk. Instead they are allowing the borrowers to rack up more credit under more expensive terms,[88] making it more likely that the consumer might suffer serious financial consequences. This demonstrates that issuers are not particularly concerned about the financial consequences to the consumer of these higher costs since distressed customers are so lucrative and that profits from these consumers more than compensate for the financial risk involved.

- **If risk-based pricing truly reflects risk, it should decline or at least moderate as risk decreases.** For example, credit card delinquencies have been declining steadily in the last two years, demonstrating lower total risk to the issuers. During the recent economic slump, the highest credit card delinquency rate was 4.75 percent in the fourth quarter of 2002 (well below the more than 6 percent level delinquencies were at during the economic downturn of 1992), but delinquency rates have fallen steadily since then, to 3.91 percent in the fourth quarter of 2004.[89] The key risk that credit card issuers identify is the risk of default, but that has also been declining. Although charge-off rates were at a two-decade high in 2002, they have also moderated somewhat.[90] Given that issuers have stated so frequently that they are adhering to the doctrine of risk-based pricing, it is perfectly appropriate for consumers to ask why they do not see lower interest rates in response to a more positive credit environment.

- **The assessment of retroactive interest rates is another sign of abusive charges, not risk-based pricing.** As stated above, interest rate increases that apply to past purchases cannot be justified under a true risk-based pricing model. Issuers assess risk based on the best information available on a consumer's credit history. If the risk profile of the consumer declines, the only way issuers could possibly justify a rate increase would be if it were legitimately related to the customer's increased risk, if it did not violate the creditor's agreement to offer credit under certain terms for a specific length of time, and if it were applied prospectively.

- **Increased expenditures on marketing at a time of increasing caution by consumers is also a red flag that pricing in the credit card industry is skewed**. As documented above, issuers continue to increase their marketing expenditures significantly, even as consumers respond less frequently to mail solicitations and show more caution in taking on new debt. A rational market response to these dynamics would be to pull back on marketing expenditures, unless other factors existed, such as windfall profits resulting from abusive pricing.

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[88] Pacelle, Mitchell, "Growing Profit Source for Banks: Fees From Riskiest Card Holders," *Wall Street Journal*, July 6, 2004.
[89] Federal Financial Institutions Examination Council (FFIEC), Consolidated Reports of Condition and Income, FFIEC 031 & 041, available online at the Federal Reserve.
[90] Federal Reserve Board, Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks, available at http://www.federalreserve.gov/releases/chargeoff/.

In response to these "tell-tale" signs of price gouging, it is time for issuers to provide more information to lawmakers and the public about their true costs. It is time for issuers to demonstrate to Americans that their pricing practices are truly fair.

F. LEGISLATIVE RECOMMENDATIONS

1. Eliminate abusive lending by credit card companies. A good starting point would be to enact S. 499, Senator Dodd's Credit Card Accountability Responsibility (Credit CARD) Act of 2005. This proposal would take many important steps to rein in abusive lending practices. For instance, it would mandate that issuers lend responsibly to young Americans, by either assessing an applicant's ability to pay or requiring a co-signor who could pay back the amount loaned. S. 499 would also prohibit credit card lenders from attempting to collect on high-interest loans in bankruptcy that exceed the federal prime rate by more than 20 points.

2. End unjust interest rates and fees. Once again, the Credit CARD Act has a number of important provisions. S. 499 would prohibit issuers from applying interest rates retroactively to past purchases. It would also require credit card companies to take the same approach as the Internal Revenue Service (IRS) in assessing whether a customer has paid on time. Issuers would be required to accept the postmarked date as proof of on-time payment. CFA also recommends that issuers be prohibited from unilaterally altering the terms and conditions of a credit card agreement until a card expires without the affirmative permission of a customer. We also urge Congress to consider legislation that would prohibit the imposition of "universal default" interest rates based on alleged missteps with another issuer. Congress should also ensure that all fees and other charges that are assessed closely match the true cost borne by issuers. Finally, Congress should ban particularly abusive fees, such as over-limit fees, where the issuer allows a customer to exceed the credit limit.

3. Ban deceptive and unfair practices. Issuers should not be allowed to require consumers to relinquish their legal rights and enter mandatory arbitration, in the event a dispute arises. We also encourage Congress and banking regulators to prohibit deceptive advertising and "invitation to apply" solicitations that do not require a firm offer of credit and lead consumers to believe that they are pre-approved for or have a good chance of receiving certain interest rates or terms.

4. Empower consumers with more detailed information. We strongly support S. 393, Senator Akaka's Credit Card Minimum Payment Warning Act of 2005. This legislation would provide all cardholders with personalized information on the length of time—in months and years—and the total costs of paying only the minimum payment. Congress should also take steps to prevent issuers from downplaying permanent interest rates in advertisements and solicitations, while temporary "teaser" rates are prominently disclosed. We also support requiring issuers to include an improved "Schumer Box" of key terms and conditions to all cardholder agreements. It should disclose the card's APR including fees, the credit limit, and the amount of all fees, such as late charges, cash advance fees, over-limit fees and any other applicable miscellaneous fees to the table.

5. Increase penalties to deter illegal acts by credit card companies. In particular, fines under the federal Truth in Lending Act need to be increased. We also support the inclusion of a "private right of action" to empower consumers to use the Federal Trade Commission Act to challenge unfair or deceptive practices by businesses, including banks.

PREPARED STATEMENT OF LOUIS J. FREEH

VICE CHAIRMAN AND GENERAL COUNSEL, MBNA CORPORATION

MAY 17, 2005

Good morning, Chairman Shelby and good morning distinguished Members of the Committee. My name is Louie Freeh and I am here today as General Counsel of MBNA Corporation. Thank you for this opportunity to address the Committee and to share with you some observations about how the American credit card industry, and MBNA in particular, is working to ensure broad availability of credit, at a fair price in a secure environment.

MBNA is an international financial services company and the third largest issuer of credit cards in the United States. Our primary business is making unsecured loans through credit cards, consumer loans, business credit cards, and other lending products. MBNA is best known for partnering with thousands of professional organizations, colleges and universities, conservation groups, and others to deliver financial products through affinity marketing programs. Under these programs, millions of customers express their affinity with their alma mater or profession, and more than 5,000 organizations benefit by sharing in the proceeds generated when customers use an MBNA credit card. MBNA products and services are endorsed by organizations like the National Education Association, Georgetown University, and Ducks Unlimited.

MBNA began business more than 20 years ago with about 100 people in an abandoned grocery store in a rundown shopping center in Ogletown, Delaware. Today, MBNA is a *Fortune* 100 company that employs more than 27,000 people in Delaware, Maryland, Maine, Ohio, Georgia, New Jersey, New York, Pennsylvania, and Texas, as well as in Canada, the United Kingdom, Ireland, and Spain. MBNA appears perennially on several national lists as among the top 100 places to work in America. Our success has been built on an enduring commitment to provide customers top quality financial products, backed by world-class service. That commitment is best expressed by the words, "Think of Yourself As A Customer," which appear above every door in the company.

At MBNA, we use sophisticated software models to help make credit decisions, but we also rely on the analysis and judgment of highly experienced credit analysts. By making what we believe to be more informed credit decisions, MBNA has built one of the highest performing loan portfolios in the credit card business. Our loan losses are significantly lower than the industry average and most of our customers make more than their minimum payment every month. We also take pride in the fact that we treat every customer as an individual, and we make decisions based on an analysis of that individual's credit worthiness as it evolves over time.

In the larger sense, MBNA is a major participant in an industry that is a vital part of the American economy. Credit cards are so ubiquitous that it is easy to forget a time not so long ago when access to credit was a privilege reserved for the elite. Some of you will recall a time when, if you wanted a $300 personal loan, it meant filling out an application, signing countless documents, waiting for your approval and, if the approval came, submitting to a lecture from the bank officer before receiving your check and a book of payment coupons. Today, sophisticated processes allow you to get this done at an ATM.

The availability of reliable credit information, strong regulatory protections, and the willingness of companies like MBNA to take reasonable credit risks have greatly broadened the availability of credit for the average American. This capital has helped fuel the growth of our economy and the strength of our Nation. The fact is, our society would not function as it does without reasonable access to credit through credit cards.

Yet for all this progress, today's credit card loan is very much like the personal loan you may have waited several weeks to receive 20 years ago. It is an unsecured loan that the lender grants based largely on the customer's promise to repay. For example, when a customer uses a credit card to pay for an airline ticket, he is taking out an unsecured loan.

But the credit card loan is different from the old personal loan in several important ways. If the credit card customer needs additional funds or is unable to repay the loan immediately, the lender has agreed in advance to allow the customer to revolve a balance on the loan, repaying a portion each month and avoiding the need to apply for a new loan. So if the airline ticket delivers our customer to Hong Kong, the credit card lender will make funds available in the local currency. If there is a problem, the lender will be available 24 hours a day, 7 days a week to ensure that the customer is satisfied. And if the customer's card is lost or stolen, the lender

will replace the card so that the customer may return home. And the lender then bears the cost of any fraudulent use of the card. It is really a remarkable product.

Most of us do not think about the investment in people, technology, and products required to make this kind of product and service available wherever and whenever a consumer wants credit. The world of the old personal loan seems a distant memory. It is as if credit cards have always been there, and always will be. In fact, the system relies on the integrity of both parties to live up to their commitments. And the good news is, the system is working very well.

The vast majority of lenders grant credit responsibly, and the vast majority of consumers use credit cards responsibly. The result is, nearly every American today enjoys access to a reasonably priced source of capital to realize their dreams. Credit is no longer the province of the wealthy. Credit is now a reasonably priced financial tool available to nearly every American. MBNA is proud to have played a role in this progress.

There are, of course, always exceptions. Some consumers mis-handle credit cards, and lenders can always do more to improve the ways in which they grant and manage credit. But we must not make the mistake today of focusing solely on the exceptions. As we examine some of the industry's practices, we must balance our concern for appropriate safeguards with an interest in preserving access to credit for the majority of Americans who use it responsibly.

Within this context, let me turn now for a few moments to some topics the committee is concerned with. I have some observations on the marketing of credit cards to college students, the practice of repricing existing accounts and assessing fees, minimum payments, concerns about disclosures, and data security.

Student Marketing

In discussing student marketing, it is important to note that we make every effort to ensure that credit card offers are not sent to people under the age of 18.

MBNA does promote its products to college-aged customers by partnering with more than 700 colleges and universities, primarily through the college alumni associations. By working closely with school administrators, we have earned the confidence and trust of most of America's premier educational institutions.

When we market on campus, we sometimes participate in school events such as football games and orientation activities. These activities are conducted within the framework of a multiyear agreement that gives the school extraordinary control over when, where, and how we are allowed to market our products, especially to students. While we do issue credit cards to some college students, you may be surprised to learn that more than 90 percent of the credit cards we issue through colleges and universities go to the alumni, parents, and staff, not students. Alumni groups typically use the funds generated to underwrite academic and athletic enrichment programs.

Before granting credit to a college student, analysts familiar with the needs and abilities of college students review each application and decline more than half. Our experience is that most college student applicants report a separate income, and that many already have an established credit history. When evaluating an application, we consider the college students' projected performance as an alumnus, and when we grant credit, we typically assign a line of between $500 and $1,000. If a college student attempts to use his or her card beyond the credit line, we typically refuse the charge. And we do not reprice these accounts based on behavior.

Once a college student becomes a cardholder, MBNA delivers its "Good Credit, Great Future" brochure in a welcome package. The brochure highlights sound money management habits, including guidance on how to handle a credit card responsibly. We also maintain a website aimed at college-aged consumers, highlighting many of the same tips. MBNA also conducts on-campus credit education seminars and we provide articles concerning responsible credit use for student and parent publications.

The performance of our college student portfolio mirrors closely that of the national experience, as reported in GAO reports and several independent studies. However, our accounts have much smaller credit limits and much smaller balances than the norm, our college student customers utilize their cards less often than the norm, and these accounts are less likely to incur fees. Our experience has also been that college students are no more likely to mis-handle their accounts than any other group of customers.

When we grant a card to a college student, we think of it as the beginning of what we hope will be a long relationship. As he or she begins a career, purchases a home and raises a family, MBNA wants to be the lender of choice. Given this, we have absolutely no interest in encouraging poor credit habits. In fact, everyone's interest

is best served when college students make responsible use of credit. That is our goal in every situation, and certainly when dealing with college-aged customers.

We also appreciate that Congress has mandated a study concerning credit and college students. We believe this study will bear out what our experience has indicated and will provide a sound, analytical basis for determining whether or not additional legislation is necessary.

Re-Pricing and Fees

One topic often discussed is how credit card lenders price—and sometimes reprice—their products. It is not unusual to hear someone say that the prime rate is X, that home mortgages are generally priced close to that number, and that credit cards should be too. Of course this line of thinking ignores the fact that no consumer loan could have greater security than a mortgage, which is secured against real property, while few loans could have less security than a credit card.

MBNA has some 50 million customers. During any given month, 30 percent of our customers revolve a balance and pay us interest for the use of that money, another 10 percent pay in full without interest, and 60 percent have no balance and do not use their card that month. Before we lend money to customers, MBNA must itself borrow funds. We must then pay the marketing costs to attract customers and the operations costs to service their business. We must also cover the expense of providing rewards points to customers, compensating our affinity partners, protecting our customers from fraudulent transactions, and funding those loans that are charged off because they will never be repaid. And like any business, we must pay salaries, benefits, facilities expenses, and taxes. The fact is, before we return a profit to shareholders, we must earn significantly more than our cost of funds just to cover our cost of business. And this is in an environment where customers have come to expect no annual fee, generous rewards points, complete protection from fraud, 24-hour global service, and a 0 percent APR.

We manage to this environment by using our affinity model to differentiate our products, by focusing on providing outstanding products and services, by giving potential customers every good reason to join MBNA, by maintaining the flexibility to price our products to reflect the changes in the risk profiles of our customers, and by applying fees when customers decide to handle their accounts outside the agreed terms. Our over-riding objective is to ensure the integrity of the portfolio so that we can continue providing the greatest amount of credit to the greatest number of qualified customers at the most competitive rates. I think this goal is entirely consistent with the committee's fundamental concerns for the American consumer.

When we increase a customer's APR, we do so for one of two reasons: Either our costs have increased, or the customer's creditworthiness indicates a higher risk than is supported by the current pricing. However, MBNA does not practice universal default. We do not automatically reprice a customer's account without notice solely because he or she may have missed or been late on a payment to some other creditor.

The reality is, every lender must have the ability to set and, if necessary, adjust the pricing on an unsecured revolving loan in order to reflect the risk inherent in making that loan. Likewise, if a customer chooses to pay late, exceed his credit limit, or otherwise handle his account outside the agreed terms, it is not unreasonable that we would assess a fee to help cover the added risk that this poses. Without this flexibility, some lenders would simply raise their rates, forcing all customers to pay a higher rate in order to subsidize those who present increased risks, others would limit credit access to all but the most affluent, and some would just find new lines of business.

At MBNA, we work to balance all of these factors and to price our products in a way that allows us to attract and retain the best customers, while also achieving our financial goals.

Absent a default on that specific account, MBNA provides advance notice to customers when we reprice an account, and we allow customers to reject a rate increase and to pay the balance at the old rate.

Minimum Payments

I want to turn now to the subject of minimum payments. Providing customers with the flexibility of making a low minimum payment is one of the terrific features of a credit card. For customers whose incomes may fluctuate over the course of the year, the option of a low minimum payment can be a flexible tool for managing the monthly budget.

Our experience, however, is that nearly all of MBNA's customers pay more than their minimum each month and only a fraction of 1 percent of consistently pay only the minimum. In fact, many of our customers pay their balance in full each month.

While the minimum payment is meant as a tool or a guideline for consumers, we recognize that some customers fall into the habit of repeatedly making the minimum payment. When this happens, a consumer can begin having problems making a dent in the principle owed. MBNA identifies those customers whose poor payment practices indicate financial stress. We reach out to these customers and work with them to develop payment strategies that suit their circumstances.

MBNA has also announced that it will begin applying a new minimum monthly payment formula later this year. For most customers who revolve a balance and currently pay the minimum, the new formula will encourage them to pay down a larger portion of principle each month. We continue to work with the OCC and all of the banking regulatory agencies as they work to improve the effectiveness and efficiency of the system.

Disclosures/Transparency

Turning for a moment to the topic of disclosure, let me first say that MBNA is committed to keeping its customers fully and fairly informed of every aspect of their accounts. However, we believe that the volume and types of disclosures mandated by Federal and State laws, regulations, guidelines, and practices, along with the complexity of the product, have not led to greater clarity. In fact, we think these measures have often led to greater confusion and frustration for the consumer. And while we favor better disclosure, we should consider that better disclosure may not mean more disclosure. Better disclosure may mean simpler descriptions of key terms and offering consumers a range of ways to get this information, including websites, toll-free phone numbers, and simplified documents.

At MBNA, we always provide advance notice of changes in APR's and we tell customers how to opt-out of these changes. Moreover, in response to the OCC's September 2004 Advisory Letter regarding credit card marketing practices, MBNA made a number of improvements in its marketing materials and agreements. Our goal was to highlight important terms and conditions relating to fees, rates, payment allocation, repricing, and how to opt-out of changes in terms. In addition, we recently provided comment to the Board of Governors of the Federal Reserve System wherein we support the Board's decision to undertake a comprehensive review of the Federal Truth In Lending Act and Regulation Z. We believe this review is necessary because consumer credit markets and communications technology have changed significantly since the Act was last revised in 1980. We have further suggested that the Board be guided by four fundamental principles as it considers revisions to the Act.

First, *disclosures must be simple.* We know from talking to millions of customers every year that they are often confused and frustrated by the dense and lengthy regulatory language that issuers are required to use in disclosures. Ironically, the language intended to inform consumers more often overwhelms them. Much of this material ends up in the household trash. We believe it should be a priority for the Board to shorten and simplify disclosure language and to focus on the most relevant terms and conditions that consumers need to understand.

Second, *disclosures must be clear.* There are several consumer-tested models for presenting complex information in a clear and effective manner. We recommend that in addition to containing shorter, simplified language, disclosures should also be presented in ways that are understandable and meaningful. Lenders should have the option of using these consumer-friendly models as a "safe harbor" for disclosure.

In respect of the need to present information simply, clearly, and effectively, MBNA has begun voluntarily inserting its change-in-terms notices within what we call a "wrapper." The wrapper presents a top line summary of the changes in terms, along with hints to customers for managing their accounts. We also use the wrapper to remind customers of the things they can do to avoid fees, and we make suggestions on how to manage payments by mail, by phone, and by Internet. The wrapper is a step in the direction of clarity, and we are happy to have taken it.

Our third recommendation is that *disclosures should be based on uniform national standards.* The goal of greater simplicity and clarity will never be achieved as long as individual States can impose their own disclosure requirements. We do not believe that State-specific disclosures provide any significant benefits, but we know they add to the complexity of documents that customers tell us are already far too difficult.

And fourth, *disclosures should not be repetitive.* Key terms should not have to be disclosed in the account application and in the summary of terms disclosed later.

