CREDIT CARD PRACTICES: CURRENT CONSUMER AND REGULATORY ISSUES

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

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CREDIT CARD PRACTICES: CURRENT CONSUMER AND REGULATORY ISSUES

Thursday, April 26, 2007

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2128 Rayburn House Office Building, Hon. Carolyn B. Maloney [chairwoman of the subcommittee] presiding.

Present: Representatives Maloney, Watt, Ackerman, McCarthy, Baca, Green, Clay, Cleaver, Hodes, Ellison, Klein, Perlmutter; Gillmor, Castle, and Hensarling.

Also present: Representative Bachus, ex officio

Chairwoman MALONEY. This hearing will come to order. The topic of today's hearing is "Credit Card Practices: Current Consumer and Regulatory Issues." First, I would like to thank all of the witnesses for coming today and for the testimony they have prepared. And I would like to thank the members on this committee who have an interest in this subject, many of whom have introduced legislation pertaining to different aspects of it. This is the first in a series of hearings on credit card practices. At our second hearing, to be held the first week in June, we plan to have the Federal and State regulators discuss the anticipated revision to the regulations governing disclosure for credit cards by the Federal Reserve. The Federal Reserve have informed me that they expect to be issuing this in late May, and we also expect to have a panel of consumers and industry representatives to comment on the Fed's action.

Credit cards may represent the single most successful financial product introduced to our country in the last 50 years. Their benefits are manifest, giving consumers unprecedented convenience and flexibility in both making purchases and in managing their personal finances. Consumer spending, facilitated in large part by the ease of payments afforded by credit cards, accounts for nearly two-thirds of the annual U.S. economic activity. And even more dramatically, one can argue that the broad availability of credit cards, coupled with advances in technology, has helped to create and support and expand an online retail industry that is projected to reach $129 billion in sales this year according to a recent Business Week article. All told, 145 million people in America, about half the population, own credit cards. In short, credit cards, like many other tools in our society, have changed from a luxury item available to the few, to a necessity demanded and needed by the many.

But with that great success, with that widespread growth, with that necessity, comes great responsibility. The credit card industry has been clear about the responsibility imposed on consumers: the responsibility to become financially literate; the responsibility to spend only in accordance with your means; and the responsibility to pay your bills on time. But this spectacular growth in the credit cards industry does not seem to have created the same sense of responsibility in the 10 credit card issuers that control 90 percent of the market, much less the other 6,000-plus U.S. credit card issuers. It is true that competition among issuers has created initial consumer choice and can reward the diligent consumer with lower interest rates and no annual fee. But the industry has also acted to implement practices that quickly became industry standards, such as double cycle billing, universal default, no notice interest rate hikes, outside fees as much as $39 for a late payment, that brings us to our hearing today. For example, a recent article in Electronic Payments International reported that credit card issuers were expected to rake in a record $17.1 billion in credit card penalty fees in 2006, a rise of 15.5 percent from 2004, and a tenfold increase from 1996 when credit card issuers raised $1.7 billion in revenues from fees.

Did American consumers become 10 times less responsible in 2006 than in 1996? Or did the industry make a concerted and deliberate effort to squeeze even more revenue out of consumers by increasing fees and creating pitfalls in violations of the card agreement that allowed the issuer to penalize even the most responsible consumers?

Credit card issuers hold an enormous amount of power. Enshrined in the card member agreement, just listen to this section from an April 2007 card agreement of a major card issuer that was sent to my office, and I quote from the card agreement: “We may suspend or cancel your account, any feature or any component of your account at our sole discretion at any time with or without cause whether or not your account is in default and without giving you notice subject to applicable law.” From terms like that, it is not hard to see how fee income went up tenfold in the past 10 years.

I have always believed that responsible access to credit is critical to our economy and that access to appropriate credit should be as broad as possible, consistent with the safety and soundness of the financial system. Similarly, I approach credit card regulation from the point of view that we should both protect consumers and keep responsibly issued credit available in as many of our communities as possible. I am generally in favor of market-based solutions whenever possible, but in this case I am not convinced that the industry is going to make the changes that are necessary. I do want to credit some major issuers who have taken steps to move toward better practices: CitiBank has announced that it will eliminate any time for any reason re-pricing and universal default; and Chase has said that it will no longer use double cycle billing, but rather average daily balance. But I do not see the development of best practices that industry holds itself to across the board. For example, in the wake of the key GAO report last September finding that the increased complexity in rates and fees requires better disclosure, even industry agrees that changes to credit card disclosures are desperately needed because no one can understand their statement. Yet industry has not taken comprehensive action on this point. And if the industry fails to make meaningful changes, if the major issuers continue to lead the way in a race to the bottom rather than in a race to improvement, it is my belief that we will see bipartisan legislation coming forward to fix the problems that industry proved itself incapable or unwilling to fix on their own.

I look forward to the testimony, and I would now like to recognize the ranking member, Mr. Gillmor. He has 15 minutes, and we have 15 minutes over here, so we will go back and forth.

Mr. GILLMOR. I want to thank the Chair for calling this hearing, and for yielding. I think this morning's hearing is going to be a very important information-gathering session. At this point, we do not know whether legislation is going to come out of this or if it does, exactly what form it will take. But I do think it is important that whatever we do in this respect, we work together on it, and try to get bipartisan support on both sides of the aisle. I think that is going to be important not only for the committee, but also for the consumer and the industry; I think that is going to be one of our mutual goals.

Americans have access to some of the best financial services in the world and a critical part of those services is the credit card. Consumers are becoming increasingly reliant on electronic forms of payment and with the prevalence of the credit card comes some serious policy discussion. The credit card industry has expanded rapidly over the past decade and there are 600,000,000 cards in use today. My wife has a large part of those.

[Laughter]

Mr. GILLMOR. The popularity of the credit card has allowed for an evolution of credit card policies and fees. There are literally thousands of products offered by credit card issuers with all different fees, rates, and features. With market competition and innovation, credit card issuers seem to be willing to adjust their products when the consumer dictates a change is necessary.

Earlier this year, some of the biggest credit card companies voluntarily eliminated some of their controversial policies such as universal default and double cycle billing, and I would expect that trend to continue as the consumer with a bad deal can shop around with ease. Due to the nature of credit cards, fees are a major component of how an issuer is able to recoup the dangers of extended credit with no collateral. It is fair for banks to constantly evaluate how best to charge for the risks associated with particular elements of borrowers. But what is not acceptable or fair is for the issuers to hide fees, policies, or practices from their customers. Disclosure is the answer and that is why earlier this year, Ranking Member Bachus and I sent a letter to Federal Reserve Chairman Bernanke requesting a prompt review of Regulation Z. If consumers are aware of how their payments or lack thereof will affect their fees and interest rate, the choice is theirs to make.

So I look forward to working with Chairwoman Maloney and my colleagues on both sides of the aisle to address the policy issues in consumer credit, and I yield back.

Chairwoman MALONEY. The Chair recognizes my good friend and colleague from New York, Gary Ackerman, who has worked long and hard on this issue, for 3 minutes, and he has introduced a bill on a common fee, which has been called the pay-to-pay fee, where consumers are charged $5 to $15 because they have paid their credit card bill over the phone. I congratulate him for his interest and work on this bill. Gary Ackerman for 3 minutes.

Mr. ACKERMAN. Thank you, Madam Chairwoman. I just hope that the transcriber puts the comma in the right place indicating that I have worked hard on this bill, and recognizing me for 3 minutes, rather than that I worked hard on the bill for 3 minutes.

[Laughter]

Mr. ACKERMAN. Thank you, Madam Chairwoman, for scheduling the hearing. As you know, over the past 10 years, credit card companies have steadily increased financial burdens on American consumers, which in itself could be bad enough, but in addition, credit card agreements have become increasingly more complex with teaser rates, universal default, double cycle billing, transfer fees, membership fees, finance fees, over-limit fees, cash advance fees, stop-payment order fees, and the list goes on. Credit card companies have absolutely failed to disclose in an honest, straightforward manner the real terms of their product to American consumers.

In a particularly gluttonous practice, some credit card companies, having induced customers to pay their bills online, are now charging fees for their customers to pay bills online or by phone. It is not just simply for an express payment that posts the same day, but a fee simply to pay their bill. It is like having to pay a fee in order to pay for your groceries at the check-out counter. Since both online and phone method payments would provide the customer the ability to quickly make their payments and check to ensure the payment will post before the due date, a fee to use these payment options is aimed at encouraging credit card customers to pay their bills by mail. Naturally, some customers—maybe they are on vacation, maybe their statement got lost in the mail—will make their payments too late and have to pay a late fee. One late payment, of course, could result in your being tossed into the not-so-tender trap of paying a significantly increased rate.

In what is perhaps one of the most insidious schemes of all, some credit card companies are now sending their monthly statements out late in the month, giving their customers much less time to make their payments without risking a late fee, causing them to pay online or by phone only to discover they are being charged a fee to pay by phone or online. It is heads, I win; tails, you lose. A customer who is on vacation, do not worry, he didn't leave home without his American Express Card, stands no chance of paying his credit card bill without being assessed a late fee to pay online or by phone. It would be the equivalent of the Federal Government mandating that taxes be paid by April 15th but not allowing W–2 statements to be mailed out until April 6th. You would not receive your W–2 in the mail until maybe April 10th. And when you show up at the post office before April 15th, you are told that there is a $15 charge to pay by mail. Because of this outrageous predatory tactic, I have introduced, as the Chair mentioned, along with her co-sponsorship, legislation that would prohibit credit card companies from charging a fee to their customers explicitly for paying online or by phone. H.R. 873, the Credit Card Payment Fee Act, would not deal with express payments or any other of the various schemes that credit card companies have undertaken to swindle the American public, but would simply protect credit card customers from being entrapped in the vice of their Visa.

There are of course many other practices within the credit card industry that require reform. I would echo the conclusion of a September 2006 Government Accountability Office report that called for revised disclosures more clearly emphasizing the terms of a credit card agreement that affect cardholder costs, especially those actions that will cause a default or result in penalty phases.

I look forward to hearing from our witnesses this morning. I am kind of upset that the credit card companies themselves have provided no witnesses today. I hope that they are not going to squeal too much like stuffed pigs if the legislation is going to affect them and then claim that they had no input into the system. I thank the witnesses who are here today. I thank the Chair and look forward to hearing from our panel.

Chairwoman MALONEY. Thank you. Congressman Bachus, for 5 minutes.

Mr. BACHUS. Good morning. Thank you, Congresswoman Maloney, for holding this hearing and, Mr. Gillmor, for your interest in this. I think it is important for the committee to gain a better understanding of the current practice of pricing, billing, and disclosure practices of the credit card industry and the impact those practices are having on consumers. According to the GAO, Americans now hold 690 million credit cards, and between 1980 and 2005, the amount that Americans charged to their credit cards grew from an estimated $69 billion per year to more than $1.8 trillion. Not only have credit cards broadened the availability of consumer credit, allowing more Americans access to credit they deserve, they also provide consumers with a safe and effective tool for making purchases. Credit cards are very important to our national economy and have played a key role in the development of Internet commerce. Recently, however, concerns have been expressed over a number of credit card practices, including double billing cycles, universal default, late payment fees, over the limit fees, and shortening of grace periods. While I am pleased that some of the large credit card issuing financial institutions have been proactive in addressing these concerns, it is still important that we fully examine these issues to ensure adequate protection of the American consumer.

I am particularly concerned about the 55 percent of college students who acquire their first credit card during their first year of college, and the 92 percent of college students who acquire at least one credit card by their second year of college. A combination of aggressive and targeted marketing by many credit card issuers and the lack of financial literacy and immaturity often ends badly for college students. The experience of my colleagues may be different but a substantial percentage of the complaints I receive from constituents involves the parents of these students. And I might say that I could join my other constituents in having legitimate complaints on what I have witnessed in dealing with one or two of my five children. And I can say without a doubt that the treatment of them by the credit card companies was not fair and equitable.

Credit card disclosures are governed by the Truth in Lending Act and Regulation Z administered by the Federal Reserve Board. In December 2004, the Federal Reserve began a review of Regulation Z requirements concerning the format of open-end credit disclosures and the content of such disclosures and the substantive protections provided to consumers. It is now April 2007 and the Federal Reserve has yet to issue any proposed revisions to Regulation Z. Until the Federal Reserve completes its process, it will be difficult to assess whether additional measures will be needed going forward. Earlier this year, in an effort to accelerate this process, Mr. Gillmor and I wrote to Federal Reserve Chairman Bernanke urging the completion of his Regulation Z review, as Mr. Gillmor mentioned. In my view, the failure of credit card disclosure requirements to keep pace with market developments has resulted in some consumers not adequately understanding their credit card accounts. It is my belief that consumers must be well informed about credit card offerings in order to choose a credit card that is best suited to their individual needs. I look forward to hearing from today's panel on current credit card industry practices and the state of the Federal credit card disclosure framework.

Chairwoman MALONEY. The Chair recognizes Congressman Cleaver, my friend from Missouri. He has introduced legislation and has worked hard on this issue, and I recognize him for 3 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman. The reality now is that there is such a thing as death by plastic and it is becoming more and more apparent. I want to express appreciation for you holding this hearing with Ranking Member Gillmor. Recently, the Federal Reserve reported that inflation adjusted household debt grew by over 26 percent from late 2001 to 2004, while income remained flat, and that American families carried credit card balances that rose nearly 16 percent or around an average of $5,100. And many of these hard-working people are now experiencing a debt crisis while being subjected to onerous credit card terms that help to perpetuate this debt crisis. Under your leadership, Madam Chairwoman, the subcommittee has an opportunity to address a portion of this crisis and to impact credit card companies all over this country. I introduced, along with my friend and colleague, Congressman Mark Udall, a bill that we believe will be a part of the solution to the current debt crisis. The proposal seeks to protect consumers from banks and other credit card issuers who unbelievably and unjustly can increase interest rates without notice. And talking about an injustice, this is an injustice. H.R. 1461, the Credit Card Accountability Responsibility and Disclosure Act of 2007 would end credit card practices such as universal default where credit card issuers impose a higher interest rate on a credit card account if there has been any change in the credit holder's credit history, even if the change is completely unrelated to the credit card account, such as being late on a utility bill. There are some other changes, Madam Chairwoman, but trying to keep under my 3-minute limit, the bill requires that credit card holders be given clear notice of any fees or changes or charges in interest rates that would result from late payments. And finally, under H.R. 1461, minors who apply for a credit card would need one of the three things: the signature of a parent or guardian willing to take responsibility for the applicant's debt; information indicating that the applicant has some other means of repaying the debt; or a certification that the applicant has completed a credit counseling course by a qualified nonprofit budget or credit counseling agency. I perform weddings, Madam Chairwoman, and I have recently suggested to couples who come to me after college wanting to get married that we change the ceremony to say, "Until debt do us part." Thank you, Madam Chairwoman.

Chairwoman MALONEY. Congressman Castle, for 3 minutes.

Mr. CASTLE. Thank you, Chairwoman Maloney, and Ranking Member Gillmor, for holding this hearing before the Financial Institutions and Consumer Credit Subcommittee today. Credit cards have become a staple in today's marketplace. They provide enormous convenience, efficiency, and other benefits to consumers, businesses, and local and national economies. Credit cards have generated more than $2.5 trillion in transactions a year in the United States. Clearly, they have become an indispensable tool of America's consumer economy.

Today, consumers have a choice, as we have heard earlier, between 6,000 credit card lenders. Although some consumers view the large number of credit options to be daunting, the strong national credit system in the United States has been a driving force that has helped sustain our economy in recent years. Educating consumers and enabling individuals to understand their credit terms is an important task. The review by this subcommittee today will help us to better understand how consumers in the financial services industry can have a more symbiotic relationship.

Certain industry practices related to credit card fees, penalties, and interest rates have received a considerable amount of media attention lately. It is important to note that in response to increasing concerns, several credit card issuers, such as CitiGroup and Chase Card Services, have taken significant steps to improve their practices and ensure that their customers have a better understanding of their accounts. Therefore, Madam Chairwoman, after we hear from consumer organizations, institutions, and university professors, I do hope we will take the time to hear from industry regulators so that we can keep the scope of these issues in some context, and you did mention in your opening statement that we would hear from them in the first week of June.

Madam Chairwoman, I thank you for holding this hearing today, and I look forward to hearing from each of our witnesses today. I yield back.

Chairwoman MALONEY. Thank you. I really want to recognize the keen interest of the members of the panel in this issue and recognize Congressman Baca for 2 minutes.

Mr. BACA. Thank you, Madam Chairwoman. First of all, I would like to thank you for holding this important hearing here this morning. As Chair of the Congressional Spending Caucus, I am concerned about the barriers Latino families continue to face in access to affordable credit. Latinos are the fastest growing and largest minority in the country with 45 million people, 17 percent of the total population, yet they tend to have less personal savings, and fewer assets than other American families. Many low-income Latino families have an unhealthy reliance on credit cards, which can expose them to predators within the financial market. We need to have a better understanding of the Latino experience so that we can help them avoid accumulating high levels of uninsured debt and move them into the American middle class. The National Council of La Raza has written and issued a brief which examines how credit card industry practices impact Hispanic access to affordable credit. It also provides policy recommendations for empowering and protecting the Hispanic consumers. I would like to ask unanimous consent to insert this brief into today's record.

Chairwoman MALONEY. Without objection, it will be placed in the record. Thank you.

Mr. BACA. And I appreciate Congressman Bachus talking about targeting and marketing students on the credit cards. I am very concerned about the impact it has had not on a lot of our college kids, but also on a lot of our high school kids. Not only do we need to well educate our consumers, but we also need to educate the parents, because the parents are unaware that the kids are applying for the credit cards. And when the TRW report comes out, they find out that they cannot get credit because they had a credit card debt during that period of time. We need to address that; in fact, I am having a conference on May 12th to address that.

With that, Madam Chairwoman, I look forward to hearing the witnesses today, and I appreciate your having this hearing. I yield back the balance of my time.

Chairwoman MALONEY. Thank you. Congressman Hensarling is recognized for 2 minutes.

Mr. HENSARLING. Thank you, Madam Chairwoman. I approach this hearing as I approach most hearings with the adage running through my mind, "First, do no harm." My guess is a couple of decades ago people might have been gathering in a similar hearing wondering why low-income people or people of color were not granted credit and now we have a multiplicity of options for credit for people who have never enjoyed it before. We may not always like the terms, but credit is available in our society like it has never been available before, which for many families is a very good thing. It allows them maybe to pay for their groceries, and to buy school clothes, where they otherwise might not have been able to do it. I think there is a valid question about whether there is effective disclosure; consumers do have a right to know what they are getting into. I am curious at some point whether Congress has proven to be part of the problem or part of the solution. Because there is so much disclosure, I think that occasionally perhaps less would be more, and I think that it is good that this committee will look into this particular issue.

I also am reminded, at least according to my reading of the Constitution, that nobody has a constitutional right to borrow money from somebody else. If you do not like the terms, you have the right to walk away. I myself have done that on a couple of occasions when I did not like the terms or I did not like the service or I got tired of speaking to the computerized voice on the other end of the 1–800 line. So I always want to make sure consumers have those options. We know there are at least 10 major players in this market and at least 6,000 different companies that are making some type of offer to consumers today. There appears to be effective competition, so the question in my mind is, is there effective disclosure?

And so, Madam Chairwoman, I appreciate your holding this hearing, and I look forward to hearing more about this. But I am concerned that the wrong prescription could lead to a lessening of the availability of credit at the margins or perhaps making that credit more expensive. Thank you and I yield back.

Chairwoman MALONEY. Thank you. Congressman Watt for 2 minutes, and thank him for his leadership and hard work on this issue.

Mr. WATT. Thank you, Madam Chairwoman. I thank the Chair for holding this hearing, which for my purposes is very similar to, and equally as important as, the hearing that the Chair convened on exploding foreclosures and mortgage lending because in both areas there are very, very serious problems and probably a need for some legislative action. The only way we can determine what legislative action is needed and desirable is to get into the legislative record the facts about what is happening. There is the perception and I believe the fact that there are real problems in the credit card area resulting from teaser rates, increases in rates without appropriate notice, exorbitant late payment fees, fees for paying online, a major issue is interchange fees, which I think is the hidden charges that really nobody has focused on yet but I hope we will get some testimony about in this and subsequent hearings, and the general availability of easy credit. Mr. Hensarling is right, there was a time when there was no credit available. It may in fact be too easy now both in this area and in the mortgage area. And part of that is that in this area there is no real definition of what Mr. Bachus referred to as fair and equitable. So unless the industry itself will set some standards that are acceptable and deemed as reasonable to the public, it may be incumbent on us to really more aggressively define what that last little phrase in the disclosure notice or contract said when they finally got to the end after saying we can do all these things subject to law. Right now, the law is murky in a number of these areas and if the industry cannot define what is appropriate, then I think it may be necessary for us to do it in the legislative process. But we need the background, and today's hearing, and I hope subsequent hearings where we will hear from the regulators and the industry itself and other players, will lead to finding the appropriate legislative steps to take. I yield back and I again thank the chairwoman for convening the hearing.

Chairwoman MALONEY. Thank you. Without objection, all members' opening statements will be made part of the record.

We have a distinguished panel of witnesses who include both consumer and industry representatives as well as academics, and I will not attempt to give you a full biography of each but just a few highlights.

Linda Sherry, Consumer Action's director of national priorities, joined the San Francisco-based National Consumer Education and Advocacy Group in 1994, from a background as a weekly newspaper reporter in Long Island from my State, New York, and in

California. Sherry, who moved to Washington, D.C., in August of 2004 to establish an office for Consumer Action, is responsible for the organization's national advocacy work and for the research and writing of Consumer Action's free educational publication and Web site content.

Mr. Arthur E. Wilmarth, Jr. is a professor of law at George Washington University Law School. Professor Wilmarth has written extensively about banking regulation, including the role of the Federal and State governments in regulating credit cards.

Mr. Todd J. Zywicki is a professor of law at George Mason University Law School. He served as Director of the Office of Policy for the Federal Trade Commission from 2003 to 2004. More recently, he has written and testified on consumer credit issues.

Mr. Edward L. Yingling is president and CEO of the American Bankers Association, and is testifying on behalf of the Association.

Mr. Oliver I. Ireland, formerly Associate General Counsel of the Federal Reserve Board, is now at the law firm of Morrison and Foerster, where his practice includes representing credit card networks.

Cindy Zeldin is the Federal affairs coordinator in the economic opportunity programs at Demos, a public policy research and advocacy organization that has conducted extensive research on household debt. Most recently, Ms. Zeldin co-authored the Demos Report, "Borrowing to Stay Healthy", which examined medical debt that accrues on credit cards. I thank all of the witnesses for coming, and I would like to recognize Ms. Zeldin first, and then left to right. Ms. Zeldin?

STATEMENT OF CINDY ZELDIN, FEDERAL AFFAIRS COORDINATOR, ECONOMIC OPPORTUNITY PROGRAMS, DEMOS: A NETWORK FOR IDEAS & ACTION

Ms. ZELDIN. Chairwoman Maloney, Ranking Member Gillmor, and members of the subcommittee, thank you for inviting me to testify today. I am here representing Demos, a nonprofit, nonpartisan research and public policy organization working on issues related to economic security. We approach our work on credit card debt and lending industry practices through the lens of rising insecurity among low- and middle-income households in a rapidly changing economy. Against an economic backdrop simultaneously characterized by stagnant incomes at the median and the rapidly rising costs of big ticket necessities like housing, health care, and education, our Nation has witnessed tremendous growth in credit card debt over the past 2 decades.

At the same time as our economy has undergone major changes, the banking and financial industry has been steadily de-regulated. While deregulation has expanded access to credit for many people who had been denied or excluded from mainstream financial services in the past, this credit has come at a high cost. It is low- and moderate-income households whose levels of credit card debt have increased the most in recent years and our research indicates that these households are increasingly turning to credit cards to manage economic shocks like job loss or a major medical expense or to fill in the gap between the cost of basic living expenses and stagnant incomes.

The democratization of credit has in many ways become our modern day safety net, albeit one that comes with high interest rates and an endless array of penalty fees that are unleashed upon borrowers in response to just the slightest slip-up. With debt service taking a bigger bite of the household budget, there is less left over to build savings and assets, quickly trapping families in a cycle of debt. Once in debt, the capricious and abusive practices of the lending industry make it exceedingly difficult to climb out.

Credit card debt has roughly tripled since 1989, with Americans owing more than $800 billion in credit card debt today. Our national savings rate has steadily declined and the number of people filing for bankruptcy since 1990 has more than doubled to just over 2 million in 2005. The average amount of credit card debt among all households with credit card debt grew 89 percent between 1989 and 2004. In particular, low- and moderate-income households, senior citizens, and young adults under age 34 have seen rapid increases in credit card debt.

To better understand the factors contributing to household indebtedness, Demos and the Center for Responsible Lending commissioned a national household survey of households with credit card debt in 2005; 7 out of 10 low- and middle-income households reported using their credit cards as a safety net, relying on credit cards to pay for car repairs, basic living expenses, medical expenses, or home repairs. The widespread availability of revolving credit can indeed help individuals and families weather difficult financial times or manage large unexpected costs, like a major medical expense or car or home repair, by spreading payments over time and providing less disruption to the family budget. However, all too often, the practices of the credit card industry turn this beneficial credit into a debt trap.

The credit card market is a broken market. When consumers initially shop for a credit card, the key element of their comparison shopping is generally the interest rate on the card, yet the card issuer reserves the right to change the terms of the card agreement at any time for any reason with a 15-day notice, making competition illusory. A consumer can diligently shop for the best terms and conditions out there but then have these terms and conditions unilaterally changed on them.

The first practice I would like to address is penalty pricing or interest rate hikes and fees for an array of infractions, many of which are quite minor and are not necessarily reflective of a cardholder's risk profile. When a payment is late, major card issuers typically increase the interest rate on the card to a penalty or default rate. Due dates are often listed down to the hour and payments received after that time are processed the following day. With payment grace periods generally no longer in place, cardholders who submit payments that are nominally late are routinely hit with interest rate increases that can drastically increase the cost of credit. It is also important to note that these penalty interest rates are applied retroactively to the entire existing card balance, not simply prospectively to future purchases. Cardholders who are late are also slapped with a late fee. Late fees have steadily increased from the $5 to $10 range in 1990 to an average of about $34 in 2005. Penalty pricing is also typically invoked when a cardholder exceeds the credit limit on their card. Rather than denying the purchase, it is now routine practice to allow the transaction to go through but to apply an over-the-limit fee and then increase the cardholder's interest rate; over-the-limit fees averaged about $31 in 2005.

The second practice I would like to highlight is universal default, a bait and switch practice whereby card issuers retroactively change a cardholder's interest rate not because of any change in behavior with that particular card, but because of a change in the cardholder's credit score or their payment behavior with another lender. While some card issuers have halted this policy, others still engage in it, and still others increase interest rates because of behavior with other credit rates that institute these increases through a change in terms rather than automatically. Other practices, double cycle billing and payment allocation—

Chairwoman MALONEY. The Chair grants the witness an additional 30 seconds.

Ms. ZELDIN. In absence of meaningful regulation, credit card companies are free to design credit card agreements that are not only confusing in their complexity but that once deciphered are fundamentally unfair. Despite borrowing money under one set of terms and conditions, a borrower can be asked to pay back that money under an entirely different set of conditions for being a day or two late or for going just over their credit limit even if they are attempting to pay back their debt in good faith. Once in penalty territory, households are typically paying interest rates of 27 percent. For low- and middle-income households, whose levels of credit card have increased the most in recent years, these penalty interest rates drain resources from already tight family budgets, inhibiting the ability of these households to pay down their debt, let alone save money to weather future economic shocks.

Thank you.

[The prepared statement of Ms. Zeldin can be found on page 106 of the appendix.]

Chairwoman MALONEY. Without objection, all of the written statements will be made part of the record, and you will each be recognized for 5 minutes, so a summary of your testimony for 5 minutes is requested. Mr. Wilmarth? Thank you.

STATEMENT OF ARTHUR E. WILMARTH, JR., PROFESSOR OF LAW, GEORGE WASHINGTON UNIVERSITY LAW SCHOOL

Mr. WILMARTH. Chairwoman Maloney, Ranking Member Gillmor, and members of the committee, thank you for inviting me to participate in this important hearing.

Chairwoman MALONEY. Turn on your mike, we cannot hear you.

Mr. WILMARTH. Pardon me. Chairwoman Maloney, Ranking Member Gillmor, and members of the committee, thank you for inviting me to participate in this important hearing. The credit card industry has experienced a very rapid and dramatic consolidation over the past 2 decades. During that time, the share of the top 10 issuers has risen from 40 percent to 87 percent. The share of the top five issuers has grown from 35 percent to 71 percent. There are many technological factors that have contributed to this consolidation. Those factors have created large economies of scale and barriers to entry. The largest federally-charted banks dominate the credit card industry. Four of the five top credit card issuers and 7 of the top 10 issuers are national banks. An eighth issuer among the top 10 is a federally-charted thrift. Only two are non-banks, American Express and Discover, both of which have a longstanding presence in the industry. As I will mention, Federal preemption helps to explain why so many of the largest issuers are federally-charted depository institutions and why they are also dominant players in other segments of the consumer credit industry. For example, seven of the top home mortgage lenders are either nationally-chartered banks or federally-chartered thrifts.

You have already heard a lot today about fees and profits. As my statement points out, the profitability of credit card banks has remained well above that of all other banks over the past 15, if not 25, years. And these unusually high profits certainly raise questions as to the competitive features of the credit card industry. Average annual non-penalty interest rates of credit card issuers have remained above 13 percent in every year between 1994 and 2005 except for 2003, when the average rate was 12.92 percent. This is at a time when we have had historically low interest rates. Of course, as you have heard, penalty interest rates have been far higher and now are in the range above 24 or 25 percent. You have also heard about how credit cards have contributed to the rapidly growing debt burdens of U.S. households.

What I want to focus on in the remainder of my time is the impact of Federal preemption. In 1978, the U.S. Supreme Court gave national banks most favored lender status and the right to export interest rates across State lines. In 1996, the Supreme Court upheld a regulation of the OCC, which defined interest to include a wide variety of fees, such as annual fees, over-the-limit fees, late payment fees, bad check fees, and cash advance fees, so those fees could also be exported across State lines. In 1998, the OCC issued a ruling which allowed national banks to export interest rates from any State in which they have either their main office or branch. In 2004, the OCC went much further; it adopted a sweeping set of preemption rules which, to put it bluntly, essentially preempts all State consumer protection laws from applying to the practices and activities of national banks. And just recently, the GAO recommended that the OCC make clear what State laws were preempted or were not preempted. The OCC has not issued any such list. So far the OCC has acknowledged only that State fair lending laws might apply to national banks but they have given no such indication for other types of State consumer protection laws. The OCC also issued a regulation in 2004, which gave them the sole and exclusive right to enforce all applicable laws, including any State laws that might be applicable to national banks so that States have no enforcement rule under the OCC's rules.

The OCC's rules have spurred many large, multi-state banks to convert to national charter including J.P. Morgan Chase, HSBC, and Bank of Montreal. As a result, the share of national banking assets has risen from 56 to 67 percent and the share of State assets has fallen to 33 percent. Just last year, the Bank of New York, one of the largest state-chartered banks, decided to sell all of its retail branches to J.P. Morgan Chase, again thereby indicating the powerful impact of Federal preemption. In September 2005, Chairman

Don Powell indicated that unless Congress acted, the dual banking system was severely threatened.

I point out in my testimony that the OCC has had a very unimpressive record of enforcing consumer protection laws against national banks. A careful search of their Web site and other public records indicate only 13 public enforcement orders against national banks since January 1, 1995; 11 of those 13 were against small national banks, only two were against large national banks, and in each case another agency acted first. In one case, a State prosecutor in California, in another case, the Department of HUD. So my bottom line is that the OCC cannot be relied upon to be a vigorous consumer protection authority for the national banking system, which dominates the credit card industry.

Thank you very much.

[The prepared statement of Professor Wilmarth can be found on page 64 of the appendix.]

Mr. WATT. [presiding] Mr. Yingling is recognized.

STATEMENT OF EDWARD L. YINGLING, PRESIDENT AND CEO, AMERICAN BANKERS ASSOCIATION

Mr. YINGLING. Thank you Chairwoman Maloney, Ranking Member Gillmor, and members of the subcommittee, for inviting me to testify this morning. I would like to take a few minutes at the outset to discuss just what a remarkable product the credit card is. For example, we take it for granted, but the processing system for cards handles more than 10,000 transactions every second with nearly enough communication lines to encircle the globe 400 times. As the recent GAO report pointed out, the credit card industry is highly competitive and highly innovative. It has changed greatly since it began 56 years ago. First, up until around 1990, almost all cards had an annual fee of $20 to $50. Today, most cards charge no annual fee. In fact, many cards have rewards features such as rebates, points, or mileage. Thus for many consumers, most of the millions who do not revolve, the card is free or they actually earn something when they use it. Second, for those who do take out a loan, interest rates, according to the GAO, have declined by 6 percentage points since 1990. Before, almost everyone paid 18 to 20 percent. For the 28 popular cards the GAO studied, the average rate in 2005 was 12.3 percent. Third, and most importantly, more low- and moderate-income people have been able to obtain credit cards.

While we recognize there are concerns about debt levels, it is important to note that, according to the Fed, in the last 10 years, credit card balances have declined from 3.9 percent to only 3 percent of household debt. I think most people would be amazed that credit card debt is only 3 percent of total household debt.

Credit cards are also very important to small businesses, a fact often overlooked. Without them, small businesses would be at a huge disadvantage to larger businesses, which could afford their own in-house credit programs. Moreover, without cards, commerce over the Internet, which means tremendous savings for consumers, would be extremely difficult.

However, as the GAO report laid out, as credit cards have evolved, the competition that resulted in no annual fees, lower interest rates, rewards programs, greater convenience, and more availability to more consumers has also led to greater complexity. It is this complexity which is understandably raising concerns and needs to be addressed. One important issue is that the disclosures have not kept up. The ABA and card companies strongly support and are working for better, clearer disclosures. We are optimistic that the Fed will soon develop better disclosures, and we are glad to hear that they are moving quickly, Madam Chairwoman. We are also working on additional tools for consumers, such as easily accessed explanations and information, to go with these new disclosures.

A second area of emphasis must be financial education. The ABA and the major credit card companies are working together to improve this education with a particular emphasis on college age individuals. We have completed a scan of the available resources and found that every major credit card issuer, in addition to the ABA, has an education program. Now we are working to maximize the delivery of these programs to consumers. We are pleased, Madam Chairwoman, that you will be participating in our annual Teach Children to Save Day on Monday in New York. Representatives Price, Green, Drake, Costa, and Wynn have also participated. In October, we will be having our 5th annual Get Smart About Credit Day, which raises awareness about credit issues among students. Last year, Treasury Secretary Paulson and Members of Congress joined us in teaching this program.

While we work hard to improve disclosures and financial education, we recognize that there are other issues about credit cards which are of concern to Members of Congress. As the GAO pointed out, for millions of Americans credit cards provide more services at low, or more often no cost, and lower interest rates than ever before. However, for others, the increasing complexity has caused confusion, with some ending up in difficult financial situations. The industry takes these concerns very seriously and is working to address them. Madam Chairwoman, Congressman Gillmor, Congressman Watt, and others who have spoken this morning, we take your introductory comments very seriously. We need to address these issues, and I want to assure you that we are working very hard, we are meeting literally every week to move forward, and we want to keep you informed.

Recently, individual institutions have announced important changes in policies. We are seeing that competition is now leading to streamlined and simplified practices. The industry recognizes that policies that alienate some of its customers or leave individuals in financial difficulty from which they cannot extricate themselves are in no one's interest. We pledge to work with you in Congress and our customers to address these concerns.

Thank you.

[The prepared statement of Mr. Yingling can be found on page 84 of the appendix.]

STATEMENT OF TODD J. ZYWICKI, PROFESSOR OF LAW, GEORGE MASON UNIVERSITY LAW SCHOOL

Mr. ZYWICKI. Chairwoman Maloney and members of the subcommittee, credit cards have transformed the ways in which we shop, travel, and live. Credit card issuers are forced to compete for my loyalty every time I pull out my wallet to buy gas or a new book for my daughter. In such a competitive environment, issuers face relentless competition to retain my loyalty, and I admit I am not the slightest bit sentimental about switching to a better deal if one comes along. I have four cards and each of them actually pay me to use them. I had five until 2 weeks ago, but one did not give me a good enough deal so I canceled it. Little wonder in this competitive environment that, according to one Federal Reserve economist, 90 percent of credit card owners reported they are very or somewhat satisfied with their credit cards versus only 5 percent who are somewhat dissatisfied and only 1 percent, that is 1 out of 100, who are very dissatisfied. Moreover, two-thirds of respondents in a Federal Reserve survey also reported that credit card companies usually provide enough information to enable them to use credit cards wisely and 73 percent stated the option to revolve balances on their credit card made it easier to manage their finances versus only 10 percent who said it made it more difficult.

Nonetheless, the myriad uses of credit cards and the increasing heterogeneity of credit card owners has spawned increasing complexity in credit card terms and concerns about confusion that this may reduce consumer welfare. In particular, three concerns about credit cards have been expressed. First, a fear of a rise of consumer indebtedness supposedly caused by access to credit cards. Second, a concern about unjustifiably high interest rates on credit cards. And, third, a growing use by card issuers of so-called hidden fees, such as late fees and overdraft fees.

Although these concerns are often expressed, based on standard economic theory and the date we have available today, none of these concerns appears to have any merit. I address each of these concerns in detail in my written testimony, and I will only briefly summarize those findings here. First, the concern that credit cards have caused consumer over-indebtedness and financial distress is simply based on a faulty understanding of the ways in which consumers use revolving credit. Although credit card use and debt has risen substantially over the past 25 years, the data make clear that this rise in credit card debt has been the result of a substitution by consumers of credit card for other less attractive types of debt such as retail store credit, layaway plans, pawn shops, rent-to-own, and personal finance companies. Just a generation ago when you bought a refrigerator or a bedroom set you bought on time, promising to pay in monthly installments for a term of months. If you needed a short-term loan to repair a blown transmission, you might have to borrow several thousand dollars on an unsecured basis from a personal finance company, a family member, or even your local loan shark whose late payment terms were somewhat more onerous than those that we see today. Today, a consumer would likely use a credit card for each of these transactions and in fact many of these traditional types of consumer loans do not even exist anymore. Thus, the growth in credit card borrowing, as I show in my written testimony, mirrors a near identical decline in consumer use of installment consumer credit during that same time. As a result, the debt service ratio for consumer credit has fluctuated in a very narrow band over the past 25 years and in fact is approximately the same today as it was in 1980. Nor are interest rates on credit card unreasonably high when compared to similar loans. In fact, the General Accounting Office estimates that approximately 93 percent of credit cards now have variable interest rates tied to the underlying cost of funds and interest rates become both lower and more flexible over time. Moreover, the past few decades have seen the near complete abolition of annual fees on standard credit cards with no rewards programs and this has dramatically reduced the cost of using credit and heightened competition. When compared to relevant alternatives, such as payday lenders and personal finance companies, credit cards offer extremely competitive interest rates and low-fixed costs, especially for lower income and younger borrowers with limited credit options. It is not clear to me how the lives of lower income families would be improved by making it more difficult for them to get credit cards, thus forcing them to rely on pawn shops or payday lenders to buy books or sports equipment for their children. Nor is it clear how a college student or any other young American would be made better off by paternalistically being denied a credit card and thus having to furnish their apartment through a rent-to-own company. Moreover, given the paucity of attractive credit options available to low-income borrowers, there is little wonder that the substitution effect of credit card debt has been most pronounced for those families. And, in fact, the Federal Reserve reported in the 2004 Survey of Consumer Finances that even though credit card ownership has become increasingly widespread, the percentage of lowest income quintile households in financial distress is actually at its lowest level since 1989.

The past few years have also seen an increase in the use of risk-based penalty fees, such as late fees and overdraft fees. Although these fees represent only about 10 percent of issue revenues, they have caused great consternation in some quarters. A recent study by Massoud, Saunders and Scholnick, however, concluded that these fees were risk-based fees based on borrower behavior. Moreover, they found a clear trade-off between the use of these risk-based fees and interest rates. Thus, for instance, a one standard deviation reduction on credit card interest rates, 273 basis points, was found to be associated with a $2.40 increase in late fees. The economic trade-off is clear: the lower and more flexible interest rates the past decade have become possible—

Chairwoman MALONEY. The Chair grants an additional 30 seconds for you to wind up.

Mr. ZYWICKI. —only because credit card issuers become more efficient at risk-based pricing. Issuers no longer must rely solely on interest rates, which are an attempt to predict before the fact the borrower's risk, but can make greater use of risk-based penalty fees for those borrowers who demonstrate their riskiness through their actual behavior. Any regulatory efforts to cap late fees or over-limit fees would therefore almost certainly lead to increased interest rates for all consumers or other offsetting adjustments in credit contract terms. This cross-subsidization would be especially unfair to low-income but responsible borrowers who would otherwise be lumped into the same interest rate category as other borrowers.

Thank you.

[The prepared statement of Professor Zywicki can be found on page 120 of the appendix.]

Chairwoman MALONEY. Mr. Ireland.

STATEMENT OF OLIVER I. IRELAND, MORRISON AND FOERSTER, LLP

Mr. IRELAND. Good morning, Chairwoman Maloney, Ranking Member Gillmor, and members of the subcommittee. I am a partner in the Washington, D.C., office of Morrison and Foerster. Before coming to Morrison and Foerster, I was an Associate General Counsel in the legal division of the Board of Governors of the Federal Reserve System for over 15 years. I have over 30 years experience in banking and financial services, and I am pleased to be here today to discuss the important issues involving the credit card industry.

Today, credit cards are among the most popular and widely accepted forms of consumer payment in the world. Due to the convenience, efficiency, security, and access to credit that they provide, credit cards have become a driving force in our economy and new markets such as the Internet. Credit cards offer a wide-range of benefits in addition to access to credit, including freedom from carrying cash, protection from loss or theft, and preservation of claims and defenses that a consumer may have against a merchant. Approximately half of all credit card holders pay their balances in full every month and therefore also enjoy an interest-free loan. Although fees and card issuer revenues from fees have increased in recent years, consumers also are enjoying lower interest rates and wider access to credit. Despite the benefits, credit card practices, such as so-called universal default and double cycle billing have been criticized as unfair, in part, I think, because they are inconsistent with the consumer's expectation. These criticisms call into question the current credit card disclosure regime. Credit cards are subject to extensive disclosure requirements under the Truth in Lending Act and Regulation Z implemented by the Federal Reserve Board. TILA, or Truth in Lending, requires comprehensive, virtually cradle-to-grave, disclosure. In addition to TILA, the Federal bank regulatory agencies have the power under the Federal Trade Commission Act to address unfair and deceptive acts and practices on a case-by-case basis.

Simply put, I think the current credit card disclosures are too detailed, complicated, and they focus on the wrong information. Nevertheless, I believe that improved disclosures offer the potential to address current concerns about credit card practices. Although there could be credit card practices that are so unfair and so resistant to market pressure that they cannot be addressed through an improved disclosure regime, it is premature to conclude that improved disclosures cannot resolve these issues.

New approaches to disclosures may be able to simplify disclosures. For example, there appears to be a broad recognition that the Schumer Box disclosure format is effective. Similarly, the Federal banking agencies recently proposed a standardized model Gramm-Leach-Bliley Act privacy note that would provide limited information in a uniform manner to facilitate consumer understanding. The model emphasizes simplicity as opposed to accuracy and precision, something that credit card issuers cannot do lest they face class action litigation under TILA or over the terms of their account agreements. Simplified disclosures could improve the ability to comparison shop and avoid surprise late charges and other fees. In addition, as Louis Brandeis noted almost a century ago, "Sunlight is said to be the best disinfectant and electric light is the best policeman." Simplified disclosures for credit card accounts can lead to changes in credit or practices by fostering market discipline.

Achieving these goals is not without challenges. First, open-end credit accounts are complex and their terms will necessarily reflect this complexity. Second, disclosures cannot be the only source of education about financial issues. We need improved financial literacy. Third, there is a tension between simple disclosures and legal liability. Some sort of a safe harbor for simplified disclosures may be necessary. Despite these challenges, I believe that TILA, coupled with the banking agencies' other powers, provide ample authority for addressing current issues.

I appreciate the opportunity to be here today and would be pleased to answer any of your questions.

[The prepared statement of Mr. Ireland can be found on page 34 of the appendix.]

Chairwoman MALONEY. Ms. Sherry?

STATEMENT OF LINDA SHERRY, DIRECTOR, NATIONAL PRIORITIES, CONSUMER ACTION

Ms. SHERRY. Chairwoman Maloney, Ranking Member Gillmor, and members of the subcommittee, my name is Linda Sherry, and I am the director of national priorities for Consumer Action. I thank you for your leadership on this issue.

Consumer Action is a nonprofit organization that has served consumers for 36 years. For more than 20 years, we have conducted surveys of credit card rates, fees, and conditions, and our survey has become a barometer of industry practices. The focus of our study was to track the industry and help consumers obtain clear and complete facts about rates and charges before they apply for credit. I am pleased to share with you some preliminary findings from our most recent survey of 83 cards from 20 banks, including the top 10 issuers. Our surveyors posed as potential customers and this methodology gives us unique insight into what people face when they shop for credit cards. It is striking how often customer service people cannot provide even the basic facts required by Federal credit card disclosure laws. This leaves potential customers in danger of applying for a card that at best does not suit them and at worst contains predatory terms and conditions. All top 10 issuers advertise cards on their Web sites without firm APRs. Instead, they skirt regulations by providing only a meaningless range of rates. Cardholders have no way of knowing what the terms on that card will actually be until it arrives in the mail. Why should cardholders have to wait until the card has been issued to read the contract that governs their use of the card? Such practices make it difficult, if not impossible, for consumers to shop around to get the best deal. Most major issuers deny that they employ universal default punitive interest rates based solely on how customers handle other credit accounts. However, many still use credit reports as a reason to make adverse account changes under change and terms provisions. Standard in the vast majority of credit card agreements, unilateral change of terms provisions are cited as a way for companies to manage risk. But these take it or leave it contracts of adhesion force cardholders onto an uneven playing field even before they actually become customers sometimes.

Last month, we went to the Web sites of the top 10 issuers to review publicly available change of terms disclosures; 9 out of 10 reserved the right to change APRs and other terms at any time. Six banks included specific reference to credit reports or scores or other creditors as a reason to change cardholder terms. We asked customer service people at 20 issuers, "Do you raise my interest rate because of my credit record with other credit cards or lenders?" It appears that half of the surveyed banks would, at the time of the survey, raise cardholders' APRs based on information from credit reports and scores. Even if you never paid late on your card, you could be subjected to a default APR. The industry has aggressively increased fees and penalty interest rates, fueling profits that are up by nearly 80 percent since 2000. We have a right to know whether these fees bear any true relation to the bank's costs.

Average APR data doesn't tell the whole story. The spread of non-penalty rates is strikingly wide at individual banks. At one top 10 issuer, rates ranged from 8.25 percent to 25 percent on non-penalty rates. The different rates are often referred to using deceptive terms like "preferred," "elite," or "premium." Is there anything premium about a rate of 18.24 percent?

Residual interest or trailing interest is a deceptive method of calculating credit card interest right up until the day full payment is received; 45 percent of surveyed banks employ the practice. Penalty rates are as high 32.24 percent. Late payments result in higher penalty rates with 85 percent of issuers. Often the increase is automatic and standardized, not tied to any individual performance. Late fees have more than doubled in the last decade. The average grace period at the top 10 issuers has shrunk by more than 3 days since 1995. Cash advance fees have jumped 40 percent in the last decade. More disturbingly, 90 percent of the cards have no cap on the fee.

Before closing, I would like to bring to your attention just how important credit card reform is to your constituents. In less than a year, 12,327 individual constituents have used Consumer Action's Web site to write to you for protection against abusive credit card practices. This is a follow-the-leader industry. When one issuer steps out with a new anti-consumer practice, other banks are quick to follow. When attention is focused on one bad practice, such as universal default, issuers jump to say they don't do it. The problem is that lesser known unfair practices continue, such as residual interest allocation of payments to low-interest balances, junk fees on foreign transactions, and Sunday and holiday due dates that trigger unjustified late fees.

I thank you for your diligence in investigating credit card industry practices. Credit cards are an integral part of our lives. We protect people from unsafe products, shouldn't we also give cardholders an even playing field?

[The prepared statement of Ms. Sherry can be found on page 44 of the appendix.]

Chairwoman MALONEY. Thank you very much for your testimony. I would like to begin by asking Ms. Zeldin and Ms. Sherry this question. No matter whose statistics that you read or look at, the level of consumer credit debt is really quite high. And we know that consumers with high credit debt have traditionally moved that debt into mortgage debt by taking out home equity loans or refinancing their homes to pay off their cards. And I am concerned that we may be confronting a "perfect storm" with the weakening of the subprime market. The opportunity to consolidate credit card debt into home mortgages or home equity loans is less likely to be an available solution. What do your studies find? Is this a realistic concern, and I ask for your comments, Ms. Zeldin and Ms. Sherry?

Ms. ZELDIN. Yes, it is a concern. There was a lot of—I do not have the figures in front of me—but the refinancing boom did result in a lot of refinancing of credit cards, not just in the subprime market but now that home prices look to be declining in the entire housing market and homeowners will have less home value to draw upon, we can expect that drawing out home equity lines of credit will decrease and that will reduce the availability of consumers to refinance and have lines of credit that are at lower interest rates than what they may have been paying on their credit cards.

Chairwoman MALONEY. Ms. Sherry, any comments?

Ms. SHERRY. Yes, I just think that really points to the desperation of people who are burdened with unsecured credit card debt with moving target terms that increases their debt so their interest rate would be increased, and that would increase their overall debt load. It points to the desperation of these folks that they would actually go and get a home equity loan, which would put their own home in jeopardy to get out from under this kind of debt. So, yes, I definitely see it as a problem. I see people making unwise moves in the past and even as we speak today to move credit card debt into home equity debt, not a good move.

Chairwoman MALONEY. Thank you, and I would like to address this question first to Mr. Yingling and Mr. Ireland, as well as anyone else who would like to comment. There seems to be widespread agreement that the credit card disclosures are difficult for consumers to understand. I was struck last week when William Syron, the head of Freddie Mac, testified, and he said that he used credit card disclosure as an example of uselessness in testifying to this committee, and that he and his wife spent literally hours trying to figure what their credit card statement meant to no avail. And I would like to know, can industry take steps to correct that in the absence of Federal regulation? And what is industry doing about acknowledging the problem with disclosure? And apart from disclosure, are there other issues including, but not limited just to those, where you believe regulation or legislation is needed? Do you believe that correcting disclosure will cure the problems with universal default, double cycle billing, or retroactive interest increases? And I first would like Mr. Yingling and Mr. Ireland to start and then the consumer advocates and anyone else who would like to discuss this.

Mr. YINGLING. First just a comment on your previous question. I think it is fairly understandable that people would refinance into a home equity loan. They have equity in their home, and if they put it into a home equity loan, they get a lower interest rate because it is secured and in many cases, it is also tax deductible. So I do not think it is quite a sign of desperation; I think it is fairly rational.

The disclosures do not work. There is, I think, unanimous agreement. At one point, actually I am old enough to remember when they were first enacted starting in this very committee, they were considered to be model disclosures. But what has happened is that the product has gotten more complex. Some of the things that we disclose now are really not that important, and we do not disclose some of the things that are important, some of the things that are of concern to members of this committee. So we are optimistic that we will come out with a much, much better disclosure. We cannot design it ourselves because it is subject to extensive law and regulation, but we can work with the Fed and work with you in your oversight capacity to make sure that basic disclosure is useable. And, importantly, you can use that kind of format still, the original boxes, maybe even in a clearer fashion, and we have seen some banks do that on their own and use common terminology. Then it is very easy to take three or four offers and look at them and compare them across lines. One of the difficult things to decide is that you cannot have too many things in that box or you undermine the consumer usefulness of that box. So in addition to the box, we want to be able to have other disclosures behind it and other resources behind it so that consumers who want more, will read that box, that is the most important thing, and they will compare it, and then if they want to know more, they will have more available. We are working on that.

With respect to legislation and regulation, we hear, as I said in my oral testimony, the concerns. We hear them very clearly. We are working hard on it. It is a not an accident that you are seeing some major changes. Interestingly enough, I think card companies are starting to compete in ways beyond lowering the annual fee, lowering the interest rate. They are trying to compete now on offering simpler products, more easily understood products. You do see companies, for example, that now offer cards that have no over-the-limit fees. They have eliminated them. They are offering simplified kinds of cards. We also are going to work on issues that we may be able to do as an industry. We are working on those. Frankly, we have to be very careful because there are anti-trust issues, but we are hard at work on it.

Chairwoman MALONEY. Thank you. My time has expired. Mr. Gillmor is recognized for 5 minutes.

Mr. GILLMOR. Thank you very much. Let me ask on the issue of disclosure, which everybody agrees is poor, probably because there is too much of it, and it is not understandable. I guess my question is, whose fault is that, and how do you correct it? Is it the companies, is it the Federal Reserve which supposedly has the jurisdiction to regulate here? So I guess I would ask the panel does the Federal Reserve have adequate authority in the area of disclosure?

And, two, is it their fault that it is all messed up? And if not theirs, whose?

Mr. IRELAND. Mr. Gillmor, the Federal Reserve has very broad authority under the Truth in Lending Act to fashion disclosures for Regulation Z. In the area of open-end credit, as I indicated in my testimony, the overall account and the transactions and disclosing those transactions is a complicated issue if only because you have constantly moving balances that you are paying interest on but you may also have different interest rates, as we have discussed here, and fee charges in certain cases. But fees have been around for a long time though the levels have changed. And that disclosure is sort of inherently a complicated disclosure. The Truth in Lending Act itself encourages very precise, very accurate disclosures because it provides for civil liability, including class actions, if you do not do it right. So the first challenge that the institution faces is getting the disclosure right. Institutions are now working, as Mr. Yingling said, on trying to simplify some of their disclosures but there are limits as to what they can do within the current statute and the current rules. I think the Fed has an ability to contribute very substantially toward simplified disclosures. I think they may have to think creatively to do it. I also think that they have perhaps waited longer than they should to pick up this issue. As we have discussed here, there have been significant changes in the credit card industry over the years, and they have not done a comprehensive review of the Truth in Lending and credit card disclosures in a couple of decades.

Mr. GILLMOR. Mr. Yingling?

Mr. YINGLING. I would just say that it is the lawyers' fault.

Mr. GILLMOR. Well, I am a reformed lawyer.

Mr. YINGLING. I am, too.

Mr. ZYWICKI. Congressman, if I may just add briefly, according to a study done by Federal Reserve economist Thomas Durkin, to keep this in perspective, two-thirds of credit card owners find it very easy or somewhat easy to find out information about their credit card. Only about 6 percent say it is very difficult. And I would call the panel's attention to some of the key aspects of the GAO report where they note that one of the big problems is that the old TILA rules require disclosure of increasingly irrelevant terms or trivial terms such as the minimum finance charge, such as things like method of computing balances, which are too difficult to disclose in a very simple sort of way. And what the GAO report observes is that focusing on trivial, outdated, or irrelevant disclosures makes it more difficult for consumers to find the information they need to get disclosure. And the concern is that this market is changing much faster than the regulations and if further disclosure is going to be mandated, I think we should keep—

Mr. GILLMOR. I am running out of time because my time is limited here, and I do have another question I want to ask the panel. I think one of the most helpful things you could do is give us an answer to that. Mr. Ireland says it is inherently complex. Is it so inherently complex we are not going to be able to fix it? But not now because I do want ask my other question, but I think that is one of the most useful things that could come from this panel is an answer as to how to make us have meaningful disclosure. The other thing I want to ask, we keep hearing about how profitable the credit card is, I do not know whether it is or not compared to other industries. A lot of industries, you can go look and you can find for the auto industry, the drug industry, the banking industry, what return on equity is, and what the return on revenues are. What are the returns on equity, the returns on revenue in the credit card industry? Certainly there have been some studies. Mr. Yingling?

Mr. YINGLING. Actually, the Fed does a regular study so it is available. Credit card company profits compared to most industries are actually not very high. The return has been relatively stable for the last 20 years. Some of this is in the GAO study by the way. And the return on assets is slightly above 3 percent. Just to put that into perspective, that is slightly lower than the automobile industry and considerably lower than other industries. It is higher than other types of lending but, as the Fed points out, if you adjust that back for risk, because credit card lending is unsecured, it is within the parameters of what you would expect. Another test is if you look at the PE ratios of credit card companies, how the market looks at credit card companies, their price earnings ratio in the stock market is lower than the S&P 500 average. So, although you hear a lot of talk about how profitable it is, when you look at it compared to other industries, it is not all that profitable.

Chairwoman MALONEY. Thank you. The gentleman's time is expired. And we have been called for a sequence of votes that may take up to an hour. The Chair recognizes Congressman Watt for 5 minutes.

Mr. WATT. Thank you, Madam Chairwoman. I will be quick because I am not sure whether we are coming back or not. But let me just first go with this notion, Mr. Zywicki, that you advanced that you are somehow getting a free credit card and that if we do something in this area, we are likely to incentivize cross-subsidization. I am sure you know that somebody is paying for your credit card. I know when I get a free ride for whatever period it is that I have free interest, no interest, somebody is paying for that. And so there is substantial cross-subsidization going on already in this market. The half of the people that Mr. Ireland says who are getting free interest are being subsidized by people who are paying on the other side very high interest rates, late payment fees, and the various other charges that are going on.

Now, one of those is interchange fees which not a single person on this panel has said a word about. Those are the fees that credit card issuers charge to retailers for the use of their credit card. I am looking at a charge here that suggests that about $30 billion in interchange fees are charged, late fees, $16 billion, cash advance fees, $5 billion, annual fees on credit cards, $3 billion. So interchange fees, which was not mentioned by a single witness here, is the highest part of the cost of credit cards that we all pay at some level, even the people who do not use credit cards, the people who pay cash, are cross-subsidizing those of us who use credit cards because they are having to pay those interchange fees. And one of the concerns I have is that those interchange fees are not really—they are not addressing the cost of the transaction because all the studies I have seen suggest that only 17 percent of those fees are going to actually covering—and I suspect most of it is going to pay for all of the mailings that we get in the mail asking us to issue credit cards—to buy another credit card. When you say, Ms. Sherry, shop for credit cards, there is nobody shopping for credit cards, they are readily available to everybody, I guess at least a solicitation a day asking me to take out a different kind of credit card. Even from the lenders that I already have a credit card from wanting me to upgrade. Now I uniformly throw those things in the wastebasket but somebody is paying for those mailings. And the easy credit that is available out there is part of the problem.

Now, having gotten on my platform, let me just go to Mr. Yingling. You said that somebody is sitting in a room every week trying to solve this problem. Who is it that is trying to solve this? And are we going to have to solve it here or is the industry going to come up with some satisfactory standards about how to get this because if it doesn't, everybody is unhappy about it except Mr. Zywicki, who says that somebody is subsidizing him and he doesn't have to worry about it anymore. Tell me who is meeting to solve the problem?

Mr. YINGLING. We have a group called the Card Policy Council.

Mr. WATT. Who?

Mr. YINGLING. The Card Policy Council is a group within the ABA, and it consists of the major credit card issuers: MasterCard; Visa; American Express; and Discover.

Mr. WATT. Are you all issuing anything publicly to tell people what—have you set a best practices standard? Is there any kind of industry standard coming out of this?

Mr. YINGLING. What we are doing frankly is working our way through all the issues, some of which you just talked about, others that others have talked about. We are working in the disclosure area. We are working in the literacy area. We are working on some of these other issues that you all are concerned about. We should come up and brief you about it with your concerns, some of which you see—

Mr. WATT. Would you send me something in writing? My time is up and we have to go vote, but we never have enough time to address these issues. Somebody tell me what the solution to this problem is short of our legislating in this area? Anybody on this panel who has a solution to it, just give me a short description of it in writing if you would.

Mr. YINGLING. We will.

Chairwoman MALONEY. All of the members of the committee would appreciate that. The Chair recognizes Mr. Castle for 2 minutes and Mr. Ackerman for 2 minutes. We have been called and we are on a second bell. We polled the members, and we will not be coming back after this hour-long session. Mr. Castle?

Mr. CASTLE. I have 2 minutes so that eliminates the questions I was going to ask each of you very quickly. I would just like to second what the chairwoman and Mr. Watt said. I think any suggestions about some of these changes would be very helpful. Mr. Wilmarth, very quickly, you had a lot of concerns with the OCC and some federalization, etc., what is your recommendation for change, if anything, in that area, if you could do that briefly?

Mr. WILMARTH. Well, I have two recommendations at the end of my testimony. One is I think this area is closely linked to the mortgage area in my opinion, and I think the Congress needs to look at comprehensive, uniform standards of fair lending practices that would level the playing field between federally-chartered institutions and state-chartered lenders. My second proposal is, as I have said, you cannot rely upon the OCC, 95 percent of whose budget is funded by the major banks, to be a completely independent regulator. My opinion is that you need enforcement. The best tool for enforcement is the Federal Trade Commission Act. You should give the FTC, which is currently barred from bringing unfair and deceptive acts and practices cases against banks, you need to give the FTC authority to bring that kind of enforcement action against national banks because State attorneys general are independent enforcement bodies for State banks. There is no independent enforcement body for national banks.

Mr. CASTLE. Thank you. To Mr. Yingling, and I think to Mr. Ireland as well, you all talked about the disclosures. For me it is pretty simple—if I get a bill from a credit card, I like to know what is the real due date on there and what it is going to cost me if I do not get it in in that particular time. My God, it is very hard to figure out. But I think that is very important. And I think some of the banks are already starting to do this, the credit card banks. And you both have suggested that other things have to be done in that area, and I know it is a little bit uncertain with a particular box or whatever it may be. But, first of all, is that happening anyhow in the marketplace? And, secondly, is there real focus on making these changes even before regulations have to be imposed or we in Congress have to pass something to make it happen?

Mr. IRELAND. Well, I can tell you that credit card issuers are devoting major resources to simplifying their disclosures and making them easier for consumers to understand. Their ability to do that is limited by Federal law. They are going to need some help from the Federal Reserve to get to the end of this trail.

Mr. CASTLE. Thank you.

Chairwoman MALONEY. Mr. Ackerman?

Mr. ACKERMAN. Thank you very much, Madam Chairwoman. I do not have to do much shopping either, all I have to do is go to my mailbox. This is all for me. The past year or so, there was a lot more that my wife threw out because she thinks I am getting compulsive about looking at these things. I do not know that I actually make money on them, as Mr. Zywicki does, but I do try to read most of them and do as good as I could. I am not a law professor; I am just a social studies teacher. But I just pulled this one, which was on the top and started to highlight it from a bank that has been chasing me to open an account. And they offered me this wonderful platinum thing where I can get a 0 percent introductory rate until I read it and they tell me about the 7.99 fixed APR thereafter. But then I read all the print on the front, which has lots of 0 percents all over the place and frozen things and whatever, and I turn to the back and read in the small print, which I can only do without my glasses, and I will round it off to the nearest one-hundredth of a percent so you do not get 7.99. There are rates here that they offer me and tell me that I am going to be subject to all of these under different sets of conditions and they are: 0 percent; 8 percent; 13 percent; 14 percent; 16 percent; 20 percent; 21 percent; 24 percent; and 29 percent. Each of those is one one-hundredth less, you understand. And for the benefit of doing all this, paying as much as 29 percent after I get sucked in thinking I am paying 0 percent, it tells me that I have the great pleasure of not having to pay an annual fee. I think this 29 percent thing is great. I remember when I was a kid growing up on New Lotts Avenue, Shelly, he worked out of the candy store, he went to jail once for doing something like that; 29 percent is not 0 percent. And I would venture to say that, and I will paint with a very broad brush, but the people on the lower socio-economic scale of the ladder, those people that you run classes for on how to open a bank account, and savings, and all those kinds of things, they are not the people who read this. Those are the people who are going to default thinking they are getting a better rate, switching from another credit card, not knowing about the fine print on the back, getting sucked in, and finding out that they are now paying a rate that they cannot afford, and they should have stuck with what they had. These are the people that we have to be concerned with, not myself or Mr. Zywicki. I get a lot of these; they are offering me free money. I took one of them. I took several of them as a matter of fact. Some bank offered me—some non-bank, forgive me, some non-bank offered me $50,000. I said, that is a great deal. I called them up, they said, "Yes, we switch it into your account." I am pre-approved. I said, "That is wonderful. I will take every nickel you are giving me, and I will pay it back by July," whatever it was. The next thing I knew, the first statement I got, I had $250 worth of fees because I was over my credit limit. I said, "How could I be over my credit limit, I have not missed a payment, it is my first bill?" They said, "Well, the first day that you take that $50,000, we add" blah, blah, blah. I was tough enough to fight that but a lot of people who are not sophisticated enough do not know what they are getting into. And I think, just being the skeptical social studies teacher that I am, that is deliberate. And I think that is what we have to fix. And I would, as my friend Mr. Watt said, I would like the industry to sit down with us and say, "Here is how we can fix this. We do not have to offer people nine rates, thinking they are not paying any."

Chairwoman MALONEY. That is a wonderful statement, but we may miss a vote. I want to thank the panelists and the members for being here for their interest. And the Chair notes that some members may have additional questions for the panel, which they may wish to submit in writing. Without objection, the hearing records will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

And this hearing is adjourned, and I thank everybody for coming.

[Whereupon, at 11:30 a.m., the hearing was adjourned.]

A P P E N D I X

April 26, 2007

Statement of Congressman Michael N. Castle

Financial Institutions Subcommittee Hearing on
"Credit Card Practices: Current Consumer and Regulatory Issues"

April 26, 2007

Thank you Chairwoman Maloney and Ranking Member Gillmor for holding this hearing before the Financial Institutions and Consumer Credit Subcommittee today.

Credit cards have become a staple in today's marketplace. They provide enormous convenience, efficiencies and other benefits to consumers, businesses, and local and national economies. Credit cards have generated more than $2.5 trillion in transactions a year in the United States. Clearly, they have become an indispensable tool of America's consumer economy.

Today, consumers have a choice between 6,000 credit cards lenders. Although some consumers view the large number of credit options to be daunting, the strong national credit system in the United States has been a driving force that has helped sustain our economy in recent years. Educating consumers and enabling individuals to understand their credit terms is an important task -- the review by this Subcommittee today will help us better understand how consumers and the financial services industry can have a more symbiotic relationship.

Certain industry practices related to credit card fees, penalties, and interest rates have received a considerable amount of media attention lately. It is important to note, that in response to increasing concerns, several credit card issuers, such as Citigroup and Chase Card Services, have taken significant steps to improve their practices and ensure that their customers have a better understanding of their accounts. Therefore, Madam Chair, after we hear from consumer organizations, institutions and university professors, I do hope we will take the time to hear from industry regulators so we can keep the scope of these issues in some context.

Madam Chair, I thank you for holding this hearing today and I look forward to hearing from each of our witnesses.

Opening Statement
Rep. Carolyn Maloney
Financial Institutions Subcommittee
Hearing: "Credit Card Practices: Current Consumer and Regulatory Issues"
April 26, 2007

This hearing will come to order. The topic of today's hearing is "Credit Card Practices: Current Consumer and Regulatory Issues."

First, I would like to thank the witnesses for coming today.

This is the first in a two- part series of hearings on credit card practices.

In our second hearing, to be held the first week in June, we plan to have federal and state regulators to discuss the anticipated revision to the regulations governing disclosure for credit cards by the Federal Reserve. The Fed has informed me that they expect to be issuing this in late May. We also expect to have a panel of consumer and industry representatives to comment on the Fed's action.

Credit cards may represent the single most successful financial product introduced to our country in the last 50 years. Their benefits are manifest, giving consumers unprecedented convenience and flexibility in both making purchases and in managing their personal finances.

Consumer spending, facilitated in large part by the ease of payments afforded by credit cards, accounts for nearly 2/3 of the annual US economic activity.

And even more dramatically, one can argue that the broad availability of credit cards coupled with advances in technology has helped to create, support and expand an online retail industry that is projected to reach $129 billion in sales this year according to a recent Business Week article.

All told, 145 million people in America (about half the population) own credit cards.

In short, credit cards, like many other tools in our society, have changed from a luxury item available to the few, to a necessity demanded and needed by the many.

But with that great success, with that widespread growth, with that necessity, comes great responsibility.

The credit card industry has been clear about the responsibility imposed on consumers: the responsibility to become financially literate; the responsibility to spend only in accordance with your means; the responsibility to pay your bills on time.

But this spectacular growth in the credit card industry does not seem to have created the same sense of responsibility in the ten issuers that control 90 percent of the market, much less in the other 6,000-plus US credit card issuers.

It is true that competition among issuers has created initial consumer choice and can reward the diligent consumer with lower interest rates and no annual fees.

But the industry has also acted to implement practices that quickly became industry standards - such as double cycle billing, universal default, no-notice interest rate hikes, outsize fees –as much as $39 dollars for a late payment -that bring us to our hearing today.

For example, a recent article in Electronic Payments International reported that credit card issuers were expected to rake in a "record $17.1 billion in credit card penalty fees in 2006, a rise of 15.5 percent from 2004, and a tenfold increase from 1996, when card issuers raised $1.7 billion in revenues from fees."

Did American consumers become ten times less responsible in 2006 than in 1996?

Or did the industry make a concerted and deliberate effort to squeeze even more revenue out of consumers by increasing fees and creating pitfalls and violations of the card agreement that allowed the issuer to penalize even the most responsible consumers?

Credit card issuers hold an enormous amount of power – enshrined in the cardmember agreement: just listen to this section from an April 2007 card agreement of a major card issuer :

"...we may suspend or cancel your Account, any Feature, or any component of your Account, ... at our sole discretion at any time, with or without cause, whether or not your Account is in default, and without giving you notice, subject to applicable law."

From terms like that, it is not hard to see how fee income went up ten fold in the past 10 years!

I have always believed that responsible access to credit is critical to our economy and that access to appropriate credit should be as broad as possible, consistent with the safety and soundness of the financial system.

Similarly, I approach credit card regulation from the point of view that we should both protect consumers and keep responsibly-issued credit available in as many of our communities as possible.

I am generally in favor of market based solutions wherever possible, but in this case, I am not convinced that the industry is going to make the changes that are necessary.

I do want to credit some major issuers who have taken steps to move toward better practices. Citi has announced that it would eliminate "any time for any reason" repricing and universal default. Chase has said it would no longer use double-cycle billing but rather average daily balance. But I don't yet see the development of "best practices" that industry holds itself to across the board.

For example, in the wake of the key GAO report last September, finding that the increased complexity in rates and fees requires better disclosure, even industry agrees that changes to credit card disclosures are desperately needed, because no one can understand their statement.

Yet industry has not taken comprehensive action on this point.

And if the industry fails to make meaningful changes, if the major issuers continue to lead the way in a race to the bottom rather than a race to improvement, it is my belief that we will see bipartisan legislation coming forward to fix the problems that industry proved itself incapable or unwilling to fix on their own.

I look forward to the testimony

WRITTEN STATEMENT

OF

OLIVER I. IRELAND

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND
CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

April 26, 2007

Good Morning Chairwoman Maloney and Ranking Member Gillmor. I am a partner in the law firm of Morrison & Foerster, and I practice in the firm's Washington, D.C. office. Prior to joining Morrison & Foerster, I was an Associate General Counsel in the Legal Division of the Board of Governors of the Federal Reserve System for over 15 years. Prior to that, I worked at the Federal Reserve Banks of Boston and Chicago. In all, I have over 30 years of experience in banking and other financial services issues, including issues relating to credit cards. During that time, I have had the opportunity to be intimately involved in both drafting and interpreting regulations as a regulator and in advising financial institutions on how to interpret and comply with regulations. I have witnessed first hand the changes in industry practices brought about by regulatory changes and costs and other difficulties incurred in compliance. I am pleased to appear before you today to discuss important issues involving the credit card industry.

Credit Cards

Today, credit cards are among the most popular and widely accepted forms of consumer payment in the world. In 2005, the total value of credit card transactions charged by U.S. consumers alone exceeded 1.8 trillion dollars. Credit cards can be used at millions of merchants worldwide. As a result of the convenience, efficiency, security and access to credit that credit cards provide to American consumers, credit cards have become a driving force behind our national economy. Credit cards also have facilitated the development of new markets, such as the Internet, where credit cards play an essential role.

Credit cards offer other benefits to consumers including consolidation of transactions into a single statement payable once a month, the ability to accurately track expenses and freedom from cash dependency when shopping locally or when traveling around the world. In addition, consumers typically enjoy protections that are unavailable in cash transactions when they use credit cards, including protection from loss or theft and preservation of claims and defenses that a consumer may have against the merchant. Credit cards also offer other benefits such as product warranties and airline miles. Approximately half of all cardholders pay their balances in full every month and, therefore, enjoy interest-free loans.

Although fees, and card issuer revenues from fees, have increased in recent years, because of vigorous competition among credit card issuers and the use of individualized pricing models, consumers are enjoying lower interest rates and more access to credit than in the past. For example, according to a recent Government Accountability Office ("GAO") report on credit card disclosure practices ("GAO Report"), the average credit card interest rate 15 years ago was approximately 20 percent and credit cards often had annual fees in excess of $20. Today, according to the same GAO Report, the average interest rate is approximately 12 percent and nearly 75 percent of credit cards have no annual fees (report available at http://www.gao.gov/new.items/d06929.pdf). In addition, although there has been much concern about levels of credit card debt, the GAO found that credit card debt is a small portion of overall consumer debt and has actually declined as a portion of overall consumer debt.

Despite the benefits that credit cards offer, in recent years, credit card practices, such as so called "universal default" and "double-cycle billing," have been criticized as unfair to consumers in large part because these practices are inconsistent with consumers' expectations for their credit card accounts. These criticisms call into question whether the current credit card disclosure regime has kept up with the market.

Regulation of Credit Card Practices

Credit cards are subject to extensive statutory and regulatory disclosure requirements and, to a lesser extent, limitations on terms of credit card accounts under the Truth in Lending Act ("TILA") and Regulation Z adopted by the Board of Governors of the Federal Reserve System ("FRB") to implement TILA. TILA was adopted in 1968 to promote the informed use of consumer credit, comparison shopping and to promote economic stabilization through competition among financial institutions. TILA established comprehensive, cradle-to-grave disclosures and other requirements for credit cards. TILA and Regulation Z require credit card issuers to provide solicitation disclosures when marketing credit cards, initial disclosures when a new account is established, monthly statement disclosures during the life of an account and advance notice of the change in terms when terms are changed.