Our idea is that the Fed Box can be improved. Similar to the "nutritional facts" table on the side of all food products, issuers would disclose the key terms of the credit card agreement in a uniform way. The table could include a listing of the rates that apply to the different types of transactions, information on whether the

rates are variable or nonvariable, fees, grace periods, default provisions, conditions for repricing, duration of promotional rates, and so on. The major improvement is that this information would be presented in a consistent, uniform manner. Consumers could compare product features and benefits, and more easily choose those products that suit their needs, whether they want to revolve a balance or not.

In 2003, MBNA tested a "food label-style" privacy statement with a small segment of customers. More than 90 percent told us they preferred the simplified format. The study confirmed that transparency in disclosures is in MBNA's best interest, and of course the best interest of consumers. MBNA will work closely with the Board, and all the appropriate agencies, to contribute to the revision process and to implement the revised requirements.

Data Security/Identity Theft

Several recent high-profile identity theft incidents underscore the importance of data security. Before I address how MBNA manages this risk, it should be said that while credit card information often is the commodity that identity thieves want, they do not usually get it from the credit card companies. Typically, they steal this data from merchant computers, where some retailers retain customer account information despite industry rules to the contrary. Often it is the credit card issuer that identifies a pattern of theft, and since the issuer bears the financial burden when a card is used fraudulently, it is not surprising that lenders are focused on curbing this problem.

At MBNA, we monitor account activity around the clock in an effort to prevent fraud. To do this, we apply a unique blend of technology and human judgment. Some of our most experienced analysts work in our fraud prevention unit. These people bring years of experience to their assignments and understand the patterns of behavior to look for when identifying fraud. They know also that not everything that looks like it might be fraud actually is fraud. That is an important skill as well, when one goal is to ensure that customers are not denied the legitimate use of their card.

Fraud prevention starts when we review applications. Our system of judgmental lending gives us an edge in this respect, since we stress the need for direct contact with applicants—especially if we think there is any discrepancy on the application that might suggest fraud.

When customers are using their cards, MBNA employs neural network and rules-based fraud strategies to identify high fraud-risk transactions. If we think we see an issue, we act quickly to mitigate fraud risk by declining transactions and/or seeking point-of-sale customer identification.

But these are just a few examples of how we act to prevent fraud and identity theft. In all, we will spend over $100 million this year alone preventing and responding to fraud. Over the last 5 years, we have invested additional millions of capital to upgrade our systems to meet this growing challenge. One result of all these efforts is that credit card losses due to fraud, measured as a percent of sales, are now at historic lows.

Finally on this topic, I want to address the question of customer notification. We support the standards recently adopted by the Federal banking agencies. We believe that lenders must have the flexibility of being able to assess whether or not the circumstances of the breach pose a genuine risk. Establishing a default requirement where each and every breach of sensitive information triggers an all-out customer notification, as some have suggested, will result in a flood of notifications, nearly all of which will be unnecessarily alarmist. Consumers will quickly learn to ignore these notices and will become complacent, even in those instances when the threat is genuine. What we should strive for is a standard that calls for notification when the threat is real.

Chairman Shelby and Members of the Committee, this concludes my prepared remarks. I would again like to thank you for the opportunity to address some of these important topics and I look forward to responding to any questions you may have.

PREPARED STATEMENT OF ROBERT D. MANNING

UNIVERSITY PROFESSOR AND SPECIAL ASSISTANT TO THE PROVOST
ROCHESTER INSTITUTE OF TECHNOLOGY

SEPTEMBER 5, 2002

I would like to thank Chairman Richard Shelby for providing this opportunity to share my views with the Committee on the increasingly important issue of deceptive credit card marketing and consumer contract disclosures during this rapidly chang-

ing period of banking deregulation. This Committee has a long tradition of examining and protecting consumer rights in the realm of financial services and I hope that this hearing will produce new relief to financially distressed and overburdened households as they cope with the increasingly opaque credit card policies and practices. In this endeavor, I have had the pleasure of contributing to Senator Paul S. Sarbanes' investigation of consumer debt among college students and the lack of financial literacy/education programs for America's financially vulnerable youth. In addition, I applaud the legislative initiatives of Senator Christopher Dodd, who has championed credit card marketing restrictions on college campuses along with critically needed financial education programs as well as directing greatly needed attention to ambiguous contract disclosures and deceptive marketing practices. Also, it is a pleasure to acknowledge the State of New York's senior Senator, Charles E. Schumer, whose efforts to protect consumers from deceptive marketing and contract disclosure practices of the credit card industry has simplified our lives through the summary of our key credit card contract information in our monthly statements. The twin issues of rising cost and levels of consumer debt together with shockingly low levels of financial literacy among our youth and their parents have grave implications to the continued economic well-being of the Nation—especially as Americans age into debt and watch the erosion of their Social Security benefits. For these and many other reasons, I commend the Committee for accepting the daunting task of examining the increasingly serious problems that will be addressed today.

As an economic sociologist and faculty member in the Department of Finance in the College of Business at Rochester Institute of Technology, I have spent the last 19 years studying the impact of U.S. industrial restructuring on the standard of living of various groups in American society. Over the last 12 years, I have been particularly interested in the role of consumer credit in shaping the consumption decisions of Americans as well as the role of retail banking in influencing the profound transformation of the U.S. financial services industry. In regard to the latter, I have studied the rise of the credit card industry in general and the emergence of financial services conglomerates such as Citigroup during the deregulation of the banking industry beginning in the late 1970's.

In terms of the former, my research includes in-depth interviews and lengthy survey questionnaires with over 800 respondents in the 1990's and nearly 1,500 in the 2000's. The results of this research are summarized in my book, *CREDIT CARD NATION: America's Dangerous Addiction to Consumer Credit* (Basic Books, 2001) and a forthcoming series of research articles. More recently, I have begun investigating the global expansion of deregulated consumer financial services with particular attention to comparative governmental policies that enforce consumer rights in Europe, Asia, and Latin America. My next book, *GIVE YOURSELF CREDIT* (Alta Mira/Taylor Publishers, 2006), presents an updated analysis of the deregulation of the credit card industry, major public policy issues, and practical guidance for consumers for more prudent use of consumer credit. These interests in public policy and financial literacy have inspired the development of my own internet-based financial literacy/education programs at *www.creditcardnation.com.*

Banking Deregulation and the Consumer Lending Revolution: Ascension of the Free Market or Nadir of Consumer Rights?

In mid-2004, the 185 million bank credit cardholders in the United States possessed an average of almost 7 credit cards (4 bank and 3 retail) and they charged an average of $8,238 during the previous year (*Cardweb.com,* 2004a; Card Industry Directory, 2004). In 2004, about 70 million (37.8 percent) were convenience users or what bankers disparaging refer to as *deadbeats* because they pay off their entire credit card balances each month.[1] In contrast, nearly 3 out of 5 cardholders (62.2 percent) were lucrative debtors or *revolvers;* 71 million (38.4 percent) typically pay more than the minimum monthly payment (typically 2 percent of outstanding balance) while 44 million (23.8 percent) struggle to send the minimum monthly payment (*Cardweb.com,* 2004a).

Over the last 10 years, which includes the longest economic expansion in American history, the total number of bank credit cards increased 62 percent, total charge volume by 162 percent, and net outstanding debt by 129 percent (Card Industry Directory, 2004, Ch. 1). Today, early 2005, approximately three out of five U.S. households account for almost $685 billion in outstanding, "net" bank credit card debt plus almost another $100 billion in other revolving lines of credit (Card Industry Directory, 2004; *Cardweb.com,* 2004a; U.S. Federal Reserve, 2005). This re-

[1] Over the last 6 months, fueled by increasing popularity of home equity loans and the uneven economic expansion, the growth of convenience users has jumped to about 43 percent (*CardWeb.com,* 2005).

flects a meteoric rise in credit card debt—from less than $60 billion at the onset of banking deregulation in 1980.

Overall, the average outstanding credit card balance (including bank, retail, and gas) of debtor or "revolver" households with at least two adults has soared to over $12,000 (Card Industry Directory, 2004); approximately 75 percent of U.S. households have a bank credit card, up from 54 percent in 1989 (Canner and Luckett, 1992; T3Cardweb.com, 2004a). This is exclusive of "nonrevolving" consumer debt such as auto, home equity, furniture, debt consolidation, and student loans, which total over $1.3 trillion in 2005, plus over $7.2 trillion in home mortgage loans. The sharp increase in consumer debt ("revolving" and "installment") over the last 25 years (doubling over the last 10 years) and the rapid rise of credit card debt-from 19.5 percent of installment debt in 1980 to 43.8 percent in 1990 peaking at 70.4 percent in 1998 and dropping to 61.9 percent in 2004. In terms of consumer debt levels per capita, each of the more than 295 million residents of the United States owes an average of over $31,000, which helps to explain how consumer spending accounts for over two-thirds of U.S. Gross Domestic Product (GDP) or total domestic economic activity (U.S. Federal Reserve, 2005; U.S. Census, 2005). As illustrated by these startling statistics, the last two decades have witnessed the birth of the Credit Card Nation and the ascension of the debtor society (Manning, 2000; Sullivan, Warren, and Westbrook, 2000; Warren and Tyagi, 2003; Leicht and Fitzgerald, 2006).

Banking Deregulation and the Ascent of Retail Financial Services: What's Consumer Debt Got to Do With It?

The debate over the origins of the consumer lending "revolution" tend to focus on either the "supply" or "demand" side of this extraordinary phenomenon. This section explores how statutory and regulatory reforms over the last three decades have fundamentally changed the structure of the U.S. banking industry and the subsequent "supply" of financial services. During this period, the institutional and organizational dynamics of American banking have changed profoundly as well as the "supply" of financial services in terms of their use, cost, and availability. Indeed, the intensifying economic pressures of globalization (U.S. industrial restructuring, Third World debt crisis, downward pressure on U.S. wages) together with new forms of competition in the U.S. financial services industry (rise of corporate finance divisions, growth of corporate bond financing, and expansion of mortgage securitization) precipitated a dramatic shift from "wholesale" (corporate, institutional, and government) to "retail" or consumer banking (Brown, 1993, Dymski, 1999; Manning, 2000: Ch. 3). And, as explained later, consumer credit cards played an instrumental role in this process.

The basic public policy assumption of banking "deregulation" is that reducing onerous and costly Government regulation invariably unleashes the productive forces of intercompany competition that yield a profusion of direct benefits to consumers. The most salient are lower cost services, greater availability of products, increased yields on investments, product innovation, operational efficiencies, and a more stable banking system due to enhanced industry profitability (Brown, 1993, GAO, 1994; Rougeau, 1996; Dymski, 1999; Manning, 2000: Ch 3). This "free market"-based prescription for miraculously satisfying both the profit objectives of financial services executives and the cost/availability interests of consumers belies the inherent political asymmetries that have militated against the distribution of industry efficiencies over the last 20 years. It is the intractable conflict between corporate profit maximizers in the banking industry and consumer rights advocates that constitutes the focus of this analysis.

According to Jonathan Brown, Research Director of *Essential Information,* there are three systemic contradictions of laissez-faire-driven banking deregulation that limit "broad-based" consumer benefits. In brief, they are [1] excessive risk-taking by financial institutions that are facilitated by publicly financed deposit insurance programs (FDIC) and publicly subsidized corporate acquisitions of insolvent financial institutions (Savings and Loan crisis of early 1980's); [2] increased industry concentration and oligopoly pricing policies (in the absence of a strong antitrust policy) that limits cost competition over an extended period of time; and [3] diminished access to competitive, "mainstream" financial services for lower-income households as corporations focus their resources on more affluent urban and suburban communities. Brown concludes by underscoring the paradox of "free market"-driven banking deregulation, "strong prudential control [by Government and consumer organizations] becomes even more important because deregulation increases both the opportunities and the incentives for risk-taking by banking institutions [in the pursuit of optimizing profits rather than public use]" (Brown, 1993: 23). For our current purposes, the latter two trends merit further discussion.

The first distinguishing feature of the early period of banking deregulation is the sharp increase in the growth and profitability of retail banking in comparison to wholesale banking. During the early 1980's, wholesale banking activities experienced a sharp decline in profitability, especially in the aftermath of the 1982–1983 recession. These include massive losses on international loans, large real-estate projects, and energy exploration/extraction companies. Furthermore, traditional bank lending activities faced new and intensified competition such as Wall Street securities firms underwriting cheaper bond issues, corporate finance affiliates offering lower-cost credit for "big ticket" products (automobiles), and the integration of home mortgage loans into the capital market via the sale of asset-back securities (mirrored in the explosive growth of Fannie Mae) which contributed to downward pressures on bank lending margins. In addition, many consumers with large bank deposits shifted their funds into higher yield mutual funds that were managed by securities firms. This increased the cost of bank funds since they were forced to offer certificates of deposits (CD's) with higher interest rates which further reduced their profit margins (Brown, 1993; Nocera, 1994; Manning, 2000).

As astutely noted by Brown, the response of U.S. banks to these intensifying competitive pressures was predictable, "[F]inancial deregulation tends to lower profit margins on wholesale banking activities . . . where large banks have suffered major losses on their wholesale banking operations, the evidence suggests that they tend to increase profit margins on their retail activities in order to offset their wholesale losses" (Brown, 1993: 31.) Indeed, corporate borrowers have been the major beneficiaries of banking deregulation over the last two decades. This is evidenced by the sharp increase in the cost of unsecured consumer debt such as bank credit cards; see Manning (2000:19) for a cost comparison of corporate-consumer lending rates in the 1980's and 1990's.[2]

The magnitude of this shift in interdivisional profitability within large commercial banks is illustrated during the 1989–1991 recession. For example, Citicorp reported a net income of $979 million from its consumer banking operations in 1990 whereas its wholesale banking operations reported a $423 million loss. Similarly, Chase Manhattan's retail banking activities produced $400 million in 1990 whereas its wholesale banking activities yielded a $734 million loss (Brown, 1993: 31). Not unexpectedly, bank credit cards played a central role in fueling the engine of consumer lending in the 1980's. The average "revolving" balance on bank card accounts jumped six-fold—from $395 in 1980 to $2,350 in 1990 (Manning, 2000:11). According to economist Lawrence Ausubel, in his analysis of bank profitability in the period 1983–1988, pretax return on equity (ROE) for credit card operations among the largest U.S. commercial banks was 3–5 times greater than the industry average (1991:64–65). Hence, the ability to increase retail bank margins in the early 1980's (to be discussed in greater detail) led to the sharp growth in consumer marketing campaigns and the rapid expansion of consumer financial services beginning in the mid-1980's (Mandell, 1990; Nocera, 1994; Manning, 2000).

Not incidentally, the escalating demand for increasingly expensive consumer credit was not ignored by nonfinancial corporations. Growing numbers of manufacturers and retailers established their own consumer finance divisions such as General Motors, General Electric, Circuit City, Pitney Bowes, and Target. In many cases, like the dual profit structures of the banking industry, the traditional operations of these major corporations (manufacturing and retailing) encountered mounting competitive pressures through globalization and subsequently experienced sharp declines in their "core" operating margins. Escalating revenues in their financing divisions (especially consumer credit cards) compensated for these declines and, in especially aggressive corporations like General Electric, were spun-off into enormously profitable global subsidiaries such as GE Financial (Manning, 2000: Ch. 3). In fact, the financing units of Deere & Co. and General Electric accounted for 21 and 44 percent, respectively, of corporate earnings in 2004 and all of Ford's pretax profits in 2002 and 2003 (Condon, 2005). Today, financial companies account for 30 percent of U.S. corporate profits, up from 18 percent in the mid-1990's and down from its peak of 45 percent in 2002 (Condon, 2005).[3] As a result, there is growing concern

[2] The real cost of "revolving" credit card loans, exclusive of introductory or low "teaser" rates and inclusive of penalty fees, has nearly tripled since the early phase of banking deregulation in the 1980's.

[3] The success of corporate finance operations has led to more aggressive involvement with high-risk, speculative investments including "junk" bonds. For example, the sharp decline in the Federal Reserve's "discount" interest rate in 2001 led many of these finance divisions to invest heavily in the "carry trade" whereby companies borrow at low, short-term rates and invest in higher yield, long-term bonds or asset-backed (for example, mortgages and credit cards) securities. Today, with interest rates rising, the enormous profits made from these bond purchases in 2002 and 2003 will soon be replaced with losses following the decline in this favorable inter-

that shrinking bank profits derived from commercial loans to corporate borrowers, together with declining profits from the speculative "carry trade" (long-term hedging of short-term interest rates such mortgage bonds), will exacerbate pressure to increase profits on retail lending activities and thus raise the cost of borrowing on consumer credit cards.

As the consumer lending revolution shifted into high gear in the late 1980's, rising profits and rapid market growth (number of clients and their debt levels) fueled the extraordinary consolidation of American banking and especially the credit card industry. In 1977, before the onset of banking deregulation, the top 50 banks accounted for about one-half of the credit card market (Mandell, 1990). This is measured by outstanding credit card balances or "receivables" of each card issuing bank. Fifteen years later, 1992, the top 10 card issuers expanded their control to 57 percent of the market, prompting a formal U.S. Congressional inquiry into the "competitiveness" of the credit card industry (GAO, 1994). Over the next decade, bank mergers and acquisitions proceeded at a breakneck pace, propelling the concentration of the credit card industry to oligopolistic levels.

For example, Banc One's acquisition of credit card giant First USA in 1997 was followed in 1998 by Citibank's purchase of AT&T's credit card subsidiary—the eighth largest card issuer. Over the next 18 months, MBNA bought SunTrust and PNC banks, Fleet merged with BankBoston, Bank One acquired First USA, NationsBank merged with Bank of America, and Citibank bought Mellon Bank. Today, the ongoing concentration of the credit card industry features the mergers of increasingly larger corporate partners. In 2003, Citibank purchased the troubled $29 billion Sears MasterCard portfolio (Citibank, 2003). This was followed in 2004 with Bank of America's acquisition of Fleet Bank (tenth largest U.S. credit card company) and J.P. Morgan Chase's purchase of Bank One (third largest credit card company). As a result, the market share of the top 10 banks climbed from 80.4 percent in 2002 to 86.7 percent in 2003 and then to over 91 percent in 2004 (Card Industry Directory, 2004). Overall, the top three card issuers (Citibank, MBNA, J.P. Morgan Chase) control over 55 percent of the market. Not surprisingly, as market expansion and industry consolidation approaches its limits in the United States, several top megabanks have begun aggressively promoting their consumer financial services in international markets through corporate acquisitions, mergers, and joint ventures. These include Citibank, MBNA, Capitol One, GE Financial, and HSBC.

Not only has U.S. banking deregulation transformed the market structure of the US and eventually the global financial services industry but it has also facilitated the rise of the "conglomerate" organizational form. This second distinguishing feature of the recent deregulated banking era is a profit maximizing response to the maturation of industry consolidation trends. In brief, the limits of organizational growth through horizontal integration, even with its economic efficiencies of scale and oligopolistic pricing power, entails that future growth can only be sustained by expansion into new product lines and consumer markets. This multidivisional corporate structure, guided by "cross-marketing" synergies offered by "one-stop" shopping via allied subsidiaries for the vast array of consumer financial services, was initially attempted by Sears and American Express in the 1970's and 1980's with generally disappointing results (Nocera, 1994; Manning, 2000).