In addition, the federal bank regulatory agencies also have the power under the Federal Trade Commission Act, coupled with their enforcement authority under the

Federal Deposit Insurance Act, to address unfair and deceptive acts and practices by the federally supervised or insured banks that issue credit cards. This authority provides the bank regulators with the flexibility to address credit card issuer practices on a case-by-case basis. For example, in 2004, the Office of the Comptroller of the Currency ("OCC") issued guidance to alert national banks to the OCC's concerns regarding certain credit card practices that may entail unfair or deceptive acts or practices, including the practice of automatically repricing a cardholder's annual percentage rate or otherwise increasing a cardholder's cost of credit when the circumstances triggering the increase have not been fully or prominently disclosed. While noting that repricing accounts "may well be appropriate measures for managing credit risk on the part of a credit card issuer," the OCC urged national banks to fully and prominently disclose the circumstances under which accounts may be repriced and whether the bank reserved the right to do so unilaterally.

There is a general recognition that the current federal disclosures under Regulation Z have become far too detailed, far too complicated and focus on the wrong information for effective credit cost comparisons. In this regard, it is important to understand that the flexibility and features that support the benefits of credit cards also result in credit cards being inherently complex products that require the disclosure of information that is not required in simpler transactions, such as fixed-rate closed-end loans. At the same time, despite the changes in credit cards over the years, and although the FRB has the power to revise Regulation Z at its discretion, the FRB has not completed a comprehensive review of the credit card disclosure requirements required by

Regulation Z since 1982. Although the FRB began such a review in 2004, and is expected to propose regulations to modify the current disclosure framework soon, it is too early to tell how any proposed changes will affect credit card practices.

Potential Improvements

I believe that improved disclosures offer the potential to address current concerns about credit card billing practices. Although there could be credit card practices that are so unfair and, at the same time, so resistant to market pressures that they cannot be addressed through an improved disclosure regime, it is premature to conclude that improved disclosures cannot resolve these issues. New approaches to disclosures may be able to simplify disclosures for these transactions. For example, there appears to be broad recognition of the effectiveness of the Schumer-box disclosure format for credit card solicitations. The GAO Report notes that the Schumer-box disclosures have "helped to significantly increase consumer awareness of credit card costs." The Schumer box uses a tabular format box to help consumers compare key credit terms of competing credit offers and make informed decisions.

The approach used in the Schumer box is similar to the approach used in a proposal recently published by the federal banking agencies in response to concern about the length and complexity of the Gramm-Leach-Bliley Act ("GLBA") privacy notices. The federal banking agencies proposed a standardized model GLBA privacy form that would provide limited information in a uniform manner (similar to the Schumer box) to facilitate consumer understanding. Research underlying the proposed model privacy form indicated that "consumers are overwhelmed by too many words, complex information, and vague words and phrases." However, the model privacy notice goes beyond the Schumer box tabular format to simplify disclosures. The model privacy notice uses terminology that emphasizes simplicity as opposed to accuracy and precision, something that credit card issuers cannot do lest they face class action liability under TILA or litigation over the terms of the account agreements themselves.

Improved simplified disclosures could offer several potential benefits. First, a consumer would have an improved ability to compare the terms of credit card accounts and, therefore, to choose on account that minimizes potential problems for the way that he or she manages his or her account. Second, simplified disclosures could give the consumer a better understanding of how the credit card that he or she chooses functions so that rate changes and charges do not come as a surprise. Third, as Louis Brandeis said almost a century ago, "sunlight is said to be the best disinfectant; electric light is the best policeman." Simplified disclosures for credit card accounts can themselves lead to changes in creditor practices. In highly competitive markets, such as the market for retail credit cards, an increased transparency provided by simplified disclosures practices will limit credit card practices that take unfair advantage of consumers. Consumers will close existing accounts in favor of accounts with other creditors and concerns about brand risk will cause creditors to abandon such practices to avoid account closures. Over the last few months, we have already seen publicity surrounding credit card billing practices coincide with changes in those practices by credit card issuers.

Experience with the practice of universal default illustrates the potential for market pressures to regulate credit card practices. Universal default, the practice of increasing a consumer's credit card rate based on a failure to pay another creditor on time, has engendered criticism recently. Although in reality such a failure may be an indication that the consumer is encountering financial difficulties and, therefore, poses increased credit risk, it also may simply reflect a consumer with a busy schedule resulting in an occasional late or missed payment. The GAO Report, however, found that the largest credit card issuers have generally ceased practicing universal default. This change is likely due, at least in part, to the likelihood that if a consumer misses a single payment with another creditor and the card issuer increases the consumer's interest rate, the card issuer stands a good chance of losing the consumer's account to a competing credit card issuer that continues to see the consumer as a good credit risk through a balance transfer. When compared to the substantial cost of attracting and establishing a new credit card account, there is little economic incentive for a card issuer to then lose that account by repricing the account based on an isolated incident, such as a single missed payment. Other practices, such as two-cycle billing, which reflects the loss of a grace period where a consumer who has previously paid his or her account in full fails to do so, will either be accepted by consumers or abandoned by creditors once they are fully understood through improved and simplified disclosures.

Achieving these benefits through disclosures in the context of open-end credit, however, is not without challenges. First, as noted above, open-end credit accounts are inherently more complex than many other transactions and their terms will necessarily reflect this complexity. Second, disclosures cannot be consumers' only source of education about financial issues. That is, a higher level of financial literacy can enable disclosures to focus on key issues without the need to include detailed explanations or examples of the consequences. For example, the fact that the practice of making minimum payments will increase the overall cost of credit and the repayment period is probably more properly an issue of general consumer education rather than individual disclosures. Third, it seems clear that there is a tension between simple disclosures and legal liability for any failure of those disclosures to reflect the details of complex transactions. Thus, some sort of a safe harbor for simplified disclosures may be necessary.

Despite these challenges, TILA provides the FRB with broad authority to implement TILA. I believe that TILA, coupled with the banking agencies' other powers, provides ample authority for addressing these issues. We will have to await the FRB's proposed rules to see how the FRB will use its authority under TILA to address these issues.

Finally, although some may argue that disclosures are not a solution to concerns relating to credit card practices and that limitations on the terms of credit card accounts are necessary, such limitations would carry a significant risk of unintended consequences. Current credit card pricing is based on individual risk factors. Individual pricing allows a credit card issuer to offer credit cards with lower rates to lower-risk cardholders while still providing credit cards at higher rates to higher-risk consumers who otherwise might be unable to obtain credit even though they are fully capable of using it wisely. Limiting credit card practices is likely to result in more rigid pricing structures that overcharge customers at one end of the risk spectrum and curtail credit to customers at the other end of that spectrum.

I appreciate the opportunity to appear before you today, and I would be pleased to answer your questions.

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Uneven Playing Field

A Summary of Consumer Action's 2007 Survey of Credit Card Terms and Conditions

Testimony of

Consumer Action

Linda Sherry
Director, National Priorities

Before

The House Subcommittee on Financial Institutions and Consumer Credit

The Honorable Carolyn Maloney, Chair

April 26, 2007

A SUMMARY OF CONSUMER ACTION'S 2007 SURVEY OF CREDIT CARD TERMS AND CONDITIONS

Consumer Action (www.consumer-action.org), founded in 1971, is a San Francisco based nonprofit education and advocacy organization with offices in Los Angeles, CA and Washington, DC. For more than two decades, Consumer Action regularly has examined credit card rates and charges in order to track trends in the industry and assist consumers in comparing cards.

The 2006-2007 Credit Card Survey was conducted between October 9, 2006 and March 2, 2007. Consumer Action examined 83 cards from 20 banks, including the top 10 U.S. credit card issuers. We are currently analyzing this survey data and can share some of our preliminary findings with you today.

During our credit card survey we call companies' toll-free numbers posing 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.***

Each year it becomes more difficult to get information from credit card companies. The answers to our survey questions increasingly lack key details about conditions, especially those relating to fees and other costs, and to the circumstances that trigger penalty measures such as higher interest rates and reduced credit limits. Representatives often are unable to provide even the basic facts required by federal credit card disclosure laws.

Hidden terms and conditions. There is no place for potential customers to find accurate information. Credit card companies have call center staff to serve existing cardholders 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 lines are staffed by salespeople who are unable to provide accurate information about terms and conditions. This leaves potential customers in danger of applying for a card that at best doesn't suit them and at worst, contains predatory terms and conditions.

Such trends make it more difficult—if not impossible—for consumers to shop around for the best deal on a credit card. We have found examples where cardholders are required to go well into the application process—providing sensitive personal information in order to proceed—before being given legally required disclosures. The HSBC web site, for instance, provides only a range of APRs, assigns much space to marketing the "benefits" of each card, and fails entirely to provide required upfront disclosure on the grace period, balance calculation method, minimum finance charge, etc. *(See the attached HSBC credit card disclosure document from the company's web site.)*

All top 10 issuers advertise cards on their web sites that do not carry firm APRs. Instead, they skirt regulations by providing only a meaningless range of rates—cardholders don't know what rate they'll get until they apply. We believe that this pattern of disclosures that is so general as to provide no substantive information violates the credit card solicitation disclosure provisions of the Truth-in-Lending Act. At the very least, the law demands that potential cardholders be given concrete information about the costs associated with a credit card before they apply.

Punishing practices. Standard in the vast majority of credit card agreements, unilateral change in terms provisions are often cited as a way for companies to manage risk. But these "take it or leave it" contracts of adhesion force cardholders onto an uneven playing field—in many cases even before they actually become customers. Among the terms that are shoved down cardholders' throats are penalty rates. If you pay your credit card bill late even one time, often by even one day, your interest rate skyrockets.

When potential cardholders go shopping for a card or respond to an invitation to apply sent to their home, they have no way of knowing what the terms on that card will actually be until it arrives in the mail. Even if cardholders decide not to activate the card, the account is reported on their credit reports for many years. Consumers who accept a firm prescreened offer of credit have no idea what their credit limit will be. Why should cardholders have to wait until the card has been issued to see and read the contract that governs their use of the card? Why should cardholders have no reasonable right of rescission if they don't like the terms being offered?

And worst of all is the practice of applying adverse changes in terms based not on the cardholder's payment record, which may be spotless, but on credit scores or items in the consumer's credit reports. Does it make any sense to increase the interest rate of customers who are having a hard time with their debt load? Or, someone who has paid late on another credit card? No. The real purpose is to maximize revenue at the expense of those who are least able to afford it.

Consumer Action has heard from hundreds of consumers asking for help because they have been saddled with sky-high interest rates that are applied to their existing balances because of new items in their credit reports.

> *Thomaston, ME, April 3, 2007—HELP!!! I have a Chase card that is now at nearly 40% interest and the rate is only due to a late payment for my mortgage. I called but they will not reduce my rate. My interest last month was over 300 dollars!*

It is outrageous for credit card issuers to claim that they are merely using risk management techniques when they increase interest rates to loan-shark levels. We challenge the industry to explain how taking out a new car loan or having a credit card payment arrive one day late makes a customer so much more risky that the company can justify a doubling or tripling of the interest rate. If this is really risk-based pricing, why do most issuers have standardized default rates instead of a range 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 a cardholder with a 30- or 60-day late payment.

Adverse changes to existing accounts. In early 2007, most major issuers deny that they employ "universal default" policies to hike interest rates based solely on the way customers handle their other credit accounts such as car loans, mortgages and revolving credit accounts. However, we think they still use credit report information as a reason to make adverse account changes under their "change in terms" provisions. Knee-jerk interest rate hikes based on credit reports concern us greatly because of the very real probability that credit reports contain errors.

A Michigan man recently contacted Consumer Action to complain that Chase had raised his card's interest rate from 8% to 30% APR. Upon investigation, the cardholder found that his utility company had been mistaken in reporting a late payment on his credit report, which caused his credit score to drop, prompting Chase to increase his rate. The man was able to correct the mistake on his credit report, but it proves more difficult to get the credit card interest rate back to its original level. This is a common situation for burned cardholders who call Consumer Action for help.

During its most recent survey, which wrapped up on March 2, Consumer Action asked customer service representatives at 20 card issuers: "Do you raise my interest rate because of my credit record with other credit cards or lenders?" Based on the answers, it appears that half of surveyed banks would, at the time of the survey, raise cardholder APRs based on information from credit reports and scores. These banks are Chase, Citi, Commerce Bank, Discover, EverBank, Franklin Templeton Bank & Trust, GE Money Bank, HSBC, Metropolitan National Bank and US Bank (We note that Citi in a March 1 press release pledged to stop universal default.)

Consumers who contact Consumer Action report being the victims of 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 exorbitant rates to do it?

> *Elkins, WV, March 15, 2007—I've been a cardholder with Bank of America for 16 years. I recently noticed they had raised my interest rate to 32.24% and was appalled. I telephoned to request that they lower the interest rate on my account as I hear everywhere you can negotiate lower rates... I was told I don't qualify for lowered rates because I had made 13 late payments over 16 years. When I pointed out that for 16 years there has never been even one late payment on my credit report and that 95% of those supposedly late payments were less than 48 hours past the due date, I was told, "Sorry, you are not in good standing with Bank of America."*

When you're turned down for credit, the law requires that you receive a letter explaining why. But if you are hit with a penalty rate hike or other punitive adverse change in terms, you don't learn about it until your next statement arrives.

At the recent Senate hearings on credit card practices, issuers said on the record that they do everything they can to help cardholders in trouble. Meanwhile, Consumer Action hears from far too many cardholders, who, like the West Virginia woman above, are told to, "Take it or leave it." This is a shamefully inadequate response to helping cardholders in trouble!

Note: More examples of recent consumer complaints about adverse changes in terms received by Consumer Action are attached to this testimony.

Change of terms provisions. Consumer Action advises cardholders to look beyond the default rates disclosures, to clauses in the fine print of solicitations and cardholder agreements commonly labeled change of terms provisions. This is the legal boilerplate that gives issuers the right to change APRs and other key terms at will—at any time, for any reason.

On March 5, 2007, Consumer Action visited the web sites of the top 10 U.S. card issuers to review change of terms disclosures. Only one (Discover) did not include a blanket change of terms notice. American Express and Wells Fargo feature change of terms provisions but do not include any reference to credit reports or scores as a reason to change the terms of the cardholder agreement. *(See attached chart for change in terms disclosures for the top 10 issuers.)*

Some notices contain the right to change terms based on "competitive" factors. Banks may say they need to change terms in order to manage risk, but in truth they hike cardholder rates when they perceive their competitors are making more money than they are.

Residual interest. Sometimes called trailing interest, residual interest is a deceptive method of calculating credit card interest right up to the day a full payment is received. Consumer Action discovered that nine of the 20 banks surveyed employ the practice. These include top 10 issuers Bank of America, Capital One, Chase, Citi, and HSBC.

Consumer Action believes residual interest is an unfair and deceptive practice. Cardholders who access their account online to make sure their full payment has been received by the due date would see a zero balance, because the trailing interest isn't added until the close of the subsequent billing cycle.

Disclosures about residual interest practices in cardholder agreements are not standardized and if read, not generally understood. The following chart shows how residual interest works:

Residual interest example

You purchase a $3,000 TV using your 17% APR credit card and decide to pay off the balance in three payments. You have a zero balance when you purchase the TV and you make no new purchases while you pay off the balance. Your payments are received and credited on the due date, but on your next statement, you are charged $7.59 more in interest.

Billing Cycle	Payment	Interest charges	Principal paid	Current balance
1				$3,000
2	$1,025.11	$37.50	$987.61	$2,012.39
3	$1,025.11	$25.15	$999.96	$1,012.43
4	$1,025.09	$12.66	$1,012.43	$0.00
5		$7.59*		$7.59

** This interest charge is figured on a balance of $1,012.43 for 20 days (the time between the close of your billing cycle and the day your final payment of $1,025.09 was credited).*

Penalty rates. Consumer Action finds penalty rates as high as 32.24%. Late payments result in higher penalty rates with 85% of surveyed issuers—an increase from the 2005 finding of 79%. Five of these issuers (Bank of America, Citi, GE Money Bank, HSBC and Washington Mutual) said that a payment not received by a certain hour on the due date itself (i.e. 4 p.m.) would trigger an immediate penalty rate hike.

Late fees. In 1995 Consumer Action found an average late fee of $13, with no company charging more than $18. In 2007 the average fee has more than doubled to $28.02—and late fees are as high as $39 per incident.

It was in 2003 that Consumer Action first noted tiered late fees tied to the balance amount. Tiered late fees result in higher-than-average late fees for cardholders with lower balances. Fourteen issuers (70%) use tiered late fees tied to the cardholder's balance—up from 40% in 2005. This penalizes people with smaller balances more than those with high balances who might legitimately be considered a greater risk if they default.

Due dates. These days, most issuers require that your payment arrive before a certain hour on the due date or you'll be charged a late fee. Each bank sets its own cut off time for late payments on the due date. These times vary widely. BB&T Bank will not accept payments after 2 p.m. on the due date and Chase requires payments by 4 p.m. Citi changed its 2 p.m. cut off to 5 p.m. sometime in the past two years.

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 seven 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 can't credit card issuers?

Non-business due dates. Due dates that fall on Sundays or holidays have become a very common occurrence. Consumer Action attempted to discover whether cardholders are being charged a late fee if the due date falls on a weekend or holiday. Of 20 banks, seven representatives answered "yes," five "no," seven "don't know," and on one card it was impossible get a straight answer. If an employee of the bank doesn't know the answer, how can a cardholder be held responsible for not understanding the rules?

> ***Pittsburgh, PA, March 2, 2007***—*Bank of America sent me a bill showing a due date of Monday, Feb. 19, which was Presidents Day and a legal holiday. In fact, they would not accept online payments on Feb. 17, 18, or 19. They accept payments only Monday through Friday, not including holidays. The de facto due date is then Feb. 16 if you do not want to get hit with late fees. Sneaky!*

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'll be stuck with an over limit fee, which can be assessed *every* month until your balance is under the limit. The industry either should 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 barred from adding over limit fees.

> ***Gould, AR, April 2, 2007***—*As a full time college student with a part time job, I manage my money wisely. I pay my credit card bills online and I take great care to manage my finances. I have a credit card with Discover that I kept under the limit until I was one day late with a payment and they assessed my account with an over limit fee. The only reason I was late is because of the posting policies they have when you make online payments. Because of my late fee, my account was pushed over limit and I was then assessed an over limit fee. Since this happened, I have consistently made my minimum payments online and on time and now I am almost $400 over limit even though I have not made any purchases.*

Shrinking grace periods. Your credit card's grace period is the number of days in which finance charges do not accrue. The grace period disappears when you carry a balance, so this is a perk enjoyed only by the 30% or so of cardholders who pay in full every month. Consumer Action's survey found that among the top 10 credit card issuers, the average grace period is 22 days. The average grace period among these issuers has shrunk by more than 3 days since 1995.

Credit limits. Fifteen surveyed banks (75%) said they might reduce cardholders' credit limits if they exhibited certain risky behavior. The 15 banks might reduce credit limits under these circumstances:

- Poor credit history or lower credit score.
- Not paying on time or going over limit.
- Bouncing a payment check.
- Your performance on the account.
- High debt-to-income ratio.

While Consumer Action admits this practice might be a sensible way to manage a risky cardholder account, unfortunately we have heard from consumers who find their credit limit has been reduced to a point where it is lower than their existing balance, triggering over limit fees. This should never be allowed to happen to any cardholder.

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% of banks failed to quote a firm APR. By 2007, the percentage had more than tripled to 52%.

Worse, the quoted rates in a range are tagged with deceptive labels such as "premium" and "preferred" which leads consumers to think they are getting the best interest rate the bank offers. At Chase, we found "premium" rates of 18.24% and 19.24%. At Bank of America, we found "preferred" rates as high as 18.24%.

Cash advances. Credit card cash advance fees have escalated dramatically in the last decade. In 1995, the average charge was 2.2% of the amount advanced, with an average cap on the fee of $17. By 2007, the average fee had jumped to 3.07%—a 40% increase. More disturbingly, 90% of the cards have no upwards limit on the fee. On the handful of cards with a fee cap, the average maximum has more than doubled to $40.

On cash advances taken with a credit card, the interest begins to accrue immediately, even if you do not carry a balance. On the majority of cards, a higher interest rate applies on cash balances. Of all cards surveyed, 74 (89.15%) have higher APRs for cash advances as compared to purchases. (In 2005, 74.8% of surveyed cards had a higher interest rate for cash advances.) The average purchase APR is 14.91%, and the average cash advance APR is 23.09%—a difference of 8.1 percentage points. The range of rates is 14.74% (Franklin Templeton Bank & Trust) to 24.24% (Bank of America, Chase, US Bank and HSBC.)

Fees for on-time payments. Sixty-five percent of surveyed banks charged a fee for non-automated payments made by phone. The fees ranged from $3 (Amalgamated Bank of Chicago) to $14.95 (Citi and Washington Mutual). The average fee charged by these banks is $9.23. Bank of America ($14.95) and Wells Fargo ($10) charge when you pay by phone from an account at a second party bank. None of the banks charge people who pay online, however several banks have fees for "expedited" payments made within a certain period before the due date. These banks include Chase, with a $14.95 fee; and HSBC, $15.

Bounced check fees. If your bank returns your payment to the credit card company because you do not have the funds in your bank account to cover the payment, 81 (97.6%) of the surveyed banks will charge you a fee of up to $39. The average bounced check fee at these banks is $32.06. Bounced check fees range from no fee (American Express Clear Card) to $39 on 31 cards. The lowest fee found by Consumer Action is $20 at First Command Bank. In addition, Consumer Action discovered that many banks will charge a comparable fee if you write a credit card convenience check that causes your credit card to go over limit or if you ask to stop payment on a credit card check.

Balance calculation. Two-cycle interest policies calculate interest based on two billing cycles instead of the more prevalent practice of determining interest only on the immediate billing cycle. Unless you always pay in full, two-cycle billing means that you pay interest on a portion of the same balance you paid last month. Consumer Action found three banks using two-cycle billing, Discover, Chase and Washington Mutual. As the survey period ended, Chase announced at a Senate Banking Committee hearing on credit card practices that it would no long use two-cycle billing—a practice it had preserved on many cards following its takeover of FirstUSA. Washington Mutual uses a two-cycle billing method called "average daily balance" which applies interest back to the date of each purchase made in the previous cycle.

Confusing minimum payment formulas. Among the top 10 issuers, Consumer Action found nine methods for figuring the minimum monthly payment a cardholder must pay. Citi's policy is the most confusing—the issuer has at least three ways of calculating minimum payments. Citi cardholders must check their monthly billing statements to know which one applies.

American Express	Greater of: (1) 2% of balance, or (2) $15, or (3) all finance charges + $15.
Bank of America	1% of balance plus all finance charges and fees; or, 5% of balance if no fees or finance charges apply.
Capital One	Greater of 3% of balance or $10.
Chase	Greater of $10; 2% of new balance; or sum of 1% of new balance including all new interest and fees.
Citi	(1) past due and over limit amounts added to the greater of $20 or 1/48th of balance. (2) past due and over limit amounts added to the greater of new interest and late fees; $20, or 1/48th of new balance. (3) past due and over limit amounts added to the greater of $20; 1% of balance plus interest and late fees, or 1.5% of balance. On accounts with APRs above 19.99%, add $5.
Discover	2% of balance plus outstanding fees.
HSBC Bank USA	Greater of 1% of the balance plus new interest and fees, or $15.
US Bank, Wells Fargo	1% the balance new interest and fees, or $20.
Washington Mutual	Varies by account. Typically includes a certain percentage of the balance plus all new interest, late and over limit fees.

Source: Consumer Action 2007

Consumer Action believes it would benefit consumers if all banks used a standardized method of calculating the monthly minimum payment. It would also be helpful if the methods used to calculate the balance were disclosed to applicants in advance.

Hot button issue. Before closing, I would like to bring to your attention just how important the issue of credit card reform is to your constituents. Consumer Action provides a free online "Take@ction" center on its website at www.consumer-action.org. In recent months, record-breaking numbers of consumers have visited our site and sent letters to their representatives in Congress asking for legislation to protect cardholders from abusive credit card industry practices. This is a truly "hot button" issue for the people you represent! In particular, we wish to highlight two separate actions:

> • *Since Jan. 23, 2007, 7,633 visitors have sent letters (6,881 emails and 752 letters) to their lawmakers asking them to enact "Credit Card Reform" by passing new cardholder protections in the 110th Congress.*
>
> • *Since May 8, 2006, 4,694 visitors have written 4,418 emails and 276 letters to Congress to urge support of one bill—legislation introduced by Senator Robert Menendez in the 109th Congress which would have addressed key abusive practices including late posting of on-time payments, retroactive application of higher interest rates to existing balances and universal default rate hikes.*

I thank you for your diligence in investigating credit card industry practices and I urge you to support legislation to protect consumers who use credit cards, including the Credit Card Accountability, Responsibility and Disclosure Act of 2007 (HR 1461) introduced by Rep. Mark Udall and the Credit Card Repayment Act of 2007 (HR 1510) introduced by Rep. David Price.

Consumer Action has joined leading national consumer organizations to create a Joint Credit Card Reform Platform. It outlines proposals that would help curb abusive lending practices. A copy of the Joint Platform is attached.

This is a "follow the leader" industry. When one issuer steps out with a new anti-consumer practice, other banks are quick to follow. When attention is focused on one bad practice, such as universal default, issuers are quick to say they don't do it. The problem is that other lesser known unfair practices continue, such as two-cycle billing, residual interest and due dates on Sundays and holidays.

Consumer Action asks that you do everything in your power to provide an even playing field for consumers who use credit cards.

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How can they do this?

Recent Credit Card Complaints Received by Consumer Action

These complaints in consumers' own words are a sampling from Consumer Action's assistance and referral database. Should you have follow up questions for these consumers, we would be glad to assist you in contacting them.

Charlotte, NC, March 9, 2007—A few weeks ago, I received notice from Chase that the interest rate on my credit card would be raised on April 1st from 17.24% to 32.24%. I immediately wrote them back as directed within their notice asking why. This afternoon, I received a form letter from them stating that the following three reasons were why my interest rate had ballooned almost 100%:

1. Total bankcards balances are too high compared to credit limits.
2. Too many recently opened accounts compared to total accounts.
3. One or more accounts have high balances compared to credit limits.

Now, since receiving my Chase credit card last February, I have NEVER made a late payment on it. And, since I was charging practically all of my monthly expenses on it, I made payments above and beyond the expected monthly payments. I pay all of my other credit cards on time as well.

My question is, how can Chase do this? I have been nothing but an active, diligent customer of theirs. I was never notified that high balances on other cards would cause my interest rate to skyrocket, never mind the fact that, barring late payments, once Chase entered an agreement with me to provide me with credit I feel that they should be honor bound to maintain that agreement. Obviously the phrase "honor bound" should never be used when describing credit card companies, but I would still like to know how they can legally do this. It is nothing more than extortion and robbery.

Is there anything that I, an average American citizen can do to fight against this highly unethical action? Naturally I have already stopped using this card and am attempting to pay Chase off as quickly as possible before the 32.24% interest rate devours me.

Hilton Head Island, CA, March 23, 2007—I am writing about my MBNA AAA credit card [Bank of America]. My rate increase from one statement to the next was from 7.99% to 21.99%. We always paid on time and paid at least the minimum balance. I was told that I was notified via an insert in my January statement, which I don't recall ever seeing. The company will not change the new rate or credit me for additional finance charges on this bill. I don't feel it is right to be subject to a finance charge at a rate I never agreed to when I have not been negligent.

Monroeville, PA, March 13, 2007—My Providian [Washington Mutual] credit card account has always had an APR of 18.33%. Then a few months ago it was raised to 30.09% with no explanation. I rarely used the account up until June or July of 2006. I have never been late or missed any payments. I do carry a balance now that I did not have before. I have never gone over the limit. Providian has merged with another bank [Washington Mutual]. I called to have it put back at 18% but they declined the request to do that. Can they do this?

North Bergen, NJ, April 8, 2007—My Chase credit card interest rate increased from 6% to 27%. I have been a customer for 5+ years. I have never seen anything like this before. I called and asked Chase customer service, why the increase? I was told that in January they claim that my payment was two days late. I was furious and immediately cancelled the card and paid off the $15K balance. I will never use Chase again. This has got to stop. What happens to people who cannot afford to pay off their balance? Secondly, how can I prove that I mailed the payment in a reasonable time for them to receive before the deadline. It's a racket. Congress has to regulate the industry.

Schaghticoke, NY, Feb. 28, 2007—I signed up [with First National Bank of Omaha] for a card with a 1.99% interest rate for the life of my loan. I always paid on time and more than the minimum amount. My credit was excellent! In the process of moving I missed a bill for a $40 co-pay at the doctor's office. A year later, with no phone calls or letters, I was informed that my $40 had been sent to collections. I called the collection company and was told that they do not send out letters if the collection is less than $50.00. All of a sudden my credit card 1.99% rate goes to an absurd 25.85%. Upon making a phone call to First National, I was told that this is common practice! My credit history is excellent, I would never not pay a bill that I was aware of...especially a $40 one! These credit card companies are out of hand and need to be stopped.

Denver, CO, Feb. 2, 2007—I was divorced last year and had to take on debt. [I moved my balances to two Chase cards with 0% balance transfer offers.] When the year was up, they jacked my rates up to 30%. I called them, they said it was because I was only paying it to keep it from hitting the limit, which is actually the case, I was paying off higher debt cards first, which I did. I paid one of these cards off completely, and canceled it. I also paid a large chunk on the other card and they again refused to reduce my rates. The highest rate I have ever had was 18%, and have never had a company treat me with such disdain. I am working to pay this last Chase card off in the next month or two, but these people are robbing people.

Jackson Center, PA, Feb. 12, 2007—I have been a customer with Providian (now Washington Mutual) for about four years with NO late payments and almost all payments OVER the minimum. In January the interest rate was slightly over 30%. I made a payment that took my balance from almost $6,000 down to $1,000, and in February the interest went up OVER 34%!!! I tried to call and get the rate reduced in January. How can they charge so much and what can I do legally to stop this RIDICULOUS rate of interest?

Florissant, MO, March 20, 2007—I had a card account with Regions Bank/Union Planters and was never late, but in Dec 2005 I went over my limit by $59.02–that's including the over-the-limit fee. I was actually only over by $20.02 for Christmas shopping. They sent a note that the over limit amount had to be paid in the next 20 days. I not only sent in the over the limit fee, I also sent in $159.02 three days after I received the statement. They then proceeded to systematically start raising my interest rate slowly each month so that I wouldn't notice. Right away it went from 12.74% to 12.99% to 13.24% to 17.99% to 23.74% to 23.99% to 24.49% to 24.74% to 24.99% to 25.24%. That's when I caught it—when I noticed that the payment I sent in was almost the same as the interest I owed. The contract stated that the interest rate would stay the same as long as there were no more than two incidents in a year. I had only one incident – a $20 over-the-limit fee for Christmas shopping. What they did as far as I'm concerned was illegal. Now I can't pay and I have a collection company calling every other day.

Inglewood, CA, Jan 29, 2007—My Chase account has been erroneously overcharged in interest. I have called Chase about this problem on several occasions and have been unsuccessful in getting this matter resolved. It appears that in October of 2004 my interest rate was raised from 11.50% to 27.00% and now it rests at an uncomfortable 29.90%. When I asked about this, one operator told me that it was because my account had been reviewed and that I had been late on another revolving account in the past. When I reviewed my credit history with the three credit bureaus I saw that this was not the case. I have never been late on revolving account; in fact my credit is excellent. I called back on another occasion and I asked the operator to review this again. The operator said she didn't see why I was being charged such a high interest rate. I hadn't been late and suggested that I write a letter asking for this to matter to be reviewed. I would like Chase to credit me for the overpayment in interest since October 2004.

San Jose, CA, Jan 8, 2007—My Bank of America card APR changed from 13.90% to 31.90%. Before the increase, my debt was $4,800—it's now $5,500. When I returned from a second deployment in Iraq, my interest rate was changed to 31.90%. I am being charged more for the interest than the principal. I feel that this is predatory lending.

Moody, TX, April 11, 2007—I have done business with Bank of America for several years. I have one card with a large balance. I have been making double payments with a 4.90% interest rate and I am always on time. I had one accidental late payment, due to a family medical emergency, and then they raised our interest to 25%. This is criminal, in our opinion, and should not be legal! This is an unethical business.

Knoxville TN, April 11, 2007—The Juniper credit card website showed that I had available credit of $452.73 on my Juniper card. I used their site to transfer a balance of $450 from a Chase card to this account. THERE IS NO MENTION OF A BALANCE TRANSFER FEE ANYWHERE ON THE WEBSITE. I was charged $13.50 for the transfer. This put my balance $10.77 over the limit, so I was hit with a $39 over-the-limit fee. The interest rate shot up from 0% to 25.24%, so they added finance charges of $88.97.

Denver, CO, Dec. 27, 2006—I am at a loss as to why Chase raised the interest rate on my credit card. I have never been late. I pay at least the minimum payment. Last year they sent me a notice stating they were going to raise my interest rate to 24.99% or I could opt out and close my account. I closed my account. I just got my statement and without any warning they raised my rate to 24.99%. When I called them they said they pulled a credit report and because my balances were high on my other cards, that is why they raised it. I said the account had been closed because I didn't accept these terms but they said they ran another report. What can I do? These are my bills and I want to pay them back. But with this outrageous interest charge I will never be able to get this paid off for years

Albany NY, April 12, 2007—I called Washington Mutual in October 2006 to let them know that I would be having trouble paying off my credit card debt. As soon as the next payment was due my interest rate went up and a late fee was charged, putting me over the limit, causing an additional over-the-limit charge. I called them again to work out arrangements and was told that they could do nothing about it. For six months I tried to work with them to no avail. I am now being called at least six times a day, everyday and when I do pick up the phone they just want the money and can offer no other arrangements. I called them on 4/10/07 to see what they had to offer and was told that the over-the-limit and late charges will still apply every month until I can bring the credit card up-to-date. The cost of the fees is approximately $80 per month.

West Henrietta, NY, April 2, 2007—I have just received a brand new credit card from First Premier Bank. They have charged me a total of $178 in fees, including a $95 program fee, a $29 set-up fee, a $6 participation fee and an annual fee of $48. The credit limit was set at $250 and I have available credit of $72 with a $20 minimum payment already due. Is this legal? I did not knowingly agree to any of these charges.

Au Sable Forks, NY, March 29, 2007—I have gone beyond frustration with my Bank of America credit card. At every turn I get notices from Bank of America informing me that my finance charges have changed, my minimum payments can be increased to any amount. My card continued to have the finance charges increase, sometimes month-to-month. We were making our payments on time and, in fact, paying more than the minimum, and working aggressively to pay off the balance.

When the finance charges hit an absurd 24.99%, I called to make arrangements to help me pay the balance on my card. I was offered a reduced interest rate and was told that at the end of that arrangement, if I still needed assistance, that I could get back in touch with customer service and they would be able to help. I was also told that the finance charge, which was dropped to 8%, would rise slightly after the arrangement was complete, but that it should not be more than an increase of 2% or 3%. When we received our bill following the conclusion of the agreement, our rate jumped up to 15.49% as opposed to the 10 or 11% we had been told would be the case. I called and was informed that there was nothing that could be done because the account was closed. I stated that I had been told I would still have the opportunity to seek assistance, but was told in no uncertain terms that it was not possible. When I asked to speak to a supervisor or manager, I was also told that was not possible and upon insistence, was placed on hold and then dropped back into the start of the system. This happened multiple times with my husband as witness to the conversations.

What I don't understand is Bank of America's lack of respect for agreements that have been made prior to its purchase of MBNA. I have every intention of paying off my debt and have been working very hard to do so, but with this bank taking every opportunity to make that more and more difficult for me and my family, we find ourselves in a hardship situation. In other words, I have to abide by whatever terms are set forth, but Bank of America does not. In fact, I just received a notice saying that Bank of America was now able, according to the U.S. government, to change my minimum payments to any amount of their choosing. It makes me wonder how I am going to be able to continue to feed my family.

Altamont, IL, March 18, 2007—I had a Capital One credit card with a $500 balance. Due to personal reasons (medical), I did not make a payment for at least a year. I ended up with a balance of $1600. A collection agency wanted to settle for $800, which I could not afford to pay in full at the time. I agreed over the phone to pay $800, but at $50 per month.

I got up to $650 paid and then my payment was returned. My balance had been moved to a different collection agency. Now the new collection agency contacted me and wanted $1,000. I told them I would send them $150, ($800-$650) but they would not agree. They have actually switched collection agencies four times since all this has transpired. Remember this was a $500 limit credit card, I have already paid back the principal. All I owe is late fees, over the limit, and added interest on top of these fees. This whole thing has been a nightmare, I will gladly pay $800 total. A $1,600 balance on a $500 credit card is unreasonable and outrageous.

ACORN • Center for Consumer Finances • Consumer Action • Consumers Union
Consumer Federation of America • Demos
National Association of Consumer Advocates * National Consumer Law Center •
National Council of La Raza • U.S. PIRG

JOINT CREDIT CARD REFORM PLATFORM

Eliminate reckless and abusive lending by credit card companies

No unsound loans: Make issuers offer credit the old fashioned way, using sound underwriting principles based on the ability of consumers to pay and that ensure the cardholder is not overextending financially by taking on more debt.

Restrict lending to youth without conditions. Young people deserve credit, but only if they qualify. Yet right now, young people are the only group that can obtain a credit card without either a positive credit report, a job, or other evidence of ability to pay, or, barring any of these, a co-signer. No other adult can get a credit card without meeting at least one of these conditions. Young people should have the same safeguards.

No abuse of consumers in bankruptcy. Credit card issuers drive consumers into bankruptcy with abusive terms and collection practices. Stop issuers from collecting on these abusive loans in bankruptcy.

End deceptive and unjust terms, interest rates and fees

Ban retroactive rate increases. Stop issuers from changing the rules in the middle of the game by raising interest rates on past purchases.

No unilateral adverse changes in terms for no reason: Credit card company contracts currently claim the right to change terms for any reason, including no reason. Any change in terms during the course of the contract should require knowing, affirmative consumer consent and reasonable notice.

Ban universal default in all its forms. Prohibit punitive "universal default" interest rates based on alleged missteps with another issuer but involving no missed payments to the credit card company itself. It is unfair to impose a penalty rate on a consumer who has not made a late payment to that creditor. Stop card companies from using a change in terms clause to impose penalty rates.

Stop late fees for payments mailed on time. Require credit card companies to follow the Internal Revenue Service (IRS) and accept the postmarked date as proof of on-time payments. This will also eliminate the tawdry practice of assessing late payment fees when payment is received on the due date, because it did not arrive by a specific time (such as 11 a.m.).

Relate fees to cost. Ensure that all fees and other charges closely match the true cost borne by the card issuer.

End roll-over or repeat late and over-limit fees. Ban fees that are charged in consecutive months based on a previous late or over the limit transaction, not on a new or additional transaction offense, even if the consumer remains over the previous limit.

No fees for creditor approved transactions. Don't let the credit card company charge a fee for a transaction it has approved. Ban over-limit fees when the issuer approves the over limit transaction.

Empower consumers with more detailed information.

Ban deceptive credit card offers. Solicitations and "invitation to apply" solicitations that do not make a truly firm offer of credit are deceptive because they lead consumers to believe that they are pre-approved for or have a good chance of getting certain interest rates. Most consumers instead receive cards at much less favorable interest rates and terms.

Simplify pricing. Reduce the number and types of fees so consumers can compare cards and understand the real cost of using the card.

Real minimum payment warning. Give each consumer a personalized warning on his or her monthly statement calculating the length of time—in months and years—and the total interest costs that will accrue, if the consumer makes only the requested minimum payment.

Ban unfair teasers. Stop issuers from downplaying permanent interest rates in advertisements and solicitations and from trumpeting temporary rates as "fixed rates."

Enhance 'Schumer Box' disclosures. Include a "Schumer box" disclosure table in all cardholder agreements containing personalized information about the terms of the card granted. The box should include the APR, 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.

Give consumers strong protections to deter illegal acts

Ban pre-dispute binding mandatory arbitration. No consumer should be forced to waive his or her right to a court trial as a condition of using a credit card. Prohibit binding mandatory arbitration for consumers' claims *and* for collection actions against consumers.

Toughen Truth In Lending Act (TILA) penalties. TILA penalties have stagnated since 1968.

Give aggrieved consumers a private right of action to enforce the Federal Trade Commission Act to challenge unfair or deceptive practices by businesses, including banks.

Change in Terms Provisions
Top 10 U.S. Credit Card Issuers

Name	Change in terms disclosure	Date of disclosure
Chase	Rates, fees, and terms may change: We reserve the right to change the account terms (including the APRs) at any time for any reason, in addition to APR increases that may occur for failure to comply with the terms of your account. For example, we may change the terms based on information in your credit report, such as the number of other credit card accounts you have and their balances. The APRs for this offer are not guaranteed; APRs may change to higher APRs, fixed APRs may change to variable APRs, or variable APRs may change to fixed APRs. ... We may consider the following factors to determine the default rate: the length of time your Account has been open; the existence, seriousness and timing of defaults; other indications of your Account usage and performance; and information about your other relationships with us, any of our related companies or from consumer credit reports.	© 2007 JPMorgan Chase & Co. Freedom Card. Downloaded on April 5, 2007. The disclosure contained this sentence: The information about the costs of the card described in this form is accurate as of 07/05/2006.
Bank of America	As required by law, rates, fees, and other costs of this credit card offer are disclosed here. All account terms are governed by the Credit Card Agreement sent with the card. Account and Agreement terms are not guaranteed for any period of time; all terms, including the APRs and fees, may change in accordance with the Agreement and applicable law. We may change them based on information in your credit report, market conditions, business strategies, or for any reason.	©2007 Bank of America Corporation. Downloaded on April 5, 2007. The disclosure contained this sentence: The information contained in this advertisement was accurate as of 4/1/2007.
Citi	Rates, fees, and terms may change: We have the right to change the rates, fees, and terms at any time, for any reason, in accordance with the cardmember agreement and applicable law. These reasons may be based on information in your credit report, such as your failure to make payments to another creditor when due, amounts owed to other creditors, the number of credit accounts outstanding, or the number of credit inquiries. These reasons may also include competitive or market-related factors. If we make a change for any of these reasons, you will receive advance notice and a right to opt out in accordance with applicable law.	Copyright © 2007 Citigroup. Downloaded on April 5, 2007.
American Express	The terms of your account, including APRs, are subject to change. The APRs for this offer are not guaranteed; APRs may change to higher APRs, fixed APRs may change to variable APRs, or variable APRs may change to fixed APRs. We may change the terms (including APRs) at any time for any reason, in addition to APR increases for failure to comply with the terms of your account.	The information in this application is accurate through 3/31/2007. Downloaded on March 5, 2007
Capital One	Other Reasons Your Terms Could Change: We reserve the right to change the terms of your account, including APRs and fees, at any time for other reasons, including changes to competitive or general economic conditions. How Your Credit History Could Affect Your APRs: We do not ... increase your APRs *solely* because you fail to make a payment on a loan with another lender or your credit history contains other negative information. If we ever consider increasing your APRs for any reason disclosed in the above paragraph(s), we may review your credit history to determine (a) that we should not increase your APRs, or (b) the level of the increase, if any.	The information about the costs of the cards described is accurate as of 04/01/07. Downloaded on March 5, 2007.

Change in Terms Provisions
Top 10 U.S. Credit Card Issuers

Discover	No change in terms clause is included in its initial disclosures of terms and conditions.	Not applicable.
HSBC	We have the right to change your APRs, fees and other terms at any time, for any reason including, but not limited to, any change in your credit history, credit obligations, Account performance, use of your credit lines with us or any creditor, or our financal return. Any changes will be in accordance with your Cardmember Agreement and applicable law. These cards are issued by HSBC Bank Nevada, N.A. and serviced by its affiliates, HSBC Card Services Inc. and/or HSBC Card Services (II) Inc.	© HSBC Card Services Inc. 2004-2007. Dowloaded on March 5, 2007.
WaMu	We may change the APRs, fees, and other terms of your account at any time in accordance with applicable law and the Account Agreement, which we will send you when your account is opened. Factors we may consider in determining whether and how to change your terms include the frequency and severity of defaults and other indications of risk on accounts with Washington Mutual and/or other creditors.	The information above is accurate as of October 2006 and is subject to change. Downloaded on March 5, 2007.
Wells Fargo	Application Agreement: You agree to be bound by the terms and conditions of the Customer Agreement and Disclosure Statement, which will be sent to you, and understand that the terms of your account may be changed at any time, subject to applicable law.	This information about the cost of the credit card account described in this application is accurate as of March 2007. Downloaded from online application on March 5, 2007.
US Bank	Your APR may increase if you fail to make timely payments to another creditor as reflected in your credit report. All Account terms are governed by the Cardmember agreement sent with the card. Account and Cardmember Agreement terms are not guaranteed for any period of time, we may change all terms, including APRs and fees, in accordance with the Cardmember Agreement and applicable law.	This information is accurate as of 04/2007 and may change. Downloaded on April 5, 2007.
Synopsis:	**Of the top 10 U.S. credit card issuers, Consumer Action found that 9 had change of terms clauses in solicitation materials that allowed changes to existing cardholders' account terms. Of the nine, only two (American Express and Wells Fargo) do not mention a right to change terms because of credit report information or the consumer's record with other creditors. Capital One can change APRs or fees, etc. for "competitive or general economic reasons," and reserves the right to check credit history to determine the level of increase, "if any."**	

Please print a copy for your records.
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Depending on your credit worthiness, you may be offered one of these great credit card products:
A full Terms and Conditions disclosure will be provided to you before your application is processed.

	HSBC No Annual Fee Platinum MasterCard	HSBC Platinum Rewards MasterCard	The Weekend Card	HSBC Platinum MasterCard	HSBC Secured MasterCard
Annual Fee	$0	$0	$0	$39-$79	$35
Processing Fee	$0	$0	$0	$0-$49	$300 minimum deposit
Benefits	- 0% Introductory APR for 6 months on purchases and balance transfers* - MasterCard Platinum benefits - Zero Liability for fraudulent charges - Free online account access	- 0% Introductory APR for 12 months on balance transfers* or 0% Introductory APR for 6 months on purchases and balance transfers (6 month promotional offer for certain HSBC Bank branch customers only). - Unlimited Cash Back and/or Travel Rewards - MasterCard Platinum benefits - Zero Liability for fraudulent charges - Free online account access	- 0% Introductory APR for 12 months on balance transfers* - A full 2% cash back on every single credit card purchase made on Saturdays and Sundays - 1% cash back on credit card purchases made Monday through Friday - MasterCard Platinum benefits - Zero Liability for fraudulent charges - Free online account access	- Great purchasing power to strengthen your credit - 100% Fraud Liability Protection - Choice of payment due dates	- Reports to all three major credit bureaus - Earns you interest on your deposit - 100% Fraud Liability Protection - Choice of payment due dates
APR	11.49%-19.49%	11.49%-20.49%	11.49%-20.49%	14.90%	21.80%

It is our goal to provide you with the HSBC MasterCard that best fits your credit profile. If you are not offered the HSBC Platinum MasterCard, you may be offered an HSBC Secured MasterCard or non-reward MasterCard with other terms and conditions, which may not include a 0% Introductory APR, and will be disclosed before your application is processed.

***The 0% Introductory APR offer for 6 months does not apply to cash advances. The 0% Introductory APR offer for 12 months does not apply to credit card purchases and cash advances. After the Introductory Period, the Customary APR for purchases and cash advances made by credit card check will apply. The variable Customary APR will be between 11.49% and 20.49% (as of 3/1/07), depending upon your creditworthiness. If a Minimum Payment is not received and posted to your Account by the Payment Due Date, or your balance exceeds your Account credit limit, or your payment is returned unsatisfied by your bank or other financial institution for any reason, the Introductory APR will increase up to the variable Default APR of 32.24% (as of 3/1/07). The variable Cash APR is 24.24% (as of 3/1/07). There is no cash advance fee for balance transfers that post to your Account during the Introductory Period; thereafter a cash advance fee of 3% ($5 minimum/$50 maximum) for HSBC Bank Branch customers, or otherwise, 3% ($15 minimum) will apply, unless otherwise disclosed. The cash advance fee for cash advances is 3% ($15 minimum). The Minimum Finance Charge is $1.00. There is no annual fee. We apply payments to lower APR balances before higher APR balances. We have the right to change your APRs, fees and other terms at any time, for any reason including, but not limited to, any change in your credit history, credit obligations, Account performance, use of your credit lines with us or any creditor, or our financial return. Any changes will be in accordance with your Cardmember Agreement and applicable law. These cards are issued by HSBC Bank Nevada, N.A. and serviced by its affiliates, HSBC Card Services Inc. and/or HSBC Card Services (II) Inc.**

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HEARING ON "CREDIT CARD PRACTICES: CURRENT CONSUMER AND REGULATORY ISSUES" ON APRIL 26, 2007, BEFORE THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT OF THE COMMITTEE ON FINANCIAL SERVICES, U.S. HOUSE OF REPRESENTATIVES

WRITTEN TESTIMONY OF ARTHUR E. WILMARTH, JR.
Professor of Law, George Washington University Law School
Washington, D.C.

Thank you very much for inviting me to participate in this important hearing. My testimony will address the following topics related to the credit card industry: (1) the impact of consolidation in the industry, (2) profits and fees of credit card issuers, (3) the role of credit cards in the increasing debt burdens of U.S. households, (4) the impact of federal preemption in giving the largest credit card issuers virtual immunity from state consumer protection laws, and (5) the Office of the Comptroller of the Currency's relatively poor record of protecting consumers.

1. Consolidation and Market Leaders within the Credit Card Industry

The credit card industry has experienced a rapid consolidation over the past two decades. The share of total credit card loans held by the top ten issuers has risen from 40% in 1988 to 70% in 1999 and 87% in 2005. The share held by the top five issuers has grown from 35% in 1988 to 60% in 1999 and 71% in 2005.[1] This consolidation trend has been driven by a number of factors, including advances in computer technology, increased use of mass-marketing techniques, greater reliance on credit scoring, and

[1] Arthur E. Wilmarth, Jr., "The Transformation of the U.S. Financial Services Industry, 1975-2000: Competition, Consolidation and Increased Risks," 2002 *University of Illinois Law Review* 215 [hereinafter Wilmarth, "Transformation"], at 390 n.751 (providing figures for 1988 and 1999); "Top 10 U.S. General Purpose Cards," *The Nilson Report*, Jan. 2006, at 1 (providing 2005 figure for top ten issuers); "Top Credit Card Issuers," *The Nilson Report*, Feb. 2006, at 1 (providing 2005 figure for top five issuers). *See also* Julie Creswell & Eric Dash, "Bank of America to Buy MBNA, A Prime Issuer of Credit Cards," *New York Times*, July 1, 2005, at A1, C5 (describing consolidation in the credit card industry and reporting that "the 10 largest card issuers control about 87 percent of the market").

securitization. All of these developments have created economies of scale that favor large issuers.[2]

The largest federally-chartered banks dominate the credit card industry. Four of the top five credit card issuers and seven of the top ten issuers are national banks. Another of the ten largest issuers is a federally-chartered thrift (Washington Mutual). Only two of the top ten issuers are nonbanks (American Express and Discover).[3] As discussed below, federal preemption helps to explain why so many of the largest issuers are federally-chartered depository institutions.

Federally-chartered depository institutions are also dominant players in other segments of the consumer credit industry. Seven of the top ten home mortgage lenders are either national banks or federally-chartered thrifts, and they collectively control about half of the home mortgage market.[4] Seven of the top 20 subprime mortgage lenders are either national banks or federally-chartered thrifts, and together they hold about 30% of the subprime market.[5]

2. <u>Profits and Fees Generated by Credit Card Issuers</u>

The credit card business is highly profitable. The Federal Reserve Board (FRB) issues annual reports on the largest credit card banks. The FRB's most recent report stated that sixteen large banks specialized primarily in credit card lending as of December 31, 2005. Those banks had an average pre-tax return on assets (ROA) of 2.85% in 2005,

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[2] Timothy Clark et al., "The Role of Retail Banking in the U.S. Banking Industry: Risk, Return, and Industry Structure," *Federal Reserve Bank of N.Y. Economic Policy Review* (forthcoming), at 7-9; Wilmarth, "Transformation," *supra* note 1, at 388-90.
[3] "Largest General-Purpose Credit Card Issuers in the U.S.," *American Banker*, June 1, 2005, at 7 (listing Bank of America, JP Morgan Chase, Citigroup, American Express and Capital One as the five largest credit card issuers, following Bank of America's merger with MBNA); *id.* (listing Discover, HSBC, Washington Mutual, Wells Fargo and U.S. Bank as the credit card issuers ranked between sixth and tenth in size).
[4] "Top Residential lenders in the First Half," *National Mortgage News*, Oct. 23, 2006, at 1.
[5] "Top Subprime Lenders in 2006," *National Mortgage News*, April 23, 2007, at 1.

well-above the average pre-tax ROA of 1.94% for all U.S. banks in 2005. Credit card banks earned pre-tax ROAs of more than 2.0% in every year from 1992 through 2005, and their return has been above 2.7% in all but two of those years.[6] In contrast, the average pre-tax ROA for all U.S. banks exceeded 2.0% in only two years during 1992-2005, and never exceeded 2.05%.[7]

Credit card operations account for a significant proportion of the revenues and net income of the largest banks. For example, during 2005 credit cards accounted for about 17% of the net income of Citigroup, the largest U.S. banking organization and the third largest credit card issuer.[8] Similarly, during the third quarter of 2005, credit cards generated about a quarter of the total revenues of JP Morgan Chase, the third largest U.S. banking organization and the second largest credit card issuer.[9]

The fee income of credit card issuers has grown rapidly in recent years. U.S. cardholders paid more than $24 billion in credit-card fees in 2004, an 18% increase from 2003. Penalty fees (including late fees and over-the-limit fees) assessed by credit card issuers rose from $1.7 billion in 1996 to $12 billion in 2003, $15 billion in 2004, and

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[6] Bd. of Governors of Fed. Res. Sys., "Report to Congress on the Profitability of Credit Card Operations of Depository Institutions," June 2006 [hereinafter FRB Report], at 1-3.
[7] Elizabeth C. Klee & Gretchen C. Weinbuch, "Profits and Balance Sheet Developments at U.S. Commercial Banks in 2005," 2006 *Federal Reserve Bulletin*, at A77, A99 (tbl. A.1.A) (providing data for 1996-2005); William F Bassett & Mark Carlson, "Profits and Balance Sheet Developments at U.S. Commercial Banks in 2001," 88 *Federal Reserve Bulletin* 260, 279 (tbl. A.1.A) (providing data for 1992-95).
[8] Robin Sidel, "Loss of Balance: Credit-Card Issuers' Problem: People Are Paying Their Bills," *Wall Street Journal*, May 25, 2006, at A1.
[9] Robin Sidel, "J.P. Morgan to Expand Reach of Card Business," *Wall Street Journal*, Dec. 20, 2005, at C1.

$17.1 billion in 2005.[10] The fees collected by credit card issuers accounted for more than 10% of the total noninterest income of all U.S. banks in 2004.[11]

The growth in fee income for credit card issuers has been spurred by large increases in the penalty fees issuers impose on their customers. For example, average late payment fees rose from $13 in 1995 to $27.10 in 2000, $32.61 in 2004, and $34 in 2006. Similarly, average over-the-limit fees increased from $26 in 2000 to more than $30 in 2000.[12]

The percentage of issuers charging variable interest rates (i.e., interest rates that change with the prime rate) increased from 23% in 1991 to 53% in 2006. On average, non-penalty interest rates on credit cards exceeded 13% in every year between 1994 and 2005, except for 2003, when the average rate was 12.92%.[13] Average penalty interest rates rose from 21.9% in 2004 to 24.2% in 2005, and many issuers impose a penalty rate for a single missed payment.[14]

The very high profits, fees and interest rates of credit card issuers indicate that the credit card industry operates as an oligopoly rather than as a fully competitive industry. This conclusion is consistent with the very large market shares currently held by the top five and top ten card issuers (71% and 87%, respectively). Recently, a prominent analyst (and former senior executive) of the credit card industry challenged the view that the

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[10] "US card industry challenged by lawmakers," *Electronic Payments International* (London, UK), Feb. 2007, at 8; Jane J. Kim, "Credit-Card Penalties Hit New Highs: Major Issuers Boost Costs for Late Payments Past 30% Amid Rising Interest Rates," *Wall Street Journal*, Aug. 11, 2005, at D2.

[11] *See FDIC Quarterly Banking Profile*, 4th Qtr. 2005, at 5 (tbl. II-A) (reporting that U.S. banks had total noninterest income of $203 billion in 2004). As noted above, credit card issuers earned $24 billion in fees during 2004.

[12] "US card industry challenged by lawmakers," *supra* note 10; Caroline E. Mayer, "Plastic's Pickup Line," *Washington Post*, July 10, 2005.

[13] FRB Report, *supra* note 6, at 6, 7 (tbl.2)..

[14] Kim, *supra* note 10.

industry is "competitive." He instead described the industry's profits, risks and pricing practices in the following terms:

> [B]ank card pricing is the inverse of a competitive industry.... In Europe they call the bank card industry what it is: a cartel.
>
> ....
>
> Bank cards in fact might be the safest risk among retail credit products, a view commonly acknowledged in other forums by regulators, Wall Street, and the banks themselves.
>
> No other industry in the world knows consumers and their transaction behavior better than the bank card industry. It has turned the analysis of consumers into a science rivaling the studies of DNA ....
>
> The mathematics of virtually everything consumers do is stored, updated, categorized, churned, scored, tested, valued, and compared from every possible angle in hundreds of the most powerful computers and by among the most creative minds anywhere. In the past 10 years alone, the transactions of 200 million Americans have been reviewed in trillions of different ways to minimize bank card risks.
>
> In case nobody has noticed, bank card issuers have survived recent economic downturns far better than other credit products. Their profits and writeoffs have remained steady for two decades. Secured lending should be so lucky.[15]

3. <u>Credit Cards and the Increasing Debt Burdens of U.S. Households</u>

Credit card debt in the United States has exploded from $69 billion in 1980 to $675 billion in 2001 and $1.8 trillion in 2006. This rapid growth in credit card debt is consistent with the huge increase in all types of household debt during the past three decades. Total household debt (including residential mortgages, home equity lines of credit, credit card debt, and other types of consumer credit) has risen from $1.4 trillion in

[15] Duncan A. MacDonald, "Viewpoint: Card Industry Questions Congress Needs to Ask," *American Banker,* Mar. 23, 2007, at 10 (commentary by Mr. McDonald, former general counsel of Citigroup's Europe and North America card businesses).

1980 to $7.2 trillion in 2001 and $11.8 trillion in 2006.[16] Household debt as a percentage of disposable household income has increased from 58% in 1984 to 101% in 2000 and 113% in 2004.[17] On an inflation-adjusted basis, the household debt burdens of families in both the top half of income brackets (those with more than $43,000 in income) and the bottom half of income brackets almost doubled during 1992-2004. The inflation-adjusted debts of families in the upper half of income brackets rose from $82,000 to $151,000, while debts of families in the lower half of income brackets increased from $21,000 to $41,000.[18] As a recent article noted, both higher-income families and working class families

> have been able to use the combination of rising home prices and easy credit to live beyond their means in recent years as wages have stagnated. That spending has helped to fuel the U.S. economy's growth. Today, [however], with the housing market in a slump and defaults mounting in the market for subprime home loans, . . . concerns grow about Americans' heavy debt load and their ability to manage it.[19]

Credit card debt has risen in response to a veritable blizzard of solicitations by card issuers. Credit card solicitations increased from 1.52 billion in 1993 to 4.29 billion in 2003 and 6.05 billion in 2005.[20] Many commentators claim that credit card issuers have aggressively solicited consumers with credit offers that far exceed the consumers' ability to repay the potential debt. These analysts maintain that the issuers' penalty fees

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[16] Michael S. Rosenwald, "Climbing out of Debt: Recovery Can Be as Tough as Breaking an Addiction," *Washington Post*, Oct. 15, 2006, at F1 (providing figures for 1980 and 2006); Wilmarth, "Transformation," *supra* note 1, at 395 (providing figures for 2001).

[17] Ben White, "Risks Multiply for Consumers Already Deep in Debt," *Washington Post*, Oct. 24, 2004, at F6 (reporting that household debt was $9.7 trillion as of June 30, 2004, equal to 113% of disposable household income of $8.6 trillion); Wilmarth, "Transformation," *supra* note 1, at 395-96 (providing figures for 1984 and 2000).

[18] Conor Dougherty et al., "Subprime Pullback May Crimp Consumer Spending," *Wall Street Journal*, April 2, 2007, at A2.

[19] *Id.*

[20] Suein Hwang, "Another Chapter: New Group Swells Bankruptcy Court: The Middle-Aged," *Wall Street Journal*, Aug. 6, 2004, at A1 (providing figures for 1993 and 2003); FRB Report, *supra* note 6, at 5 n.9 (providing figure for 2005).

and penalty interest rates make it practically impossible for overstretched borrowers to repay their debt obligations.[21]

4. <u>The Impact of Federal Preemption</u>

An important factor behind the rapid growth of credit card debt and other types of consumer debt is federal preemption of state usury laws and state consumer protection laws. In 1978, the Supreme Court held that a provision of the National Bank Act, 12 U.S.C. § 85, gave national banks "most favored lender" status in their home state and also allowed national banks to "export" their home state interest rates to borrowers residing in other states.[22] In 1996, the Supreme Court upheld a regulation of the Office of the Comptroller of the Currency ("OCC"), which declared that the "interest" which national banks could "export" to other states included all fees that were "material to the determination of the interest rate" – including numerical periodic rates, annual and cash advance fees, bad check fees, over-the-limit fees, and late payment fees. The OCC's

[21] *See, e.g.,* Stacey Kaper, "No Knockout in Round One: A tough grilling but no new legislative ideas," *American Banker*, Mar. 8, 2007, at 1 (reporting testimony by Wesley Wannemacher, who was charged $7,500 in fees and interest over six years based on $3,200 in card purchase); Robert Berner, "Cap One's Credit Card Trap," *Business Week,* Nov. 6, 2006, at 35; Kathleen Day & Caroline E Mayer, "Credit Card Penalties, Fees Bury Debtors," *Washington Post,* Mar. 6, 2005, at A01 (reporting that penalty fees and high interest rates caused one consumer's credit card balance to grow from $1,900 to $5,600 during 1997-2003, despite $3,500 in payments and no additional purchases); Alan Lavine & Gail Liberman, "Ask Lawmakers to Halt Abusive Credit Card Practices," *Pittsburgh Post-Gazette*, Oct. 14, 2005, at D-8; Patrick McGeehan, "The Plastic Trap – Debt That Binds," *New York Times,* Nov. 21, 2004, § 1, at 1 (reporting on adverse impact of penalty fees and penalty interest rates on consumers) ; Mitchell Pacelle, "Fine Print: Growing Profit Source for Banks: Fees from Riskiest Card Holders," *Wall Street Journal*, July 6, 2004, at A1 (same).

[22] *Marquette National Bank v. First of Omaha Service Corp.,* 438 U.S. 299 (1978). For a comprehensive analysis of the "most favored lender" and "exportation" doctrines, *see* Elizabeth R. Schiltz, "The Amazing, Elastic, Ever-Expanding Exportation Doctrine and Its Effect on Predatory Lending Regulation," 88 *Minnesota Law Review* 518 (2004). Congress granted "most favored lender" status and "exportation" authority to FDIC-insured state banks and thrift institutions in 1980. *Id.* at 565-67 (discussing 12 U.S.C. § 1831d), which applies to all FDIC-insured state banks); *id.* at 601-03 (discussing 12 U.S.C. § 1463(g)(1), which applies to federally-chartered thrift institutions).

regulation thus exempts a wide range of fee practices, as well as numerical periodic interest rates, from any regulation under state law.[23]

In 1994, Congress adopted the Riegle-Neal Interstate Banking and Branching Efficiency Act ("Riegle-Neal Act"), which authorizes national banks and state banks to establish interstate branches. The Riegle-Neal Act made possible the growth of large nationwide banking organizations. In addition, the OCC issued a ruling in 1998 that allows a national bank to "export" the "interest" allowed by the law of any state in which the bank maintains either its main office or a branch.[24] In combination, these developments have effectively barred the application of state usury laws and other state consumer credit laws to national banks as well as federally-chartered thrifts and FDIC-insured state banks. With regard to each such institution, "almost no state consumer credit law is going to pose any serious obstacle to its consumer credit operations."[25] Each such institution can locate its consumer credit operations in a state that offers the fewest regulatory restrictions on the terms that the OCC deems to be "material to the determination of the interest rate" (e.g., numerical periodic rates and all fees that are considered to be part of the "price" for credit). The institution can then "export" those terms to customers residing in all other states, regardless of any conflicting laws in those states.[26]

In 2004, the OCC issued a regulation (the "activities preemption regulation") that expands the scope of preemption for national banks far beyond matters that relate to

[23] *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735 (1996) (upholding the validity of 12 C.F.R. § 7.4001(a)); *see also* Schiltz, *supra* note 22, at 560-65 (discussing *Smiley* and the OCC's expansive interpretation of "interest" under 12 U.S.C. § 85).
[24] Schiltz, *supra* note 22, at 553-56 (discussing OCC Interpretive Letter No. 822, Feb. 17, 1998).
[25] *Id.* at 618.
[26] *Id.* at 561-65, 618.

"interest." The OCC's regulation seeks to preempt all state laws that "obstruct, impair, or condition a national bank's ability to fully exercise its Federally authorized powers" in four broadly-defined areas – viz., real estate lending, lending not secured by real estate, deposit-taking, and other "operations."[27] The OCC's activities preemption regulation is closely similar to preemptive rules previously issued by the Office of Thrift Supervision ("OTS") with respect to the lending, deposit-taking and other "operations" of federally-chartered thrifts.[28]

The OCC's rule with respect to non-real estate lending specifically preempts a wide range of state laws from applying to credit card loans made by national banks, including (i) state licensing and registration laws, (ii) state laws dealing with collateral and credit enhancements, (iii) state laws limiting the terms of credit, (iv) state laws affecting escrow accounts, (iv) state laws dealing with access to credit reports, (v) state laws regulating disclosure and advertising, and (vi) state laws dealing with interest rates and other payments and disbursements.[29] The OCC's rule does not preempt certain types of state laws (i.e. those governing contracts, torts, crimes, collection of debts, acquisition and transfer of property, taxation and zoning) if such laws have only an "incidental" effect on the non-real estate lending activities of national banks.[30] However, the OCC has stated that these state laws typically apply to national banks because they "establish

[27] *See* 12 C.F.R. § 34.4(a) (real estate lending); *id.* § 7.4008 (lending not secured by real estate); *id.* § 7.4007 (deposit-taking); *id.* § 7.4009 (other "operations"). For a comprehensive analysis and critique of the OCC's rules, *see* Arthur E. Wilmarth, Jr., "The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection," 23 *Annual Review of Banking and Financial Law* 225 (2004) [hereinafter Wilmarth, "OCC's Preemption Rules"].
[28] *See* 12 C.F.R. §§ 560.2, 557.11, 545.2, discussed in Wilmarth, "OCC's Preemption Rules," *supra* note 27, at 235, 283-84.
[29] 12 C.F.R. § 7.4008(d)(2).
[30] *Id.* § 7.4008(e).

the infrastructure that makes it practicable to exercise a permissible Federal power."[31] From this explanation, one can reasonably infer that the OCC intends to recognize the applicability of state laws only when they are *helpful* to the exercise of a national bank power.[32]

The Government Accountability Office (GAO) issued a report in April 2006, stating that the OCC's activities preemption regulation "does not fully resolve uncertainties about the applicability of state consumer protection laws to national banks and their operating subsidiaries."[33] The GAO noted that the only state consumer-oriented laws that the OCC has specifically acknowledged to apply to national banks are "fair lending laws."[34] The GAO further pointed out that "[s]ome state officials questioned the extent to which state consumer protection laws, particularly those aimed at preventing unfair and deceptive acts and practices, are preempted for national banks and their operating subsidiaries."[35] The GAO recommended that the OCC "clarify the applicability of state consumer protection laws to national banks."[36] Notwithstanding that recommendation, to date the OCC has not issued any public clarification as to the categories of state consumer protection laws that it deems *not* to be preempted by its activities preemption regulation.

In 2004, the OCC also issued a second regulation (the "visitorial powers preemption regulation") that bars state officials from initiating any administrative or

[31] *See* 69 Fed. Reg. 1904, 1912, 1913 (2004) (preamble to OCC's activities preemption regulation).
[32] *See* Wilmarth, "OCC's Preemption Rules," *supra* note 27, at 233-36, 274.
[33] U.S. Gov't Accountability Off., "OCC Preemption Rules: OCC Should Further Clarify the Applicability of State Consumer Protection Laws to National Banks," GAO-06-387 (April 2006), at 8; *see also id.* at 12-17, 44-45.
[34] *Id.* at 8, *see also id.* at 14-15.
[35] *Id.* at 8; *see also id.* at 13, 16.
[36] *Id.* at 10; *see also id.* at 44-45.

judicial proceeding to enforce applicable laws (state or federal) against national banks.[37] The validity of that regulation is currently being tested in a case pending before the Second Circuit Court of Appeals.[38] A third OCC regulation declares that operating subsidiaries of national banks are entitled to the same preemptive immunity from state laws that national banks are granted under federal law (including the OCC's rules). That regulation was upheld by a recent decision of the Supreme Court.[39]

The combined effect of the OCC's preemption regulations is to make the OCC the final arbiter of the scope of national bank powers as well as the sole enforcement agency with respect to national banks and their operating subsidiaries. The OCC's regulations are designed to accomplish the agency's stated goal of creating a "national banking system" that will "enable national banks to operate to the full extent of their powers under Federal law, without interference from inconsistent state laws."[40] Former Comptroller of the Currency John D. Hawke, Jr. has called preemption "a major advantage of the national charter," and said that he wasn't "the least bit ashamed to promote it."[41]

The OCC's preemption rules have already had a very significant impact in encouraging large, multistate banks to convert from federal to state charters. For example, during 2004-05, JP Morgan Chase, HSBC and Bank of Montreal (Harris Trust) converted from state to national charters and moved more than $1 trillion of banking

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[37] *See* 12 C.F.R. § 7.4000, discussed in Wilmarth, "OCC's Preemption Rules," *supra* note 27, at 228-29, 327-34.
[38] *OCC v. Spitzer,* 396 F. Supp. 2d 383 (S.D.N.Y. 2005), *appeal pending sub nom. Clearing House Ass'n v. Spitzer,* No. 05-5996cv(L) (2d Cir., appeal filed Nov. 7, 2005).
[39] *Watters v. Wachovia Bank, N.A.*, No. 05-1342 (U.S., April 17, 2007) (upholding the validity of 12 C.F.R. § 7.4006).
[40] 69 Fed. Reg. 1904, 1908 (2004) (preamble to OCC's activities preemption regulation).
[41] Wilmarth, "OCC's Preemption Rules," *supra* note 27, at 274-75 (quoting remarks made by Mr. Hawke during a speech and newspaper interview in 2002).

assets from the state banking system into the national banking system. As a result of those charter conversions, the share of all banking assets held by national banks rose from 56% to 67%, while the share held by state banks declined from 44% to 33%. In April 2006, the Bank of New York (BONY), one of the largest remaining state banks, agreed to sell its 338 retail branches to JP Morgan Chase. BONY's branch sale provides further evidence that the OCC's preemption rules have given multistate national banks a decisive competitive advantage in retail banking.[42] In a speech given in September 2005, FDIC Chairman Don Powell described the impact of the OCC's and OTS' preemption rules as follows:

> The facts of life today with regard to preemption are fairly simple. A state-chartered bank that wants to do business across state lines is at a substantial competitive disadvantage relative to a national bank or federal thrift. . . . In my view, there is little doubt what the current competitive imbalance, if not addressed, means for the future. . . . Ultimately, Congress will have to decide this issue. . . . In the end, Congress may choose to level the playing field and preserve the dual banking system or it may, through inaction or otherwise, choose not to, and let the dual banking system fade into history. In my opinion, that would be a mistake.[43]

Thus, the preemption rules of the OCC (and to a lesser extent, those of the OTS) have fundamentally transformed our consumer credit industry. The broad scope of those rules has given large federally-chartered depository institutions a virtually unlimited immunity from state consumer protections laws and from state enforcement proceedings. Accordingly, it is necessary to evaluate whether the OCC is likely to provide effective

[42] Arthur E. Wilmarth, Jr., "The OCC's Preemption Rules Threaten to Undermine the Dual Banking System, Consumer Protection, and the Federal Reserve Board's role in Bank Supervision," *Proceedings of the 42nd Annual Conference on Bank Structure and Competition* (Fed. Res. Bank of Chi. 2006), at 102, 105-06 [hereinafter Wilmarth, "Preemption Dangers"].

[43] Wilmarth, "Preemption Dangers," *supra* note 42, at 106 (quoting Sept. 26, 2005 speech by Mr. Powell to the American Bankers Ass'n).

protection to consumers from abusive practices by the biggest national banks that dominate the credit card industry and other segments of the consumer lending market.

5. The OCC's Unimpressive Record of Consumer Protection

Unfortunately, the OCC has not compiled an impressive record of protecting consumers. The OCC is primarily focused on maintaining the safety and soundness of national banks. The OCC's preemption rules therefore emphasize the goal of giving national banks wide latitude to conduct their business activities in accordance with "uniform [federal] standards of operation and supervision" that will reduce their compliance costs and maximize their profits and stability.[44]

The OCC enforces national bank compliance with applicable laws and regulations primarily through its examination process and secondarily through the imposition of safety-and-soundness plans and orders.[45] However, bank examinations and safety-and-soundness enforcement measures are highly discretionary and shrouded in secrecy. Findings made during compliance examinations are strictly confidential and are not made available to the public except at the OCC's discretion.[46] Similarly, the OCC is not required to publish the results of its safety-and-soundness enforcement actions. The OCC's website lists only three safety-and-soundness orders, which the OCC issued against small national banks during 1997-99, and the website does not provide weblinks to the text of any of those orders.[47] Thus, the OCC's procedures for compliance examinations and safety-and-soundness orders do not appear to provide any public notice

[44] 69 Fed. Reg. 1904, 1907-08 (2004) (preamble to OCC's activities preemption regulation).
[45] *See, e.g.,* 70 Fed. Reg. 6329-34 (2005) (OCC guidelines establishing standards for residential mortgage lending practices); OCC Annual Report, Fiscal Year 2005, at 13-16, 22.
[46] *See, e.g.,* 12 C.F.R. §§ 4.32(b), 4.36(b), 18.10.
[47] Wilmarth, "Preemption Dangers," *supra* note 42, at 109, 113-14 n.32. My recent search of the section of the OCC's website entitled "Enforcement Actions" (www.occ.treas.gov/enforcementactions/enforcementactions_search.aspx) produced the same result.

or other recourse to consumers who have been injured by violations identified by the OCC.