By the late 1990's, two financial services behemoths sought to bridge the statutory divide between commercial banking and the insurance industry by combining their different product lines into a single corporate entity: Citigroup. Technically, the 1998 merger of Citibank and Travelers' Insurance Group was an illegal union that required a special Federal exemption until the enactment of the Financial Services Modernization Act (FSMA) of 1999 (Manning, 2000: Ch. 3).[4] With cost-effective technological advances in data management systems together with U.S. Congressional approval of corporate affiliate sharing of client information (FSMA) and the continued erosion of consumer privacy laws (Fair Credit and Reporting Act of 2003), Citigroup became the first trillion dollar U.S. financial services corporation that offered the "one-stop" supermarket model for all of its clients' financial needs. These include retail and wholesale banking, stock brokerage (investment) services, and a wide-array of insurance products for its customers in over 100 countries. Again, bank credit cards played a crucial role through the collection of household consumer information, the cross-marketing of Citigroup products and services, and its high

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est rate "spread." As a result, corporate finance affiliates must offset these losses by increasing the volume of more costly corporate loans which is problematic with current market conditions. This will increase pressure to raise lending margins on their consumer financial services.

[4] Also referred to as the Gramm-Leach-Biley Act (GLBA) of 1999.

margin cashflow that helped in offsetting costly merger and integration-related expenses (Manning, 2000: Ch. 3).[5]

A third distinguishing feature of banking deregulation is the widening institutional gap or bifurcation of the U.S. financial services system. That is, the distinction between "First-tier" or low-cost mainstream banks and "Second-tier" or "fringe" banks such as pawnshops, rent-to-own shops, "payday" lenders, car title lenders, and check-cashers. This widening institutional division between these consumer financial services sectors has dramatically increased the cost of credit among immigrants, minorities, working poor, and heavily indebted urban and increasingly suburban middle-classes (Caskey, 1994; 1997; Hudson, 1996; 2003; Manning, 2000: Ch. 7; Peterson, 2004). Indeed, the usurious costs of financial services in the second-tier reflect the ideological zeal of regulatory reformers whose goal is to rescind interest rate ceilings, loan "quotas" imposed on mainstream banks for disadvantaged communities, and vigorous enforcement of financial disclosure laws. Shockingly, the cost of credit typically exceeds 20 percent per month for consumers who often earn poverty-level incomes and less.

The significance of this trend is two-fold. First, the systematic withdrawal of First-tier banks from low income communities restricts the access of these residents to reasonably priced financial services. Although morally reprehensible, banks frequently justify their actions in terms of economic efficiencies and profit utility functions that are arbitrated by "free-market" forces. The political reality, however, it that this policy is a defiant rejection of the affirmative obligation standard of the Community Reinvestment Act (CRA) of 1977 (Brown, 1993, Fishbein, 2001; Carr, 2002). That is, the banking industry receives enormous public subsidies through (1) depositor protection programs/policies, (2) access to low-cost loans through the Federal Reserve System's lender of last resort facility, and (3) privileged access to the national payments/transactions system (Brown, 1993). The *quid-pro-quo* for satisfying this affirmative obligation standard has been an understanding that banking institutions have a duty to provide access to financial services to disadvantaged groups within their local communities, to engage in active marketing programs for promoting these financial services and products, and, in the process, to absorb some of the administrative expenses and costs of their financial products/services. By ignoring their responsibility to CRA, first-tier financial institutions have invariably increased the population of "necessitous" consumers whose limited resources exacerbates their reliance on "second-tier" financial services and their vulnerability to predatory lenders.

Second, the tremendous price differential between the two banking sectors increases the financial incentive for first-tier banks to abandon low-income and minority communities and return directly or indirectly through financial relationships with second-tier financial institutions (Hudson, 1996; 2003; Manning, 2000:Ch 7; Peterson, 2004). This is becoming an increasingly common practice of the largest banks. For instance, Citibank purchased First Capital Associates in 2000 which had been penalized by Federal regulators from the Office of the Comptroller of the Currency (OCC) for its past predatory lending policies and was again recently chastized by the Federal Reserve for originating predatory home mortgages, HSBC's purchase of Household Bank in 2000 was delayed following the negotiation of a $400 million predatory lending settlement, and Providian Bank was fined $300 million by the OCC in 2000 for its unfair and deceptive practices in the marketing of its "subprime" card cards (Manning, 2001; 2003).

As the growth of traditional financial services markets stagnates, major banks are aggressively promoting "subprime" consumer lending programs with triple digit finance charges (effective APR's) such as HSBC's partnership with H&R Block's Rapid Advance Loan (RAL's) and Capital One Bank's fee-laden credit cards such as its "EZN" card which imposes $88 in fees for $112 line of credit. It is the desperation of consumers who depend on credit for household needs, especially after personal bankruptcy or an economic calamity (job loss, medical expenses, or divorce), that leads them to "trustworthy," major financial institutions whom they expect to offer the best financial rates on consumer loans. However, instead of receiving "No Hassle" credit cards with moderate interest rates, unsuspecting Capital One customers often receive subprime cards with little credit and unjustifiably high fees.[6]

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[5] Citigroup's consumer financial services companies have outperformed the insurance division in growth and profit margins—especially after 2001. As a result, Citigroup has retreated from its one-stop, financial supermarket concept and has agreed to sell its Travelers Life & Annuity division to Metlife Inc for $11.5 billion in winter of 2005 (Reuters, 2005b).

[6] See *Foster* v. *Capital One Bank,*et al for ongoing class action lawsuit regarding deceptive marketing and excessive fees for the "Capital One Visa Permier" credit card that features 0 per-

In the case of First Premier Bank, the $250 line of credit at 9.9 percent features $178 in fees.

Not surprisingly, the credit card industry continues to report record profits this year. In 2003, pretax profit (Return on Investment) of $17.1 billion climbed 32.4 percent from 2002 even though interest revenue declined slightly from $66.5 to $65.4 billion (Card Industry Directory, 2004). According to the June 2003 FDIC report on bank profits, [First Quarter 2003] "is the largest quarterly earnings total ever reported by the [banking] industry. . . [and] the largest improvement in profitability was registered by credit card lenders [with] their average Return-On-Assets (ROA) rising to 3.66 percent from 3.22 percent a year earlier;" *The Card Industry Directory* (2004) reports 2003 ROA at 4.02 percent and credit card industry analyst R.K. Hammer Investment Bankers report it at an even more impressive 4.40 percent. The extraordinary profitability of consumer credit cards is illustrated by comparing the ROA of credit card issuers with the overall banking industry. According to the FDIC, the increase in the ROA for the banking industry rose from 1.19 percent in 1998 to 1.40 percent in 2003 (First Quarter) or 17.6 percent. According to the U.S. Federal Reserve Board, ROA for the credit card industry was 2.13 percent in 1997 and has risen impressively to 2.87 percent in 1998, 3.34 percent in 1999, 3.14 percent in 2000, 3.24 percent in 2001, 3.5 percent in 2002, and 3.66 percent in 2003. This is largely due to lower cost of borrowing funds (widening "spread" on consumer loans), decline in net charge-offs ($911 million or 18.5 percent lower in 2003 than 2002),[7] decline in delinquent accounts ($919 million or 14.3 percent lower in 2003 than 2002), cross-marketing of low-cost insurance and other financial services, and dramatic increase in penalty and user fees.

One of the most striking features of the deregulation of the U.S. banking industry is the sharp increase in the cost of "revolving" credit (Ausubel, 1991; 1997; Manning, 2000). For instance, the 'real' cost of borrowing on bank credit cards has more than doubled due to widening interest rate "spreads" (doubled from 1983 to 1992) in addition to escalating penalty and user fees. The former is a result of the 1978 US Supreme Court (*Marquette National Bank of Minneapolis* v. *First National Bank of Omaha*) decision that permitted banks to relocate their corporate headquarters simply to find a "home" where they could essentially "export" high interest rates across State boundaries and effectively evade State usury regulations (GAO, 1994; Rougeau, 1996; Manning, 2000; Evans, and Schmalensee, 2001; Lander, 2004). The largest credit card issuers, led by Citibank, swiftly moved to States without interest rate ceilings. The dramatic increase in fee revenues is attributed to the 1996 U.S. Supreme Court decision, *Smiley* v. *Citibank,* which ruled that credit card fees are part of the cost of borrowing and thus invalidated State-imposed fee limits (Macey and Miller, 1998; Evans, and Schmalensee, 2001). Overall, penalty and cash advance fees have climbed from $1.7 billion in 1996 to $12.0 billion in 2003—12.4 percent of total credit card revenues in 2003. The average late fee has jumped from $13 in 1996 to over $30 in today. Incredibly, combined penalty ($7.7 billion) and cash advance ($4.3 billion) fees exceed the after-tax profits of the entire credit card industry ($11.13 billion) in 2001.

In conclusion, banking deregulation has produced an economic boom for the U.S. financial services industry. In the 1990's, it recorded 8 successive years of record annual earnings (1992–1999) and rebounded with 5 successive years of record profits since the end of the 2000 recession, (FDIC, 2004; Daly, 2002). In fact, the assets of the 10 largest U.S. banks total $3,552 billion at the end of June 2003—an as-

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cent introductory APR on all purchases and a variety of fees including $39 annual membership and $49 refundable security deposit.

[7] Historically, about 60 percent of bad consumer debt or bank "charge-offs" is due to unsecured credit card or "revolving" loans. According to the Card Industry Directory (2004: 11), card industry "charge-offs" declined from $35.4 in 2002 to $33.2 billion in 2003 or less than one-half of total bank charge-offs. This constitutes about 5 percent of net outstanding credit card balances at the end of 2003 (*Cardweb.com,* 2004). Note, this is not the same as the outstanding loan principal "charge-offs" since banks typically do not classify delinquent debt as in "default" until 90 to 120 days. For example, based on the following conservative estimates, one-third of this gross "charge-off" amount is attributed to: [a] delinquent interest rates over the last 4 months (about $2.0 billion at 23.9 percent APR) plus [b] late fees (about $0.9 billion at $35 per month) together with [c] overlimit and cash advance fees ($0.3 billion at $35 per month and 3 percent per transaction) plus [d] 12 months of interest prior to delinquency ($4.5 billion at 17.9 percentAPR) and [e] legal/collection fees ($0.8 billion at $140 per account). In addition, recently "discharged" credit card debt is selling for 6.5 to 7.0 percent "face value" on the secondary market (Card Industry Directory, 2004: 11). Overall, the data suggest that the "true" loss of capital to the major credit card issuing banks is approximately 60 percent of the reported "charge-off" value. These estimates assume that at over one-fourth of these "charge-off" amounts are due to late fees, overlimit fees, accrued finance charges, and collection related fees which are subsequently sold on the secondary market.

tounding increase of $509 billion from 2002 (16.7 percent). Overall, the assets of the 10 largest U.S. banks exceed the cumulative assets of the next 150 largest banks (*American Banker,* 2003). And, this trend does not appear to be abating. Today, rising interest rates (most credit cards feature variable interest rates), higher fee schedules, and improving debt "quality" underlie projections for new record profits for the banking industry (Reuters, 2005a). As will be discussed in Section Three, the skyrocketing profits of the credit card industry underlie this trend with increasing capricious pricing policies and deteriorating customer service.

Seduction, Indulgence, or Desperation?
The Explosion of Consumer Credit and Debt

The increasing societal dependence on consumer credit since the onset of banking deregulation is staggering. Between November 1980 and November 2003, revolving "net" credit card debt has climbed twelve-fold, from about $51 billion to over $636 billion. Similarly, installment debt has jumped from $297 billion in 1980 to $1,264 billion today. Overall, U.S. household consumer debt (revolving, installment, and student loan) has soared from $351 billion in 1980 to over $2,100 billion in 2005. Together with home mortgages, total consumer indebtedness is about $9 trillion at the end of 2003 (Federal Reserve, 2004). This trend is especially significant since the U.S. post-industrial economy has been fueled by consumer related goods and services that account for over 2/3 of America's economic activity (Gross Domestic Product). Indeed, U.S. households have not restrained their consumption even though real wages have been stagnant (from mid-1970's to late 1990's and again today), job benefits (health, pension) have declined, prices of major purchases have increased dramatically (housing, autos, college), temporary or "contingent" work continues to increase, and over 2.5 million jobs have disappeared over the last 3 years.

Several factors help to explain the record-setting debt burden of American households—especially middle class families. First, as measured by share of disposable income, the 1980's and 1990's feature the unprecedented growth of consumer debt-from 73.2 percent of personal income in 1979 to a staggering 114.5 percent in 2001. The overwhelming proportion (75.7 percent) of this new level of debt is due to escalating home mortgages. Between 1979 and 2001, the share of household income allocated to housing jumped from 46.1 percent in 1979 to 85.0 percent in 2003 (Mishel, Bernstein, and Allegretto, 2005). This enormous increase in housing costs has diverted previous discretionary income that was used for other personal or family needs. Although mortgage debt is the least expensive consumer loan, this sharp increase has squeezed the ability of households to pay for other purchases and/or finance unexpected expenditures such as health care or auto repairs.

Not surprisingly, most American households have steadfastly responded by maintaining their standard of living and financing their expenditures with lower personal savings and higher credit card and installment loans. In fact, as the U.S. personal savings rate fell to record lows in the late 1990's—near zero in 1998—credit cards became the financial "safety net" for financially distressed and economically vulnerable households. In 1980, three-fourths (74.5 percent) of nonmortgage consumer debt was financed through installment loans such as for furniture, appliances, and electronics. During and immediately after the 1989–1991 recession, revolving credit card debt soared—from 37.9 percent of installment debt in 1989 to 54.9 percent in 1992. This was accompanied by mass marketing campaigns that promoted credit card use for "needs" as well as "wants" such as groceries, rent and mortgage payments, and even income taxes. By 1998, outstanding credit card debt was 70.4 percent of outstanding installment debt. This proportion has fallen due to new debt consolidation options such as mortgage refinancings, home equity loans, and aggressive marketing of low-interest auto loans. Indeed, home equity loans were not even available to consumers in the late 1980's. By 2003, home equity loans account for over one-tenth (10.9 percent) of disposable personal income.

In the decade since the end of the 1989–1991 recession, during the longest economic expansion in U.S. history, "net" credit card debt surged from about $251 billion in 1992 to over $685 billion at the end of 2004 while installment debt jumped from $532 billion to $1.3 trillion. Significantly, scholars disagree over whether these new debt levels can be restrained. Juliet Schor (1998) has received national attention for asserting that much of this debt is avoidable since the pressures of competitive consumption are social and thus can be resisted by embracing traditional values that discourage consumption such as thrift, frugality, and material simplicity. Hence, she asserts that "keeping up with the Jones" is a voluntary decision that can be rejected by "downshifting" to a simpler, less expensive lifestyle. On the other hand, Elizabeth Warren and Amelia Warren Tyagi (2003) argue that the debt arising from the "two-income trap" is primarily due to middle-class necessities such as housing, automobiles, medical care, education, and insurance. Their highly influen-

tial work contends that households have no recourse but to assume higher debt burdens as a rational response to increasing economic pressures such as health care, job loss/interruption, family crises, insurance, and education-related costs.

The role of structural factors in influencing the decision of middle-class households to assume higher levels of debt is suggestive. Two other measures of financial distress as measured by the U.S. Federal Reserve Board are households with high debt burdens (40 percent or more of household income) and late payment (60 days or more) of bills. Between 1989 and 1998, the lower income, middle-class reported the most economic difficulty. For instance, the high debt service burdens of modest income households ($10,000 to $24,999) rose from 15.0 percent to 19.9 percent while moderate income households ($25,000 to $49,999) rose from 9.1 percent to 13.8 percent; households with incomes over $50,000 increased marginally to about 5 percent while those under $10,000 rose from 28.6 percent to 32.0 percent. Similarly, late payments increased marginally among households with at least $50,000 annual income to about 4.4 percent (most increase since 1992) while the $25,000 to $49,999 group nearly doubled from 4.8 percent in 1989 to 9.2 percent in 1998; households with modest income ($10,000 to $24,999) remained unchanged at 12.3 percent (Mishel, Bernstein, and Boushey, 2003).

Since the sharp decline in consumer interest rates beginning in late 2000, lower finance costs have provided some measurable financial relief to American households. However, the greatest beneficiaries of this low interest rate period have been the groups with the highest family incomes. Between 1992 and 2001, middle-income households ($40,000–$89,000) have experienced an aggregate increase in their debt service burden (as a share of household income) whereas upper income households have experienced a significant decline (28.6 percent)—from 11.2 percent to 8.0 percent. Overall, the debt service burden of the upper income earning households is about one half of the lower- and middle-income households (8.0 percent versus 16.0 percent). This is consistent with the cost of credit card debt during the current era of financial services deregulation whereby convenience users receive free credit (plus loyalty rewards such as free gifts and cash) and revolvers pay double-digit interest rates and soaring penalty fees. In comparison, the working poor have witnessed a modest decline in their debt service burden, from 15.8 percent in 1992 to 15.3 percent in 2001 (Mishel, Bernstein, and Allegretto, 2005). It is important to note, moreover, that various important sources of financial liabilities are not included by the Federal Reserve in its reports on outstanding nonmortgage consumer debt and thus understates the degree of household economic distress—especially among lower-income families. These include car leases, payday loans, pawns, and rent-to-own contracts. As a result, the data indicate that during the recent decade of robust economic growth, the lower- and middle-income households utilized increasing levels of consumer credit while straining to service their escalating debt levels. This is consistent with the findings of Teresa Sullivan, Elizabeth Warren, and Jay L. Westbrook (2000) in their pathbreaking study of consumer bankruptcy in the 1990's.

Not surprisingly, the aggressive marketing of bank and retail credit cards to traditionally neglected groups, such as college students and the working poor, encouraged the assumption of new levels of consumer debt. For example, the Survey of Consumer Finance reports that the largest increase in consumer credit card debt was among households with a reported annual income of less than $10,000. Between 1989 and 1998, the average credit card debt among debtor households soared 310.8 percent for the poorest households and 140.9 percent among the oldest households (Draught and Silva, 2003.) The overall average for all debtor households during this period is 66.3 percent. Similarly, credit card debt jumped sharply among college students and young adults.

During the late-1980's, when banks realized that students would use summer savings, student loans (maximum limits raised in 1992), parental assistance, part-time employment, and even other credit cards to service their consumer debts, the spike in college credit limits contributed to the surge in "competitive consumption" across college campuses that has redefined the lifestyle of the "starving" student and provided an opportunity for college administrators to continue increasing the cost of higher education (Manning, 1999; 2000: Ch. 6; Manning and Smith, 2005). Today, credit card issuing banks are aggressively competing in this new "race to the bottom" marketing campaign as the moral boundary that has traditionally impeded brazen solicitations of teenagers has been broached with sophisticated marketing campaigns aimed at high school and even junior high students (Manning, 2003(b); Mayer, 2004; Manning and Smith, 2005; Ludden, 2005). Long gone are the days when parents were required to cosign a credit card account. Instead, banks have learned that students will assume higher levels of consumer debt at a much faster rate if their consumptive behavior is shielded from their parents.