The OCC's record is similarly undistinguished with respect to consumer enforcement actions taken against national banks for violations of consumer protection laws. Since January 1, 1995, the OCC has taken only thirteen public enforcement actions against national banks for violations of consumer lending laws.[48] With two exceptions, all of those actions were taken against small national banks. One of the two exceptions involved an OCC enforcement order issued against Providian National Bank, a large credit card bank, in 2000. However, the OCC did not take action against Providian until the San Francisco District Attorney's office had already initiated its own prosecution of Providian for abusive and unfair practices.[49] A former senior executive in the credit card industry commented on the Providian case as follows:

> A California prosecutor . . . embarrassed the OCC into taking action against Providian [National] Bank for telemarketing and pricing practices that bordered on the criminal. For a decade Providian had been well known in the [credit] card industry as the poster child of abusive consumer practices, but apparently not to the OCC.[50]

The second OCC enforcement order involving a large bank was issued against ABN AMRO Mortgage Group, Inc., (AAMG), an operating subsidiary of LaSalle Bank Midwest, N.A., in January 2006. According to an OCC news release, the Department of

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[48] *See* Wilmarth, "Preemption Dangers," *supra* note 42, at 109, 114 n.33, which found twelve enforcement actions based on a search of the portion of the OCC's website entitled "Consumer Protection News: Unfair and Deceptive Practices" (www.occ.treas./gov/Consumer/Unfair/htm.), and a review of 69 Fed. Reg. 1904, 1913 & nn.70-71 (2004) (preamble to OCC's activities preemption regulation). My recent review of the section of the OCC's website entitled "Enforcement Actions," *supra* note 47, located a thirteenth enforcement action. That action, discussed below, was taken against ABN AMRO Mortgage Group, Inc., an operating subsidiary of LaSalle Bank Midwest, N.A., on January 4, 2006 (OCC News Release No. 2006-1; OCC Enforcement Order # 2005-162) [hereinafter AAMG Enforcement Order].

[49] Wilmarth, "OCC's Preemption Rules," *supra* note 27, at 315-16; Wilmarth, "Preemption Dangers," *supra* note 42, at 109.

[50] Duncan A. MacDonald, Letter to the Editor, "Comptroller Has Duty to Clean Up Card Pricing Mess," *American Banker*, Nov. 21, 2003, at 17.

Housing and Urban Development (HUD) notified AAMG as to suspected improprieties involving AAMG's underwriting of Federal Housing Administration (FHA) loans. Following an internal investigation, AAMG informed HUD and the OCC that it had found violations of HUD regulations in its underwriting practices for FHA loans. After AAMG disclosed those violations, the OCC and HUD conducted a formal investigation and issued an enforcement order against AAMG. However, it is unclear whether the OCC would have found those violations absent HUD's notice to AAMG and AAMG's internal investigation and disclosure of the violations.[51] Thus, neither of the OCC's two public enforcement orders against large banks for consumer lending violations was actually initiated by the OCC.

Since January 1, 1995, the OCC has not issued a public enforcement order against any of the eight largest national banks for violating consumer lending laws.[52] In contrast to this absence of public enforcement action by the OCC against major national banks, state officials and other federal agencies have issued numerous enforcement orders against leading national banks or their affiliates – including Bank of America, Bank One, Citigroup, Fleet, JP Morgan Chase, and US Bancorp – for a wide variety of abusive practices over the past decade, such as predatory lending, privacy violations, telemarketing scams, biased investment analysis, manipulative initial public offerings, and allowing hedge funds to engage in late trading and market timing in bank-sponsored mutual funds. In many of those cases, state officials such as New York Attorney General

[51] *See* OCC News Release 2006-1, with regard to AAMG Enforcement Order, *supra* note 48.
[52] The only OCC consumer protection order issued against any of the top eight national banks during this period was a "me too" order issued by the OCC against Bank of America for allowing hedge funds to engage in late trading and market timing in its mutual funds. That order was issued after other federal and state agencies had already taken enforcement measures against Bank of America. Wilmarth, "Preemption Dangers," *supra* note 42, at 109. My recent search of the OCC's website for "Enforcement Actions," *supra* note 47, confirmed the foregoing results.

Eliot Spitzer, Minnesota Attorney General Mike Hatch, and Massachusetts Secretary of State William Galvin spearheaded the investigations and spurred federal regulators to take action.[53]

During 2003 alone, state officials initiated more than 20,000 investigations and took more than 4,000 enforcement actions in response to consumer complaints about abusive lending practices. During the past several years, state officials have obtained large settlements with Providian, First Alliance, Household International and Ameriquest that required those lenders to pay approximately $1 billion in penalties and restitution. Several studies have concluded that state anti-predatory lending laws provide significant benefits to consumers, particularly in light of the inadequate protections offered by current federal laws in the area of subprime lending.[54]

Unfortunately, the OCC's self-interest provides a plausible explanation for its failure to take public enforcement actions against any of the largest national banks for violating consumer lending laws. More than 95% of the OCC's budget is financed by assessments paid by national banks, and the twenty biggest national banks account for nearly three-fifths of those assessments. Large, multistate banks were among the most outspoken supporters of the OCC's preemption regulations and were widely viewed as the primary beneficiaries of those rules. In addition to its preemption regulations, the OCC has frequently field amicus briefs in federal court cases to support the efforts of national banks to obtain court decisions preempting state laws. The OCC's efforts to attract large, multistate banks to the national banking system have already paid handsome

[53] Wilmarth, "OCC's Preemption Rules," *supra* note 27, at 314-16, 348-56; Wilmarth, "Preemption Dangers," *supra* note 42, at 109.
[54] Wilmarth, "OCC's Preemption Rules," *supra* note 27, at 315-16; Wilmarth, "Preemption Dangers," *supra* note 42, at 111, 114 n.40 (citing studies).

dividends to the agency. During 2004-05, the OCC's assessment revenues rose by 15%, primarily due to the transfer of $1 trillion of banking assets into the OCC's jurisdiction by virtue of the charter conversions of JP Morgan Chase, HSBC and Bank of Montreal. Thus, the OCC has a powerful financial interest in pleasing its largest regulated constituents, and the OCC therefore faces a clear conflict of interest whenever it considers the possibility of taking an enforcement action against a major national bank.[55]

The OCC's Consumer Assistance Group (CAG) provides additional evidence that the OCC is not committed to a vigorous enforcement strategy in the area of consumer protection. The CAG handles all consumer complaints filed against national banks through a single call center located in Houston, Texas. In 2005, the CAG employed fifty full-time employees, representing less than two percent of the OCC's total workforce of more than 2,800 employees (including 1,900 bank examiners). Similarly, the CAG accounted for just over one percent of the OCC's operating budget for fiscal year 2005 ($5.4 million out of a total operating budget of $500 million). The CAG does not have any enforcement functions. It describes itself as a "neutral arbiter" and says that it cannot act as an "advocate" for either the consumer or the bank. The CAG tells consumers that it "cannot give legal advice or personal opinions about consumer complaints and/or the bank's position." The CAG also warns consumers that "only a court of law" can resolve "factual or contract disputes between the bank and the customer." Therefore, the CAG advises consumers that "[i]f your case involves such a dispute, we will suggest that you consult an attorney for assistance."[56]

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[55] Wilmarth, "OCC's Preemption Rules," *supra* note 27, at 232, 274-77, 356; Wilmarth, "Preemption Dangers," *supra* note 42, at 104-05, 109-10, 112 n.16.
[56] Wilmarth, "Preemption Dangers," *supra* note 42, at 110; U.S. Gov't Accountability Off., "OCC Consumer Assistance: Process Is Similar to That of Other Regulators but Could Be Improved by Enhanced

Based on the foregoing statements, the CAG certainly does *not* view itself as a vigorous defender of consumer rights. The CAG holds annual meetings with the ten national banks that provoked the largest number of consumer complaints during the previous year. In addition, the CAG alerts the OCC's compliance examiners if there are significant patterns of consumer complaints at particular national banks.[57] However, as previously noted, the OCC's supervisory and examination process is highly discretionary, is not visible to the public, and does not establish any formal procedures for granting relief to injured customers.

Four additional facts indicate that the CAG and the OCC's compliance examinations are *not* effective in discouraging abusive practices by large national banks. First, as noted above, almost all of the OCC's public consumer enforcement actions have targeted *small* national banks. However, most consumer complaints are filed against *large* national banks. During 2004, ten large banks accounted for four-fifths of all complaints received by the CAG. Second, compared to other federal bank regulators, the CAG received a much higher rate of consumer complaints per billion dollars of supervised banking assets during 2000-04. Third, compared to other federal bank regulators, a much higher percentage of complaints filed with the CAG during 2000-04 were closed because consumers either withdrew their complaints or commenced litigation. During the same period, the percentage of withdrawn or litigated complaints *rose* steadily at the CAG, while the percentage of complaints in which the CAG found bank errors *declined* steadily. It seems clear that many consumers did not find the CAG

Outreach," GAO-06-293 (Feb. 2006) [hereinafter GAO-CAG Report], at 8-9, 23-25; OCC Annual Report, Fiscal Year, 2005, at 1, 3, 7, 13, 23-24; *see also* the portion of the OCC's website entitled "Consumer Complaints and Assistance" (www.occ.treas/gov/customer,htm)..

[57] Wilmarth, "Preemption Dangers," *supra* note 42, at 110; GAO-CAG Report, *supra* note 56, at 21-23.

to be helpful, an outcome that is not surprising in view of the CAG's explicit statements that it will not act as an "advocate" for consumers and will not attempt to resolve "factual or contract disputes." Fourth, until it was criticized by the GAO, the CAG did not provide any mechanism for feedback by consumers, in sharp contrast to the OCC's long-established complaint process for bankers who are dissatisfied with OCC examinations.[58] All of these facts suggest that the OCC gives a relatively low priority to consumer protection. The CAG, like the OCC's public enforcement actions against small national banks, appears primarily to be a public relations gesture designed to deflect criticism from state regulators and consumer groups.

In one well-publicized case, the OCC refused to help hundreds of consumers who complained after Fleet Bank raised the interest rates on their credit cards despite promises of a "fixed" rate. In a representative letter, the OCC told Fleet's complaining customers that "we can only suggest that you contact private legal counsel regarding any additional remedies."[59] When one of the aggrieved customers filed a federal class action in December 2000, alleging deceptive lending practices by Fleet, the OCC responded by filing amicus briefs *on behalf of Fleet* in both the district court and the Third Circuit Court of Appeals. The Third Circuit determined, however, that the plaintiff presented a genuine issue for trial based on her claim that Fleet's disclosures were misleading and violated the Truth in Lending Act (TILA). Based on the Third Circuit's opinion, one can

[58] Wilmarth, "Preemption Dangers," *supra* note 42, at 110-11; GAO-CAG Report, *supra* note 56, at 9-25.
[59] Wilmarth, "OCC's Preemption Rules," *supra* note 27, at 353; Jess Bravin & Paul Beckett, "Friendly Watchdog: Federal Regulator Often Helps Banks Fighting Consumers," *Wall Street Journal*, Jan. 28, 2002, at A1 (quoting OCC letter).

certainly question whether the OCC acted properly when it concluded that federal law did not give customers any reasonable grounds for obtaining recourse from Fleet.[60]

For the foregoing reasons, Congress cannot expect the OCC to act vigorously in adopting substantive protections for credit card customers or in taking public enforcement actions against the largest credit card issuers. Congress should promptly move forward with legislation to establish uniform fair lending and consumer protection standards for all credit card issuers and other consumer lenders, whether federally-chartered or state-chartered. In view of the aggressive preemption rules adopted by the OCC and the OTS, uniform legislation is needed to restore a "level playing field" between federally-chartered and state-chartered consumer lenders. In addition, Congress should amend the Federal Trade Commission Act (FTC Act) to allow the Federal Trade Commission to bring enforcement proceedings against national banks for unfair and deceptive acts and practices. Currently, the FTC is barred from bringing such actions under 15 U.S.C. § 45(2), and only the OCC may prosecute such actions. In view of the OCC's obvious conflict of interest in supervising the same institutions that fund its budget, the OCC should not be given sole enforcement power over national banks with respect to consumer protection matters. The FTC should be given concurrent and independent enforcement authority over national banks with regard to all matters arising under the FTC Act, in the same way that state attorneys general have independent authority to enforce applicable state laws against state banks.

Arthur E. Wilmarth, Jr. (04/25/07)

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[60] Wilmarth, "OCC's Preemption Rules, *supra* note 27, at 353-54; *Roberts v. Fleet Bank (R.I.), N.A.*, 342 F.3d 260, 266 (3d Cir. 2003) ("Construing the TILA strictly against the creditor and liberally in favor of the consumer, as we must, we believe that the TILA disclosures [made by Fleet] in this case, read in conjunction with the solicitation materials, present a material issue of fact as to whether Fleet clearly and conspicuously disclosed its right to change the [credit card's annual percentage rate]").

Testimony of

Edward L. Yingling

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Financial Institutions and Consumer Credit

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April 26, 2007

Madame Chairwoman and members of the Subcommittee, my name is Edward L. Yingling. I am President and CEO of the American Bankers Association (ABA). ABA, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

I appreciate the opportunity to testify regarding the payment card industry, which is an amazing success story of the American consumer economy. While credit cards draw the most attention, the payment card industry is much broader, including increasingly popular products such as debit cards and pre-paid cards. Payment cards safely connect consumers instantly to a panoply of products and services. They provide merchants of all sizes with broad access to the buying public, funding for small businesses, and billions of dollars in annual payment-processing savings. Retail commerce, including over the Internet, would not exist as we know it today without them.

Today, credit cards are responsible for more than $2.5 trillion in transactions a year and are accepted at more than 24 million locations in more than 200 countries and territories. There are more than 6,000 U.S. credit card issuers.[1] In the last 20 years, the number of debit cards has grown from 60 million to nearly 420 million. Pre-paid cards have grown rapidly, with spending expected to exceed $155 billion in 2006. Payment cards rely on a processing system that handles more than 10,000 transactions *every second* and has enough communications lines to encircle the globe nearly 400 times.

We recognize that members of this subcommittee and others have concerns about aspects of these payment cards, and in particular, credit cards. Very recently, the Government Accountability Office (GAO) produced a very important study on credit cards – a study that we believe does an excellent job in providing factual information and laying out critical issues.[2] An important point of that study is how the credit card industry has evolved, from one where almost every card charged a similar interest rate and required an annual fee to an industry with lower interest rates, in many cases no annual fees, and with more consumer benefits and choices. At the same time, the fee structure and other aspects of credit cards have become more complex – outstripping what once was, but is no more, an effective disclosure system.

The GAO report and members of this subcommittee have all raised legitimate questions that deserve active discussion. The ABA, on behalf of our membership (which includes all the major credit card issuers), wants to take this opportunity to state that we want to work with this subcommittee, our

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[1] Providers include banks and non-banks issuing MasterCard and Visa cards, as well as about two hundred retailers, 40 oil companies, 40 third-party issuers that offer "private label" cards with various store brands on them, plus Discover Card, Diners Club, and American Express.
[2] GAO Report, Credit Cards: Increased Complexity in Rates and Fees Heightens the Need for More for More Effective Disclosures to Consumers, September 2006.

regulators, and other interested parties to address these concerns. The significant changes that have occurred in recent years make this the ideal time to do so.

In my statement, I would like to focus on three points:

- **Payment cards play a vital role in our economy, stimulating growth, facilitating commerce, and bringing retailers and consumers together;**

- **The industry has evolved in response to consumer needs and competition among issuers. Payment card services have become more complex, with many more benefits and options for consumers;**

- **As complexity has increased new issues have arisen. Clearly, better disclosures are needed. ABA supports efforts underway to develop better disclosures.**

I will address each of these points in turn.

I. Payment Cards Play a Vital Role in Our Economy

Economic performance depends upon a stable, efficient, and secure means of exchanging value. In the United States, payment cards make this exchange possible every minute of every day. Nearly two-thirds of American families use payment cards routinely, taking for granted their convenience, reliability, and security. But payment cards are not simply helping our economy along, they are driving it forward.

In its recent report, the GAO found that the number of credit cards currently in use has grown from less than 100 million in the mid-1980s, to over 690 million through 2005. Accounting for trillions of dollars in transactions every year, credit cards are responsible for a large and growing share of consumer spending in the United States. As consumer expenditures are the largest single component of our economy, accounting for more than 70 percent of our nation's Gross Domestic Product, it is difficult to overstate the vital role that credit cards play in propelling our economy.

Payment cards of all kinds provide the passkey to new sales channels in the 21st century. Unlike checks, or even cash, cards are accepted around the world as readily as around the corner. Payment card acceptance gives business owners access to the broadest possible customer base and helps to level the playing field between larger and smaller merchants. Credit cards also guarantee that merchants will be paid.

The majority of Internet purchases are made with payment cards. Because of the Internet, where consumers are located no longer prevents them from finding the best products and the best prices. Furthermore, even the smallest merchants worldwide can sell products by accepting cards as payment. In 2003, electronic payment methods, such as online bill paying, debit cards and credit cards, for the first time became more popular than the old-fashioned checkbook. Two-thirds of consumers pay at least one bill electronically.

Gift cards are expected to exceed $80 billion in 2006, a 20 percent increase over 2005, according to Tower Group.[3] More than 65 percent of consumers purchased or received gift cards last year. It is easier and more secure to use gift cards than it is to use cash. Store gift cards promote brand loyalty. These benefits increase consumer confidence and facilitate commerce.

[3] Gift cards are a subset of pre-paid cards which also include travel, payroll, incentive, insurance, teen, and money transfer cards, to name a few.

Payment cards not only open lines to more customers for businesses, they also provide small businesses – which are responsible for more than half of all new jobs created each year – with many additional benefits. For example, using cards to process business payments offers huge savings for small and large businesses alike. In 2003, RPMG Research Corp. concluded that companies save approximately $23 billion annually by shifting from paper to electronic payment processing. Experts believe credit cards can save up to 70 percent of the cost involved in processing purchase orders. Lower money management costs for businesses mean lower costs for consumers.

Credit cards also give small businesses access to credit to help finance their operations. These small firms benefit from flexible terms and unrestricted uses to manage monthly expenses, track purchases, and weather short-term fluctuations in cash flow. Nearly half of all the small firms in the United States depend upon credit cards for their financing. For example, small businesses made more than $100 billion in purchases using Visa Business cards last year.

Increasingly, small businesses are using payroll cards instead of traditional paychecks, providing employers greater security and flexibility. These payroll cards are particularly beneficial for employees who may be new to banking.

II. Payment Cards Have Evolved, Becoming More Complex With Many More Benefits and Options for Consumers

Since the first charge card came on the market 56 years ago, the payment card industry has changed dramatically. It now reaches countless individuals and allows them to choose cards that best suit their financial needs and life styles. First developed as a perk for select businessmen, payment cards today are held by the great majority of American households and provide vital access to both personal and global financial resources. As the payment card market has matured and consumer choices have expanded, payment cards themselves have become more complex.

The aforementioned GAO report found that the benefits credit cards offer consumers today are far greater than they were in the past. According to the GAO, 75 percent of families now hold at least one credit card, meaning that more and more people are able to take advantage of the many benefits of credit cards. They are a flexible and instant means of payment for purchases large and small, and they permit access to bank accounts and cash from automatic teller machines (ATMs) twenty-four hours a day year-round. Furthermore, they are safer than cash, accepted more places than checks, and can be used almost anywhere in the world.

Payment cards provide confidence and convenience when traveling, are a means of identification, and entitle consumers to many popular and valuable enhancements, such as rebates and awards tailored to their purchasing habits and special interests. The GAO found that rewards programs, such as cash-back and airline travel, and other benefits such as rental insurance or lost luggage protection, have become standard. These enhancements are a result of the intense competition issuers engage in as they fight for consumer loyalty.

For many customers, credit cards are also the point of entry into the world of credit. Using credit cards, consumers can pay for items on schedules that suit their budgets and needs. Credit card use establishes credit histories, which people use to obtain jobs, rent and buy homes, or purchase cars and other big-ticket items. Credit histories permit individuals to demonstrate their creditworthiness and have dramatically expanded access to credit to all members of society in the most efficient, non-discriminatory way possible. As former Chairman Alan Greenspan noted in 2005: "Improved access to credit for consumers…has had significant benefits. Unquestionably, innovation and deregulation have vastly expanded credit availability to virtually all income classes. Access to credit has enabled families to purchase homes, deal with emergencies, and obtain goods and services."

Credit cards give consumers increased control over their finances and provide tools for effective money management. With the help of customized monthly statements or via up-to-the-minute account access over the Internet, card accounts help households keep track of exactly how much and where their money is spent. Short-term credit is also a proven means by which average consumers can weather unexpected financial disruptions or pay for unexpected expenses. Americans participate fully in today's world economy largely because of the access that a spectrum of card products provides.

Innovations in the payments card industry have resulted in strong protections against fraud, including state-of-the-art technology that protects consumers from unauthorized access to their accounts. For example, credit card issuers notify consumers if it seems likely their account security has been violated and can automatically suspend account access until the status of the account is verified. Consumers face little if any liability for unauthorized or unlawful use of their credit cards. Generally, consumers' liability is limited to $50 under federal law and, in many cases, cardholders pay nothing for credit card losses as issuers waive the $50. It is hard to imagine a more powerful, flexible tool that offers so many protections against loss or fraud.

Profitability, Risk, and Pricing

With such an important and universal product like payments cards, many questions arise about issuers' profitability, risk, pricing and disclosures. Take credit cards, for example. Credit card loans are the riskiest form of consumer lending for banks. When a bank issues a credit card, it is extending a line of credit to a borrower whom it may never have met and who can tap the line of credit day or night, for any reason, over a long period of time. Furthermore, unlike a car or mortgage loan, a credit card loan is unsecured, meaning the bank would suffer a greater loss if the loan is not repaid. Moreover, borrowers generally have an incentive to pay the secured loans first so as not to put the collateral, such as a car, at risk.

Credit cards are profitable in large part because of careful management of the risks involved. The average return on assets for credit card issuers is about three percent, according to the GAO report. To illustrate this point, this means that if a credit card issuer lends $100, at the end of the year, if all goes well, it receives on average about $3 in return plus the original $100. Then consider that some individuals never pay back their debt, there are fraudsters who constantly try to game the system, and there's a huge infrastructure of technology and staffing that allows someone to use his or her credit card anywhere in the world, at any time, and have all the processing and accounting done with near perfection. It's mind-boggling to consider the computer network, communications system, billing and processing facilities, fraud protection programs, and customer service requirements needed to handle the 10,000 transactions per second around the world. It's an enormous, complicated and expensive structure – all dedicated to delivering the efficient, safe and easy payment vehicle we've all come to enjoy.

The GAO report found that credit card pricing has evolved – largely as a result of strong competition and innovation. ***Interest rates have declined.*** Up until about 1990, card issuers commonly charged a single, fixed interest rate around 20 percent, with credit cards available only to a smaller subset of American consumers. However, the GAO found that between 1990 and 2004, the average interest rate declined by 6 percent. For the 28 popular cards reviewed by the GAO, the average interest rate assessed for purchases was 12.3 percent in 2005.

It is also notable that ***credit card annual fees have largely disappeared.*** According to the GAO report, up until about 1990, card issuers charged annual fees ranging between $20 and $50. By 2005, roughly 75 percent of credit cards no longer carried an annual fee.

Competition, innovation, and consumer needs have caused the industry to evolve, and in a way that fits the classic model for new products. Early offerings were relatively simple, with few features and similar pricing for interest rates and fees. Over time, competitors offered additional services and features as they sought new customers. Markets were segmented and targeted. Very significantly, millions of Americans that would not have been eligible for cards became eligible. As part of this development, the terms and pricing became more complex, which has led to the new concerns. In addition, the challenge of clear disclosures became more difficult, as there was more to disclose.

It is true that credit cards today include higher and more complex fees for things such as late and returned payments, and exceeding credit limits. But it should be noted that the GAO also concluded that the profits of credit issuing banks have been stable over the last seven years. In fact, aside from some wide fluctuations in the mid-1990s, profits remained relatively stable between 1986 and 2004, with an average return on assets of 3.12 percent. Furthermore, the GAO found that the vast majority of card issuers' revenue stems from interest income, not fees. Indeed, the GAO concluded that interest revenues comprise between 69 and 71 percent of total card issuer revenues.

Many customers pay nothing at all for the benefits of credit cards. In fact, the GAO – reflecting similar findings of the Federal Reserve in its Survey of Consumer Finances – found that nearly half of all cardholders avoid paying any significant interest charges because they pay their balance in full each month. These convenience users "availed themselves of the benefits of their cards without incurring any direct expenses." Others take advantage of low-interest, or even zero-interest, introductory periods offered by card issuers.

As computers and analytical techniques became more sophisticated, lenders became better able to use credit scores to help predict future performance on loans and then price those loans accordingly. This risk-based pricing helps banks manage risk better and is a sound lending practice encouraged by bank regulators.

This was not always the case. As previously noted, twenty-five years ago, credit cards often had one fixed interest rate for all borrowers, regardless of their credit ratings. That meant the best borrowers were paying rates higher than the risk they posed, and riskier borrowers were paying less than the risk they posed – in essence, the best borrowers were subsidizing the high-risk ones. That is not the case today with risk-based pricing. Risk-based pricing gives the best rates to the most creditworthy individuals.

More importantly, risk-based pricing enables many deserving individuals to get a credit card who previously could not. Individuals that do not have perfect credit histories may nonetheless be deserving of access to credit. With pricing according to risk, these individuals are able to share in the benefits and convenience a credit card provides. As George Washington University professor Michael Staten said in his article entitled *Risk-based Pricing in Consumer Lending*: "It is no coincidence that the dramatic expansion of credit to consumers in the United States over the last two decades occurred simultaneously with the widespread adoption of risk-based pricing by bank credit card issuers (beginning around 1988), automobile lenders (by 1990) and eventually mortgage lenders (since the mid-1990s)."[4]

Pricing according to risk is not just a tool used solely by lenders. Auto insurers give careful drivers with a clean driving record the best rates for insurance and will raise rates for those that get speeding tickets or have caused accidents. Home insurers give discounts for smoke detectors or set

[4] Staten, Michael, "Risk-based Pricing in Consumer Lending," Credit Research Center, McDonough School of Business, Georgetown University, March 2005.

higher rates for homes with building materials that are more susceptible to fire, such as shake-shingle roofs.

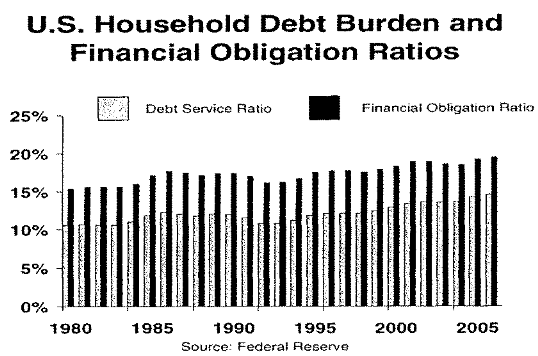
Importantly, federal law requires issuers to disclose all the terms and conditions associated with a card, including when and for what reason the terms may be changed. For example, every credit card solicitation and application must disclose and highlight the most important terms. Ten point font is the minimum font size for these disclosures; some must use 18-point font. In fact, credit card issuers are subject to thorough and far-reaching government oversight that addresses everything from fair billing to consumer disclosures to data security. Unlike other businesses, the credit card industry is routinely examined and evaluated by full-time state and federal banking regulators, which have sweeping investigative authority. A sample of the major federal laws that govern the credit card industry is attached as an appendix. Regulations and mandatory guidance implementing these laws are backed up by severe legal and financial penalties to ensure strict and consistent compliance.

Another area of concern has been the overall debt burden of consumers, including credit card, mortgage and other debt. It is certainly true that over the last 25 years, consumer use of debt financing has grown as more people rely on it to purchase everything from homes to everyday goods. Today, debt for all purposes is near $12 trillion. At the same time, income and wealth have also increased and consumers' ability to manage the debt has not changed significantly. In this regard, the GAO report provides important information. For example, GAO found that:[5]

- Total household debt levels as a percentage of income has remained relatively constant since the 1980s, according to the Federal Reserve data on aggregate debt burdens. The monthly debt service payments required on all household debt (including mortgage debt and revolving and

[5] GAO Report, page 58.

non-revolving consumer loans) generally fluctuated between 11 percent and 14 percent from 1990 to 2005, similar to the levels observed during the 1980s.



- Credit card debt remains a small portion of overall household debt, even among households with the lowest income levels. According to the Federal Reserve, credit card balances as a percentage of total household debt have declined from 3.9 percent of total household debt in 1995 to just 3.0 percent as of 2004.

- The proportion of households that could be considered to be in financial distress does not appear to be increasing significantly. According to the Federal Reserve Board's Survey of Consumer Finances, the proportion of households that could be considered to be in financial distress – those that report debt-to-income ratios exceeding 40 percent and that have had at least one delinquent payment within the last 60 days – was relatively stable between 1995 and

2004. Furthermore, the proportion of the lowest-income households exhibiting greater levels of distress was lower in 2004 than it was in the 1990s.[6]

Expanded use of credit cards is often cited as a cause of rising debt levels. However, about half of credit card users pay their balance in full each month. Thus, the reported rise in debt overstates the actual debt because many people use credit cards as a ***method of payment***, rather than as a ***revolving debt instrument***. As former Federal Reserve Chairman Alan Greenspan noted in 2004: "The convenience of credit cards has caused homeowners to shift the way they pay for various expenditures to credit card debt. In short, credit card debt-serve ratios have risen to some extent because households prefer credit cards as a method of payment, and hence, the increase does not necessarily indicate greater financial stress."

I want to also address the concerns that the rising trends in delinquencies and default rates on mortgages might spill over to credit cards. Typically, one would expect to see credit card delinquencies rise *before* mortgage delinquencies, as people generally choose to be late on unsecured loans before putting at risk the security that backs loans, such as cars or homes. We have not seen this trend and fortunately do not see evidence of this in the most recent data. The ABA tracks the number and dollar amount of non-mortgage consumer loans delinquencies every quarter. These are loans that are 30 days or more past due (seasonally adjusted), which provides an early indicator of problems. Late payments on credit cards accounts were basically unchanged from the third quarter through the fourth quarter of 2006 (4.57 percent and 4.56 percent, respectively). These rates are well below the highs recorded in July of 2005 when delinquency rates were just under 5 percent.

[6] The GAO report uses the latest Federal Reserve survey on consumer finances and it is likely that rapid growth in mortgage debt and the recent problems with subprime mortgages has pushed these ratios higher since 2004. The basic point with respect to credit cards, however, remains valid.

Those 2005 credit card delinquencies were more likely a result of fast-rising gas prices and continuous increases in short-term interest rates by the Federal Reserve which squeezed consumers' budgets.

In the dollar terms, credit card delinquencies declined to 3.45 percent (seasonally adjusted) and are near the lowest levels we have seen since 1995. Given these numbers, we are cautiously optimistic that the spillover from mortgage delinquencies to credit cards will be small, particularly given continued job growth and a still expanding economy.

Of course, we recognize that these ratios have probably moved up as a result of recent problems in the mortgage markets, but the basic point remains valid relative to credit cards.

III. As Complexity Has Increased, New Issues Have Arisen. Better Disclosures and More Financial Education Are Needed

Credit cards are so easy to use that people often take them for granted. Borrowing money, through any channel, is a significant obligation that should be taken very seriously. Like any bank loan, credit cards are governed by a specific contract, and disclosures must be consistent with existing law and regulation.

As the features and options expanded, credit and other payment cards became more complex; as a result, disclosures became more complicated and lengthy, often reflecting the legal requirements of fully and accurately explaining the lending terms and conditions. Clearly, these largely legal documents do not lend themselves to simple explanations.

The recent GAO study confirmed the fact that disclosures have not kept up with the complexity of payment cards. In fact, GAO's sole recommendation was for better disclosure standards in order to provide consumers with a greater understanding of card usage. The banking industry agrees with the GAO that better disclosures are needed.

The GAO report indicated that disclosures required by law, such as under the Truth in Lending Act and its attendant Regulation Z, are often written at an education level that is too high and sometimes contain design features that make them difficult to read. Moreover, the report found many existing disclosure requirements to be less useful for the more complicated structures of today's credit cards, and that issuers are further challenged to provide complete disclosure of account terms in a manner that complies with detailed and rigorous legal standards. The GAO report also recognized the efforts of many large card issuers to improve their current disclosures by highlighting existing "effective" disclosures that are more consumer-friendly. Moreover, the GAO report noted the SEC best practices for creating clear disclosures that "disclosure documents are more effective when they adhere to the rule that less is more."

ABA fully supports the comprehensive review of credit card disclosures by the Federal Reserve. Updating and simplifying should be the focus. In our comments to the Federal Reserve on modernizing disclosures, we have laid out several key themes:

- **Disclosures should be reviewed with an eye toward making them more concise, readable, and understandable.** "Summary" disclosures should avoid information overload and be limited to those most consumers will find most important. As there is no typical borrower or account holder, an attempt to provide comprehensive notices of all terms will not succeed in simplifying the notices. The summary disclosures should advise consumers to review the agreement for additional, important information.

- **Uniform formatting in summary disclosures and model terminology should be considered to promote uniformity and consistency.** Consumers will be more likely to use and understand disclosures if terminology and the summary format is consistent, particularly for solicitations and initial disclosures. Flexibility should be retained for periodic statements in order to permit innovation and encourage competition.

- **Focus groups should be used as a resource to determine which terms should be disclosed and how they should be written.** It is also important to perform tests so that the program measures what consumers actually look at and absorb, rather than what they think they will read and understand.

- **The Federal Reserve and the banking industry should also develop a credit card users' manual to assist consumers in understanding credit cards and credit card offers.** This should be provided to improve consumers' understanding of credit card practices and pricing and help them to shop for and select the best payment card to meet their individual needs. Such a document would complement specific product disclosures that the lender would provide.

The ABA and major credit card companies submitted detailed comments to the Federal Reserve early in the regulatory process. We anticipate that a specific proposal will be put out for comment shortly, and we urge the Federal Reserve to move as quickly as possible on this important issue.

In anticipation of this proposal, ABA and the major credit card issuers are working together to develop ideas for the most-user friendly possible disclosures, as well as other information on credit cards that will be helpful to consumers. We are committed to this effort and would be pleased to work with members of the Financial Services Committee on ways to provide consumers with the information they need.

I would also like to stress the importance of financial education. Like all financial commitments, credit cards carry important obligations. Understanding this commitment is vital for smart financial planning. As payment cards have become more complex, financial literacy is essential.

Sound financial knowledge is essential to manage all of one's credit commitments well. Congress has repeatedly recognized the importance of financial literacy in helping Americans exercise good judgment, most recently in the Fair and Accurate Credit Transactions (FACT) Act of 2003. In addition to providing greater consumer access to credit information, the FACT Act established the Financial Literacy and Education Commission with the purpose of improving financial literacy. The Federal Reserve and Federal Trade Commission are required, on an ongoing basis, to review the effectiveness of card disclosures and to address all other consumer concerns regarding credit fairness.

The banking industry is actively engaged in providing financial education. Nearly 90 percent of financial institutions are involved in public school education and 90 percent offer some kind of credit counseling. The ABA Education Foundation provides leadership and resources to help increase financial literacy. Just this past Tuesday, April 24, bankers across the country celebrated the Foundation's 11th annual National Teach Children to Save Day. As part of the Teach Children to Save program, over 10,000 bankers go into classrooms each spring and teach lessons on savings, budgeting and money management. We were pleased, Madame Chairwoman, that you will be participating in this program in New York on April 30 with bankers, and we want to thank Representatives Pryce, Green, Drake, Costa, and Wynn for participating with bankers earlier this month in Teach Children to Save programs in their districts. SEC Commissioner Paul Atkins, FDIC Chair Sheila Bair, and over a dozen Treasury officials also participated in the Foundation's event.

On October 18, 2007 is the fifth annual ABA Education Foundation Get Smart About Credit Day. This program is designed to raise awareness among teens and young adults about credit and the importance of using it wisely. This past year, Treasury Secretary Paulsen and several members of Congress joined bankers in classrooms as part of this program. The Foundation would be very happy to work with any member of this subcommittee who would like to participate in our Get Smart About Credit Program in this fall.

The ABA and the major credit card companies are also working together on a way to improve consumer education about credit cards. As a result of our discussions with Members of Congress, a particular focus will be on college-age individuals. Our first step was to scan what individual institutions were doing. It is clear from that scan that, in fact, every major credit card company, as well as the ABA, has developed a significant program for education and is working to provide that information to consumers, often with a focus on students. Nevertheless, we believe more can be done to deliver this education to consumers, and we are working together to that end.

Americans should receive the credit they deserve. Most fulfill their commitments and use credit as a means to live a full and diverse financial life in which credit cards play an important part. Making sure consumers understand the important obligations they assume each time they use their credit cards is critical to effective management of personal finances.

We also fully recognize that there are other issues relating to credit card practices that are of concern to Members of Congress. As the GAO study effectively pointed out, for millions of Americans credit cards provide more services and greater convenience, at lower interest rates, than they did a few years ago. In many cases, consumers paid nothing for the use of the card; in fact, they may be paid – through rebates, points, or mileage – to use the card. However, for others the increasing complexity of the offerings has led to real concerns and some individuals have ended up in a very difficult financial situation.

The industry takes these concerns very seriously. Members of Congress have asked the ABA and the industry to address these concerns, and I want to assure the members of this Subcommittee that we are working to do just that. Individual institutions have recently made significant announcements of changes in their policies. I have been in numerous discussions in recent months with the major credit card companies, and there is a true recognition of the need to address practices that result in consumers sometimes ending up in difficulty. With the recent announcements, what we are seeing is another manifestation of the competitiveness of the credit card industry. Frankly, that competitiveness, which led to great innovation, lower interest rates, and lower or no annual fees, also led to the complexity which has sometimes caused problems. Now that competition is driving individual institutions to streamline and simplify the credit card products.

Conclusion

The story of payment cards is one of ever-broadening access and great technological advances. They make today's rapid, efficient economy possible. They provide consumers with a wide variety of choices, allowing them to choose the card best suited to their financial needs and way of life. The simplicity of use is a result of decades of innovation and behind-the-scenes global networks.

Just as an example, a consumer could have a credit card that enables him or her to buy goods and services all over the world in a matter of seconds. The consumer could pay nothing for this card – in fact, the consumer could get a one percent rebate on everything charged and the card company might even make a small contribution to the consumer's favorite charity when the card is used (through an affinity card for that charity). The consumer has the option to pay off the balance, after a 30-day or so free loan, with no interest, or can choose to take out a loan with flexible payments. The card also provides security and convenience. This is a truly remarkable product.

Having said that, we recognize that the market has evolved considerably in recent years and that there are legitimate issues and concerns. There is a strong base from which to address those concerns. First, there is a solid basic regulatory structure that can be used. Second, the highly competitive nature of the card market puts consumers in the driver's seat. For example, we have seen that features that are unpopular with consumers often are competed away.

The pricing of the card products has evolved. Interest rates are lower and annual fees are rare. More services, including rebates and rewards, are offered. But some fees have gone up. In addition, a broad consensus has developed that disclosures are inadequate and confusing. The industry recognizes these concerns and wants to work with you, Madame Chairwoman, other Members of Congress and our regulators to address them, while maintaining the competitive and innovative market for payment cards.

Appendix

Regulations Imposed on the Card Industry

Truth in Lending Act (TILA) – TILA establishes uniform methods of computing the cost of credit, disclosure of credit terms, and procedures for resolving errors on certain credit accounts. Major provisions of the TILA regulations require lenders to provide borrowers with meaningful, written information on essential credit terms, including the cost of credit expressed as an annual percentage rate (APR); respond to consumer complaints of billing errors on certain credit accounts within a specific period; identify credit transactions on periodic statements of open-end credit accounts; provide certain rights regarding credit cards; and comply with special requirements when advertising credit.

Fair Credit Reporting Act (FCRA) – FCRA defines a credit reporting agency and adopts procedures for maintaining fair use of consumer credit information. The Act establishes procedures for correcting mistakes on a consumer's credit report and requires that a consumer's record be provided only for legitimate business purposes. It also requires that the record be kept confidential. A credit record may be retained seven years for judgments, liens, suits, and other information. Bankruptcies may be retained for 10 years. If a consumer is denied credit, a free credit report may be requested within 30 days of denial. The **Fair and Accurate Credit Transactions (FACT) Act** of 2003 renewed FCRA with new consumer protections, including free annual credit reports and tools against identity theft.

The Equal Credit Opportunity Act (ECOA) – The Act's regulations establish guidelines for gathering and evaluating credit information, and require written notification when credit is denied. Regulations prohibit creditors from discriminating against applicants on the basis of age, race, color, religion, national origin, sex, marital status, or receipt of income from public assistance programs. Regulations also require creditors to give applicants a written notification of rejection of an application, a statement of the applicant's rights under the Equal Credit Opportunity Act, and a statement either of the reasons for the rejection or of the applicant's right to request the reasons. Creditors who furnish credit information on married borrowers must report information in the names of both spouses.

Electronic Funds Transfer Act (EFTA) – The Act establishes the rights, liabilities, and responsibilities of parties in electronic funds transfers (EFTs) and protects consumers using EFT systems, such as ATMs and debit cards. Regulations establish the rules for solicitation and issuance of EFT cards; govern consumers' liability for unauthorized electronic funds transfers (resulting, for example, from lost or stolen cards); require institutions to disclose certain terms and conditions of EFT services; provide for documentation of electronic transfers; set up resolution procedures for errors; and cover notice of crediting and stoppage of pre-authorized payments from a customer's account. Stored-value cards and home banking by computer are also subject to regulation under this Act.

Gramm-Leach-Bliley Act (GLBA) – Regulations require financial institutions to provide notice to their customers about their privacy policies and practices. Regulation provides consumers with the right to prevent a financial institution from disclosing nonpublic personal information to nonaffiliated third parties, by providing a means to "opt out."

Unfair or Deceptive Acts or Practices (UDAP) – Regulations establish consumer complaint procedures and define unfair or deceptive acts or practices of banks in connection with extensions of credit to consumers. Under these regulations, a consumer complaint concerning either an alleged unfair or deceptive practice or an alleged violation of law or regulation will be investigated by the appropriate federal agency.

Fair Debt Collection Practices Act (FDCPA) – This Act explicitly prohibits abusive, deceptive, and unfair debt collection practices. It applies to third-party debt collectors or to those who use a name other than their own in collecting debts. Complaints regarding debt collection practices should generally be filed with the Federal Trade Commission.

Source: Federal Reserve

Testimony of Cindy Zeldin,
Federal Affairs Coordinator, Economic Opportunity Program, Dēmos

Before the United States House of Representatives Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit

"Credit Card Practices: Current Consumer and Regulatory Issues"

April 26, 2007

Chairwoman Maloney, Ranking Member Gillmor, and Members of the Subcommittee, thank you for inviting me to testify today. My name is Cindy Zeldin, and I am here representing Dēmos, a nonprofit, nonpartisan research and public policy organization working on issues related to economic security. As part of our ongoing work on these issues, Dēmos has conducted extensive research on consumer debt, particularly credit card debt, at the household level.

We approach our work on credit card debt and lending industry practices through the lens of rising insecurity among low- and middle-income households in a rapidly changing economy. Against an economic backdrop simultaneously characterized by stagnant incomes at the median and the rapidly rising costs of big-ticket necessities like housing, health care, and education, our nation has witnessed tremendous growth in credit card debt over the past two decades. Credit card debt has roughly tripled since 1989, with Americans owing more than $800 billion in credit card debt today.[1]

At the same time as our economy has undergone major changes, the banking and financial industry has been steadily deregulated. While deregulation has expanded access to credit for many people who had been denied or excluded from mainstream financial services in the past, this credit has come at a high cost. It is low- and moderate-income households whose levels of credit card debt have increased the most in recent years, and our research indicates that these households are increasingly turning to credit cards to manage economic shocks like job loss or a major medical expense or to fill in the gap between the cost of basic living expenses and stagnant incomes.

The democratization of credit has, in many ways, become our modern day safety net, albeit one that comes with high interest rates and an endless array of penalty fees that are unleashed upon borrowers in response to just the slightest slip-up. With debt service taking a big bite of the household budget, there is less left over to build savings and assets, quickly trapping families in a cycle of debt. Once in debt, the capricious and abusive practices of the lending industry make it exceedingly difficult to climb out. Indeed, the business model of the credit card industry is predicated upon, in the words of Harvard Professor Elizabeth Warren, hidden "tricks and traps" designed to maximize income from interest rates and penalty fees. When a cardholder falters, even just a little, they are placed in what Professor Ronald Mann calls a "sweat box" designed to extract as much in interest and fees as the card issuer possibly can.[2]

The credit card market is a broken market. When consumers initially shop for a credit card, the key element of their comparison shopping is generally the interest rate on the card. Yet this comparison shopping does not represent a well-functioning, competitive marketplace because the card issuer reserves the right to change the terms of the card agreement at any time, for any reason with a 15-day notice. Card issuers make no determination of the ability of a cardholder to repay at the time when they extend the credit card, but rather increase the interest rate retroactively once a consumer is late with a payment, exceeds their credit limit, or even has a change in credit score. Penalty interest rates can be as high as 30 or even 40 percent, with the average penalty APR around 27 percent.[3] Late fees and over-the-limit fees now are in the $29 to $39 range.

Trends in Credit Card Debt

Credit card debt has roughly tripled since 1989, with Americans owing more than $800 billion in credit card debt today.[4] Our national savings rate has steadily declined, and the number of people filing for bankruptcy since 1990 has more than doubled to just over 2 million in 2005.[5] To better understand what these trends mean for low- and middle-income households in today's economy, Dēmos has researched credit card debt trends by analyzing Survey of Consumer Finances data, research which has found that certain demographic subgroups have experienced particularly rapid increases in credit card debt since 1989. These groups are low- and moderate-income households, senior citizens, and young adults under age 34.

The average amount of credit card debt among all households with credit card debt grew 89 percent between 1989 and 2004. The average self-reported balance of indebted households was $5,219 in 2004. It is important to note that the SCF data are based on self-reported amounts of debt by respondents, and there is evidence that consumers tend to underestimate their credit card debt. Table 1 displays average credit card debt, and the percent change in that debt from 1989 to 2004, by income group.

Table 1. Average Credit Card Debt of Households with Credit Card Debt (2004 Dollars)			
Income	**Average Credit Card Debt in 1989**	**Average Credit Card Debt in 2004**	**Percentage Change, 1989-2004**
<$10,000	$622	$2,750	342.5%
$10,000 - 24,999	$1,528	$3,378	121.1%
$25,000 - 49,999	$2,468	$4,831	95.8%
$50,000-99,999	$2,854	$4,667	63.6%
$100,000 - >	$5,856	$7,691	31.3%

Source: Dēmos' Calculations using 1989. 1992, 1995, 1998, 2001 and 2004
Survey of Consumer Finances

Dēmos' report *Retiring in the Red* documented dramatic increases in the amount of credit card debt among older Americans. Roughly three out of every four Americans over 65 hold credit cards. Of these cardholders, slightly more than one in three (35 percent) carried debt in 2004, up from 29 percent in 1989. While the percentage of indebted cardholders increased only slightly, the amount of debt carried by older Americans grew precipitously. Average revolving balances among indebted seniors over 65 increased by 193 percent from 1989 to 2004, from $1,669 to $4,906 (in 2004 dollars).

In our issue brief *Generation Debt*, we examined trends in credit card debt among young Americans. The average credit card debt of Americans aged 25 to 34 years old increased by 51 percent between 1989 and 2004, to a self-reported household average of $4,358. According to the Survey of Consumer Finances, nearly 2 out of 3 young Americans aged 25 to 34 have one or more credit cards, a level basically unchanged since 1989. Compared to the population as a whole, however, young adult cardholders are much more likely to be in debt: 68 percent of young adult cardholders revolve their balances, compared to 58 percent of all cardholders.

The Plastic Safety Net: Findings from Dēmos' National Survey of Low- and Middle-Income Households

To better understand the factors contributing to household indebtedness, Dēmos and the Center for Responsible Lending commissioned a national household survey of households with credit card debt. The survey, conducted in March 2005 by ORC Macro, consisted of 1,150 phone interviews with low- and middle-income households whose incomes fell between 50 percent and 120 percent of local median income—roughly half of all households in the country. In order to participate, a household had to have credit card debt for three months or longer at the time of the survey.

The survey asked a series of questions about what types of expenses in the past year had contributed to the households' current level of credit card debt. Seven out of 10 low- and middle-income households reported using their credit cards as a safety net—relying on credit cards to pay for car repairs, basic living expenses, medical expenses or house repairs. Only 12 percent of households did not report any type of safety net usage, which may indicate a relatively low percentage of credit card debtors who use credit to "live beyond their means," purchasing items that are not critical or necessary.

Table 2: In the past year, please tell me if the following items have contributed to your current level of credit card debt, or not.		
	Yes %	No %
Car repairs	48	52
Home repairs	38	63
A major household appliance purchase	34	66
Basic living expenses such as rent, groceries, utilities	33	67
An illness or necessary medical expense	29	71
A layoff or the loss of a job	25	75
Tuition or expenses for college for a child, a spouse or partner, or yourself	21	79
Money given to other family members, or used to pay the debts of other family members	19	81
Tuition or other school-related expenses for a child who is of high school age or younger	12	88
Percent Who Answered Yes		
To none of these expenses:	12	
To one or more	88	
To two or more	71	
To three or more	48	
To four or more:	28	

In addition to asking about specific types of expenses, the survey also asked households whether they had used credit cards in the past year to pay for basic living expenses, such as rent, mortgage payments, groceries, utilities or insurance, because they did not have money in their checking or savings account. One out of three households reported using credit cards in this way—reporting that they relied on credit cards to cover basic living expenses on average four out of the last 12 months. Households that reported losing a job sometime in the last three years and being unemployed for at least two months, as well as households who had been without health insurance in the last three years, were almost twice as likely to use credit cards to pay for basic living expenses. Not surprisingly, households who needed to use credit for their basic living expenses had lower level of savings and higher credit card balances than households who did not use credit cards to pay for their basic expenses.

We also found that households in our survey that reported medical expenses as a factor in their credit card debt had higher levels of credit card debt than those who did not cite medical expenses as contributing to their credit card debt. Overall in the survey, 29 percent of indebted low- and middle-income households reported that medical expenses contributed to their current level of credit card debt. Within that group, 70 percent had a major medical expense in the previous three years. Overall, 20 percent of indebted low- and middle-income households reported both having a major medical expense in the previous three years and that medical expenses contributed to their current level of credit card debt. That subset of households had average credit card debt of $11,623.

Credit Card Industry Practices

The widespread availability of credit cards can help individuals and families weather difficult financial times or manage large, unexpected costs like a major car or home repair. However, the practices of the credit card industry make it exceedingly difficult to pay down this debt.

Deregulation of the industry began with a Supreme Court ruling in 1978. In *Marquette National Bank of Minneapolis v. First Omaha Service Corp*, the Court ruled that Section 85 of the National Banking Act of 1864 allowed a national bank to charge its credit card customers the highest interest rate permitted in the bank's home state—as opposed to the rate in the state where the customer resides.[6] As a result, regional and national banks moved their operations to more lender-friendly states, such as South Dakota and Delaware, where there were no usury ceilings on credit card interest rates. In domino-like fashion, states began loosening their own usury laws. Today, 29 states have no limit on credit card interest rates.[7]

As a result of *Marquette*, credit card companies that are located in states without usury laws and without interest rate caps—all the major issuers—can charge any interest rate they wish, as long as they comply with consumer disclosure rules. The *Marquette* decision allowed banks to nationalize credit card lending and take full advantage of the ease of centralized processing provided by the Visa and MasterCard systems. As a result, credit cards, which were once the province of the wealthy and elite business class, quickly became part of mainstream American culture. Riskier borrowers—often those on the lower end of the income distribution—were brought into the market, and lenders were able to charge higher interest rates to compensate for the increased risk.[8]

In the mid-1990s, further deregulation of the credit card industry again contributed to the increasing costs of credit for consumers. In 1996, the Supreme Court ruled in *Smiley vs. Citibank* that fees could be defined as "interest" for the purposes of regulation. As such, under the rules established by *Marquette*, the laws regulating fees were now to be determined by the state laws in which the bank was located. Prior to the ruling, the card companies were bound by the state laws of the customers' residence. Post-Smiley, credit card companies steadily raised the amount they charged in fees.

On average, interest rates on credit cards have declined over the past 30 years, and well-off consumers who pay their balance in full each month benefit from the convenience and often the rewards programs that credit card companies offer. This group of cardholders has been known to be referred to as "deadbeats" by card issuers, however, because they are not bringing in interest and penalty fee revenue. Of course, credit card companies take in revenue from interchange fees, which all transactions bring in. While interchange fees accounted for $20.62 billion in revenue in 2005, interest brought in $71.13 billion and penalty fees brought in $7.88 billion.[9] The majority of cardholders may not be in the penalty zone, but those consumers who are generate very high profits for the industry. While consumers shopping for a new credit card may not expect that they will ever be subject to penalty interest rates and fees, card issuers routinely invoke these penalty pricing tactics for relatively minor transgressions, turning customers who may have diligently researched and signed up for the credit card with the best rates and terms they could find into retroactively "repriced" default interest rate payers if they are simply tardy with a payment.

Several industry practices are worthy of scrutiny, and I will describe some examples. The first is penalty pricing, or interest rate hikes and fees for an array of infractions, many of which are quite minor and are not necessarily reflective of a cardholder's risk profile. When a payment is late, all the major card issuers typically increase the interest rate on the card to a penalty, or "default," rate (according to the GAO, these rates average 27.3%). Due dates are often listed down to the hour, for example at 1pm on a particular date, and payments received after that time are processed the following day. With payment grace periods no longer in place, cardholders who submit payments that are nominally late are routinely hit with interest rate increases that can drastically increase the cost of credit. It is also important to note that these penalty interest rates are applied retroactively to the entire existing card balance, not simply prospectively to future purchases. Cardholders who are late are also slapped with a late fee. According to a report by the GAO, late fees have steadily increased from the $5 to $10 range in 1990 to an average of $33.64 in 2005.[10] Penalty pricing is also typically invoked when a cardholder exceeds the credit limit on their card. Rather than denying the purchase, it is now routine practice to allow the transaction to go through, but to then increase the cardholder's interest rate retroactively and to apply an over-the-limit fee. According to the GAO, over-the-limit fees averaged $30.81 in 2005.

Card companies should be required to provide a reasonable late-payment grace period to protect responsible debtors from being unduly penalized by a run-of-the-mill tardy payment. Credit card companies should also be held accountable to the original contract with the cardholder for all purchases up to any initiated change in terms, and any change to the APR should be limited to future activity on the card.

The second practice I would like to highlight is universal default, a bait-and-switch practice whereby card issuers retroactively change a cardholder's interest rate not because of any change in behavior with that particular card, but because of a change in the cardholder's credit score or their payment behavior with another lender. While some card issuers have halted this policy, others still engage in it, and still others increase interest rates because of behavior with other creditors but institute these increases through a change-in-terms rather than automatically, which means that cardholders must be given at least 15 days notice under the Truth in Lending Act. According to the GAO, cardholders would have to be given the right to opt out of the change under the laws of the states in which four of the six largest issuers are chartered. However, 15 days may not be sufficient time for a cardholder to make other credit arrangements, and, if a cardholder is required to stop using the card or to pay off the entire balance in a short period of time, opting out may not be a feasible option.

Two other practices highlighted in the recent GAO report on credit cards also deserve attention: payment allocation methods and balance computation methods. Most major card issuers allocate payments first to the portion of the balance that is assessed the lowest rate of interest. In fact, the balance with the lowest interest rate would need to be fully paid before payments can be allocated to the portion of the bill with higher interest. An example of how this might work is when a cardholder transfers a balance from another credit card because a low interest rate was advertised for balance transfers. All payments would be applied to that balance transfer at the low rate, while the previously existing balance (from purchases made with the card) would continue to accrue interest at the higher rate. In the case of balance computation methods, the GAO report drew attention to a practice known as double-cycle billing, whereby cardholders who move from nonrevolving to revolving status are charged interest on their original balance that previously had been subject to an interest-free grace period.

To address these and other industry practices and to restore responsible credit practices and fair lending terms for borrowers, Demos supports legislative changes such as those incorporated in legislation introduced by Senator Menendez (S. 2655) in 2006.

Conclusion

In the absence of meaningful regulation, credit card companies are free to design credit card agreements that are not only confusing in their complexity, but that, once deciphered, are fundamentally unfair. Despite borrowing money under one set of terms and conditions, a borrower can be asked to pay back that money under an entirely different set of conditions for being a day or two late or for going just over their credit limit. Once in penalty territory, households are typically paying interest rates of 27 percent. For low- and moderate-income households, whose levels of credit card debt have increased the most in recent years, these penalty interest rates drain resources from already tight family budgets, inhibiting the ability of these households to pay down their debt, let alone save money to weather future economic shocks.

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[1] Federal Reserve Statistical Release, Consumer Credit, April 6, 2007, available at http://www.federalreserve.gov/releases/g19/Current/g19.htm
[2] See the testimony of Alys Cohen before the Senate Permanent Subcommittee on Investigations, March 7, 2007.
[3] GAO, "Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," September 2006.
[4] Federal Reserve Statistical Release, Consumer Credit, April 6, 2007, available at http://www.federalreserve.gov/releases/g19/Current/g19.htm
[5] American Bankruptcy Institute. "U.S. Bankruptcy Filings 1980-2005."
[6] Vincent D. Rougeau, "Rediscovering Usury: An Argument for Legal Controls on Credit Card Interest Rates," *University of Colorado Law Review*, Winter 1996.

[7] Lucy Lazarony. "States with Credit Card Caps." Bankrate.com, March 20, 2002. <www.bankrate.com/brm/news/cc/20020320b.asp>

[8] David A. Moss and Johnson A. Gibbs, "The Rise of Consumer Bankruptcy: Evolution, Revolution or Both?," 1999 National Conference of Bankruptcy Judges, p 13.

[9] Testimony of Elizabeth Warren before the Senate Banking Committee, January 25, 2007, data from CardWeb

[10] GAO, "Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," September 2006.

Cindy Zeldin is the Federal Affairs Coordinator in the Economic Opportunity Program at Dēmos, a public policy research and advocacy organization that has conducted extensive research on household debt. Most recently, Ms. Zeldin coauthored the Dēmos report *Borrowing to Stay Healthy*, which examined medical debt that accrues on credit cards. She holds a Master's Degree from The George Washington University and a B.A. from Emory University.

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Before the
United States House of Representatives
Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit

Hearing on
"Credit Card Practices: Current Consumer and Regulatory Issues"

Thursday, April 26, 2007

10:00am

Room 2128 Rayburn House Office Building

This testimony with all Figures and the academic articles referenced herein are available for download on my website at http://mason.gmu.edu/~tzywick2/.

TODD J. Zywicki is Professor of Law at George Mason University School of Law, Editor of the *Supreme Court Economic Review*, and Senior Fellow of the James Buchanan Center, Program on Politics, Philosophy, and Economics. From 2003-2004, Professor Zywicki served as the Director of the Office of Policy Planning at the Federal Trade Commission. He teaches in the area of Bankruptcy, Contracts, Commercial Law, Business Associations, Law & Economics, and Public Choice and the Law. He has also taught at Georgetown Law Center, Boston College Law School and Mississippi College School of Law and is a Fellow of the International Centre for Economic Research in Turin, Italy. He has lectured and consulted with government officials around the world, including Italy, Japan, and Guatemala. Professor Zywicki has testified several times before Congress on issues of consumer bankruptcy law and consumer credit. Professor Zywicki is a Member of the United States Department of Justice Study Group on "Identifying Fraud, Abuse and Errors in the United States Bankruptcy System." He is the author of the forthcoming books, *Bankruptcy and Personal Responsibility: Bankruptcy Law and Policy in the Twenty-First Century* (Yale University Press, Forthcoming 2007) and *Public Choice Concepts and Applications in Law* (West Publishing, Forthcoming 2008).

Professor Zywicki clerked for Judge Jerry E. Smith of the U.S. Court of Appeals for the Fifth Circuit and worked as an associate at Alston & Bird in Atlanta, Georgia, where he practiced bankruptcy and commercial law. He received his J.D. from the University of Virginia, where he was executive editor of the Virginia Tax Review and John M. Olin Scholar in Law and Economics. Professor Zywicki also received an M.A. in Economics from Clemson University and an A.B. cum Laude with high honors in his major from Dartmouth College.

Professor Zywicki is the author of more than 50 articles in leading law reviews and peer-reviewed economics journals. He is one of the Top 50 Most Downloaded Law Authors at the Social Science Research Network, both All Time and during the Past 12 Months. He served as the Editor of the *Supreme Court Economic Review* from 2001-02. He is a frequent commentator on legal issues in the print and broadcast media, including the *Wall Street Journal*, *New York Times*, *Nightline*, *The Newshour with Jim Lehrer*, CNN, CNBC, Bloomberg News, BBC, *The Diane Rehm Show*, and *The Laura Ingraham Show*. He is a contributor to the popular legal weblog The Volokh Conspiracy. He is currently the Chair of the Academic Advisory Council for the following organizations: The Bill of Rights Institute, the film "We the People in IMAX," and the McCormick-Tribune Foundation's "Freedom Museum" in Chicago, Illinois. He was elected an Alumni Trustee of the Dartmouth College Board of Trustees.

It is my pleasure to testify today on the subject of "Credit Card Practices: Current Consumer and Regulatory Issues." The growth in the consumer use of credit cards over the past three decades has transformed the American economy, placing in consumers' hands one of the most powerful financial innovations since the dawn of money itself. Credit cards have transformed the ways in which we shop, travel, and live. They have enabled the rise of the E-Commerce economy, delivering goods and services to consumers' doorsteps and permitting consumers to shop when and where they like, unconstrained by traditional limits on competition and consumer choice. They have enabled consumers to travel the world without the inconvenience of travelers' checks. And they have transformed the way in which we live, from such small improvements such as relieving us the inconvenience of checks and frequent visits to ATM machines to large improvements such as providing security against crime. Credit cards can be used as a transactional medium, a source of credit, or even as a short-term source of cash. Credit cards provide consumers with additional benefits, from cash back on purchases, frequent flier miles, car rental insurance, dispute resolution services with merchants, and 24 hour customer service. It has been aptly observed that that with a credit card you can buy a car; without a credit card you can't even rent one. Many of these benefits, of course, have been most salient for lower-income, young, and other similar populations, and unsurprisingly, growth in credit card use has been rapid among those populations.

But the myriad uses of credit cards and the increasing heterogeneity of credit card owners has spawned increasing complexity in credit card terms and concerns about confusion that may reduce consumer welfare. American consumers encounter complexity every day in the goods and services they purchase, such as cars, computers, and medical services, just to name a few. And the complexity of credit card terms is modest when compared to that of the Internal Revenue Code, as are the penalties (financial and otherwise) for failure to understand its terms. The relevant issue for regulation, therefore, is whether the complexity is warranted in light of its benefits.

In considering whether further legislation or regulation of credit card terms or disclosures is appropriate, two questions should be considered. First, what is the problem to be corrected through regulation? And second, will the benefits of the regulation justify the costs, including the unintended consequences of the regulation?

Based on what is known about consumer use of credit cards and credit card practices, it is doubtful that an analysis of these simple questions can justify further governmental intervention in the credit card industry. In fact, the increasing dynamism of the credit card industry suggests that regulators would be better served by revisiting, modernizing, or reconsidering certain extant regulations, rather than piling additional new regulations on top of old.

This is not to imply that certain credit card issuers or practices may not seem unfair or improper. But there are ample tools for courts and regulators to attack deceptive and fraudulent practices on a case-by-case basis when they arise. Unlike case-by-case common law adjudication, however, legislation or regulation addresses itself to *categorical* rulemaking, thus before categorical intervention is warranted it is necessary to examine whether categorical problems have arisen.

I have taught and written extensively on questions related to credit cards, consumer credit generally, and the relationship between consumer credit and consumer bankruptcies. Several years ago I published *The Economics of Credit Cards*, 3 CHAPMAN

L. REV. 79 (2000).[1] I have also published *An Economic Analysis of the Consumer Bankruptcy Crisis*, 99 NORTHWESTERN L. REV. 1463 (2005,[2] as well as *Institutions, Incentives, and Consumer Bankruptcy Reform*, 62 WASHINGTON & LEE L. REV. 1071 (2005).[3] I am currently working on a book on consumer credit and consumer bankruptcy tentatively titled *Bankruptcy Law and Policy in the Twenty-First Century* to be published by the Yale University Press, from which portions of this testimony are drawn. I am honored to have the opportunity to share my research with you here today. From 2003-2004 I served as Director of the Office of Policy Planning of the Federal Trade Commission.

What is the problem to be corrected through regulation?

Advocates of greater regulation have alleged three problems that are purported to justify additional regulation of the credit card market: (1) Consumer overindebtedness caused by access to credit cards, (2) Unjustifiably "high" interest rates on credit cards, and (3) A growing use of so-called "hidden" fees. Reviewing the empirical evidence available on these issues, however, there is no sound evidence that any of them present a meaningful problem for which greater regulation is appropriate.

(1) Consumer Overindebtedness

There is no doubt that consumer use of credit cards has increased over time, as has credit card debt. But available evidence reveals that this increase in credit card debt has not in fact resulted in an increased financial distress for American households. Instead, this increased use of credit cards has been a *substitution* from other types of

[1] Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=229356.
[2] Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=587901.
[3] Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=681483.

consumer credit to an increased use of credit cards.[4] For instance, when consumers in earlier generations purchased furniture, new appliances, or consumer goods, they typically purchased those items "on time" by opening an installment loan and repaying the loan in monthly payments or through a layaway plan. A consumer who needed unrestricted funds to pay for a vacation or finance a car repair would typically get a loan from a personal finance company or a pawn shop. Today, many of these purchases and short-term loans would be financed by a credit card, which provides ready access to a line of credit when needed, without being required to provide a purchase-money security interest, dealing with the up-front expense and delay of a personal finance loan, or pawning goods.[5] Credit cards are far more flexible and typically less-expensive than these alternative forms of consumer credit, thereby explaining their rapid growth in consumer popularity over time. Federal Reserve economist Tom Durkin observes that credit cards "have largely replaced the installment-purchase plans that were important to the sales volume at many retail stores in earlier decades," especially for the purchase of appliances, furniture, and other durable goods.[6] Former Federal Reserve Chairman Alan Greenspan similarly observed, "[T]he rise in credit card debt in the latter half of the 1990s is mirrored by a fall in unsecured personal loans."[7]

[4] *See* Zywicki, *Bankruptcy Law and Policy*, Chapter 3.

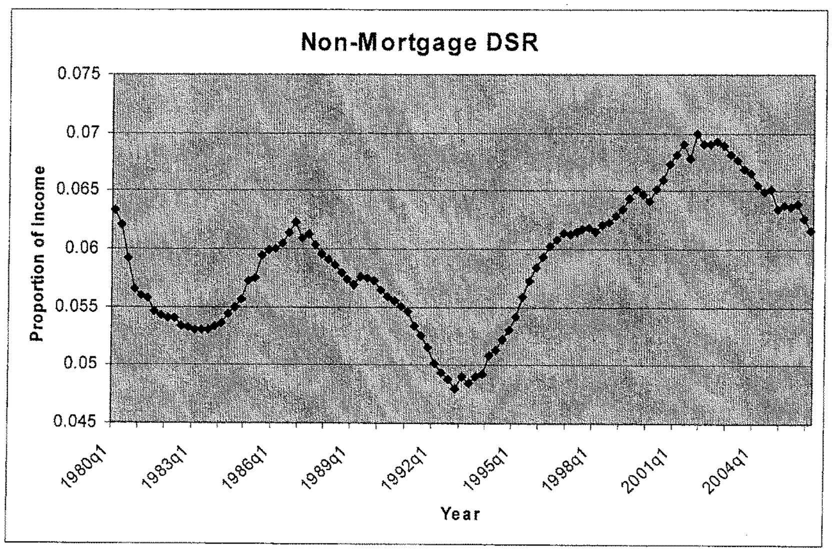
[5] Wal-Mart recently announced, for instance, that it was terminating its once-popular layaway program. Like other major department stores, Wal-Mart acknowledged that this form of credit had become irrelevant because of widespread access to credit cards. Unlike layaway, purchasing goods using a credit card permits the consumer to use the goods while paying them off, whereas under layaway the store keeps the goods until they are paid for.

[6] *See* Thomas A. Durkin, *Credit Cards: Use and Consumer Attitudes, 1970–2000*, 86 FED. RES. BULL. 623 (2000).

[7] Alan Greenspan, *Understanding Household Debt Obligations*, Remarks Given at the Credit Union National Association 2004 Governmental Affairs Conference (Feb. 23, 2004), *available at* http://www.federalreserve. gov/boarddocs/speeches/2004/20040223/default.htm.

In fact, the evidence suggests that the growth in credit cards as a source of consumer credit is explained almost completely by this substitution effect. Thus, even as credit card use has risen rapidly over time, it does not appear that this has contributed to any increase in consumer financial distress.[8]

Since 1980, the Federal Reserve has calculated on a quarterly basis the "debt service ratio," which measures the proportion of a household's income dedicated each month to payment of its debts.

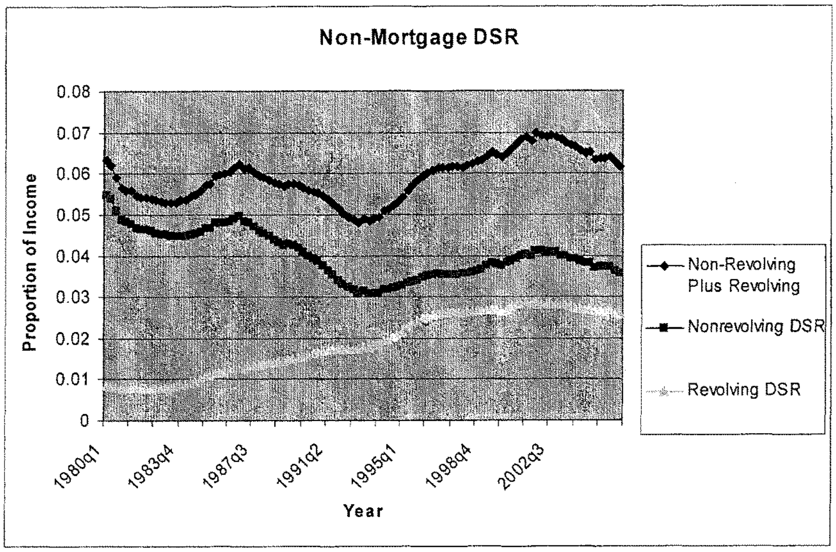


As this figure illustrates, the overall debt service ratio for non-mortgage debt (consumer revolving plus nonrevolving debt) has fluctuated in a fairly narrow band during the period 1980 to 2006. In fact, the non-mortgage debt service ratio was actually

[8] *Accord* BOARD OF GOVERNORS OF THE FEDERAL RESERVE, REPORT TO CONGRESS ON PRACTICES OF THE CONSUMER CREDIT INDUSTRY IN SOLICITING AND EXTENDING CREDIT AND THEIR EFFECTS ON CONSUMER DEBT AND INSOLVENCY 5 (June 2006) (hereinafter FEDERAL RESERVE REPORT).

slightly higher at the beginning of the data series in 1980 (0.0633) than at the end in the first quarter of 2006 (0.0616) with local peaks and troughs throughout.

Further isolating non-mortgage consumer debt into revolving and nonrevolving components illustrates the substitution effect:



As can be readily observed, from 1980 there has been a gradual downward trend in the debt service burden of nonrevolving installment credit, such as car loans, retail store credit (such as for appliances or other consumer goods) and unsecured loans from personal finance companies, that mirrors the upward trend for the credit card debt service burden over this same period, leaving the overall consumer credit debt service ratio unchanged. Moreover, according to the Survey of Consumer Finances, the percentage of households in financial distress (as measured by a total debt service ratio, including mortgage credit, of greater than 40%) has fluctuated within a narrow band since 1989.[9]

This substitution effect of credit card for other types of consumer credit has been most pronounced for lower-income debtors, primarily because this group historically has faced the most limited credit options; thus, credit cards are likely to seem especially attractive to them. As a report of the Chicago Federal Reserve Bank concluded, "The increase in the credit card debt burden for the lowest income group appears to be offset by a drop in the installment debt burden. This suggests that there has not been a substantial increase in high-interest debt for low-income households, but these households have merely substituted one type of high-interest debt for another."[10] As with the overall population, the percentage of lowest-quintile households in financial distress has been largely constant since 1989, and in fact, the percentage of lowest-income households in financial distress is actually at its lowest level since 1989.

In fact, it is likely that this data actually tends to *overestimate* the contribution of revolving debt to the debt service ratio, because of peculiarities in the way in which the debt service ratio is measured. First, there has been a dramatic increase in household wealth holdings over the past decade or so, first because of the roaring stock market of the late-1990s, and then the rapid appreciation in housing values into the 2000s. Because consumers rationally borrow against and consume some percentage their accumulated

[9] FEDERAL RESERVE REPORT at 13.

[10] Wendy M. Edelberg & Jonas D. M. Fisher, *Household Debt*, CHI. FED. LETTER, Nov. 1997, at 1, 3 (1997); *see also id.* at 4 ("[I]ncreases in credit card debt service of lower-income households have been offset to a large extent by reductions in the servicing of installment debt."); Arthur B. Kennickell et al., *Family Finances in the U.S.: Recent Evidence from the Survey of Consumer Finances*, 83 FED. RES. BULL. 17 (1997) (noting that the share of families using installment borrowing fell between 1989 and 1995 as a result of increased use of mortgages, credit cards, and automobile leasing); Glenn B. Canner & James T. Fergus, *The Economic Effects of Proposed Ceilings on Credit Card Interest Rates*, 73 FED. RES. BULL. 1, 4 (1987) (noting that rise in credit card use may have been the result of "a substitution of credit card borrowing for other types of installment credit that do not provide flexible repayment terms").

wealth, during periods of rapidly increasing household wealth (such as during the 1990s) consumers would be expected to increase their consumption and consumer debt in order to liquidate some of this accumulated wealth. The ratio of consumer credit to household net worth has been about 4% of household wealth for at least the past 50 years, thus as consumer wealth rises consumers will tend to increase their debt holdings even though their measured income does not increase.[11]

Second, the data used here to measure revolving credit likely tends to overestimate the true amount of revolving credit because of a rise in transactional use over time, an overestimation that tends to grow over time. Revolving credit is measured by the credit card balance *outstanding* at the end of a given month, regardless of whether it is actually revolved or paid off at the end of the billing cycle. As a result, the data also report as part of outstanding revolving credit balances on transactional accounts that will be paid at the close of the billing cycle, but happen to be outstanding at the time of reporting. Because some of this transactional debt is still outstanding at the end of the month, it is recorded as an outstanding debt balance and thus an increase in transactional credit card use will artificially increase the measured amount of revolving credit and overstate revolving credit as a percentage of income.