Although credit card industry sponsored research has sshould minimize the social problems associated with rising student consumer debt levels, typically with flawed quantitative methodologies that are based on propriety data that "unfriendly" researchers are not permitted to examine (c.f. Barron and Staten, 2004; Manning and Kirshak, 2005), the growth of consumer debt at younger ages are undeniable trends among America's youth. For parents and higher education professionals, this intensifying marketing of credit and gift cards to high school students provides both an opportunity to introduce/expand personal financial literacy programs as well as pose a daunting challenge in confronting college age social problems that are rapidly expanding into secondary schools. As a result, the marketing of credit cards to high school seniors and college freshmen suggests that their debt capacities will be stretched at much earlier ages which will increase the likelihood of not completing college as well as the possibility of consumer bankruptcy in their early to mid-20's with its age-specific biases such as the nondischargeability of student loans. Recent studies suggest that the fastest growing groups of consumer bankruptcy filers are those that have previously registered the lowest rates: Senior citizens and young adults under 25 years old (Sullivan, Warren, and Westbrook, 2000; Sullivan, Thorne, and Warren; 2001; Manning and Smith, 2005).

A final factor concerns consumer confidence and perception of household wealth. Over the last two decades, middle class households have become active participants in the stock market, either indirectly through their employer pension portfolios or directly through personal investment accounts. When consumers are optimistic about the future, such as their job prospects or accumulation of wealth, they are likely to spend more financial resources—even if their current economic situation is unfavorable. As the stock market soared in the late 1990's, especially the Nasdaq, the psychological "wealth effect" encouraged many families to assume new financial obligations that exceeded their household income.

The data is surprising. It reveals that only a small proportion of the U.S. population has benefited from the enormous wealth that was generated during the longest economic expansion in U.S. history (Wolff, 2003). For example, between 1989 and 2001, the bottom 40 percent of American households increased their stock holdings from an average of only $700 to $1,800 while the next 20 percent (the middle income (41 percent–60 percent) households) increased modestly from $4,000 to $12,000 or about $667 per year. In comparison, the upper middle income families (61 percent—80 percent) experienced an increase of from $9,700 to $41,300 in stock assets. Similarly, most wealth accumulated by working and middle income households during this period is attributed to housing appreciation. The bottom 40 percent of American families witnessed an increase in "other assets" from $21,000 to $26,600 and the middle 20 percent rose from $96,800 to $113,500; the next 20 percent of American households reported an increase from $201,500 to $234,600 (Mishel, Bernstein, and Allegretto, 2005).

The most striking trend in the wealth data, for the majority of U.S. middle-class families, is that the accumulation of consumer debt exceeds the growth of stock investments. For the bottom 40 percent, household debt declined marginally (2.3 percent) while for the next 20 percent of U.S. households (41 percent–60 percent) consumer debt rose from $37,000 to $50,500. If U.S. housing prices had not appreciated so sharply over the last decade, nearly 60 percent of American families-on average—would not have been able to accumulate any net assets during this period. Clearly, the economic winners during this period are the most affluent families; household net worth rose $147,100 (42.9 percent) for the next top 10 percent (81 percent–90 percent) of American households and a staggering $635,400 (65.1 percent) for the next top 9 percent (Mishel, Bernstein, and Allegretto, 2005). In comparison, the financial boom of the 1990's has become an increasingly costly debt burden for most American families today.

Assessing the Consumer Lending Revolution:
Rising Tides and Sinking Ships

The distinguishing features of the deregulation of consumer financial services include: (1) the profound shift in bank lending activities from corporate to consumer loans, (2) fundamental transformation of the industry structure (consolidation, conglomeration), dominant institutional form (conglomerate such as Citigroup), and geographic location, (3) profound shift from State to national regulatory system (U.S. Congress, Office of Comptroller of the Currency) with the ascension of Federal Preemption (Manning, 2003(c) Furletti, 2004; Lander, 2004), (4) dramatic increase in the aggregate levels of household debt, (5) sharp increase in the inequality of the cost of unsecured consumer loans such as credit cards (especially in comparison to installment loans), (6) institutional pressure to continue rapid growth of unsecured consumer loans by expanding into new demographic markets such as students, sen-

iors, and the working poor; and (7) the historically unprecedented growth of consumer bankruptcies.

First, the soaring growth of unsecured credit card debt takes off in the mid-1980's and is accompanied by the dramatic increase in consumer bankruptcies; between 1985 and 1990, consumer bankruptcy filings more than doubled from 343,099 to 704,518. In the aftermath of the 1989–1991 recession, consumer bankruptcy filings closely follow the effect of rising unemployment through 1992 (steadily rising to 946,783) and then fall moderately with declining unemployment rates through 1995 (843,941). In 1995, however, consumer bankruptcy filings exhibit a profoundly different relationship with fluctuations in the rate of unemployment. Indeed, this underscores the second salient feature of contemporary American bankruptcy filing trends: An inverse correlation with unemployment levels. That is, the robust economic expansion of the late 1990's, which generated over 220,000 new jobs each year, produced a substantial drop in U.S. unemployment AND a sharp increase in U.S. consumer bankruptcy filings. This historically unprecedented relationship persisted through 1998 when bankruptcies registered an all-time high of 1,418,954. Since 1999, the traditional relationship between macroeconomic conditions and consumer bankruptcy resumed, as filings fell to 1,376,077 in 2001 and then steadily rose to1,493,461 in the aftermath of the 2000 recession. Following the sluggish economic recovery, however, consumer bankruptcies have risen to new record highs of 1,638,804 in 2003 and 1,624,272 in 2004 while unemployed has dipped (U.S. Bankruptcy Courts, 2005). The dramatic increase in consumer bankruptcy rates is underscored when the number of eligible bankruptcy filers per capita is calculated during this period. Between 1985 and 2004, it soared from less than 200 filings per 100,000 to over 1,000 per 100,000.

As previously discussed, the shift from State-chartered community banks to federally chartered national banks was accompanied by a fundamental shift in risk tolerance and bank underwriting standards which led to a profusion of new and more costly consumer financial services such as revolving credit cards. Indeed, when the last major reform of the Federal bankruptcy code was enacted in 1978, consumer installment lending reigned supreme as bank underwriting standards were relatively rigidly defined by outstanding debt (household liabilities) to income (household revenues) ratios. Indeed, U.S. bankruptcy law reflected the reality household debt was largely collateralized installment loans that linked levels of indebtedness to the existent level of household income. Hence, Federal law consecrated the Constitutional right that "necessitous" debtors—truly worthy indigents—could either seek a reasonable repayment plan (Chapter 13) or discharge their debts (Chapter 7) by liquidating their assets with only a relatively moderate financial disadvantage to creditors who received a pro rata distribution of debtors' assets.

Over the last 25 years of banking deregulation, bank underwriting standards and the cost of unsecured consumer loans have changed dramatically. Today, household debt "capacity" is stretched by extended repayment schedules (from 15 to 40 year mortgages) and, more instructively, by multiple sources of household wealth/revenues: Two or more incomes, asset formation through home ownership (housing equity), and wealth accumulation through stock market investments. Unlike the pre-1980 regulated era, American households can leverage three or more sources of revenue to qualify for secured and unsecured consumer loans. This explains how aggregate household debt—as measured by its share of disposable income—has climbed an extraordinary 56.4 percent over this period: From 73.2 percent in 1979 to 114.5 percent in 2003 (Mishel, Bernstein, and Allegretto, 2005). The major problem for most families is that it is easier to secure a loan than it is to generate greater revenues (with the exception of selling one's home). For households perilously close to insolvency, both large (job loss, medical care, divorce) and small (rising interest rates, high energy costs, medications) economic factors can precipitate a financial collapse.

As the tremendous increase in highly profitable "revolving" debt has transformed "good" loans into "bad" or unperforming loans, many households whom can no longer afford the minimum payments on their financial obligations have resorted to the U.S. bankruptcy court. Indeed, many financially responsible families have faithfully serviced their major financial obligations until the financial duress of unexpected revenue loss/expenses and/or the escalating weight of unsecured loans force them into an economic abyss.[8] One of my many criticisms of the Bankruptcy Abuse

[8] For those interested in comparative studies of consumer bankruptcy or whom wish to address the fundamental causes of the U.S. bankruptcy "crisis," the first step is a major overhaul of the American health system. Indeed, while the United States has severely tightened its consumer bankruptcy codes in 2005, the Western European countries are liberalizing their bank-

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Prevention and Consumer Protection Act of 2005, is that it fails to significantly encourage either responsible lending by creditors or responsible repayment by debtors. That is, by shifting the cost of administering the process of debt collection to the bankruptcy filer and the public sector, it indirectly discourages responsible lending by subsidizing the cost of making loans to potentially risky clients. In this way, the new law could have the unintended consequence of increasing future bankruptcy filing rates.

Similarly, the failure of Congress to fundamentally reform the historic Chapter 13/Chapter 7 binary of debtor repayment/discharge has the unintended consequence of discouraging responsible debt repayment behavior by overindebted borrowers. That is, the reality of the current period of banking deregulation is that a small but growing third group of necessitous debtors has emerged that can not repay all of their debts through a costly 3–5 year Chapter 13 repayment program and do not want to evade their financial responsibilities through a Chapter 7 liquidation program. Instead, Congress has been blinded by the demands of the creditor lobby to effect a truly radical reform of the Federal bankruptcy code that could serve the interests of both consumers (who wish to enter into a program of "responsible debt relief") and creditors who currently receive little if any pro rata distribution of debtor assets through a Chapter 7 liquidation. This situation is illustrated in Table 10 which compares the traditional 3-year repayment programs (CCCS, Chapter 13) with an alternative debt negotiation program. For financially distressed consumers who struggle to make their minimum credit card payments, column 2 shows the futility of ever repaying their high cost credit card debts. Overindebted consumers who wish to be responsible for their financial obligations and enter into a voluntary CCCS repayment program are shocked when they realize that nonprofit Consumer Credit Counseling Services are funded by creditors and their repayment programs are even more costly and difficult to complete. Chapter 13 reorganization programs, which are the objective of the "means testing" provision of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, are a less financially costly than the CCCS option but with long-term consequences for future consumer borrowing. Significantly, less than one-fourth of Chapter 13 filers successfully complete their programs. Ironically, a third informal option which offers consumers "responsible debt relief," by enabling debtors to negotiate an informal payoff of between 20 and 45 percent, satisfies the creditors demands for obtaining a significant payment from debtors with the economic means to pay some of their financial obligations while satisfying the desire of debtors to satisfy their creditors to the best of their ability while avoiding the emotional devastation of filing for personal bankruptcy. It is my estimate that approximately 150,000 to 250,000 bankruptcy filers could qualify for such a program each year which would lessen the demands on the overburdened bankruptcy system and increase financial distributions to creditors by $2.5 to $4.0 billion each year. These potential informal 13 participants are those whom fail to complete their Chapter 13 program as well as Chapter 7 filers that would prefer to offer a negotiated debt settlement in order to avoid filing for bankruptcy.

Policy Recommendations: Consumer Rights Or Privileges

In response to queries as to appropriate regulatory responses to deceptive marketing and predatory pricing policies of the credit card industry, I propose the following recommendations:

[1] Limit lines of credit to college students without an independent source of income and whose parents/guardians will not cosign a revolving credit card contract to $500. If the credit card account is in good standing, then line of credit could be increased an additional $500 per year up to a maximum of $2,500.

[2] Exclusive Credit Card Marketing Agreements with public colleges and universities must be competitively bid and the final contract must be made available for public review. The criteria for selection of vender must be specified and the agents of the public college or university whom negotiated the contract must be identified.

[3] Respect for personal privacy must be explicitly specified in the contract with public colleges and universities. The card issuing banks must adhere to an "opt-in" provision whereby personal identifying information of staff, students, and alumni must not by obtained without securing permission. This includes student identification numbers (especially Social Security numbers), phone numbers, and email addresses.

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ruptcy laws even though their national health care systems virtually preclude the possibility of personal financial insolvency due to medical expenses. Furthermore, a more generous unemployment compensation system entails less European dependence on the credit card financial "safety-net."

[4] Banks should not be allowed to raise interest rates to punitive levels (over average rates) simply due to the consumer not using the credit card for a limited period of time. For example, Chase has a policy of raising interest rates on credit card to over 20.0 percent APR that have not been recently used in an attempt to induce customers to close the infrequently used account.

[5] Consumers should be granted a 60 notice for implementing "universal default" provision of their contract which triggers as sharp increase in the finance charges (for example from 5.9 percent to 22.8 percent) due to reported credit payment patterns on other accounts. Also, consumers should be informed of the specific reasons for invoking the "universal default" provision and what they have to do as well as how long it will take to receive the original interest rate

[6] When a person sends in a preapproved credit card application for a specified line of credit and interest rate and is approved for a credit card with much less favorable terms (for example from $10,000 to $5,000 line of credit and from 5.9 percent introductory rate APR to 18.9 percent APR), a letter should be sent informing the consumer of the changes in the expected credit card with the option to cancel the account before receiving the card. This is a practice commonly known as "bait and switch."

[7] Doubling billing cycles, popularized by MBNA, should be eliminated and replaced with a single date that is designated for balance payoffs as well as payment due dates.

[8] Some credit card companies such as Citibank specify a particular hour of the day that payment must be received in order not to incur a late fee. Due to vagaries of postal delivery, the posted time for incurring a late fee should be 12 pm.

[9] Fees for subprime credit cards should not exceed 15 percent of the available line of credit up to a maximum of $100.

[10] The cost of credit for subprime credit cards should include mandated fees in calculating the APR in consumer disclosure information.

[11] Consumers should have the right to terminate a subprime credit card without incurring activation fees within 30 days of opening the credit card account.

PREPARED STATEMENT OF CARTER FRANKE

CHIEF MARKETING OFFICER, CHASE BANK U.S.A., N.A.

MAY 17, 2005

Mr. Chairman, Senator Sarbanes, Members of the Committee. Good morning. My name is Carter Franke and I am the Chief Marketing Officer at the Wilmington, Delaware-based Chase Card Services Division of Chase Bank U.S.A., N.A.

Today, I sit here as a representative of the more than 16,000 Chase employees around the country who support our credit card services. Chase is a significant issuer of MasterCard and Visa credit cards with more than 94 million cards issued. Our customers are primarily those that fall in the "super-prime" and "prime" categories—the most responsible and most knowledgeable credit users in the country. Our cardmembers used Chase and Bank One issued cards to spend $282.7 billion on goods and services last year.

In just a few short decades, changing consumer habits and expanding technologies have established credit cards as an essential part of American economic life. Consumers rely on credit cards for virtually every type of purchase imaginable and have rightfully come to expect that their credit card will be accepted just about everywhere. More than 25 million merchants worldwide—five million of them in the United States alone—are part of the credit card payment system. Everything from small businesses to the world's largest companies rely on this safe, secure, and efficient payment system, which is made possible by credit cards. And the economy benefits: In 2004 credit cards financed an estimated $1.68 trillion in transactions.

Today's Internet commerce would not be possible without credit cards. Cards and the technologies that they use are directly responsible for the growth of the mail order business, travel bookings, online auctions, and hundreds of other transaction types. In addition, in the long-term, credit cards help consumers build solid credit histories that ultimately enable them to enhance their family's financial security.

All of these benefits are achieved with the assurance that, unlike cash, all credit card purchases are completed with zero-liability protection for the consumer should the card be lost or stolen. This helps makes credit cards safer and more convenient than cash. Consumers also benefit from built-in dispute resolution should they not be satisfied with any purchase.

We operate in a highly competitive industry—one where many customers can easily vote with their feet. Our customers, in particular, have many choices in the marketplace today and that competition is good for consumers. This competition also drives us to offer many products and features, such as cards with travel, entertainment or cash rewards—all of which are carefully designed to meet the specific requirements of our customers—to ensure they choose, and stay with, Chase.

A credit card loan is not like a home or car loan. A credit card loan is unsecured, meaning that the consumer is not required to post collateral to back it up. In other words, we extend credit to people based on their profile of financial responsibility rather than on their actual assets. In short, the only security we have in our loan is the customer's promise and his or her ongoing ability to repay the loan.

As I mentioned earlier, Chase's credit card business is focused on the "superprime" and "prime" markets. In other words, Chase credit cards are issued, for the most part, to consumers with exceptionally good credit histories. As a result, our business model is built upon consumers making their payments regularly and on time. All of our decisions on credit limits, fees, and changes in interest rates, are based on sound economic analysis, our business experience and the interests of our customers.

However, unsecured consumer credit is a shared responsibility between lender and borrower. We enable consumers to purchase, on an immediate basis, the goods and services provided by millions of merchants around the country. We track each cardmember's transactions, provide accurate and clear monthly statements, and process payments promptly. Of course, our goal is to provide problem free access to the credit lines that we provide and to achieve the highest level of customer satisfaction possible. While problems do arise, we provide ongoing access to Chase representatives so that questions will be answered immediately and problems can be resolved expeditiously 24-hours per day. In return, we ask our cardmembers to meet their payment obligations and report any problems they may be experiencing.

We believe that all consumers, especially those who have opened an account for the first time, need to understand the nature of their responsibilities and, more generally, how to use credit responsibly. In 2003–2004 alone, Chase donated more than $5.8 million in financial literacy grants to nonprofit community-based organizations to help fund credit education programs. In the same time period, Chase invested approximately $107 million working with partners across the Nation to fund voluntarily responsible credit counseling services, create online financial education and credit and debt management tools. More than anything, we want to maintain a first-in-wallet position with our customers and develop a long-term relationship with them.

In short, while we provide consumers with a broad range of choices in products and features, we recognize that without shared responsibility and an ongoing commitment to financial literacy we cannot succeed.

We at Chase are extremely proud of the fair and responsible way our company operates and in the relationship we have established with our tens of millions of cardmembers. Let me cite a few examples:

At Chase we value our customers, and that understanding of value drives all of our pricing decisions. A missed payment on a nonChase card does not drive automatic repricing of any Chase account. We also realize that in the vast majority of cases, a late payment on a Chase card is not a sign of increased risk, but of timing, vacations or other realities of busy lives. For that reason, a late payment will not result in a price increase for over 90 percent of Chase cardmembers.

Chase cardmembers, among the most responsible users of credit in the industry, are also very responsible when it comes to paying their accounts. Well over a third of our customers pay their balance in full, enjoying the convenience of an interest free loan every month. And, more than 90 percent of our payments are for more than the minimum payment.