Transactional or "convenience" use of credit cards as a purchasing rather credit medium has been rising over time, both in terms of number of credit card transactions as well as dollar values. During the past 15 years, convenience use grew by approximately 15% per year, whereas the amount borrowed on credit cards as revolving credit grew

[11] *See* Thomas A. Durkin, Comment, *in* THE IMPACT OF PUBLIC POLICY ON CONSUMER CREDIT 36, 40 (Thomas A. Durkin and Michael E. Staten eds., 2002).

only about 6 ½% per year.[12] In part, the increase in transactional use of credit cards has been driven by the spread of rewards cards, such as cash-back programs or frequent flyer miles.

The mismeasurement of transactional credit card use as credit card borrowing tends to overstate credit card debt by approximately ten percent, a figure that has doubled in the past decade as a result of the rapid rise of credit card convenience use.[13] The percentage of credit card transactions that are paid off at the end of each month relative to those that end up revolving has risen over time, indicating a growth in convenience use. In addition, the median monthly charge amount for convenience users has risen over four times more rapidly for convenience users than for revolvers. The median monthly charge for convenience users has increased by about $130 (from $233 in 1991 to $363 in 2001), whereas the average charge of revolvers is substantially smaller and has increased more slowly, rising only $30 during that same time period (from $117 to $147). Again, much of this growth in the median size of transactional purchases probably results from a rise in cash-back and cobranding benefits. In addition, because convenience users do not have to pay for their purchases until the end of the billing period *plus* the grace period after receiving their bill, they have the opportunity to take advantage of interest rate "float" during the time between their purchase and payment of the obligation, which may be as long as 45-60 days. During that period, a transactional user essentially receives a free loan from the credit card issuer at zero percent interest[14] during which time those same funds can be invested in assets that generate a positive return, even if only a money

[12] Kathleen W. Johnson, *Convenience or Necessity? Understanding the Recent Rise in Credit Card Debt*, Finance and Economics Discussion Series, Federal Reserve Board, 2004-47.
[13] *See* Johnson, *Convenience or Necessity?*
[14] Technically the interest rate is slightly negative because of the time value of money.

market account or similar safe, short-term investment. In fact, empirical evidence tends to suggest that consumers do exactly this—convenience users tend to carry smaller precautionary balances in their checking accounts than revolvers, suggesting that they are taking advantage of this float. In addition, revolvers are more likely to make use of debit cards than are nonrevolvers, which can be explained by the fact that revolvers do not receive the benefit of interest-rate float because they are required to pay the full interest on the account.[15]

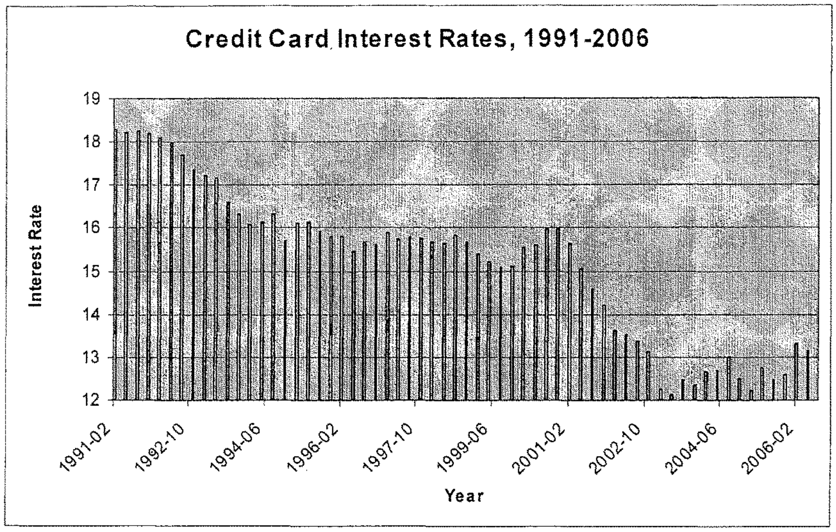
Overall, therefore, there is no evidence that increased use of credit cards has caused consumers as a whole to become overindebted. In fact, the rise in credit card use is the result of a substitution away from other less-attractive forms of credit (because of cost, flexibility, or other drawbacks such as the need to pawn personal goods) to credit cards.

(2) "High" Credit Card Interest Rates

Many commentators insist that the growth in credit card use as a source of revolving credit is irrational in light of the "high" interest rates charged on credit cards.[16] But credit card interest rates have fallen substantially over the past fifteen years:

[15] Jonathan Zinman, *Why Use Debit Instead of Credit? Consumer Choice in a Trillion Dollar Market.* Brown and Plache find that 62 percent of revolvers who acquired a general purpose debit card actually used that card whereas only 37 percent of nonrevolvers used their debit card. *See* Tom Brown & Lacy Plache, *Paying with Plastic: Maybe Not So Crazy*, 73 U. CHICAGO L. REV. 63, 84 (2006).

[16] Note that if the interest rates really were higher on credit cards than on the types of credit that they supplant, then one would expect this to be reflected in a higher debt-service ratio, which as we have just seen, it is not.

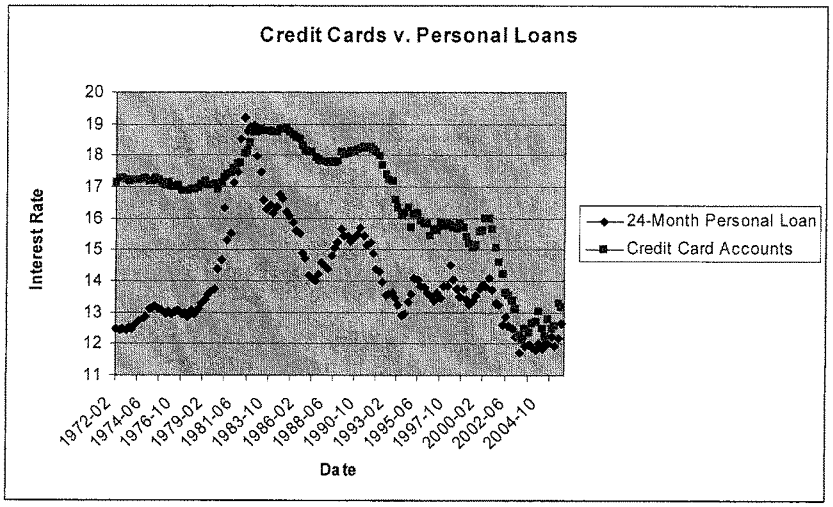


Annual fees, which were once a standard component of credit card contracts, virtually disappeared from credit cards during this period, except for those cards that offer frequent flier miles or some other benefit program that requires some administrative activity.[17] This elimination of annual fees, which were in the range of $20-$50 per year, was a massive across-the-board price reduction that not only reduced the cost of credit cards to consumers, but also increased competition in the credit card market by making it easier and less-expensive for consumers to carry multiple cards and to use the cheapest or most appropriate card for any given transaction.

This rapid decline in credit card interest rates explains the substitution from other types of consumer credit. Compare credit cards to the closest alternative to credit card borrowing, the traditional short-term unsecured installment loan, such as from a personal

[17] GAO REPORT at 23. The GAO Report noted that some cards offered rewards but still did not charge annual fees.

finance company. The following Figure displays interest rates on 24-month unsecured installment loans versus credit card interest rates for the past thirty years:



As can be readily observed, the difference between interest rates on short-tem personal installment loans and credit card accounts has narrowed over time. Indeed, in recent years the interest rate on credit card accounts has frequently fallen below that of short-term personal loans. A recent survey of consumer banking rates in the Washington, D.C., area found the prevailing interest rate on credit cards was 8.16%, whereas the prevailing rate for personal loans was 10.45%.[18] Moreover, once up-front initiation fees on personal loans are taken into consideration the overall cost of personal loans is almost certainly higher overall.[19] And this doesn't even consider the time, inconvenience, and

[18] The *Washington Times* reports area consumer banking rates each Friday. Data is drawn from those published reports.

[19] Brito and Hartley reported, for instance, "A senior bank officer told us that the costs to the bank of processing a loan are so high that they cannot afford to make a loan of less than $3,000 for one year except at interest rates *above* those charged on credit cards." They also note, "inquiries in Houston in February 1992 revealed rates ranging from 17 percent and a $100 fixed fee for a collateralized 1-year loan at a

more limited usefulness of a personal finance loan, or the more flexible repayment option of credit cards. According to one survey conducted by the Federal Reserve, 73% of consumers report that the option to revolve balances on their credit cards makes it "easier" to manage their finances versus only 10% who said this made it "more difficult."[20]

This decline in credit card interest rates has resulted from robust competition in the credit card market and savvy shopping by consumers. Survey evidence indicates that consumers who revolve credit card balances are extremely likely to be aware of the interest rate on their credit cards and to comparison shop among cards on that basis, and those who carry larger balances are even more likely to be aware of and comparison shop on this term than those who revolve smaller balances.[21] By contrast, those who do not revolve balances tend to focus on other aspects of credit card contracts, such as whether there is an annual fee, the grace period for payment, or benefits such as frequent flier miles. In fact, consistent with the observation of more aggressive interest rate shopping by revolvers, those who revolve balances are charged *lower* interest rates on average than those who do not.[22]

Empirical evidence indicates that credit card interest rates also generally reflect changes in the riskiness of credit card lending. Thus, when credit card chargeoffs

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branch of a major national finance company to over 50 percent for small loans ($300 maximum) at a local finance company." In short, bank loans of similar size and duration "either do not exist or are available only at terms more onerous than those offered by credit card issuers." By contrast, credit cards generally require no application fee and no minimum loan size. *See* Dagobert L. Brito & Peter R. Hartley, *Consumer Rationality and Credit Cards*, 103 J. POL. ECON. 400, 402 (1995).

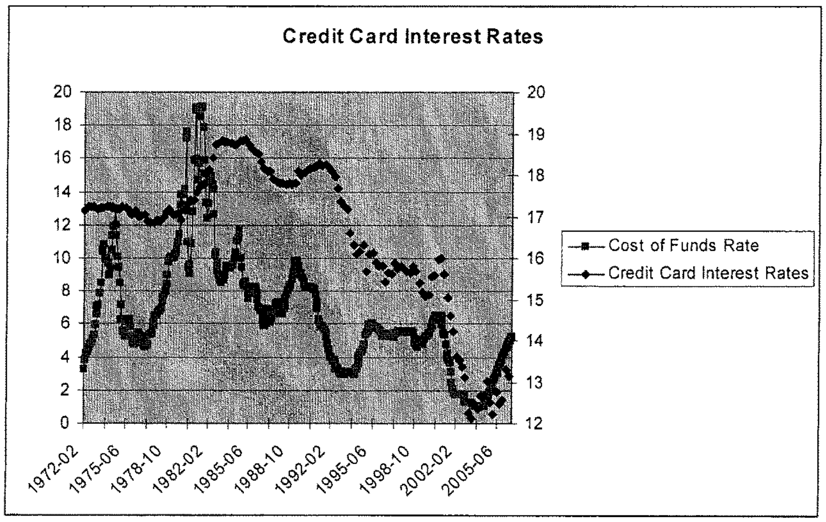
[20] Durkin, *Credit Cards: Use and Consumer Attitudes* at 623.

[21] *See* Thomas A. Durkin, *Credit Card Disclosures, Solicitations, and Privacy Notices: Survey Results of Consumer Knowledge and Behavior*, FEDERAL RESERVE BULLETIN p. A 109 (2006).

[22] Tom Brown & Lacey Plache, *Paying with Plastic: Maybe Not So Crazy*, 73 U. CHICAGO L. REV. 63 (2006).

increase, the spread charged between the underlying cost of funds and the interest rate rises.[23]

Furthermore, credit card interest rates have become less "sticky" over time, indicating that technological and risk-scoring innovations as well as more flexible risk-based pricing (as detailed below) has made credit cards even more responsive to competitive pressures. According to the General Accounting Office 93% of the cards they examined in 2005 had variable interest rates—a rise of 9 percentage points in just two years.[24] As a result, interest rates on credit cards have become more closely tied to overall interest rates in the economy, as illustrated in the following Figure.



[23] *See* Adam B. Ashcraft, Astrid A. Dick, and Donald P. Morgan, *The Bankruptcy Abuse Prevention and Consumer Protection Act: Means-Testing or Mean Spirited?* Working Paper, Federal Reserve Bank New York (Dec. 19, 2006).

[24] GENERAL ACCOUNTING OFFICE, CREDIT CARDS: INCREASED COMPLEXITY IN RATES AND FEES HEIGHTENS NEED FOR MORE EFFECTIVE DISCLOSURES TO CONSUMERS 15 (Sept. 2006).

As can be seen, interest rates on credit cards historically were relatively "sticky," when compared to other types of interest.[25] But note in particular that interest rates on credit cards were *equally sticky* throughout the *entire period* of 1972-1989. The era of the 1970s, of course, was an era of dramatically *increasing* interest rates – essentially the mirror opposite of the falling interest rates of the 1980s. During the period 1972-1982, the federal funds rate rose form a monthly low of 3.29% in February 1972 to a high of 19.10% in June 1981. Annual averages ranged from 4.43% in 1972, steadily increasing to 16.38% in 1982, before they started falling again. Thus, credit card interest rates were *also* sticky during the 1970s and early-1980s despite a *rising* cost of funds rate. Regardless of whether the cost of funds rate is rising or falling, for a period of 20 years the interest rate on credit cards has remained relatively constant, until the decline in interest rates in recent years. If credit card issuers were reaping large profits off the "spread" between the cost of funds and interest rates in the 1980s, they by definition were suffering equally large losses during the 1970s and the early 1980s. In fact, during this period, the average return on credit card operations was lower than for other sectors of banking activity. So, in general, whether the cost of funds rate has been rising or falling, interest rates on credit cards have been much less responsive to changes in the cost of funds than have other forms of consumer credit.

In recent years, however, credit card interest rates became much more responsive to changes in the cost of funds rate during this period. Beginning with the final quarter of 1994 to the present, the interest rates on credit cards became tied much more closely to the cost of funds rate rose, and for credit card accounts actually assessed interest, the fit is

[25] An extended discussion of the explanation for the traditional stickiness of credit card interest rates is provided in Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAPMAN L. REV. 79 (2000).

even tighter, again likely reflecting the higher emphasis placed on this term by revolvers when shopping for cards.[26]

On the whole, therefore, there appears to be no evidence of any market failure with respect to interest rates on credit cards. Competition and increasingly sophisticated consumer choice have brought about lower and more responsive interest rates over time. Alternative types of consumer credit offer similar interest rates, but often higher fees and more inconvenience than do credit cards.

(3) Fees and Other Price Terms

Interest rates on credit cards have fallen and become more flexible during the past decade, but during that same time period late fees, overdraft fees, and other fees have risen in frequency and amount. These fees remain only a relatively small percentage of issuers' revenues, however, only amounting to about 10% of issuers' revenues, whereas interest payments still amount to about 70% of revenues.[27] The remainder of revenue is generated by merchant discount fees and the like. Moreover, although the GAO was able to find some isolated instances where assessment of these fees imposed an undue hardship on particular consumers, it was unable to find any systematic evidence of categorical abuse or misuse of these fees.

This increased use of penalty fees arose during the same time period that credit card interest rates both became lower and more flexible. This does not appear to be a coincidence. Evidence indicates that, in general, these fees are risk-based fees triggered

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[26] *See* Kathleen Johnson, *recent Developments in the Credit Card Market and the Financial Obligations Ratio*, FED. RES. BULLETIN 473, 477 (Autumn 2005) (noting that correlation between credit card interest rates and the prime rate was only 0.09 during the 1980s and early 1990s but has risen to 0.90 from mid-1990s to present).

[27] GAO REPORT at 70-72.

by actual borrowing behavior and when used in combination with interest rates provides issuers with greater flexibility in pricing credit terms than relying on interest rates alone. Interest rates are generally an *ex ante* before the fact estimate of a given borrower's likelihood of default. Late fees, over-limit fees, and other similar fees, by contrast, are more tightly tied to the borrower's exhibited risky behavior. The only systematic empirical study of these fees of which I am aware concludes that these fees are risk-based and complement interest rates for efficient risk pricing.[28] Massoud, Saunders, and Scholnick find, for example, that a one standard deviation in bankruptcy per capita leads to an increase in penalty fees of $0.62 to $1.31. Similarly, a one standard deviation change in the chargeoff ratio was found to change late fees in a range of $4.35 to $7.57. In addition, they find that a 1 basis point reduction in card interest rates will result in an increase in penalty fees of between 0.88 and 4.11 cents. Thus, in their study, a one standard deviation in credit card interest rates (273 basis points) was estimated to change late fees by $2.40. Moreover, they found no evidence that assessed penalties were larger for low-income borrowers.

The increased use of risk-based fees has occurred at the same time as increased variable-rate pricing on credit cards, as the combination of these two pricing mechanisms is evidently more efficient than interest rates alone. In addition, it appears that consumers who pay these fees are not surprised by their existence, but are aware of them before they enter into the transaction that triggers the fee.[29]

In addition, if credit card penalty fees were actually some sort of new form of consumer abuse, rather than simply a more accurate pricing scheme, then this tradeoff

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[28] *See* Nadia Massoud, Anthony Saunders, and Barry Scholnick, *The Cost of Being Late: The Case of Credit Card Penalty Fees,* working paper (January 2006).
[29] *See* Durkin, *Credit Card Disclosures* at p. A114.

between higher risk-based fees and lower interest rates would result in larger economic rents or "economic profits" to the banking industry. In fact, return on assets has been largely constant for credit card banks over the past two decades, even though there has been a steady rise in the returns of other commercial banks.[30] Thus, during the early days of credit cards, issuers relied heavily on annual fees that were assessed on all cardholders, regardless of risk. During the 1990s, issuers phased out widely-disliked annual fees and moved toward greater emphasis on interest rates that were more closely tied to borrower risk. The gradual increase in the use of risk-based fees to supplement interest rates has made credit pricing reflect risk still further. This suggests that the transition to more risk-based pricing has come about through market competition, resulting in more efficient pricing of credit terms to consumers. First, there was a general phasing out of annual fees and greater emphasis on interest rates, then recent years has seen a gradual increase in the use of penalty fees to further more closely tailor price to cardholder risk.

Cost-Benefit Analysis and Unintended Consequences

Available evidence indicates that the credit card market is competitive and responsive to consumer choice. Understanding the economics of the credit card market therefore raises serious challenges for any proposals to heighten regulation of the credit card market. In fact, misguided regulation can have serious unintended consequences that will end up reducing consumer welfare; thus, any proposal for additional regulation should be studied carefully to ensure that the benefits of any such regulation exceed the costs, including any unintended consequences that such regulation is likely to spawn. In

[30] *See* GAO REPORT at 76. For a discussion of the special difficulties in inferring credit card "profits" from the standard analysis of "return on assets" used in the banking industry, *see* Zywicki, *The Economics of Credit Cards*.

addition, it would be wise to examine the continuing relevance and utility of existing regulations before proposing new regulations.

There are three basic manners in which credit can be regulated: substantive regulation, disclosure regulation, or market and common law "regulation." Each has costs and benefits.

Substantive Regulation

The oldest and hoariest type of regulation of consumer credit is substantive regulation of credit terms, such as usury restrictions that cap the rate that can be charged on interest rates. Substantive regulation of terms is generally frowned upon today, as thousands of years of economic history has generally demonstrated that the costs of substantive regulation generally exceed any benefits that it would generate.

In particular, there are three predictable unintended consequences that result from substantive regulation of consumer credit terms: (1) term substitution and repricing, (2) product substitution, and (3) rationing. Each of these three would likely manifest themselves in response to efforts to place new regulations on credit cards.

(1) Term Substitution and repricing: Credit card contracts are complicated, multiple-term contracts. Term substitution refers to the phenomenon that regulation of some terms of this multiple-term contract will cause issuers to adjust other terms in order to reach the market clearing "price." Even in the relatively short history of credit cards, history is littered with examples.[31] Prior to the Supreme Court's decision in *Marquette National Bank v. First of Omaha Corp.*, 439 U.S. 299 (1978), most consumer credit card contracts were governed by usury restrictions that capped the interest rate that could be

[31] *See* Zywicki, *Economics of Credit Cards* for an extended discussion.

charged on credit cards. As interest rates generally rose during the 1970s, this rate ceiling meant that card issuers could not charge a market rate of interest on their consumer loans. The era witnessed a number of offsetting term repricing adjustments by credit card issuers, all of which almost certainly made consumers worse off. First, issuers imposed annual fees on all cards to make up for the shortfall from the inability to charge a market rate of interest. Not only was this an inefficient pricing mechanism because it wasn't calibrated to borrower risk, it also forced transactional users of credit cards to subsidize revolvers who were able to borrow at the sub-market interest rate. Similarly, retailers would bury their credit losses by marking up the price of the goods they sold on credit; for instance, states with stricter usury ceilings also had higher retail prices for appliances. Usury restrictions also had a number of other unfortunate negative impacts on consumers. Customer benefits were lower in states with stricter usury ceilings, such as shorter banking hours and the elimination of other services such as free Christmas gift wrapping at department stores. Moreover, this term substitution also had the effect of making credit more heterogeneous in nature, making it more difficult and expensive for consumers to compare prices and shop. Most notably, annual fees made it more expensive for cardholders to carry more than one card, thereby making it difficult to switch from one card to another that presented a better deal.

The immediate aftermath of *Marquette* was the opportunity for credit card issuers to charge a market rate of interest for their products. In turn, this led to the rapid elimination of annual fees, which were no longer necessary to offset regulatory caps on interest rates. In turn, this enabled greater competition and consumer choice, which eventually resulted in a fall in a proliferation of card variety, lower interest rates, and heightened competition. According to a study by Thomas Durkin of the Federal Reserve, 90% of consumers report that they are "Very" or "Somewhat Satisfied" with their credit cards.[32] Given the ease of comparison shopping and the wide variety of cards in the marketplace, it should not be surprising that most consumers have found products and issuers with which they are largely satisfied.

Empirical evidence strongly suggests that efforts to place substantive limits on credit card pricing today would likely generate similar offsetting term substitution. As noted, empirical evidence indicates that penalty fees imposed by credit card issuers are generally tied to consumer risk and as a result have an offsetting effect on interest rates. Any regulatory efforts to cap or otherwise regulate late fees, overlimit fees, and the like, would therefore almost certainly lead to increased interest rates for all consumers, or other offsetting adjustments in credit contract terms. It is not readily apparent why regulators would seek to impose a regulatory scheme that forces responsible and less-risky borrowers to pay higher interest rates to subsidize irresponsible and risky borrowers who pay their bills late or exceed their credit limits. This cross-subsidization is especially unfair to low-income but responsible borrowers who would otherwise be lumped into the same interest rate category as these other borrowers. In fact, the GAO Report indicates that at least one credit card issuer is experimenting with a credit card that would eliminate all penalty fees—but in exchange would impose a much higher interest rate (above 30 percent) if the cardholder pays late or otherwise defaults on the terms of the card.[33] Thus, while there appears to be some isolated instances of penalty

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[32] Thomas Durkin, *Consumers and Credit Disclosures: Credit Cards and Credit Insurance*, FEDERAL RESERVE BULLETIN (April 2002).
[33] GAO REPORT at 24.

fees run amuck, blanket regulatory limitations on these fees will likely make credit card pricing less efficient and harm overall consumer welfare.

(2) Product Substitution: Notwithstanding the ability of credit card issuers to readjust uncontrolled terms of the credit card contract to try to price credit efficiently, in some situations the inability to charge efficient risk-based prices will make it impossible to extend credit card credit to some borrowers. Nonetheless, Americans need access to credit to deal with life's surprises, such as the need for unexpected car repairs, medical bills, to furnish a new apartment, or simply for a student to buy an interviewing suit to seek a job. If these individuals are unable to get access to credit cards, experience and empirical evidence indicates that they will turn elsewhere for credit, such as pawn shops, payday lenders, rent-to-own, or even loan sharks.[34] As noted above, there is no evidence that more widespread access to credit cards has worsened household financial condition because this growth in credit has been a substitution from other types of consumer credit.

It is hard to see how a college student or any young American is made better off by being denied a credit card and thus forced to furnish her apartment through a rent-to-own company. Nor is it readily apparent to me how a lower-income family who needs schoolbooks or a clarinet for their child is made better off by being forced to borrow from a payday lender or pawn shop to make ends meet. The young and the poor already have

[34] *See* Susan Lorde Martin & Nancy White Huckins, *Consumer Advocates v. The Rent-to-Own Industry: Reaching a Reasonable Accommodation,* 34 AM. BUS. L.J. 385 (1997); Signe-Mary McKernan et al., *Empirical Evidence on the Determinants of Rent-to-Own Use and Purchase Behavior*, 17 ECON. DEV. Q. 33, 51 (2003); James P. Nehf, *Effective Regulation of Rent-to-Own Contracts*, 52 OHIO ST. L.J. 751, 752 (1991); Eligio Pimentel, *Renting-To-Own: Exploitation or Market Efficiency?*, 13 LAW & INEQ. J. 369, 394 (1995); LENDOL CALDER, FINANCING THE AMERICAN DREAM; JOHN P. CASKEY, FRINGE BANKING: CHECK-CASHING OUTLETS, PAWNSHOPS, AND THE POOR 37-67 (1994; RICHARD L. PETERSON & GREGORY A. FALLS, IMPACT OF A TEN PERCENT USURY CEILING: EMPIRICAL EVIDENCE (Credit Research Ctr., Working Paper No. 40, 1981); *see also* Robert W. Johnson & Dixie P. Johnson, *Pawnbroking in the U.S.: A Profile of Customers* 47 (Credit Research Ctr., Monograph No. 34, 1998)

fewer and less-attractive credit options than middle class families—restricting their credit options still further by making it even more difficult for them to get access to attractive credit on competitive terms does not seem to be a plausible way of making their lives better.

(3) Rationing: Finally, if issuers are unable to reprice terms so as to reach a market-clearing price for all consumers, and those consumers are unable to get needed credit from pawn shops, loan sharks, and other less-attractive lenders, the eventual result will be that some Americans will lack access to much-needed credit. This is the well-established finding of thousands of years of economic history, going back at least to Ancient Greece. What of the person who needs access to credit to repair a broken transmission so that he can get to work? In the end, at least some consumers are going to be forced to survive without credit that will allow them to repair their car, buy braces for their children, or Christmas presents for their relatives. Simply wishing that he could have access to credit on terms favored by regulators will not make it so and it is not clear what policy benefit is gained by pretending otherwise.

Disclosure Regulation

The drawbacks of substantive regulation of consumer credit terms are well-understood. As a result, it has become increasingly common to mandate certain disclosures, rather than to impose substantive regulations on consumer credit. Evidence suggests that some disclosures, like the requirement of disclosing the APR for credit card loans, has tended to facilitate consumer awareness of competing credit offers and thus to shop for the best deal available.[35]

But as with substantive regulation, there is a trade-off to increased mandatory disclosures. Consumers have limited attention for reading disclosures and issuers have limited space and expense for making disclosures. Thus, mandating some disclosures necessarily makes it more difficult to disclose fully other card terms that some consumers may care more about or may make it more difficult for consumers to find the information that they care about.

For instance, approximately half of American consumers do not revolve a balance on their credit cards. For those consumers, the APR is a completely irrelevant term in shopping for and using a card. And the evidence suggest that in fact transactional users of credit cards pay much less attention to the APR and Finance Charge than do those who revolve balances (and the larger the balance the more attention is paid).[36] Transactors generally care more about other aspects of cards, such as grace periods, benefits (such as car rental insurance or purchase price protection), and any rewards they offer (such as frequent flier miles or cash back). Although requiring disclosure of information of interest rates is certainly useful for those who shop on that basis for the other half of card users who do not revolve balances it is simply unnecessary clutter that makes it more difficult for them to locate the information that they want from a card issuer.

Moreover, experience demonstrates that once disclosures are mandated, they become very difficult to update in light of changing circumstances. This can be a particular problem in rapidly-evolving markets such as the credit card market. For

[35] *See* Durkin, *Credit Card Disclosures.*
[36] Durkin, *Credit Card Disclosures* at p. A 113.

instance, the "Schumer Box" requires disclosure of useless or trivial information such as the amount of the minimum finance charge, which according to the GAO Report, was typically about 50 cents. Other mandatory disclosures, such as the method for computing balances, may be too complicated or of little importance to most consumers in choosing among cards.[37] The GAO Report observes that the outdated structure of the Schumer Box, TILA, and Regulation Z make it difficult to accurately and effectively disclose many of the new terms on credit cards that have been described, rendering such disclosures less helpful than would otherwise be the case.

Nonetheless, trivial, outdated, or irrelevant disclosures are given the same importance as other more important terms, and newly important terms are difficult to disclose at all. For mandatory disclosures to be an effective tool for facilitating consumer choice, rather than a counterproductive distraction and threat of information overload, regulators must be committed to updating them swiftly and regularly in order to keep up with rapid changes in the market and consumer preferences.

Still another problem with the actual practice of disclosure regulation is the apparent effort to use disclosure regulation as a "back door" version of substantive regulation, to try to guide consumers in the "right" direction. Thus, although it is recognized that usury restrictions are counterproductive, it is implicitly assumed that forcing disclosure of the "high" rate of interest will shock consumers into moderating their credit use, along the lines of "If consumers *only knew* how much they were paying in interest, they would borrow less." A related problem is mandating disclosures in order to advance some political or social goal, rather than to facilitate careful and responsible consumer borrowing. Thus, Congress recently mandated the disclosure of the amount of

[37] GAO REPORT at 54.

time it would take to pay off a cardholders existing balance assuming that only the minimum payment were made. Federal Reserve economist Thomas Durkin estimates that this disclosure actually will be useful to only 4% of cardholders who state that they actually intend to stop adding new charges to the card and to repay their balance by making only the minimum payment.[38] Although this disclosure effects a very small number of consumers—who could otherwise get the same information simply by calling their credit card issuers—it will necessitate still further expense by cardholders and further increase the costs to consumers of locating the information that they actually care about. Properly implemented, standardized disclosure may facilitate autonomous consumer choice by making it easier for consumers to comparison shop among credit products. But efforts to use disclosure as a back door version of substantive regulation is likely to be ineffective at bringing about the desired substantive outcome, while simultaneously failing to provide the useful information to consumers that disclosure regulation should produce.

Finally, according to another study by Durkin, two-thirds of credit card owners find it "very easy" or "somewhat easy" to find out information about their credit card terms, and only six percent believed that obtaining this information was "very difficult." Two-thirds of respondents also reported that credit card companies usually provide enough information to enable them to use credit cards wisely and 73% stated that the option to revolve balances on their credit card made it "easier" to manage their finances versus only 10% who said this made it "more difficult." Finally, 90% of credit card owners were "Very" or "Somewhat Satisfied" with their credit cards, versus only 5%

[38] Thomas A. Durkin, *Credit Cards: Use and Consumer Attitudes, 1970-2000*, FED. RES. BULLETIN 623, 634 (Sept. 2000).

who were "Somewhat Dissatisfied" and only 1% percent—that's 1 out of 100—who were "Very Dissatisfied."

In short, consumers seem overwhelmingly satisfied with their credit cards, the information they receive from credit card issuers, and ease with which they can get information about their cards. Credit card issuers appear to have the incentives to provide timely and accurate information to consumers and by all accounts appear to be doing so.

Market Competition and Common Law as Regulation

It must also be kept in mind that market competition is a form of regulation as well. The credit card market is extremely competitive, with thousands of issuers constantly competing to woo consumers with better offers. Consumers routinely carry as many as four credit cards in their wallets, ready to switch immediately to the card that offers a more attractive package of benefits and terms. In such a market, it is unlikely that oppressive or unfriendly contract terms would last, and in fact this seems to be the case. The GAO Report found, for instance, that only 3 of the 28 cards that they examined had "universal default" clauses in 2005.[39] The GAO Report also found that between 2003 and 2005 only a minority of credit card issuers used the so-called "double-cycle billing method" of calculating finance charges and I understand that even those issuers have eliminated that scheme today.[40] In addition, only 2% of cards charge annual fees, and virtually all of them provide some rewards program in return. In fact, annual fees traditionally have been the cost of credit cards most despised by consumers—in fact,

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[39] GAO REPORT at 26.
[40] GAO REPORT at 28.

when annual fees were first implemented in the 1970s, consumers cancelled 8% of their credit cards immediately.[41]

In addition, courts have used traditional common law rules and contract remedies to punish fraudulent or deceptive practices by card issuers. This has been quite efficacious in protecting consumers and raises further questions about the need for additional regulation.

Thus, although issuers may try to impose on consumers a variety of disagreeable terms, the ease with which consumers can shift from one card to another, and the heated competition among issuers for consumer loyalty, renders such a scenario relatively implausible. Whether annual fees, universal default clauses, or "double-cycle billing," the market appears to be quite self-correcting in terms of delivering to consumers the credit card products that they desire—which explains the 90 percent positive satisfaction rate described above.

[41] *See* Zywicki, *Economics of Credit Cards.*

NCLR
NATIONAL COUNCIL OF LA RAZA

ISSUE BRIEF
EXECUTIVE SUMMARY

Latino Credit Card Use: Debt Trap or Ticket to Prosperity?

With a new Congress pledging to help the American middle class, a spotlight on the credit card industry is timely. Credit card use among Americans influences the extent to which middle-class families can become financially secure. As the fastest-growing and largest minority group in the country, Latino families continue to face several roadblocks to accessing affordable credit. Barriers to affordable credit can help to explain the wealth gap between White and Latino households; in 2002 the median White household maintained eleven times the wealth of similar Latino households.

For any legislative effort to be effective, policy-makers must deliberate on how credit card industry policies and practices adversely affect Latino consumers. Latinos still tend to have less personal savings and fewer assets than other American families, and for low-income Latino families in particular, an unhealthy reliance on credit cards can expose them to predators within financial markets. Additionally, accumulating high levels of unsecured debt will greatly impact their ability to move into the ranks of the American middle class. This policy brief is the first analysis of Latino credit card use. The National Council of La Raza's (NCLR) major findings include the following:

- **The vast majority of American households use credit cards, but a substantial share of Latino households do not.** A national survey revealed that 80% of American households use credit cards compared to only 56% of Hispanic households.
- **Credit card use and credit card debt is on the rise in the Hispanic community.** Between 1992 and 2001, the share of Hispanic families who held credit cards grew from 43% to 53%, and the average credit card debt among Hispanics increased by nearly 20% for that same period.
- **The majority of American households who use credit cards do not carry a balance, but most Latino credit card users do.** More than 45% of credit cards users report revolving a balance, compared to 77% of Latinos.
- **A substantial share of all credit card users and a proportionately larger**

share of Latino credit card users have difficulty managing their credit card debt. A recent Demos study on household debt showed that 7.3% of all respondents were "maxed out," while 12.7% characterized their debt situation as "burdensome…not enough money to pay down [the balance]." However, 11.4% of Hispanics reported they were "maxed out and can't use [their cards], while 19.3% described their situation as "burdensome and not enough money to pay down [the balance]."

Additionally, Latino consumers face several structural barriers in the credit card market which lead to disparities in participation. For example, 22% of Hispanic borrowers had no credit score compared to 4% of Whites and 3% of African Americans. Because of overall credit status and limited experience in the U.S. credit market, Hispanic consumers are also less likely than their peers to receive multiple credit card offers and, thus, need to spend relatively more time and energy searching for cards with desirable terms. Further, the 2004 Survey of Consumer Finances showed that only 7% of Hispanic consumers who carry a balance report "substantial" shopping for the best credit rates and fees, compared to 12% for similar White consumers. Moreover, data reveal that negative experiences with shopping for credit can cause some Latino consumers, especially those with balances, to stop shopping altogether. Twenty-five percent of Hispanic consumers who use cards and were denied a loan did not reapply for fear of rejection.

Recent studies show that many low-income Latino consumers depend on credit cards to make ends meet. Almost 39% of Latinos reported basic living expenses and 30% reported medical expenses as contributing to household debt. For these consumers, credit card issuer policies and fees can exacerbate their financial troubles.

NCLR's analysis of the data revealed the following:

- **Because of the structure of the credit card market, Latinos have limited access to affordable, unsecured credit cards.** For example, the industry's reliance on a consistent and verifiable payment history as a principal means of determining who receives a solicitation for a card excludes creditworthy Latinos.
- **Latino consumers who do have access to credit cards are more likely than their peers to receive inferior offers.** The factors that credit card firms use to set rates and terms on offers (e.g., recorded payment history, household income) result in Hispanics receiving inferior offers.
- **Because Hispanic card users are proportionally more likely to be among those struggling to manage their debt, they are more susceptible than their peers to adverse industry policies and practices.** For instance, one study showed that 43.95% of Hispanics surveyed reported making late payments. Consequently, universal default policies and change-in-terms provisions disproportionately harm Latino customers.

Unfair and abusive credit card policies and practices trap Latinos into a cycle of debt. Credit card debt can strip wealth from low- and moderate-income Latino families and exacerbate their financial troubles. The following are a few of the many policies and issues that NCLR believes are problematic:

- Unilaterally changing the terms of a consumer's credit card contract.
- Charging perverse fees to consumers, which are not associated with the cost or additional risk to the lender.
- Double-billing consumers on purchases made outside of the U.S.
- A weak regulator, unable to proactively protect consumers from abusive practices in the industry.

Latino consumers need and demand strong consumer protections and greater enforcement from regulators if they are to successfully navigate the mainstream credit card market. More specifically, policy-makers must enact a monthly minimum payment warning; ban universal default, change-in-terms policies, and mandatory arbitration clauses; and stop double-billing on foreign conversion fees. Furthermore, regulators must work harder to meet their congressionally-mandated mission to examine and penalize bad actors and set higher standards for the industry. Finally, policy-makers must support community-based financial counseling programs, which would go a long way in helping consumers distinguish between good and bad debt and prevent credit card debt from becoming unmanageable.

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Latino Credit Card Use: Debt Trap or Ticket to Prosperity?