A small segment of our customers do have a change in creditworthiness, which we deal with fairly and responsibly. If a customer's overall credit profile deteriorates materially, and thus exposes us to an increased risk of nonpayment, economic considerations may cause us to raise the interest rate. In these cases, and in accordance with applicable law, we provide the customer with an "opt out" option. This enables the customer to reject our change in terms, close their account, and pay off the balance under their existing terms. Once closed, the interest rate on a Chase account that is paid according to its terms will not be changed.

Importantly, in today's digitized world, Chase is firmly committed to protecting our customers' privacy and to ensuring that their information is secure. On privacy, Chase is of course in compliance with the requirements of Gramm-Leach-Bliley. And we constantly work to upgrade our data security to protect our customers from inadvertent or intentional breach. More than 1,100 people are focused solely on the de-

tection and prevention of fraud at Chase. We are proud to have some of the best fraud protection practices and lowest fraud rates in the industry. And, if there is a fraudulent charge, cardmembers are not held responsible because of our zero-liability fraud policy for all customers.

Mr. Chairman, we understand that our business may seem complicated and even, at times, unfriendly. I hope that the information I have provided today has offered you some substantive insights into our business and an understanding of our true commitment to fairness for all of our customers. At times we are faced with difficult decisions relative to individual cardmembers and their accounts and, when reviewed on an isolated basis, may seem inappropriate. Our decisions are designed to permit the vast majority of cardmembers continue to receive the best possible rates, service, and access to the benefits credit cards provide. We look forward to working with you and the Members of the Committee to answer your questions and address your concerns.

PREPARED STATEMENT OF EDMUND MIERZWINSKI

CONSUMER PROGRAM DIRECTOR, U.S. PUBLIC INTEREST RESEARCH GROUP

MAY 17, 2005

Chairman Shelby, Senator Sarbanes, Members of the Committee, thank you for the opportunity to offer U.S. PIRG's views on abusive credit card industry practices. We commend you for having this timely hearing. I am Edmund Mierzwinski, Consumer Program Director of U.S. PIRG. As you know, U.S. PIRG serves as the national lobbying office for State Public Interest Research Groups. PIRG's are nonprofit, nonpartisan public interest advocacy organizations with offices around the country.

Introduction

The extremely concentrated credit card industry, in efforts to increase profitability above already substantial levels, continues to engage in a growing and wide number of unfair, anticonsumer practices. These practices are enabled by a pliant Federal bank regulatory apparatus, which has generally ignored the growing problem while relying on an unfortunate series of court decisions to expand Federal preemption and narrow the authority of State enforcers to better protect their own citizens.

The most common unfair credit card company practices include the following:

- Unfair and deceptive telephone and direct mail solicitation to existing credit card customers—ranging from misleading teaser rates to add-ons such as debt cancellation and debt suspension products, sometimes called "freeze protection," which are merely the old predatory credit life, health, disability insurance products wrapped in a new weak regulatory structure to avoid pesky State insurance regulators;[1]
- increased use of unfair penalty interest rates ranging as high as 30 percent APR or more, including, under the widespread practice of "universal default," the practice of imposing such rates on consumers who allegedly miss even one payment to *any* other creditor, despite a perfect payment history to that credit card company;
- imposing those punitive penalty interest rates retroactively, that is, on prior or existing balances as well as on future purchases, further exacerbating the worsening levels of high-cost credit card debt;
- higher late payment fees, now generally $30–$40, which are often levied in dubious circumstances, even when consumers mail payments 10–14 days in advance;
- aggressive and deceptive marketing to new customer segments, such as college students with neither a credit history nor an ability to repay, as well as marketing to persons with previous poor credit history;
- partnerships with telemarketers making deceptive pitches for over-priced freeze protection and credit life insurance, roadside assistance, book or travel clubs, and other unnecessary card add-ons;
- the increased use of unfair, predispute mandatory arbitration as a term in credit card contracts to prevent consumers from exercising their full rights in court; and

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[1] See an Office of the Comptroller of the Currency (OCC) regulatory interpretative letter endorsing debt cancellation and debt suspension products as part of the business of banking (and exempt from stricter State insurance regulation) at *http://www.occ.treas.gov/interp/jan01/int903.doc.*

the concomitant growing use of these arbitration clauses in unfair debt collection schemes;

- the failure of the industry to pass along the benefits of what, until recently, were several years of unprecedented Federal Reserve Board interest rate cuts intended to provide economic stimulus, through the use of unfair floors in variable credit card contracts. The Fed kept dropping rates, but the card companies did not, once these floors were reached.

There are two engines that drive this train of unfair practices. First, the companies include a contract clause that states: Any term can be changed at any time for any reason, including no reason. Second, the aforementioned use of one-sided predispute binding mandatory arbitration clauses[2] prevents consumers from challenging these practices in court.

The practices described above can be illustrated with the following examples:

- Banks entice consumers to open or continue credit card accounts with promises of a fixed interest rate on unpaid balances on purchases. Thereafter, they unilaterally increase the so-called fixed rate, and may change it to a variable rate.[3]
- Banks bait credit card consumers with teaser offers promising a low introductory interest rate on additional credit card debt and the consumer's preexisting (regular) interest rate thereafter. But after individual consumers accept the offer and increase their debt, banks unilaterally and without notice raise the consumer's regular interest rates because now, the individual consumer's debt is allegedly "too high." Banks also reserve the right to take regular credit card payments and apply them to the lowest interest rate debt instead of the highest, in a circumstance where a consumer has transferred zero percent debt to a card with an existing balance.
- Banks ignore consumers' disputes to charges, which, according to banks themselves, need not be paid pending resolution. Instead, banks unilaterally use such nonpayment to charge late fees and raise interest rates.
- Banks reduce credit limits of consumers on their credit card accounts unilaterally and without advance notice, and do so in such manner and to such an extent as to intimidate consumers into abandoning their legitimate objection to charges.
- Banks fail to adequately inform consumers in advance of a proposed increase in interest rate based on the individual consumer's purportedly high debt or other information in such consumer's credit report. Thereby, consumers have no opportunity to avoid the increased interest rate, and are saddled with significant additional interest payments without advance notice.
- Credit card companies use low, short-term "teaser rate" introductory APR's to mask higher regular APR's. The introductory APR is one of the primary tools used to market a card, and it usually appears in large print on the offer and envelope. In a recent PIRG study discussed below, of 100 card offers surveyed, 57 advertised a low average introductory APR of 4.13 percent. Within an average of 6.8 months, the regular APR shot up 264 percent to an average regular APR of 15.04 percent. The post-introductory APR, as well as the length of the introductory period, were not prominently disclosed.
- Important information is disclosed only in the fine print of the offer. For example, the fine print of most offers states that if an applicant does not qualify for the offered card, s/he will receive a lower-grade card, which usually has a higher APR and punitive fees. The fine print is easy to overlook, and as a result, a consumer may receive a card that s/he did not want.
- Free does not mean free. The "free" offers that are advertised with many cards are not usually as impressive as they appear. Most are "free-to-pay" schemes, where the failure to cancel within 30 days imposes hefty annual fees for tawdry products. Others include significant restrictions or hidden costs.
- Companies are failing to disclose the actual APR's of cards. Increasingly, credit card companies are quoting a range of APR's in offers rather than a specific APR, a practice called "tiered" or "risk-based" pricing. These ranges are frequently so wide as to be utterly useless to consumers. Even recent directives of the Office

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[2] The consumer organizations testifying today, U.S. PIRG, the Consumer Federation of America and Consumer Action, are all founding members of a broad new campaign to educate the public and the Congress about the need to eliminate one-sided binding mandatory arbitration (BMA) clauses imposed as contracts of adhesion in consumer contracts, sometimes merely with a notice of change of terms inserted in a consumer's bill. See *http://www.stopbma.org*.

[3] It is the bank position that the Truth In Lending Act allows them to change fixed rates with as little as fifteen days notice and that a fixed rate is merely a rate that is not variable. A variable rate is defined as one tied to an index, such as *The Wall Street Journal* prime rate as disclosed on a certain date.

of the Comptroller of the Currency (OCC) have begun to recognizes some of these practices as unfair.

- Fine print fees for cash advances, balance transfers, and quasi-cash transactions such as the purchase of lottery tickets significantly raise the cost of these transactions. But the terms governing these transactions are buried in the fine print, where consumers can easily miss them. Minimum fees, also stated only in the fine print, allow credit card companies to guarantee themselves high fee income regardless of the transaction amount.

Another way to look at these problems is to look at an example: In a recent court complaint against a credit card company, a consumer attorney pleaded the following facts:

> On June 17, 2002, the balance owed on the consumer's account was $702.00. On June 18, 2002, the bank added a $59 club membership fee that caused the consumer's account to exceed his credit limit by $11 (the balance owed was $761 and the credit limit was $750). From June 2002 until August 2004, even though the consumer made timely monthly payments each month, the bank added $435 in over-limit fees to this account and $495 in late charges on this account.

This consumer responded to some bank-initiated telemarketing pitch or bill insert to join some a membership club, then the bank allowed him to go over his limit to complete the transaction for a purchase it itself had initiated, then that triggered an ongoing cascade of repeated late and over-the-limit fees that have caused the consumer to end up in a cycle of rising debt even though he no longer uses the card. This example, multiplied by millions of consumers, gives you an idea of how credit card debts have piled up in this country.

Regulatory Actions and Court Actions Against Credit Card Companies

These views are not merely our own nor merely those of consumer attorneys. The very worst of the industry's excesses have resulted in increased regulatory, legislative, and legal scrutiny. Even the Treasury's Office of the Comptroller of the Currency (OCC), no consumer protector, has begun to escalate its efforts against unfair credit card company practices. Although it has not yet taken any public actions against any well-known major institutions, it has gone after a number of unknown fringe institutions and one albeit large, but relatively upstart mono-line credit card bank, Providian. More recently, the OCC has issued a series of regulatory guidances admonishing banks against certain common unfair practices and even consolidated these actions onto one website to make their efforts appear more comprehensive.[4] Unfortunately, the OCC has not imposed public penalties or sanctions on any of the current "Top Ten" banks, even though most advocates believe the practices are endemic to the industry.

Meanwhile, State Attorneys General Enforce the Law

Of course, State Attorneys General, always the top consumer cops on the beat, have long been aggressively pursuing crime and other anticonsumer practices in the credit card suites. Some recent actions by state Attorneys General and Federal regulators include the following.

- In January 2005, Minnesota Attorney General Mike Hatch filed an unfair practices suit against Capital One Bank and Capital One F.S.B. for using false, deceptive, and misleading television advertisements, direct-mail solicitations, and customer service telephone scripts to market credit cards with allegedly "low" and "fixed" interest rates that, unlike its competitors' rates, supposedly will never increase. Capital One, of course, is one of the Nation's largest credit card companies, with an aggressive advertising campaign urging consumers to put a Capital One card in their wallet and avoid the other companies, generally portrayed by Capital One as Vikings, Visigoths, or other sorts of plundering barbarians. Other States, including West Virginia, have since announced parallel investigations of Capital One. West Virginia, this month, had to file suit to enforce its subpoenas against the bank.[5]
- In the last several years, numerous State Attorneys General, including Minnesota, Texas, West Virginia, New York, and others have filed actions against the large sub-prime credit card company Cross Country Bank for its deceptive and predatory practices when marketing to consumers with impaired credit histories.

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[4] Obtain these guidances and copies of recent regulatory actions at the OCC credit card practices website available at *http://www.occ.treas.gov/Consumer/creditcard.htm.*

[5] 9 May 2005, See news release "ATTORNEY GENERAL DARRELL McGRAW SUES TO ENFORCE SUBPOENAS INVESTIGATING CAPITAL ONE BANK AND CAPITAL ONE SERVICES," available at *http://www.wvs.state.wv.us/wvag.*

The Attorney General of Minnesota's complaint alleges the bank uses racial, derogatory, and abusive epithets in the bank's threatening phone contacts with customers.[6] The Attorney General of Pennsylvania had this to say in 2004: "Instead of helping consumers as promised, the defendants actually pushed cardholders further into debt when they used the credit cards. Those who failed to make the payments, were subjected to a barrage of abusive, harassing collection practices that included the use of profanity and multiple calls to consumers' homes or offices."[7]

- In December, 2002, 28 States and Puerto Rico settled a case with First USA (a unit of Bank One, which is now part of JP Morgan Chase after its acquisition of Bank One) "that will provide new protections against misleading telemarketing campaigns for more than 53 million credit card holders. First USA Bank N.A.—the largest issuer of Visa credit cards—and also known as Bank One Delaware NA, has agreed to implement broad reforms in its relationships with third-party vendors to ensure that nondeceptive marketing campaigns are used in soliciting the bank's credit card holders. Specifically, under the agreement, First USA must prohibit vendors from engaging in deceptive solicitations."[8]
- In February 2002, 27 States negotiated an agreement for Citibank, then the Nation's largest credit card issuer, to stop deceptive practices in the marketing of similar tawdry add-on products. "The States raised concerns that the marketing practices of Citibank's business partners were deceptive and often resulted in consumers being charged for products and services—such as discount buying clubs, roadside assistance, credit card loss protection, and dental plans—that they had no idea they agreed to purchase."[9]
- In 2001, the OCC imposed multimillion dollar penalties and a restitution order against Direct Merchants' Bank for its practice of "downselling" consumers by prominently marketing to consumers one package of credit card terms, but then approving those consumers only for accounts with less favorable terms, and touting the approved account in a fashion designed to mislead the customer about the fact he or she had been 'downsold'[10]."
- In 2000, the tiny San Francisco District Attorney and the California Attorney General[11] began an investigation later joined by what many claim was an embarrassed and late to the party OCC, which resulted in imposition of a minimum of $300 million in civil penalties and a restitution order against Providian for deceptive marketing of mandatory credit life insurance, known as freeze protection, and other violations. The OCC, not generally known for hyperbole in defense of the consumer, said the following: "We found that Providian engaged in a variety of unfair and deceptive practices that enriched the bank while harming literally hundreds of thousands of its customers."[12]
- Since 1999, the Minnesota Attorney General and other States have settled multimillion dollar claims against U.S. Bank for its practice of allowing telemarketers access to its credit card customer records for the purpose of deceptively marketing add-on products including credit life insurance, roadside assistance packages, and other gimmickry billed to consumers who did not even give their credit card numbers and had no knowledge that they had allegedly placed orders or would be billed for any product.
- Several private class action lawsuits have been settled recently against other large banks for abusive practices, such as charging consumers late fees, even when they pay on time.

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[6] See "State Sues Cross Country Bank over Harassing Debt Collection Practices," 3 April 2003, available at the Minnesota Attorney General's website *http://www.ag.state.mn.us/consumer/PR/pr_CrossC_40303.htm*. In November, 2004 the State obtained a temporary injunction barring the bank's abusive practices. See *http://www.ag.state.mn.us/consumer/PDF/CrossCountryBank.pdf*.

[7] 24 June 2004, Press release of Pennsylvania Attorney General's Office "AG Pappert takes action against bank and its collection company in alleged predatory lending/credit card scheme," available at *http://www.attorneygeneral.gov/press/pr.cfm*.

[8] 31 December 2002, FIRST USA TO HALT VENDORS' DECEPTIVE SOLICITATIONS, Press Release of New York Attorney General Eliot Spitzer, available at *http://www.oag.state.ny.us/press/2002/dec/dec31a_02*.html.

[9] 27 Feb 2002, AGREEMENT CURBS TELEMARKETING APPEALS TO BANK CUSTOMERS, Press Release of New York Attorney General Eliot Spitzer, available at *http://www.oag.state.ny.us/press/2002/feb/feb27b_02*.html.

[10] Fact Sheet Regarding Settlement Between the OCC and Direct Merchants Bank, 3 May 2001.

[11] See "Providian to Refund $300 Million to Consumers Over Alleged Abusive Credit Card Practices," 28 June 2000 available at California Attorney General page *http://caag.state.ca.us/newsalerts/2000/00–098.htm*.

[12] June 28, 2000, Statement of Comptroller of the Currency John D. Hawke, Jr.

- The Federal courts have also acted in favor of consumers in several important cases. In 2003, the 3rd Circuit found that Fleet Bank had violated the Truth In Lending Act (TILA) when it promised Paula Rossman a no-annual-fee credit card and changed the terms immediately, less than a year after she had obtained the card, even though Rossman had not violated any of the contract's terms by paying late, going over her limit, or anything else. The court described the essential problem this way:

> A statement, therefore, that a card has "no annual fee" made by a creditor that intends to impose such a fee shortly thereafter, is misleading. It is an accurate statement only in the narrowest of senses—and not in a sense appropriate to consumer protection disclosure statute such as the TILA. Fleet's proposed approach would permit the use of required disclosures—intended to protect consumers from hidden costs—to intentionally deceive customers as to the costs of credit.[13]

Of course, Rossman highlights one of the critical hypocrisies and significant flaws in the Federal unregulation of the credit card marketplace, where credit card contracts are take-it-or-leave contracts of adhesion imposed on consumers that supposedly allow the bank to make any changes at any time for any reason. As the court quotes Fleet's contract in Rossman:

> We have the right to change any of the terms of this Agreement at any time. You will be given notice of a change as required by applicable law. Any change in terms governs your Account as of the effective date, and will, as permitted by law and at our option, apply both to transactions made on or after such date and to any outstanding Account balance.[14]

- Numerous colleges and universities, as we illustrate below and as Doctor Manning will indicate in his testimony, have banned or strictly regulated the marketing of credit cards on campuses, to address widespread complaints about tawdry practices.

Policy Recommendations of U.S. PIRG to Address Abusive Credit Card Practices

Prohibit Deceptive and Unilaterally Unfair Practices, Including Retroactive Interest Rate Increases: Enact legislation such as the omnibus proposal by Senator Dodd, S. 499, a Member of this Committee, to prohibit a number of unfair practices, starting with the notorious retroactive interest increase. When banks impose universal default, or otherwise increase interest rates, they do not merely increase rates on interest accruing on future purchases, but also on prior balances. This has the effect of saddling the consumer with massive debt.

Require Real Disclosure of Minimum Payment Warnings: Senator Akaka of this Committee has proposed legislation, S. 393, (a similar provision is also included in S. 499) that would require every consumer's credit card billing statement to include a new disclosure. The Akaka Minimum Payment Warning is one of the few disclosures that rises above the clutter and will make a difference, and that is the reason banks vehemently oppose this proposal. The minimum payment warning would tell consumers how many actual years it would take to pay off their specific credit card, at their current balance and interest rate, if they only made the minimum requested payment and never used the card again. Each consumer would receive a different, dynamic disclosure, which would change monthly. We were disappointed when the Senate rejected the similar Akaka amendment during floor consideration of the draconian bankruptcy bill, S. 256, successfully and aggressively sought by the credit card industry and enacted into law at lightning speed this Congress, despite no evidence of bankruptcy abuse. Instead, that new bankruptcy act includes yet another virtually worthless generic disclosure. That disclosure was approved and signed off on by the industry simply because it will not work to reduce the credit card debts that cripple many American consumers. In a speech to bankers last week, Acting OCC Comptroller Julie Williams said "in order for the free market to work, consumers need to have the means to make informed decisions."[15] We urge the OCC to back the Akaka bill. It will work.

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[13] See *Rossman* v. *Fleet Bank (RI) Nat'l Ass'n,* 280 F.3d 384, 390–91 (3d Cir. 2002) available at *http://laws.lp.findlaw.com/3rd/011094.html.*

[14] See *Rossman* v. *Fleet Bank (RI) Nat'l Ass'n,* 280 F.3d 384, 390–91 (3d Cir. 2002) available at *http://laws.lp.findlaw.com/3rd/011094.html.*

[15] See OCC news release, "Acting Comptroller Williams Tells Bankers Disclosures not Working for Consumers," 12 May 2005 available *http://www.occ.treas.gov/scripts/newsrelease.aspx?Doc=Z1J2IZ9.xml.*

Ban on Late Fee Penalties When Payments Postmarked Before Due Date and Require a Minimum 30 Days To Pay Bill: In response to uncertainty over mail delivery following events related to the September 11 terrorist attacks, the OCC issued a 12 September 2001 "encouragement" that banks voluntarily work with debtors who may pay bills late, especially if due to mail disruption.[16] A better solution in 2005, after 4 years of ever escalating complaints about ever-escalating late fees, would be to establish a hard date rule for all consumers. If the bill is postmarked by the due date, it is considered on time and no penalties can be imposed. Such a bill would address numerous problems faced by consumers.

First, with the endorsement of the OCC, bills are no longer on time unless received by a certain time during the due date. Second, attempts to make overnight deliveries when you do not remember to send your bill at least 2 weeks in advance result in late payments anyway, because overnight deliveries are not accepted at the same address. Finally, some banks have begun using confusing 3 week payment cycles which have made it harder to make payments on time.

In the past, numerous House Members have proposed hard due date legislation, where a bill postmarked by the due date would be considered on time. Others have proposed legislation requiring a minimum 30 days for bills to be considered on time for the purpose of avoiding late payment penalties.[17]

Ban the Universal Default "Bait-and-Switch:" We have received numerous complaints that more and more banks are reviewing credit reports of existing customers and raising rates due to a decline in credit score or an alleged one or two late payments to any other creditor, even if the consumer's payments to the credit card issuer are timely and the account is in good standing. While we do not disagree that banks should be able generally to risk-price their products, we do not believe that universal default is being used as a proportional response but merely as a tool to increase revenue. We believe the regulators should be required to come forward with an analysis of the growing problem. After all, if the banks can offer dozens of different products to new customers based on their risk, why do not they have dozens of proportional responses for consumers when their risk increases?

As Representative Sanders has proposed, in the Credit Card Bait and Switch Act of 2003, HR 2724, the use of universal default should at least be strictly regulated, and as Senator Dodd has proposed in S. 499 this year, retroactive rate increases should be banned.

Give College Students And Other Young People Only The Credit They Deserve: Credit card companies issue credit to students without looking at credit reports (they do not have any) and without regard to ability to repay. Other Americans must have a good credit report or a cosigner to obtain credit. College students merely apply. College students and other young people should be protected from credit card debt hassles by having to meet similar standards, as S. 499 (Dodd) would provide. The proposed bill offers several ways for young consumers to qualify to obtain credit cards.

Further Restrict Pre-Acquired Account Telemarketing: Many of the deceptive practices described in the state actions above involve banks sharing customer information with tawdry third-party telemarketers selling even tawdrier products characterized by overpriced travel clubs and mediocre health insurance plans. In addition, many institutions have seized on the identity theft epidemic fueled by their own sloppy credit granting practices to pitch overpriced credit monitoring add-ons. In our view, neither the provisions of Gramm-Leach-Bliley dealing with encrypted credit card numbers nor changes to The Telemarketing Sales Rule have adequately stopped banks from treating their customers unfairly due to the lure of massive commissions from their telemarketing partners.

Cap Interest Rates: Reinstate Federal usury ceiling for credit cards to prohibit the use of unconscionable penalty interest rates. Prime plus 10 per cent seems like a reasonable profit.

Ban Mandatory Pre-Dispute Arbitration: The Congress has enacted legislation protecting car dealers from unfair arbitration clauses in their contracts with car manufacturers. The Senate has passed legislation similarly protecting farmers from arbitration in their contracts with powerful agribusiness concerns. It is time to enact similar legislation to protect consumers. Bills to ban predispute mandatory arbitration in consumer credit card contracts have been proposed in 1999 by Rep. Gutierrez (HR 2258) and in 2000 by Rep. Schakowsky (HR 4332).

Ban The Use of Arbitration in Debt Collection Schemes: Arbitration agreements are not only being used in attempts to prevent consumers victimized by deceptive

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[16] See OCC Press release NR–2001–79.

[17] See, eg, bills previously filed by Representatives including Darlene Hooley, (HR 3477, 1999) and Andy Jacobs, (HR 1537, 1995) and John McHugh, (HR 1963, also in 1995).

advertising and interest rate practices to have their day in court. Increasingly, according to a major new report by the National Consumer Law Center, major credit card companies, including First USA and MBNA, are partnering with arbitration firms to establish debt collection mills that force consumers into paying debts, including debts they may not even owe:

> Now, at least two giant credit-card issuers and one of the Nation's largest firms arbitrating their consumer disputes have combined these practices in a disturbing new way: They are using binding, mandatory arbitration primarily as an offensive weapon, by fast-tracking disputes over credit-card debt into rapid arbitration. A number of consumers charge that the banks often do this with little notice, after long periods of dormancy for the alleged debt or over consumers' specific objections—then force those who do not respond swiftly or adequately into default. The arbitrator often forces the consumer to also pay for the hefty arbitration costs and the card issuer's attorney, making the total tab for consumers several times the original amount owed and many times what it would have been in more traditional debt settlements. So it is a neat pathway to turbo-charged profits for both the card issuer and the arbitrator.[18]

We were disappointed that the Congress recently enacted a one-sided bankruptcy bill, absent proof of abuse. The bill failed to rein in these practices. We respectfully urge you to consider our proposals to rein in the unfair credit card company practices described above that have exacerbated the growth of credit card debt, which is the real problem we face, not abuse of the bankruptcy laws. In addition to the bankruptcy law's general manifest harshness and its intended elimination of a critical safety net during uncertain economic times, the bill's nominal credit card disclosures are deficient and unacceptable, as we pointed out above.

In addition to banning certain practices as above, U.S. PIRG, the Consumer Federation of America, and others recently joined the National Consumer Law Center in detailed and comprehensive comments to the Federal Reserve Board on ways to improve the Truth In Lending Act's disclosures and other regulations. The comments provide a window on the way that the industry exploits loopholes and inconsistencies in the Act to hurt and exploit consumers.[19] The TILA was supposed to be a remedial act, a law written to prevent unfair practices, and has often been correctly interpreted that way in the courts, yet the regulators have insisted on allowing the industry to carve out nooks and crannies that allow banks to avoid the spirit of the law. The proposals below augment and update the disclosures in the important 1988 disclosure legislation that established what is known as the "Schumer" box, which requires credit card company solicitations to clearly and prominently disclose all fee and interest related "trigger terms."[20]

Additional key statutory changes recommended in those comments include the following:

- A cap on all other charges, whether considered a finance charge or not, to an amount the card issuer can show is reasonably related to cost.
- No unilateral change-in-terms allowed.
- No retroactive interest rate increases allowed.
- No penalties allowed for behavior not directly linked to the specific card account at issue.
- No over limit fees allowed if issuer permits credit limit to be exceeded.
- No improvident extensions of credit—require real underwriting of the consumer's ability to pay.
- Meaningful penalties for violating any substantive or disclosure that provide real incentives to obey the rules.
- A private right of action to enforce Section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive practices by businesses, including banks.

Abusive Credit Card Industry Practices on Campus

Having saturated the working adult population with credit card offers, credit card companies are now banking on a new market: College students. Under regular cred-

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[18] See 17 February 2005, "New Trap Door for Consumers: Card Issuers Use Rubber-Stamp Arbitration to Rush Debts Into Default Judgments," National Consumer Law Center, available at *http://www.consumerlaw.org/initiatives/model/content/ArbitrationNAF.pdf.*

[19] See Comments of National Consumer Law Center, U.S. PIRG, Consumer Federation of America et al "Regarding Advance Notice of Proposed Rulemaking: Review of the Open-End (Revolving) Credit Rules of Regulation Z," Federal Reserve System, 12 CFR Part 226, Docket No. R–1217 available at *http://www.consumerlaw.org/initiatives/test*_and_comm/content/open_end_final.pdf.

[20] The Fair Credit and Charge Card Act of 1988's disclosures were championed by Representative Chuck Schumer, now a Senator and a Member of this Committee.

it criteria, many students would not be able to get a card because they have no credit history and little or no income. But the market for young people is valuable, as industry research shows that young consumers remain loyal to their first cards as they grow older. Nellie Mae, the student loan agency, found that 78 percent of undergraduate students had credit cards in 2000. Credit card companies have moved on campus to lure college students into obtaining cards. Their aggressive marketing, coupled with students' lack of financial experience or education, leads many students into serious debt. According to a recent PIRG study, the Burden of Borrowing, credit card debt exacerbates skyrocketing student loan debts. That 2002 study found that 39 percent of student borrowers now graduate with unmanageable levels of debt, meaning that their monthly payments are more than 8 percent of their monthly incomes. The study also found that student borrowers were student borrowers were even more likely to carry credit card debt, with 48 percent of borrowers carrying an average credit card balance of $3,176.[21]

Campus Marketing: In 2004, Maryland PIRG and the Maryland Consumer Rights Coalition releasing a shocking study of credit card marketing practices on the State's college campuses. Among the highlights of Graduating Into Debt[22] were the following:

- Credit card vendors are setting up tables on some campuses in violation of university policies prohibiting or limiting tabling.
- At least two schools currently sell their student lists (names, addresses, and telephone numbers) to credit card issuers.
- Several schools have exclusive marketing agreements with one credit card issuer for which they receive financial compensation.
- Only one school that allows on-campus marketing has a comprehensive written policy specifically governing credit card marketing.

Previously, a PIRG study, the Credit Card Trap, released in April 2001, included a detailed study of the worst credit card practices. The report was released at the same time as we announced a detailed fact sheet available at a new website *truthaboutcredit.org.*[23] Because Linda Sherry of Consumer Action is releasing more recent survey data, I will not go into details on the report's survey results. The key findings of a year 2000 survey of 100 credit card offers included in "The Credit Card Trap" are available online.[24] The report also included a survey of college student marketing, which we summarize here.

Marketing to College Students Is Aggressive

The State PIRG's surveyed 460 college students within the first month of either the fall or spring semester of 2000–2001. The key findings include:

- Two-thirds of college students surveyed had at least one credit card. The average college student had 1.67 credit cards.
- 50 percent of students obtained their cards through the mail, 15 percent at an on-campus table, and 10 percent over the phone.
- 50 percent of students with cards always pay their balances in full, 36 percent sometimes do, and 14 percent never do.
- 48 percent of students with one or more cards have paid a late fee, and 7 percent have had a card cancelled due to missed or late payments.
- 58 percent of students report seeing on-campus credit card marketing tables for a total of 2 or more days within the first 2 months of the semester. Twenty-five percent report seeing on-campus tables more than 5 days.
- One-third have applied for a credit card at an on-campus table. Of these, 80 percent cite free gifts as a reason for applying.
- Only 19 percent of students are certain that their schools have resources on the responsible use of credit. Three out of four of these students (76 percent) have never used these resources.

The State PIRG's have run counter-education campaigns against credit card marketing on campus. The industry and its vendors set up tables where hawkers distribute "free" t-shirts, Frisbees and candy to students who apply for cards. They also

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[21] See "The Burden of Borrowing," the State PIRGs' Higher Education Project, March 2002, available at *http://www.pirg.org/highered/highered.asp?id2=7972.*

[22] See "Graduating Into Debt: Credit Card Marketing on Maryland College Campuses," February 19, 2004, Maryland Consumer Rights Coalition and Maryland Public Interest Research Group, available at *http://marypirg.org/MD.asp?id2=12264&id3=MD&.*

[23] "The Roadmap To Avoid Credit Hazards" is downloadable at *http://www.truthaboutcredit.org/roadmap.pdf.* Numerous other materials and reports are available at *http://www.truthaboutcredit.org.*

[24] See the State PIRG credit card education website *http://www.truthaboutcredit.org.*

aggressively post so-called "take-one" flyers on bulletin boards in every classroom. PIRG chapters have set up tables where we distribute credit card education literature. We also have created our own "think twice" take-one flyers and posted them on campuses. The brochures link to our website, *truthaboutcredit.org*.

We believe it is appropriate and proper for colleges and universities to regulate credit card marketing on campuses, including consideration of restrictions or bans on credit card tabling and other marketing. In addition, colleges should improve generally weak financial literacy, credit card and debt training programs for students, as should high schools. However, we believe that these responses are best made by student governments, college administrators or state legislatures, not the Congress, so we make no specific recommendations here.

Brief Profile of the Credit Card Industry

Our policy changes can be made without hurting the credit card companies, who have enjoyed a lucrative 10 year run at the expense of consumers. Credit card lending is the most profitable form of banking, according to the Federal Reserve's most recent report to Congress in 2004: "Although profitability for the large credit card banks has risen and fallen over the years, credit card earnings have been consistently higher than returns on all commercial bank activities."[25] In recent years, those profits have hovered at or near record levels. Profits in 2003 were $30 billion according to various sources, with late and over-the-limit fees adding dramatically to the total.

There may be, as the industry witnesses will trumpet, some 6,000 credit card issuers. But there are only 10 that matter. The actual marketplace is highly concentrated. The Nation's top 10 bank credit card issuers grew an average of 6.5 percent during 2003, holding aggregate card loans of $538.9 billion, approximately 77 percent of the total U.S. market.

Since 1980, revolving debt, which is largely credit card debt, increased from just $56 billion to $800 billion, according to the most recent Federal Reserve postings of May 2005.[26] Approximately 55 percent of consumers carry balances (the rest are convenience users) meaning consumers with credit card balances average $10,000–$12,000 each in total credit card and revolving debt.[27]

Credit card companies have increased profit by increasing the amount of credit outstanding by decreasing cardholders' minimum monthly payments, increasing interest rates, and piling on enormous fees. Until very recently, credit card companies engaged in a practice of decreasing the minimum percentage of the balance that cardholders must pay in order to remain in good standing. Today, most companies still require a minimum monthly payment of only 2 percent or 3 percent of the outstanding balance. As a result, cardholders who choose to pay only the minimum each month take longer to pay off their balances, paying more interest in the process. In its recent guidances, the OCC has admonished banks to raise these minimum payment levels. "The required minimum payment should be sufficient to cover finance charges and recurring fees and to amortize the principal balance over a reasonable period of time."[28]

According to a U.S. PIRG analysis, a consumer carrying just $5,000 of debt at 16 percent APR would take 26 years to pay off the balance if she only made the 2 percent requested minimum payment, even if she cut the card up and never used it again.

An industry source indicates that in 2003, 69 percent of U.S. households received an average of 4.8 offers per month, or 58 offers/year. The Federal Reserve also estimates that this has resulted in American consumers now carrying an average of 4.8 credit cards each.[29] During 2004, U.S. households received estimated 5.23 billion

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[25] "The Profitability of Credit Card Operations of Depository Institutions: An Annual Report by the Board of Governors of the Federal Reserve System, submitted to the Congress pursuant to Section 8 of the Fair Credit and Charge Card Disclosure Act of 1988," June 2004, available at *http://www.Federalreserve.gov/boarddocs/rptcongress/creditcard/2004/ccprofit.pdf.*

[26] See *http://www.Federalreserve.gov/releases/g19/Current.*

[27] The banks frequently cite a Federal Reserve analysis of University of Michigan Survey of Consumer Finances polling data to allege that only 45 percent of consumers carry a balance. Consumer group contacts with industry sources indicate that these numbers are low. If true, of course, average balances would be even higher. Consumer groups use a conservative figure of 55 percent carrying balances, with some sources putting the number as high as high as 60 percent or more. For a discussion of our analysis of credit card debt calculations, see the State PIRG report "Deflate Your Rate," March 2002, available at *http://www.truthaboutcredit.org.*

[28] OCC Advisory Letter AL 2004–4, April 28, 2004, available at *http://www.occ.treas.gov/ftp/advisory/2004–4.txt.*

[29] "The Profitability of Credit Card Operations of Depository Institutions: An Annual Report by the Board of Governors of the Federal Reserve System, submitted to the Congress pursuant

Continued

credit card offers, up 22 percent compared to 2003 and exceeding the previous record of 5.01 billion offers set in 2001.[30]

State Preemption: Another Part of the Problem

Although States have recently aggressively sshould enforce unfair and deceptive practices laws against credit card companies, the States have been limited in their enforcement by the growing use of preemption theory to restrict their regulation of the industry. In 1978, in Marquette,[31] the Supreme Court held that States could export nationally the interest rates of the bank's home State, prompting a concentration of the industry in a few bank-friendly States, including Delaware and South Dakota. In 1996, the court in Smiley[32] extended the Marquette holding by defining late fees as "interest," allowing a bank's home State late fee rules to similarly be exported nationally.

These onerous decisions applied only to the regulation of interest and fees, not to disclosures. In 2002, a U.S. District Court used National Bank Act preemption theory, backed by the OCC, to overturn an important new California law requiring a monthly minimum payment warning, further restricting State authority to protect consumers.[33] Then, of course, in 2004, the OCC imposed two onerous administrative rules restricting States from enactment or enforcement against national banks and their State-licensed operating subsidiaries.[34]

These decisions and actions have aided and abetted the anticonsumer practices of this industry and deserve careful scrutiny by the Committee. We remain disappointed that the committee has not reined in the over-reaching OCC rules, although it did hold an important oversight hearing in the last Congress.[35]

Conclusion

We thank you for holding this important oversight hearing. We urge the committee to go further and enact legislation protecting consumers from unfair credit card company practices. We hope that we have provided you with adequate information to support the need for action by the Congress to rein in the credit card industry's most unfair and abusive practices and would be happy to work with your staffs on proposed legislation.

PREPARED STATEMENT OF MARGE CONNELLY

EXECUTIVE VICE PRESIDENT, CAPITAL ONE FINANCIAL CORPORATION

MAY 17, 2005

Good morning, my name is Marge Connelly, Executive Vice President, Capital One Financial Corporation, and I am pleased to appear before you today to talk about the state of the credit card industry.

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to Section 8 of the Fair Credit and Charge Card Disclosure Act of 1988," June 2004, available at *http://www.Federalreserve.gov/boarddocs/rptcongress/creditcard/2004/ccprofit.pdf.*

[30] According to Mail Monitor, the direct mail tracking service from Synovate.

[31] In 1978, the Supreme Court in *Marquette* v. *First Omaha Service Corp.* invalidated State usury laws as they apply to national banks. Marquette held that under Section 85 of the National Bank Act (NBA) of 1863 national banks could export to any of their customers, no matter where they lived, the highest interest rate allowed in the bank's home State, now usually Delaware, Virginia, Nevada, or South Dakota. See *Marquette Nat. Bank.* v. *First of Omaha Services,* 439 US 299 (1978).

[32] In Smiley, the Supreme Court extended Marquette to allow exportation of a home State's fees. The court paid deference to a new OCC rule that added a wide range of fees to the definition of interest under Section 85 of the National Bank Act, including late fees, over limit fees, annual fees, and cash advance fees. See *Smiley* v. *Citibank (South Dakota).* 517 US 735 (1996)

[33] Since the Federal Truth In Lending Act was nonpreemptive with respect to certain account statement disclosures, California enacted legislation (Civil Code Section 1748.13) requiring that monthly credit card statements disclose information about how long it would take to pay off a card if you only made the minimum requested monthly payment. Federal law did not then require this, although a similar, weaker provision is included in the bankruptcy law recently signed (Public Law 109–8). The law was overturned on summary judgment in *American Bankers Association* v. *Lockyer,* 239 F. Supp. 2d 1000, 1009 (E.D. Cal. 2002).

[34] See the PIRG OCCWatch website for detailed information on the OCC's anticonsumer actions, including links to its rules, *http://www.pirg.org/occwatch.* Also see "Preemption Of State Consumer Laws: Federal Interference Is A Market Failure," by U.S. PIRG's Edmund Mierzwinski, which appeared in the Spring 2004 (Vol. 6, No. 1, pgs. 6–12) issue of the Government, Law and Policy Journal of the New York State Bar Association. The article includes a major section on the OCC rules, available at *http://www.pirg.org/consumer/pdfs/mierzwinskiarticlefinalnysba.pdf.*

[35] 7 April 2004, Review of the National Bank Preemption Rules, Oversight Hearing of the U.S. Senate Banking Committee, available at *http://banking.senate.gov.*

Overview

Capital One is one of the largest credit card providers in the world, and a diversified financial services company with over 49 million accounts and $81 billion in managed loans outstanding as of March 31, 2005. In addition to credit cards, we are one of the nation's premier auto finance companies, and also offer our customers an array of other banking and related products and services. We employ nearly 15,000 associates worldwide, with offices around the country and overseas. Earlier this year, Capital One announced its planned acquisition of Hibernia Corporation, a financial holding company headquartered in New Orleans that has over $21 billion in assets and offers a full range of deposit products and a wide array of financial services through more than 300 locations in Louisiana and Texas.

Capital One, along with the other companies testifying before the Committee, has played a leading role in building the national credit superhighway that, in the past 15 years, has greatly advanced economic democracy in America. While credit card lending is only a small percentage of consumer credit—about 4 percent [1]—its real contribution lies elsewhere. The credit card is now one of the consumer's main contacts with the payment system,[2] and has fostered a vast national transformation that has changed commerce for the better.[3] Using payment cards, consumers can conduct everyday transactions without writing checks and without having to do the associated recordkeeping. Consumers can shop by telephone or the internet at a time and in a setting that is convenient for them, saving both time and money while increasing consumer choice.

As with all significant social and economic changes, this transformation has been accompanied by its share of controversy, and Capital One is grateful for the opportunity to participate in the Committee's exploration of the issues surrounding the credit card industry today. But first, it is necessary to spend some time understanding payment cards' development and role in society.

Democratization of Credit and the Transformation of Commerce

Developments in information technology and the availability of consumer credit information spurred major changes in the credit granting process. The beginnings of a national consumer credit market were acknowledged in the passage of the Fair Credit Reporting Act (FCRA) in 1974, updated by this Committee in 1996 and most recently in 2003. Credit became more widely available on a national basis, as credit bureaus developed large databases that provided lenders with a more holistic and consistent view of a particular consumer's risk characteristics. Nevertheless, pricing was still not highly differentiated, and approximately half of the eligible U.S. population could still not qualify for a credit card.

Even as late as 1987, the credit card market was mired in a "one-size-fits-all" approach, characterized by uniform interest rates and annual fees.

Largest Ten Issuers (1987)	APR (percent)	AMF (dollars)
Citibank	19.8	20
Bank of America	19.8	20
Chase Manhattan	19.8	20
First Chicago	19.8	20
Wells Fargo	19.8	20
First Interstate	19.8	20
Manufacturers Hanover	19.8	20
MNC Financial	19.8	20
Marine Midland	19.8	20
Security Pacific	19.8	20

The market was ripe for innovation, and the founders of Capital One saw an opportunity to use the information provided by our national credit reporting system to customize product offerings to customers based on their particular needs, interests and risk profiles.

Our founders realized that the "one-size-fits-all" approach made little sense when each consumer possessed vastly different needs and characteristics. While some consumers were risky, many more were less so—in varying degrees. Without the ability

[1] Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances, Federal Reserve Bulletin, January 2003, Chart 10, page 21.

[2] Credit Cards: Use and Consumer Attitudes, 1970–2000, Federal Reserve Bulletin, September 2000.

[3] Ibid.

to differentiate one from another, however, lenders were compelled to raise prices to cover the cost of higher credit losses, or to cut back on the granting of credit to reduce the losses. Either way, consumers suffered. The less risky customers were paying too much, and for the rest, credit was hard to come by—if available at all.

Capital One was able to use information within the legal framework provided by the FCRA to make significant advances in underwriting—better distinguishing the risk characteristics of our customer base. The benefits of greater access to better information went beyond risk analysis, however. Capital One and other companies were also able to use information to create profound innovations in the marketing and design of credit cards. Our company led the charge with new product ideas like balance transfers, where customers could shift balances away from high-priced cards to our lower-priced offerings, and low introductory rates. The resulting reductions in price and expansion of credit into traditionally underserved markets sparked a consumer revolution that can fairly be called the "democratization of credit."[4]

By this decade, the desultory competition and flat pricing structure of old were no more. In their place came fierce price competition which has produced billions of dollars in savings for consumers across the country.

Largest Eight Issuers (March 2005)	Lowest Long-Term APR	AMF (dollars)
Capital One	4.99 percent Variable	0
Chase/Bank One	7.99 percent Fixed	0
Bank of America	5.25 percent Variable	0
MBNA	5.25 percent Variable	0
Providian	7.24 percent Variable	0
American Express	8.24 percent Variable	0
Discover	5.99 percent Variable	0
Citibank	7.99 percent Variable	0

These numbers actually do not capture all the savings to consumers caused by increased competition, because they do not take into consideration the widespread availability of low introductory and balance transfer rates.

The last 15 years also saw significant developments in the pioneering of affinity cards, with benefits for consumers and the organizations they most value; rewards programs which provide consumers with value added benefits ranging from airline miles to college savings plans; and cobranded products, which allow consumers to enjoy discounts and other privileges at their favorite retail outlets.

The power of this heightened competition has not been lost on consumers—in just 10 years as an independent company, Capital One has grown its account base from 5 million to 49 million worldwide—all without the once vital "bricks and mortar" network of branches. We can give consumers the best deals no matter where they reside—from mid-town Manhattan to the smallest farm community in Iowa.

For consumers, the benefits are self-evident: Prices for credit continue to decline and availability to widen—most notably in the traditionally underserved low- and moderate-income communities.

In addition to the direct economic benefits of lower pricing, consumers have received an equally significant qualitative benefit from advances in the payment card industry, and that is the transformation of everyday commerce. Credit cards serve as a "payment device in lieu of cash or checks for millions of routine purchases as well as for many transactions that would otherwise be inconvenient or perhaps impossible,"[5] such as making retail purchases over the Internet or by telephone. The explosion in internet commerce, and indeed the establishment of whole new marketplaces such as Ebay, could not have occurred without the relatively recent development of payment cards. With the advent of payment cards in the 1950's, consumer debt has had two components: Nonrevolving debt, consisting of traditional installment-purchase type loans for such things as appliance purchases, and revolving debt, consisting of "prearranged lines of credit."[6] Since the late-1960's, revolving debt has increasingly replaced nonrevolving debt, and some of this revolving credit is "convenience credit" that replaces cash and is paid in full every month.[7] As noted above, credit card debt composes around 4 percent of all consumer debt, but it is erroneous to look at this as unqualified new debt for the reason just cited—the rise

[4] The Fair Credit Reporting Act: Access, Efficiency & Opportunity, Information Policy Institute, June 2003.

[5] Federal Reserve Bulletin, September 2000, page 623.

[6] Ibid, page 624.

[7] Ibid, Chart 1″Consumer credit outstanding as a proportion of disposable income, 1956–1999, page 624.

in revolving debt since the late 1960's has been accompanied by a decline in non-revolving debt (relative to income) while overall consumer debt has remained fairly constant relative to income.[8] This is not to say that a portion of credit card debt is not new in the sense that it is in addition to, rather than in replacement of, other debt the consumer would have incurred; but that new credit does not appear to be a large part relative to income. Critics of the industry portray credit-card debt as a massive debt burden for the American consumer, but the size of the debt as a component of overall consumer indebtedness does not support that charge. Where payment cards clearly have had a pervasive impact, out of proportion to the amount of credit that they represent, is in their economic functionality-as a substitute for cash and checks, and as an enabler for new marketplaces and forms of commerce.

The Challenges of Successful Competition

As the above discussion helps to emphasize, there is no more competitive industry. Several thousand financial institutions issue general purpose credit cards such as MasterCard and Visa, in addition to those issued by American Express, Discover, and many retailers. As many as 50 of the largest credit card issuers distribute their cards nationally, Capital One among them. Obviously, this market is not dominated by any one issuer. There are few barriers to entry and exit. In recent years, newcomers such as Juniper Bank and the banking arm of State Farm Insurance have taken market share from more established issuers,[9] contributing to the pressure on all market participants to focus on products that best serve consumers.

In the face of this intense competition, each day at Capital One, our associates work hard to retain our existing customers, acquire customers new to the market, and attract the customers of our competitors with better offerings. This nationally competitive environment has completely displaced the balkanized, localized credit card markets of 30 years ago—markets that featured high, largely undifferentiated pricing combined with an onerous and highly subjective application process and limited availability and access to credit.

As a result, the industry now plays a preeminent role in the day-to-day lives of consumers. Capital One has 38 million U.S. credit card accounts, and any one of those customers can drop our product and immediately get a replacement from any one of at least 10 major competitors. We live by and for our customers, and we are committed to retaining them.

There have been many complaints that credit card fees are too high—in particular, fees for infractions of account rules (late fees, overlimit fees, returned-check fees). But in fact, the rise in these fees corresponds with the industry's movement toward lower interest rates and annual membership fees on accounts generally, as credit card lenders compete fiercely to offer consumers what they most want. Consumers have voted for those low-rate and low-membership-fee products by signing up for them—and leaving those products with higher rates and membership fees. But in order to offer those low rates, and those zero-dollar membership fees, it has become critically important for credit card lenders to manage risk in their accounts more effectively, including the use of default fees to compensate for the added risk of those customers who do not abide by the account rules.

Because it is so easy for consumers to switch credit card issuers—and millions do so every year—credit card companies must take very seriously any suggestion that our customers are not being treated fairly. As competition intensifies and credit products become more complex, it becomes more important to be sure that customers understand the terms of their accounts and are not surprised by any fees or charges they may incur, or changes in terms.

In other words, it is not enough to have built the national credit superhighway with all of its speed and cost benefits, but we must ensure that it has good road signs and exits—all without impeding traffic flow or imposing unreasonable tolls. Capital One has some proposals in that area, but before discussing those, it is vital to achieve a common understanding of open-end credit and the underwriting process.

Open-End Credit and the Underwriting Process

Open-end, unsecured credit is just that—it is credit that is extended in variable amounts over an indefinite period of time with no collateral to secure the debt. The lender extends or "underwrites" this credit solely on its analysis of the consumer's likelihood to repay. A "snapshot" of the consumer's ability and willingness to repay at a given point in time must support a lending decision that can have consequences indefinitely into the future. There is no collateral, as with auto or with mortgage

[8] Ibid.
[9] Credit Cards, 2003, SMR Research.

loans. Prior to the development of open-end credit delivered through credit cards, the consumer would apply for an installment purchase loan for a particular good or purpose. The loan was for a fixed period of time. If a consumer purchased a refrigerator, the lender would assess the likelihood to repay for that particular item and offer a rate based on the particular risk factors involved. The credit was extended only in a specific amount for a specific period of time. The lender's risk was limited to that amount and time period, and even within that time period, the lender's credit risk declined over the life of the loan as the customer paid down the loan according to the prescribed schedule. If the consumer next wanted to buy a washing machine, the process started all over again, and if the consumer's risk profile had changed, he or she could get a different rate, or not be granted credit. With open-end credit, the consumer receives a prearranged credit line and can make subsequent purchases up to the credit limit without any further approval process. The lender's exposure is for an indefinite period during which the borrower's creditworthiness can fluctuate considerably.

In unsecured lending, if the lender is to make money (or even stay solvent), every bad loan must be compensated for by many good loans. And the rate charged on those loans must reflect their risk. To illustrate why that is so important, consider a simple example.

The example, shown in the chart in Attachment I, consists of two simple loan portfolios, each containing 100 loans of $1000 apiece. One portfolio has an interest rate of 19.9 percent, similar to prevailing credit card interest rates of two decades, ago, the other a rate of 6.9 percent similar to prevailing rates today.

If one loan in the 19.9 percent portfolio defaults, it takes the interest from 10 performing loans to compensate for the default. But if one loan in the 6.9 percent portfolio defaults, it takes the interest from 29 performing loans to compensate for the default.

The importance of accurate underwriting in today's morecompetitive interest rate environment is obvious. The challenge for every lender is to fit the maximum number of borrowers into the continuum of rates that that lender charges while keeping defaults to a minimum. Whoever does the best job of fitting borrowers to a particular interest rate attracts the most customers, because that lender can offer the lowest rate and manage defaults so that the lender still makes money. When a lender extends open-end credit, it is vital that, to the extent possible, the lender keeps the consumer in the right credit portfolio during the life of the credit relationship; otherwise the lender's underwriting failure unfairly distributes cost to other consumers and imperils the lender's ability to remain in business. Anything that enhances this process has obvious consumer benefits, and anything that disrupts it has equally negative consumer effects.

Because credit-card lending is unsecured, accurate underwriting is a matter of the lender's financial life and death. And because credit-card lending is open-ended, it requires special tools to manage risk over the indefinite future during which the customer's behavior and creditworthiness may change. These tools include fees for rule violations, and the ability to modify credit lines, and suspend or terminate the account, and the ability to reprice, or reunderwrite, the account. As noted above in the comparison of closed-end vs. open-end credit, closed-end credit is a discrete underwriting event where the underwriting can be adjusted with each purchase, whereas the indefinite nature of open-end credit increases the risk of meaningful changes in credit quality. The ability to price for risk in either a closed or open-end context is vital to expanding access to credit while maintaining an appropriate distribution of rates for all borrowers.

Proposals for Change

Keeping all of that in mind, let me return to the question how the industry can improve the signs and exits for the consumer who is driving along the credit superhighway. First, an example of an effective sign is the "Schumer Box" that currently accompanies credit card solicitations. It prominently and efficiently discloses a number of key terms for the consumer. Building on the strengths of the Schumer Box, we have submitted to the Federal Reserve, pursuant to their Advance Notice of Proposed Rulemaking for Regulation Z, a proposal to enhance solicitation disclosures as illustrated by the Fact Sheet in the poster before you and in Attachment II to my statement.

After listening to consumers whom we gathered in a number of focus groups (not Capital One cardholders, except by chance), we synthesized the following principles, which we reflected in the Fact Sheet: Importance; Comparability; Clarity; Simplicity; and Specificity.

Applying those principles, we produced our Fact Sheet, including a number of changes from the current disclosure regime:

- More prominent and standardized disclosure of events that may give rise to changes in the customer's interest rate; moving those disclosures from where they currently appear, in footnotes to the Schumer Box, into the heart of the Fact Sheet.
- Disclosure of the range of credit limits that the customer may receive (not currently required or permitted to be disclosed in the Schumer Box).
- Disclosure of certain fees not currently required to be in the Schumer Box.
- Disclosure of other matters of importance to prospective customers: We propose disclosing the manner of payment allocation.

We look forward to working with the Federal Reserve Board on their important project to bring Regulation Z and the credit-card disclosures that it governs into the 21st century.

Conclusion

To conclude, Capital One wants our customers to be well-informed and financially literate. Well-informed customers are the most likely to understand and appreciate our products, and to use them wisely. Effective, standardized disclosure is key to achieving that goal, and that is why the Federal Reserve review of Regulation Z is so important. Capital One looks forward to actively and constructively participating in this process to bring about meaningful improvements to the industry. Again, we appreciate this opportunity to present our views to the Committee.

Attachment I

$1000 loans made to 100 borrowers (principal = $100,000) to be paid in one year (no compounding, regular monthly payments)

	Scenario 1	Scenario 2
Interest rate	19.9%	6.9%
Value of each loan (paid in one year; paid regularly over the year)	≈ $1,099.50	≈ $1,034.50
Effective rate of return	≈ 10%	≈ 3.0%
Value of the portfolio	$109,950.00	$103,450.00
The non-performance of one of the 100 loans = the interest payments of	10 borrowers	28.99 borrowers
To earn expected profit (in $) at given interest rate on the assumption that one borrowers will default at the outset, loans must be made to	110 borrowers (=starting principal of $110,000.00)	128.99 borrowers (=starting principal of $128,990.00)
Effective rate of return (with one expected default and new borrowers/added principal to compensate)	9.04%	2.67%

At lower interest rates, the rate of return on each loan requires more borrowers to make up for each non-performer than do loans with higher interest rates. In Scenario 2, 28 borrowers are needed to safeguard the principal extended to one borrower. In Scenario 1, only 9 borrowers are needed to do so.

Attachment II

CREDIT CARD FACT SHEET

PRICING & FEES

X%min-X%max Variable	Purchase APR after Month/Year	X% Variable	Balance Transfer APR after account opening
X% Variable	Intro Purchase APR until Month/Year (PRIME + XX.XX%)	X% Variable	Intro Balance Transfer APR
		X% or $X	Balance Transfer Fee
$X min-$X max	Initial Credit Line	X% Variable	Cash Advance APR
		X% or $X min.	Cash Advance Fee
$X (frequency)	Membership Fee	$XX	Minimum Finance Charge
$X	Late Fee	X% or $X	Minimum Payment
$X	Overlimit Fee	XX days	Interest-Free Period for Purchases if balance is paid in full monthly
		$XX	Return Check Fee

REASONS YOUR RATES MAY CHANGE

You pay late or you pay less than the minimum requested.	**• [Up to] XX% Default APR(s)** **• (creditor specific information for reduction or elimination of default APR)**
You break a rule on another account with us.	• [Up to] XX% Default APR(s) • (creditor specific information for reduction or elimination of default APR)
You break a rule on an account with another creditor.	**• [Up to] XX% Default APR(s)** **• (creditor specific information for reduction or elimination of default APR)**
You have negative information show up on your credit report.	• [Up to] XX% Default APR(s) • (creditor specific information for reduction or elimination of default APR)
Your transactions go over your credit limit.	**• [Up to] XX% Default APR(s)** **• (creditor specific information for reduction or elimination of default APR)**
Your check is returned – unpaid.	• [Up to] XX% Default APR(s) • (creditor specific information for reduction or elimination of default APR)
Your terms may change from time to time due to market conditions or other reasons.	**• Changes will be made in accordance with applicable law and the Card Agreement that will be sent with your card.**

ADDITIONAL INFORMATION ABOUT YOUR ACCOUNT

Your APR is a variable rate that changes monthly based on (Rate Index + XX.XX%).

Your payments and credits will be applied to balances with lower APRs before balances with higher APRs.

Please visit our website: www.creditcards.com or call us at 888.123.4567 for additional information.

This Standard Fact Sheet is used by all creditors. Please use it to make an informed decision.

Cover it covers any reasons that the rates or the provisions may change.

PREPARED STATEMENT OF LINDA SHERRY

EDITORIAL DIRECTOR, CONSUMER ACTION

MAY 17, 2005

Consumer Action (*www.consumer-action.org*), founded in 1971, is a San Francisco based nonprofit education and advocacy organization with offices in Los Angeles and Washington, DC. For more than two decades, Consumer Action has taken an annual in-depth look at credit card rates and charges to track trends in the industry and assist consumers in comparing cards. Our 2004 survey included 140 cards from 45 companies, including the top 10 issuers. We are currently conducting our 2005 survey and can share a few preliminary findings with you today.

Consumer Action also accepts complaints from consumers nationwide via phone, post and e-mail in English, Spanish, Cantonese, and Mandarin. For 9 years, complaints about unfair credit card practices have topped our list of all complaint categories. In 2004, 38 percent of the complaints we received were about credit cards.

For our annual credit card survey we call companies' toll-free numbers as consumers. This gives us insight into what people face when they shop for credit. The principal focus of our studies is the ability of consumers to obtain clear and complete facts about credit card rates and charges—before they apply for credit.

Our experience is that obtaining accurate information from credit card companies is frequently exasperating and difficult, and the answers are often lacking in key details about conditions, especially those relating to fees and other costs, and to the circumstances that trigger universal default rules. Representatives often are unable to provide even the basic facts required by the Credit Card Disclosure Act.

Hard to Find Terms and Conditions

There is no place for potential customers to find accurate information. Credit card companies have call center staff to serve existing customers and separate personnel to take applications from potential customers. Non-customers are blocked from calling customer service because you need an account number to get through. Application personnel cannot provide accurate information about terms and conditions. This leaves potential customers in danger of applying for a card that at best does not suit them and at worse, contains predatory terms and conditions.

High-Pressure Sales

Application lines are staffed by salespeople who attempt to pressure callers to apply for a card without providing substantive information. This means applicants often apply for cards with no concrete knowledge about the terms and conditions.

Outrageous Anticonsumer Practices

Penalty rates and universal default, often cited as a way for companies to manage risk, top the list of unfair practices.

- Penalty rates are much higher interest rates triggered when you pay your credit card bill late even one time.
- Universal default rate hikes are imposed by credit card companies based on the way customers handle other credit accounts.

What we find outrageous in both instances is that companies claim that they are merely using risk based pricing when they increase the interest rate. We challenge the industry to explain how taking out a new car loan or having a credit card payment arrive 1 day late makes a customer so much more risky that a doubling or tripling of the interest rate is justified. If this is really risk-based pricing, why do companies have a standardized default rate instead of one that reflects the actual added risk? There is no way that a credit card payment coming in one day late creates as much risk for a credit card company as foreclosure on a car loan.

Does it make any sense to increase the interest rate of customers who are having a hard time with their debt load? No. The real purpose of these policies is to maximize revenue at the expense of those who are least able to afford it.

Universal Default

An increasing number of issuers use universal default policies to hike interest rates based on the way customers handle other credit. Consumer Action's 2004 survey found that 44 percent of the surveyed banks use this information to identify so-called risky cardholders and raise their interest rates, even if they have never made a late payment.

Consumer Action found penalty rates as high as 29.99 percent in 2004, at a time when the prime rate was at 4 percent. Preliminary data from our 2005 survey shows penalty rates as high as 35 percent. Consumers who have contacted Consumer Action have reported being hit by default rates that were double and triple

their old rates. Credit card companies say they must protect themselves against risky customers, but do they have to resort to usury to do it?

In November, a Bastrop, TX woman complained to Consumer Action about a universal default rate hike: "AT&T Universal card just raised our interest rate from 12.9 percent to a whopping 28.74 percent because of a late payment they found listed in my husband's credit report to another credit card company (payments to AT&T have been on time). This will make it impossible for my husband and I to pay off this card with a $11,700 balance. Is this legal? AT&T says it is not up for discussion."

When you are turned down for credit, the law requires that you receive a letter explaining why. But if you are hit with a universal default hike, you do not learn about it until your next statement arrives. And even then, all you learn is your new higher rate. You are not told about the specifics that caused the hike.

Note: Thirty-nine examples of recent consumer complaints about universal default received by Consumer Action are attached to this testimony.

Penalty Rates

Late payments result in higher penalty rates with 85 percent of the issuers we surveyed in 2004. Consumer Action found average penalty rates of 22.91 percent–1.38 percentage points higher than the 2003 averages. Of these issuers, 31 percent said a penalty rate could be triggered by just one late payment.

In January, a Topeka, KS housepainter complained to Consumer Action that Chase had "raised our interest rate to 27.24 percent from 9 percent. They said we had two over 30-day past due payments in the last year. I asked them when and they gave me 2 months, one time we were 2 days late and the other 7 days late, but they said the due date starts from the time the statement is printed. I told them, How can that be, when we have not even received the bill? I told them we were going through hardships, with me being laid off and my wife and I going through a miscarriage. I cannot work outside the union or I would lose our health insurance. We have had a Chase card for 10 years and never had a problem before. Our payment due is $217 and the finance charge is $216.65. Needless to say, we cannot get anywhere with this debt."

Late Fees

In 1995 Consumer Action found an average late fee of $13, with no company charging more than $18. In 2004, the average was $27.45, with three major banks charging $39 late fees at certain balance levels. With average monthly minimum payments at 2 percent of the balance, the late fee on a $2,000 balance would be double the minimum payment. This is outrageously excessive.

An Indianapolis, IN woman who complained to us in February was assessed a late fee by MBNA even when she paid early. "I paid my credit card bill early, and as I paid before the 'closing date' it was not credited toward the 'payment due date,' and I incurred a late fee. Here's an example: Monthly cycle from 12/04/04–01/04/05; 'Closing date' = 01/04/05; 'Payment due date' = 01/28/05. Any payments made early, from 12/04/04–01/04/05 are not considered payments toward the 01/28/05 payment due date. Only payments from 01/05/05–01/28/05 are considered payments for the cycle of 12/04/04–01/04/05. Thus a 'late fee' can be assessed even if payment was made early."

In 2003, Consumer Action first noted tiered late fees tied to the balance amount. On a percentage basis, this penalizes people with smaller balances more than those with greater exposure. The number of issuers employing the practice jumped from 20 percent in 2003 to 48 percent in 2004. Tiered late fees are a deceptive way of charging higher-than-average late fees to cardholders with lower balances.

Due Dates

These days, most issuers require that your payment arrive before a certain hour on the due date or you will be charged to a late fee. Our 2004 survey found that 58 percent of surveyed banks had a cut-off time on the due date. If you are even 5 minutes past this cut off time, it can cost you up to $39 even thought your payment arrives on the actual due date.

A Massachusetts man contacted Consumer Action in January to complain about a rate hike: "My wife just called me to let me know that Bank One, one of the credit card companies we use, just raised our introductory rate of 0 percent to 10.24 percent. When my wife called to find out why, they told her that the last payment was posted 2 days late. The bill with the payment was mailed 7 days before the due date from Massachusetts to Delaware."

Even people who try to make timely payments will be hit with a late fee if their payment was delayed in the mail. We hear from many consumers who allowed 7 days to post a payment, yet still the bank assessed a late fee. Banks should consider

postmarks when posting payments. If the Internal Revenue Service can do it, why cannot credit card issuers?

Over Limit Fees

Contrary to what many people believe, a purchase that takes you over your credit limit will not necessarily be denied. Instead, you will be stuck with an over limit fee, which can be assessed every month until your balance is under the limit. The industry should either deny charges that go above the credit limit or not charge a fee. If they are going to accept charges over the credit limit they should be happy just with the added interest and be forbidden from adding on fees.

A Framingham, MA woman wrote this to Consumer Action last year: "I can understand a credit card company adding a late fee but what I have a serious problem with is when the late fee puts you over the limit and they then add on an over limit fee. This is a vicious cycle that is hard to stop. Once you have gone over the limit, unless you have enough money to get it down, what can a consumer do? The over limit fees keep adding up thus causing everything to go up, interest, etc. Is it really legal for them to charge you an over limit fee when their late fee actually put you over the limit? This really needs to be addressed."

Deceptive Interest Rates Quotes

The annual percentage rate (APR) is one of the most basic facts that must be disclosed in advance to credit card applicants under the Truth in Lending Act. But since 1999 Consumer Action has found that an increasing number of banks fail to quote a firm APR, and instead provide a meaningless range of rates. This practice defies Federal credit card disclosure provisions and prevents consumers from comparing cards. In 1999, only 14 percent of banks failed to quote a firm APR. By 2004, the percentage had more than tripled to 51 percent.

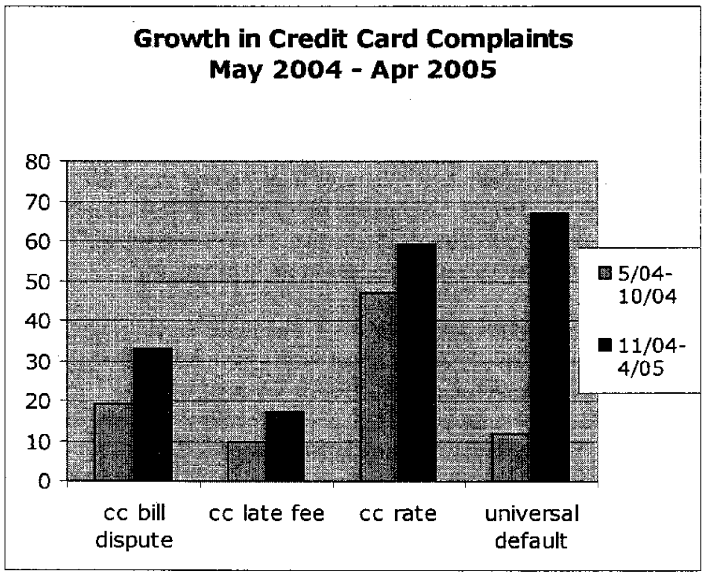
Cash Advances

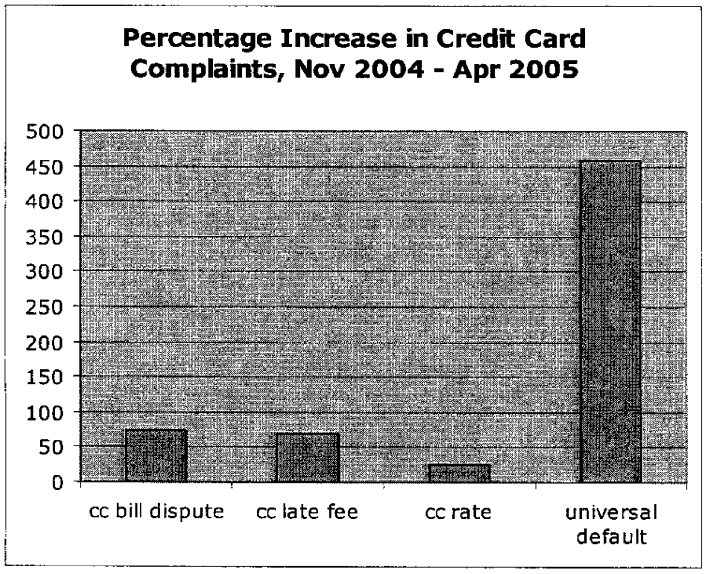
The charges for credit card cash advances have escalated dramatically in the last decade. In 1995, average charges were 2.2 percent of the amount advanced, with an average maximum limit on the fee of $17. By 2004, the average fee had jumped to 3 percent-a 36 percent increase, and the average maximum to $30.62, up 80 percent. More disturbingly, in 2004 only 17 percent of surveyed issuers limited consumers' costs by capping the fee.

This is a "follow the leader" industry. When one issuer steps out with a new anticonsumer practice, other banks are quick to follow. Having watched closely as these changes in credit card lending have transpired, Consumer Action concludes that the industry is in the process of fundamentally redefining its business model to shift the risk of lending from itself to unwitting customers.

I thank you for your diligence in investigating credit card industry practices and I urge you to support legislation to prevent credit card banks from preying on consumers.

ONE YEAR RETROSPECTIVE OF UNIVERSAL DEFAULT COMPLAINTS MADE TO CONSUMER ACTION





RESPONSE TO A WRITTEN QUESTION OF SENATOR SARBANES FROM LOUIS J. FREEH

Q.1. The following clause is contained in the credit card agreements of many issuers: "We reserve the right to change the terms at any time for any reason." It is my understanding that current law only requires that a cardholder receive the change in terms notice 15 days before her interest rate is increased and that most of the notices do not provide the specific reason for the increase. The notices also, in some instances, do not provide a toll-free number for consumers to call and speak to an individual, as opposed to receiving a recording, to find out why their rate has been adjusted.

Will your company commit to including a toll-free number on change-in-term notices so that consumers have a readily accessible number to call and be able to speak to an individual to determine why their interest rate has changed?

A.1. Since 1986, MBNA has provided our customers with a toll-free number available 24 hours a day that connects with live representatives who are available to answer questions regarding their accounts, including answering questions about changes in terms. To further improve this process, in 2003 MBNA created an additional toll-free number that connects customers to representatives specially trained to provide detailed answers about repricing and change in terms notices. MBNA is founded on the principle of exceptional customer service and we believe always having representatives available to customers when they have questions about their accounts is fundamental to that premise.

As I indicated in my testimony, MBNA does not practice "universal default" and customers are provided a "just say no" opportunity. In the latter instance, MBNA practices exceed that required by law.

Finally, the question from Senator Sarbanes raises the issue of the notices themselves. As I stated at the hearing, MBNA has long advocated for simpler, more easily understood notices. Specifically, I testified: "Turning for a moment to the topic of disclosure, let me first say that MBNA is committed to keeping its customers fully and fairly informed of every aspect of their accounts. However, we believe that the volume and types of disclosures mandated by Federal and State laws, regulations, guidelines, and practices, along with the complexity of the product, have not led to greater clarity. In fact, we think these measures have often led to greater confusion and frustration for the consumer. And while we favor better disclosure, we should consider that better disclosure may not mean more disclosure. Better disclosure may mean simpler descriptions of key terms and offering consumers a range of ways to get this information, including websites, toll-free phone numbers, and simplified documents.

At MBNA, we always provide advance notice of changes in APRs and we tell customers how to opt-out of these changes. Moreover, in response to the OCC's September 2004 Advisory Letter regarding credit card marketing practices, MBNA made a number of improvements in its marketing materials and agreements. Our goal was to highlight important terms and conditions relating to fees, rates, payment allocation, repricing, and how to opt-out of changes in terms. In addition, we recently provided comment to the Board

of Governors of the Federal Reserve System wherein we support the Board's decision to undertake a comprehensive review of the Federal Truth In Lending Act and Regulation Z. We believe this review is necessary because consumer credit markets and communications technology have changed significantly since the Act was last revised in 1980. We have further suggested that the Board be guided by four fundamental principles as it considers revisions to the Act.

First, disclosures must be simple. We know from talking to millions of customers every year that they are often confused and frustrated by the dense and lengthy regulatory language that issuers are required to use in disclosures. Ironically, the language intended to inform consumers more often overwhelms them. Much of this material ends up in the household trash. We believe it should be a priority for the Board to shorten and simplify disclosure language and to focus on the most relevant terms and conditions that consumers need to understand.

Second, disclosures must be clear. There are several consumer-tested models for presenting complex information in a clear and effective manner. We recommend that in addition to containing shorter, simplified language, disclosures should also be presented in ways that are understandable and meaningful. Lenders should have the option of using these consumer-friendly models as a "safe harbor" for disclosure.

In respect of the need to present information simply, clearly, and effectively, MBNA has begun voluntarily inserting its change-in-terms notices within what we call a "wrapper." The wrapper presents a top line summary of the changes in terms, along with hints to customers for managing their accounts. We also use the wrapper to remind customers of the things they can do to avoid fees, and we make suggestions on how to manage payments by mail, by phone, and by Internet. The wrapper is a step in the direction of clarity, and we are happy to have taken it.

Our third recommendation is that *disclosures should be based on uniform national standards.* The goal of greater simplicity and clarity will never be achieved as long as individual States can impose their own disclosure requirements. We do not believe that state-specific disclosures provide any significant benefits, but we know they add to the complexity of documents that customers tell us are already far too difficult.

And fourth, *disclosures should not be repetitive.* Key terms should not have to be disclosed in the account application and in the summary of terms disclosed later.

Our idea is that the Fed Box can be improved. Similar to the "nutritional facts" table on the side of all food products, issuers would disclose the key terms of the credit card agreement in a uniform way. The table could include a listing of the rates that apply to the different types of transactions, information on whether the rates are variable or nonvariable, fees, grace periods, default provisions, conditions for repricing, duration of promotional rates, and so on. The major improvement is that this information would be presented in a consistent, uniform manner. Consumers could compare product features and benefits, and more easily choose those

products that suit their needs, whether they want to revolve a balance or not.

In 2003, MBNA tested a "food label-style" privacy statement with a small segment of customers. More than 90 percent told us they preferred the simplified format. The study confirmed that transparency in disclosures is in MBNA's best interest, and of course the best interest of consumers. MBNA will work closely with the Board, and all the appropriate agencies, to contribute to the revision process and to implement the revised requirements."

RESPONSE TO A WRITTEN QUESTION OF SENATOR SARBANES FROM CARTER FRANKE

Q.1. The following clause is contained in the credit card agreements of many issuers: "We reserve the right to change the terms at any time for any reason." It is my understanding that current law only requires that a card holder receives the change in terms notice 15 days before her interest rates is increased and that most of the notices do not provide the specific reason for the increase. The notices also, in some instances, do not provide a toll-free number for consumers to call and speak to an individual, as opposed to receiving a recording, to find out why their rate has been adjusted.

Will your company commit to including a toll-free number on change-in-term notices so that consumers have a readily accessible number to call and be able to speak to an individual to determine why their interest rate has changed?

A.1. Currently, when we send a notice to a customer changing their APR, we generally provide a phone number on that notice that will allow the customer to call and speak to a representative regarding the reason(s) the customer's account was repriced.

In some instances, due to the operational complexity of managing our various partner relationships and their requirements for dedicated toll-free phone numbers for their members, we will occasionally refer the customer to call the number on the back of the card or on their statement.