By Beatriz Ibarra and Eric Rodriguez*

INTRODUCTION

In recent years, select lawmakers, experts, and consumer and civil rights advocates have been urging Congress to examine policies and practices in the credit card industry more carefully. Credit cards are now ubiquitous and used by most Americans to improve their credit ratings for wealth-building purposes or to sustain themselves financially. However, the growth of the credit card market has been accompanied by mounting public outrage over policies and practices in the industry and an emerging public policy concern over the implications of rising household debt. The 110th Congress has begun with a thematic focus on the economic challenges facing middle-class American families, and the current policy environment has given momentum to a renewed focus on the credit card industry.

With respect to credit cards, Hispanic** families are at an important intersection. They need to access credit but are in danger of becoming victimized and, because of their economic

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** The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to identify persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, and Spanish descent; they may be of any race.

standing, rising household debt is a serious concern. At the same time, a staggering racial and ethnic wealth gap exists; in 2002 the median net worth of Hispanic households was $7,932 compared to $88,651 for White non-Hispanic households.[1] Increasing wealth levels for Latinos will undoubtedly be accompanied by some form of increased household debt. Good public policies are needed that promote wealth accumulation and access to good credit, without endangering the financial standing of families.

As previous National Council of La Raza (NCLR) analyses show, disparities in wealth can be traced to factors that result in limited access to financial wealth-building products such as mortgages and savings accounts. Many have sought to explain the disparity in participation between Latinos and non-Latinos in financial markets as related to language or cultural issues. Accordingly, the remedies have often been relegated to activities such as translating promotional materials for financial products, while few experts have even bothered to document or study the Hispanic experience in any depth.

That said, moving Latino families into the ranks of the American middle class will undoubtedly entail more Hispanic workers having access to and using credit cards. It is imperative that policy-makers and experts have a better understanding of the Latino experience and perspective if effective policies are to be developed and implemented. Accordingly, this issue brief examines how the structure of the market and credit card industry policies and practices impact Hispanic access to affordable credit and the lack of regulatory oversight in the market. Finally, the brief will provide policy recommendations for empowering and protecting Hispanic consumers.

BACKGROUND

The U.S. credit card market is dynamic and complex and includes a number of important players: banks or credit card issuers, payment facilitators, credit bureaus, merchants, and consumers.

Many banks and merchants, including utility companies and other creditors, accept credit and debit card payment for consumer purchases. For this reason, card payment associations that facilitate and process credit card transactions between these parties are central players in the market. Associations, such as Visa and MasterCard, compete with Discover and American Express, two proprietary cards with their own payment networks. These associations have been instrumental in innovating and expanding the credit card market, in large part by integrating technology that helps to connect credit card issuers with merchants in more advanced ways (e.g., telephone and online purchasing). Although credit card issuers set pricing, associations set credit card processing rules. In midyear 2006, Visa and MasterCard remained the largest credit card brands with purchase volume reaching nearly $600 billion and a 71.2% share of the market.[2] Visa and MasterCard alone reported 584 million credit cards in circulation and 6.8 trillion transactions.[3]

The ten credit card issuers with the largest credit card balances outstanding own 90% of the total market.[4] Top issuers include Citigroup Inc., Chase Card Services, Bank of America, which now owns MBNA, and Capital One Financial Corp. Furthermore, credit cards are a major part of overall U.S. banking business; Citigroup's credit card services reportedly accounted for approximately 17% of the bank's

$24.59 billion of net income in 2005.[5] Credit card business is attractive to big banks, in large part because the profits that a bank collects from credit card lending can be three or more times the ordinary rate of return on the bank's equity for traditional deposits and lending services.[6] In 2004, the credit card industry as a whole collected $43 billion in profit from interest and finance charges, annual fees, and punitive fees charged to customers, such as late payment, over-the-limit, and balance transfer fees.[7]

In the marketplace, consumers are broadly differentiated by factors such as their credit history and income. They may also be distinguished by their credit card behavior. For example, credit card users may be placed into several general categories, including individuals who 1) use credit cards but do not carry a balance; 2) sometimes carry a balance; and 3) usually or always carry a balance. There are also American households who do not have credit cards at all. The figures on Hispanic household credit card use reveal the following:

- **The vast majority of American households use credit cards, but a substantial share of Latino households do not.** According to the 2004 Survey of Consumer Finances, more than 80% of all respondents said that they use credit cards compared to only 56% of all Hispanic households.[8]
- **Credit card use is on the rise in the Hispanic community.** Between 1992 and 2001, the share of Hispanic families who held credit cards grew from 43% to 53%.[9] The average credit card debt among Hispanics is also on the rise, increasing by nearly 20% between 1992 and 2001, from $3,082 to $3,691.[10]
- **The majority of American households who use credit cards do not carry a balance, but most Latino households do.** According to the 2004 Survey of Consumer Finances, more than 45% of all respondents who use credit cards reported carrying a balance compared to about three out of four (77%) Latino respondents.[11]
- **A substantial share of all credit card users and a proportionately larger share of Latino credit card users have difficulty managing their credit card debt.** According to a recent survey, approximately 19.3% of Hispanics described their situation as "burdensome and not enough money to pay down [the balance]," and 11.4% of Hispanics reported they were "maxed out and can't use [their cards]."[12] However, 12.7% of *all* respondents characterized their debt situation as "burdensome and not enough money to pay down [the balance]," while 7.3% were "maxed out and can't use [their cards]."[13]

Credit cards are an important method for establishing a consistent and verifiable track record of borrowing and paying back credit, which is critical for long-term family wealth-building. Using credit cards and paying the balance each month may also improve an individual's credit score. A recent study showed that 17.1% of Hispanics say they keep some debt to build their credit score, compared to 16.7% of African Americans and 12.9% of Whites.[14] Nevertheless, to build a good credit history, Hispanic consumers need greater access to mainstream financial institutions where the most affordable credit products are developed and sold.

The disparity in credit card use between Hispanics and their non-Hispanic peers is problematic. Without access to mainstream, affordable, unsecured credit cards, Hispanic consumers are forced to rely on subprime or predatory lenders that charge fees which can effectively add up to 300% interest for short-term loans. These lenders often prey on vulnerable, low-income populations to make a profit. Some loan products are even inherently designed to put borrowers in a perpetual debt cycle, such as payday loans.

At the same time, accumulating and revolving substantial amounts of credit card debt can also negatively affect a consumer's financial status. The amount of revolving credit debt outstanding among Americans reached $825.2 billion in 2005,[15] and there are concerns about the impact that accumulating debt has on net worth, particularly for Hispanics. In 2001, the average Hispanic household with credit card debt spent 19% of its income on paying down debt, compared to 24% for White households and 20% for African Americans.[16] These data reveal that Latino credit card users are disproportionately within the category of American households most likely to struggle with managing credit card debt.

Important Court Cases: In Brief

The first charge card appeared on the market in 1914 to cover the cost of goods and services bought from a particular merchant. Banks entered the credit card market in the late 1950s, which over time enabled the expansion of the open-end, general purpose credit card for use nationwide.

Not all consumers had access to credit following the development of credit cards. Lenders began to market credit cards more aggressively following the 1978 U.S. Supreme Court decision, *Marquette vs. First Omaha Service Corp.** The Court held in *Marquette* that lenders could charge the highest interest rate allowed in the state where it is incorporated. Because companies could easily relocate to states with higher usury rate ceilings, the case resulted in the liberalization of state usury ceilings, forcing states to deregulate their credit card laws. Virtually free from state usury restrictions, lenders could offer credit to consumers whom they perceived to be high-risk borrowers and charge high interest rates to cover the risk. Many credit card issuers incorporated in states where they would have the most flexibility in the rates and fees that they charged, such as Delaware and South Dakota.

In *Smiley vs. Citibank* (1996), the Court held that fees, like interest rates, could be determined by the laws of the state where the lender is incorporated.** The decision led to a sharp increase in the amount that issuers charged for late fees.

The *Marquette* and *Smiley* decisions contributed significantly to the credit card industry's growth and profitability. Today, the weakest state laws govern the industry nationwide, essentially creating barriers for other states to enact usury rate ceilings.

* *Marquette Nat'l Bank of* Minn. V. *First of Omaha Serv. Corp.*, 439 U.S. 299, 301 (1978).

** *Smiley v. Citibank* (S.D.), N.A. 517 U.S. 735, 740-47 (1996).

Credit Card Market: Structural Factors and Barriers

There is general agreement that the credit card market currently maintains a level of competitiveness that should benefit all consumers. Though several companies dominate the market and the number of credit card issuers is shrinking, the proliferation of offers with "teaser" rates (i.e., low or zero introductory interest rates) is evidence of robust competition and suggests that many consumers may be well served.* Indeed, individuals who use credit cards but do not carry a balance can be said to be exerting considerable pressure on card companies to improve offers in the market.[17]

That said, Latinos are less likely than their non-Latino peers to have access to mainstream credit cards. Moreover, for those who use cards, Hispanics are more likely than Whites to have credit cards with high interest rates. For example, a recent study revealed that 12.89% of Hispanic households have an interest rate greater than 20% on their credit card with the highest balance, compared to 7.5% of White households.[18] These disparities in the market can be traced, in large part, to the following factors:

- **The methods used to evaluate creditworthiness.** Before extending credit to a consumer, a credit card issuer will undertake a process to gather and analyze information on existing or prospective borrowers regarding their ability to repay. Under the Fair Credit Reporting Act (FCRA), credit card issuers have access to consumer information collected by the three major credit bureaus: Experian, Equifax, and TransUnion.** In addition to relying on consumer credit scores, issuers take into account the number of credit cards the consumer currently holds, combined credit card balances, credit limits on every credit card, and any record of past delinquencies.[19] How well a consumer is rated on these factors will determine whether the lender extends credit, the amount of credit extended, and the annual percentage rate.

  The industry's reliance on these factors suggests that Latinos are less likely than their peers to receive offers of credit. According to a study by the Center for Community Capitalism, 22% of Hispanic borrowers had no credit score compared to

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* Notably, the Government Accountability Office (GAO) reports that consumers with access to credit cards with low or zero introductory interest rates hold on to that rate for an average of eight months.

** These credit bureaus compile and sell lists of consumer names and credit reports to credit card issuers, which contain sensitive, personal financial information of these consumers. Under FCRA, issuers may also access confidential consumer information requested in connection with "firm offers of credit." The information sold to issuers may only be used to inform preapproved credit card solicitations and may not be used to target and market to potential customers. In March 2001, the Federal Trade Commission issued a ruling against TransUnion for violating FCRA by selling information to target marketers who lack one of the "permissible purposes" enumerated under the Act. The ruling may be found at: http://www.ftc.gov/opa/2000/03/transunion.htm.

Credit Limit and Balance of Total Households and Hispanic Households		
Average among those who use cards	**Total Households**	**Hispanic Households**
Number of Cards	3	3
Carry a balance*	45%	77%
Median balance	$2,380	$1,900
Median credit limit for households who reported carrying a balance	$12,000	$6,000

Hispanics carry higher balances as a percentage of their credit limits. The median balance for Hispanics represents 32% of their credit limit, compared to 19.8% for other households.

Source: Unpublished data from the 2004 Survey of Consumer Finances tabulated by the Federal Reserve on behalf of NCLR.

* NCLR calculation based on data from the 2004 Survey of Consumer Finances.

4% of Whites and 3% of African Americans.[20] Latinos' aversion to debt arguably makes them more creditworthy than their peers, but they are penalized for their lack of a repayment history. Furthermore, the standard observable characteristics that credit card issuers rely on to determine creditworthiness ensure that Hispanics with credit scores will receive offers with less favorable terms than their peers. For instance, Hispanics who use cards are more likely than their peers to report making late payments that exceed 60 days.[21] In a recent study, among the individuals who reported making late payments, 43.95% were Hispanic.[22]

- **Search costs.** Consumers expend time and energy on identifying which cards to apply for, completing credit card applications, and waiting for a response from the credit card issuer. The effort needed to complete this process may differ depending on the type of borrower and the borrower's resources, including education and Internet access. In many cases, rather than consumers seeking credit card issuers, companies use consumer information to identify and pursue potential new customers. Credit card issuers rely on consumer credit information to determine whether to tender preapproved credit card offers. Those with good credit payment histories may be more likely to receive multiple credit card offers, effectively reducing these customers' search costs. The number of credit card solicitations mailed to individuals has significantly increased, from 1.1 billion in 1990 to 5.23 billion in 2004.[23] In some ways, through prescreening and preapproval offers, credit card issuers are choosing their potential customers.* Another source estimates that the average consumer in the U.S. receives approximately 40 credit card solicitations a year.[24] Because of overall credit status and limited experience in the U.S. credit market, Hispanic consumers are less likely than their peers to receive multiple credit

* Another important means of identifying and targeting consumers is through the use of affinity credit cards. Affinity credit cards, which consist of a contract between an issuer and a group or club formed around a common interest, have proven to be a successful marketing tool for reaching new customers. For example, credit card issuers have developed affinity cards to target religious groups, university alumni, and minority groups.

card offers and, thus, need to spend relatively more time and energy searching for cards with favorable terms.

- **Shopping.** The effort a consumer spends on "shopping" for credit is influenced by various factors. The 2004 Survey of Consumer Finances showed that 52% of individuals who use credit cards characterize their shopping for credit as "moderate" to "substantial." This may suggest that individuals are more likely to comparison shop for rates and fees. Only 7% of Hispanic consumers *who carry a balance* report "substantial" shopping for credit, compared to 12% for similar White consumers. Low shopping among individuals with credit card balances serves to lock in vulnerable consumers. The research also shows that households with large credit card balances are more likely to be rejected or to be granted a lower-than-desirable credit limit, suggesting that these households may be discouraged from shopping.[25] The 2004 Survey of Consumer Finances reports that 25% of Hispanic consumers who use cards and were denied a loan did not reapply for fear of rejection. In other words, negative experiences with shopping for credit can cause some Latino consumers, especially those with balances, to stop shopping altogether.

- **Economic status.** Individuals who are unable to pay off their credit card balance every month often depend on credit cards to make ends meet. A recent household debt survey showed that, of the individuals carrying credit card debt, only 12% did not report any type of safety-net usage.[26] When asked what contributed to their credit card debt, a leading answer from *all* respondents was basic living expenses (33%) and medical expenses (29%).[27] For Latinos, 39% reported basic living expenses and 30% reported medical expenses as contributing to household debt.[28] Notably, for many Hispanic consumers, lending money to family members is a significant contributor to their overall household debt.

- **Industry policies and fees.** Credit card issuers also develop and implement certain policies in addition to standard fees for existing customer accounts. Standard fees that apply evenly to all consumers are relatively well-known (e.g., balance transfer fee, late fee). Other credit card policies, on the other hand, are relatively more obscure and include monthly minimum payment requirements, grace periods on purchases, deadlines for payment receipt, and standards regarding whether to offer more than one card to a customer. As with fees, the application of these policies can vary widely among credit card issuers and with different types of credit cards issued by the same company. Such policies can significantly influence the likelihood that a consumer is charged a punitive fee. The impact of a card issuer's policies and fees also vary depending on the financial status of the borrower. For those who are revolving credit card balances and accumulating debt, issuer policies and fees can exacerbate their financial troubles and firmly ensconce them in long-term and unmanageable household debt. (See box on page 11 for other fees and abusive practices.)

- **Switch costs.** Consumers are often charged a fee to switch or transfer a balance to another credit card. Frequently switching or transferring a balance may also harm a consumer's credit score. Still, for consumers facing interest rates as high as 28% or 30%, transferring a balance to a credit card with more favorable terms may be in their best interest. However, consumers with high balances are more likely to have their transfer credit card application denied by the issuer. These consumers are also more likely to be offered credit cards with unfavorable terms. This is significant because high-balance consumers who accept credit card offers with inferior terms are more likely to default.[29] Furthermore, those consumers who have a hard time switching cards are more likely than others to be held captive by their credit card issuer.

The 2004 Survey of Consumer Finances shows that 34% of Hispanic households who carry a balance reported being rejected for a loan. Hispanic households are also slightly more likely than total households to cite "credit" as a reason for the rejection (23% compared to 20%, respectively).[30] The opportunity to switch or transfer a balance to a credit card with more favorable terms is not available to all credit card customers. For Hispanics, the inability to switch credit cards may extend the time it takes to pay down balances, explaining why some Latinos disproportionately report that credit debt is burdensome.

Secured and Unsecured Credit Cards

Two major types of credit cards dominate the market: secured and unsecured. Secured credit cards may be used to pay for the same goods and services as unsecured cards, but require consumers to open an account or purchase a certificate of deposit as security for the line of credit they receive. If a borrower misses a payment, the lender may withdraw money from the borrower's account. The issuer tenders credit in accordance with the terms of a contract, and the borrower promises to pay. These cards are typically reserved for those without easily verifiable payment histories or those with poor credit ratings. Although many secured credit card issuers charge an application and processing fee that may be burdensome for low-income consumers, there are conditions under which this type of card is good for consumers. For those who lack access to unsecured credit cards, secured credit cards may be the only method for building (or rebuilding) a credit history. Furthermore, some secured credit card issuers report the card to credit bureaus as unsecured, which may improve the borrower's credit score depending on their behavior. By contrast, unsecured credit cards provide a line of credit that is not secured by personal property.

Challenges in Policy and Practice

As described in the previous section, there are a variety of structural factors and market forces that help to explain inadequate participation by latinos in the mainstream credit card market. In addition to these factors, many policies and practices adopted by credit card issuers adversely affect consumers.

As the data and analyses reveal, Latinos who use credit cards are more likely to find themselves with unmanageable debt and are highly susceptible to adverse policies and practices. As a result, many low-income Hispanic families are trapped in a cycle of debt. The following issues, challenges, and policies are of particular concern for Latinos.

- **Monthly minimum balance requirements are deceptive.** By making only the monthly minimum payments, consumers carry their credit card balances longer, which means they ultimately pay more in interest and are at higher risk for incurring fees. As a result, these consumers are heavily burdened by their credit balances. Many consumers do not recognize the disadvantage of paying only the monthly minimum payment requirement. According to a PBS investigatory report, 35 million Americans pay only the required minimum,[31] and credit card issuers benefit from this practice through more finance charges. As previously mentioned, Latino consumers report carrying higher balances than their peers and having trouble managing debt. Some consumers are unaware of how much it costs to make only the minimum payment, and for other consumers the minimum is all they can afford. Without the knowledge or necessary funds to pay the principal, many consumers will be paying off their debt for many years to come.
- **Universal default and change-in-terms provisions are unethical.** Universal default is a policy that enables a credit card issuer to increase a consumer's interest rate based on the consumer's credit behavior with other creditors. Events that may trigger application of the universal default policy include exceeding credit limits; making a late payment on a mortgage, auto, or credit card loan; or negative changes in a consumer's credit score. Depending on the credit card issuer, the penalty interest rate could exceed 30%. The Government Accountability Office (GAO) recently reported that while many card issuers have ceased applying universal default, some still do.

The GAO also reported that four of the largest credit card issuers list unfair change-in-terms provisions in their credit card agreements.[32] Change-in-terms provisions enable the issuer to change the terms of the credit card agreement at any time as long as the issuer provides written notice to the consumer 15 days before the issuer changes the consumer's rates. Although written notice is better than never disclosing the change in rates, studies show that a majority of consumers do not read change-in-terms notices, defeating their purpose.[33] Even those who do read such notices are likely to be confused by the complex and technical language used. The ability of an issuer to unilaterally change a contract whenever it chooses is exceptional and dangerous for consumers.

This so-called "penalty pricing" is common in many industries for defaulting on a promise to pay. However, the penalty interest rates that credit card issuers apply to customer accounts far exceed their cost. This is especially true because many issuers also collect a fee from consumers for the triggering event (e.g., over-the-credit-limit fee or late payment fee) leading to a change in rate. Additionally, the penalty interest rate, in many cases, does not adequately represent the customer's risk. For example, a customer with a favorable 5% annual percentage rate (APR) who has never missed a credit card payment could be subjected to an interest rate of as much as 30% APR or more for being one day late on a payment. Further, the penalty interest rate may be applied retroactively, effectively charging consumers more for products or services that they already purchased.[14] Finally, Hispanics are more likely than their peers to report making late payments that exceed 60 days.[15] One study showed that among the individuals who reported making late payments, 43.95% were Hispanic.[16] Consequently, universal default policies and change-in-terms provisions disproportionately and adversely harm Latino customers.

- **True comparison shopping is next to impossible.** In its review of multiple credit card agreements, the GAO made the following statement regarding disclosures: "[R]equired disclosures often were poorly organized, burying important information in text or scattering information about a single topic in numerous places. The design of the disclosures often made them hard to read with large amounts of text in small, condensed typefaces and poor, ineffective headings to distinguish important topics from surrounding text."[17] It is close to impossible for a consumer to differentiate between credit cards that are available on the market. Important pricing information, such as the change-in-terms provision, is hidden in the fine print of the credit card agreement, and it is hard to anticipate the effect of such a clause until it is invoked. Consequently, consumers may not be aware that issuers can change their rate terms until their rates are changed on existing debt and they are notified through the mail.
- **Inflation and application of fees are out of control.** The amount and range of fees is on the rise.* In the 1980s, a typical late fee ranged from $5 to $10.[18] Today, the average late fee applied to a consumer account is $33.[19] Notably, the price set for fees does not appear to be associated with the cost or additional risk to the lender. Credit card fees have dramatically increased while the cost for banks to purchase funds has not. Credit card issuers claim that they charge fees to deter consumers from paying late. However, many credit card issuers apply penalty fees even if the consumer pays on the day that payment is due, and some issuers charge a fee for paying over the phone.
- **Double-billing is unfair.** The foreign conversion fee is applied to a customer's account to cover the cost of converting foreign currency into dollars when a purchase is made outside of the U.S. Firms that process credit card transactions, such as Visa or MasterCard, traditionally charge

* The wide range of fees include the annual fee, balance transfer fee, late payment fee, over-the-credit-limit fee, credit limit increase fee, set-up fee, return item fee, expedited payment fee, expedited delivery fee, replacement card fee, additional card fee, and the foreign conversion fee, just to name a few. For example, credit card issuers may charge consumers an annual fee, a participation fee, a program fee, or a monthly maintenance fee. Further, some fees are one-time fees, some are monthly, and some are charged annually.

Additional Abusive Credit Card Industry Practices

Double-cycle billing: Double-cycle billing enables credit card issuers to charge interest to a consumer on a debt that the consumer has already paid. For example, if a consumer with a zero-interest rate credit card pays $450 on a $500 balance, the issuer will charge the consumer interest on the $500 amount plus the $50 amount that the consumer has left to pay.

Issuing multiple low-limit credit cards to borrowers: According to a recent article in *BusinessWeek* magazine, Capital One Financial Corp. (COFC) has adopted the practice of issuing multiple credit cards with $300 to $500 credit limits to subprime borrowers.* Owning multiple credit cards with low credit limits increases the likelihood that a consumer will exceed those limits and make late payments because of the difficulty associated with juggling multiple cards. For banks and issuers, giving multiple credit cards to subprime borrowers increases their opportunity to collect penalty fees.

Late payment cut-off times: Many credit card issuers penalize consumers who pay on the day that payment is due but not before a certain "cut-off" time. For example, a payment received on the day payment is due, but after 2:00 p.m., may be late under some credit card issuer policies, leading to a late payment charge averaging $34. Some banks also impose penalty interest rates for even a single late payment.

Mandatory arbitration clauses: Mandatory arbitration clauses are prevalent in credit card agreements, essentially stripping consumers of their day in court. Moreover, arbitration appears to disproportionately benefit card issuers over consumers. Studies show that out of 19,705 cases decided in arbitration, only 87 consumers prevailed.**

Fees for telephone payments: Some credit card issuers charge a fee to consumers for paying their bill over the telephone, even if the payment is on time. Further, disclosing the telephone payment penalty fee in a credit card solicitation is not required under the Truth in Lending Act.

Many of the practices listed above are either unfair or unreasonable. These practices harm consumers even when they are exhibiting good consumer behavior such as paying their credit card on the day payment is due. Some in the industry have clearly adopted these practices for the sole purpose of maximizing profits.

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* Berner, Robert, "Cap One's Credit Trap," *BusinessWeek*, November 6, 2006.

** Carter, Carolyn, Elizabeth Renauart, Margot Saunders, and Chi Chi Wu, "The Credit Card Market and Regulation: In Need of Repair," *North Carolina Banking Institute*, Vol. 10, March 2006.

the fee to the consumer. According to Consumer Action's 2004 credit card survey, theses firms charge 1% of the cost of each transaction,[40] and American Express charges 2% of the cost of each transaction.[41] More recently, credit card issuers have begun charging an additional fee for purchases made abroad. A recent study showed that 26 out of 45 issuers charge a foreign conversion fee in addition to the fee charged by transaction processing firms.[42] The total average conversion fee may be as high as 3% of the amount of each transaction in U.S. dollars.[43] Foreign conversion fees charged by both the transaction processing firm and the bank results in double-billing for the consumer for every purchase they make abroad.

Consumer Rights in the Fair Credit Reporting Act (FCRA): In Brief

In sum, FCRA promotes accuracy and fairness in the credit reporting process and privacy of information in files of consumer reporting agencies. Under the Fair and Accurate Credit Transaction Act of 2003 within FCRA, consumers have the right to:

- Receive notice if their application for credit has been denied and receive information about the agency that provided the information to the creditor
- Receive a free credit report annually from each credit bureau
- Dispute inaccurate or incomplete information in their credit report directly with the furnisher of the information
- Place a fraud alert in their credit file to prevent identity theft or fraud

For more information, visit the National Consumer Law Center website at http://www.nclc.org/action_agenda/facta/nclc_analysis.shtml.

These fees affect all consumers who travel and especially immigrants who travel from the U.S. to their home country and use their credit card to make purchases.

- **Credit reporting and scoring are flawed.** The current system of credit reporting has three main flaws. First, there is no requirement for banks to report consumer behavior to the three major credit bureaus. Second, the information contained in a consumer's credit report may vary from one credit bureau to the next. This particularly impacts Hispanic consumers with limited credit histories because lenders may not have all the information necessary to assess their creditworthiness. Studies show that 29% of consumer credit scores differ by 50 points between credit bureaus.[44] This may not matter for a high-scoring consumer, but could place millions of other consumers unfairly into subprime ratings. Furthermore, studies show that 50% to 70% of credit reports contain inaccurate information regarding a consumer's general credit history.[45] Third, there is no requirement for lenders to weigh all three credit scores to determine the creditworthiness of potential customers. Also, most credit scoring models collect only limited information on other data that could demonstrate creditworthiness, such as utility bills. These trends may explain why many Hispanics remain disconnected from and underserved by credit markets, including auto, mortgage, and credit card lending.
- **Predators target Latinos for credit card-related scams with impunity.** Hispanics are more than twice as likely as non-Hispanic Whites to be victims of fraud. According to a Federal Trade Commission (FTC) survey, 14.3% of Hispanics are victims of fraud, compared to 6.4% of non-Hispanic Whites.[46] Common credit-related scams committed in the Hispanic community include fraudulent credit repair services and affinity credit card scams.*

* Credit repair service scams involve individuals claiming to repair a consumer's credit record for a fee. The consumer pays the fee but receives nothing in return, often spending up to $200 for the service.

Although affinity credit cards have been a successful tool for reaching new customers, they may also be used to lure consumers into harmful scams. Affinity credit card scams involve individuals who purport to be offering a credit card that is custom-tailored to meet the needs of Hispanic consumers. In reality, the consumer is paying for a fake card that cannot be used to purchase any goods or services. Consumers who are victims of credit repair or affinity credit card scams may file a complaint with the FTC. When the FTC observes a trend in consumer complaints, it may choose to take action. Because the FTC often does not collect data by race/ethnicity, it is difficult to determine if predators are targeting particular communities or to document these trends. Despite the FTC's efforts to collect consumer complaint information from the Hispanic community, credit card-related scams persist, stripping income from the families who can least afford it.

- **Regulator is weak.** The Office of the Comptroller of the Currency (OCC) is the principal regulator and supervisor of national banks in the U.S.* Part of its congressionally-mandated mission is to "ensure fair and equal access to financial services for all Americans." This includes protecting consumers against wrongful treatment as it relates to credit cards. To meet its mission, the OCC created the Customer Assistance Group, a call center designed to assist consumers with complaints against national banks, including those that issue credit cards. Although the OCC collects thousands of complaints each year, it faces several conflict of interest problems that limit its ability to effectively address the needs of consumers. For example, the OCC is funded by the same

The Mortgage Lending Example

Policy-makers have made great strides in the mortgage lending arena by enacting several consumer protection laws. Although these laws can and should be strengthened, they serve as an example of the kinds of protections that are needed in the credit card lending industry. Indeed, consumers who use credit cards and act responsibly and in good faith should be protected from abusive policies and practices.

- **Home Mortgage Disclosure Act (HMDA):** Requires HUD to collect data by race and ethnicity and make data available to the public. HMDA made it easier to identify possible discriminatory lending patterns.
- **Fair Housing Act (FHA):** Prohibits lenders from discriminating in mortgage loans on the basis of race, color, religion, national origin, sex, familial status, or handicap.
- **Consumer Reinvestment Act (CRA):** Imposes affirmative obligations on banks to serve low-income minority markets better.

* Before filing a complaint, a consumer must determine which agency regulates the bank that issued the credit card. In addition to the OCC, the Board of Governors of the Federal Reserve System exists to supervise banks that are chartered by individual states and that elect to become members of the Federal Reserve System, bank holding companies, and branches of foreign banks. The Federal Deposit Insurance Corporation regulates state-chartered banks that are not members of the Federal Reserve System. The Office of Thrift Supervision supervises federal savings and loan associations and federal savings banks. Finally, the National Credit Union Association regulates federally-chartered credit unions.

national banks that it regulates. Operational funds are collected through bank assessments, examinations, and processing fees. The OCC does not receive any appropriations from Congress. Banks may also, in effect, choose their regulatory agency, enabling them to choose the least restrictive.

There are other disincentives for regulators to aggressively and actively scrutinize abusive credit card practices or prohibit banks from offering other harmful products. The OCC's principal mandate is to promote "safety and soundness" of banks under its jurisdiction. Since credit cards are a highly profitable segment of their members' bank business, regulators may be reluctant to aggressively challenge abusive practices.

Currently, the burden is on the consumer to know that their issuer is an OCC-regulated bank and how to contact the OCC when problems arise. The OCC's consumer complaint hotline number does not appear on any credit card contract or monthly statement. The OCC has no obligation to follow up with consumers whose complaints have not been resolved, and complaints that cannot be resolved easily get filed for future reference; the result is a lack of confidence by consumers that their efforts will produce results.

- **Most current financial education strategies are ineffective.** There are a multitude of financial education programs targeted to the general public and the Hispanic community which include a credit component. Providers include financial institutions, including credit card issuers, federal and local government agencies, and national and community-based organizations with a consumer protection focus. Financial education programs include brochures, workbooks, videos, Internet seminars, and classes. Although many credit education programs are now translated or "transcreated" into Spanish, few materials are custom-tailored to address the unique needs of Hispanic consumers in credit markets. Additionally, effective distribution of these materials into the hands of consumers who need it most and funding for active follow-up have been limited. The effectiveness of even well-resourced "financial literacy" programs is questionable.

NCLR's research shows that one-on-one financial counseling (not to be confused with creditor debt counseling) is a more effective method for increasing financial literacy and building assets for Hispanic consumers.[47] However, there are few resources to build the type of infrastructure that would be necessary to deliver such financial counseling services to low-income Hispanic families.

Policy Recommendations

Abusive credit card policies and practices have hampered the ability of many Hispanic consumers to build a good credit history and save more of their hard-earned money. Consequently, the ability to build the assets and wealth necessary for long-term economic stability is also hampered. With the enactment of effective consumer protections, greater enforcement, and enhanced community awareness of industry policies and practices, Hispanic consumers may be better equipped to improve their economic standing. The following recommendations are designed to reach this end:

- **Enact a mandatory, individualized minimum payment warning.** Policy-makers should enact the "Credit Card Minimum Payment Warning Act of 2005" (S. 393), which would require credit card issuers to insert standard language in a consumer's credit card statement warning them of the consequences of paying only the monthly minimum payment requirement. The Act would also require credit card issuers to include personalized payment calculations that reveal how much consumers will pay, in months and years, if they pay only the minimum. This disclosure would both serve as a reminder for consumers who consciously pay the minimum every month and educate consumers who are unaware of the consequences.
- **Ban universal default and change-in-terms policies.** Policy-makers should abolish credit card industry policies that are fundamentally unfair. The universal default policy fits this definition because it enables credit card issuers to apply penalty rates to a consumer's account even though the consumer has not missed payments or defaulted on their loan. Further, the charge may be applied retroactively, essentially charging consumers more for products or services that they already purchased.[49] According to the National Consumer Law Center, the credit card industry is the only industry that has the ability to apply a penalty interest rate to past purchases.

  Policy-makers should also prohibit unilateral change-in-terms provisions. At minimum, application of any change-in-terms provision should apply to new debt only. If a consumer does not consent to the change in credit card terms, this should not constitute a default and the issuer should not have the authority to demand that the consumer immediately repay their balance in full.
- **Eliminate binding and mandatory arbitration clauses.** Eliminating mandatory arbitration clauses would bring meaning back to many consumer protections that have been weakened by such clauses. Additionally, Hispanic consumers would be empowered to choose the best method to address their grievances.
- **Establish uniformity in contract language.** Policy-makers should follow the GAO's recommendation to require credit card issuers to clearly disclose to the consumer -- in languages and formats that the vast majority of consumers can understand -- all policies and practices that affect costs. Furthermore, policy-makers should establish uniformity in credit card agreements, eliminating the use of creative terminology to describe common industry policies and practices. These recommendations would help to facilitate comparison shopping, making it easier for consumers to differentiate between credit card offers.
- **Stop double-billing on foreign conversion fees and highlight the fee in Spanish-language credit card offers.** Consumers should not be subject to double-billing on purchases made

outside the U.S. or pay more than what it cost the lender to convert foreign currency into dollars. Regulators should require credit card issuers to highlight the foreign conversion fee in all non-English-language credit card offers. Regulators should also encourage financial institutions to develop and market credit cards with a country-specific waiver of all foreign conversion fees.

- **Fix the credit reporting and collection system.** Credit card issuers should be required to report credit information to the major credit bureaus. Additionally, the Federal Reserve should develop and test a single tri-merge credit score, which would combine and average credit scores from the three major credit bureaus which lenders could use to more accurately determine a consumer's creditworthiness. Finally, a commission made up of consumer advocates, credit bureaus, and financial institutions should be formed to evaluate and improve credit reporting and accuracy standards, develop a process for conducting accuracy audits, and develop reporting requirements.
- **Create a financial counseling network.** Policy-makers should create a financial counseling infrastructure at the community level. Resources would be used to hire and train community-based financial counselors, develop software to track client progress, and build capacity. The goal of such a program will be to reach Hispanic consumers before they accumulate unmanageable debt or develop characteristics that could harm their credit score, and educate them on abusive practices in the credit card industry and how to identify and avoid credit card-related scams.
- **Eradicate targeted credit card-related scams.** Federal agencies need to be more proactive in their efforts to eradicate credit card-related scams that strip wealth from Hispanic communities. This would require funding initiatives that involve partnering with community-based organizations, local consumer protection agencies, and the media to highlight and address abusive practices in the community. Many of these community-based agencies have already built the necessary trust with consumers to be effective. Furthermore, agencies need to improve their ability to address consumer complaints and collect data by race/ethnicity to detect trends within segments of the population.
- **Increase regulatory oversight.** The OCC should work proactively to increase its efforts to identify and eliminate abusive practices in the credit card industry. This would include recognizing harmful trends more quickly, increasing investigations on issuers, and applying penalties when issuers are found to engage in harmful practices. Additionally, the OCC should develop and implement a plan to increase awareness in the Latino community of its Consumer Assistance Group. The plan should include developing partnerships with community-based organizations that have built the trust of the community. Further, the OCC should market its consumer complaint toll-free hotline in both English and Spanish on all materials sent by credit card issuers to consumers. The OCC should also advertise the hotline on Spanish-language radio and television.

The OCC should also conduct formative research of English-speaking and non-

English-speaking consumers to determine the types of consumer problems that are not reflected in the complaints it receives and to determine why many Hispanic consumers who have been victimized do not file complaints against their credit card issuer.

Conclusion

Although modest, the recommendations outlined above would go a long way in protecting vulnerable consumers. In addition to these recommendations, big ideas are needed to reform the credit card industry and shift the balance of power into the hands of consumers.

With household debt adversely impacting Americans' ability to save for their retirement or education, or simply to make ends meet, policy-makers must elevate credit card reform to the top of their agenda and work to find meaningful solutions.

Methodology

Our objective was to describe how the structure of the credit card market and industry policies and practices impact Hispanic access to affordable credit and to analyze regulatory oversight in the market. Before drafting our analysis, NCLR conducted the following activities:

- **Reviewed formative qualitative research (focus groups).** In an effort to inform its 2005 household debt survey, Demos first conducted focus groups including several with Hispanic English- and Spanish-speaking participants. Demos graciously provided NCLR with the summary of these focus groups, which NCLR staff used as a baseline for developing moderator questions and organizing a roundtable on the experience of Latinos with credit cards.
- **Convened a roundtable discussion.** NCLR staff convened a roundtable, "Latino Credit Card Use: Documenting the Latino Experience," at the 2006 NCLR Annual Conference in Los Angeles, California. The purpose of the roundtable was to identify the most pertinent credit card-related issues that Hispanic consumers face, share credit-related consumer complaint information and knowledge about existing efforts to protect consumers and to address grievances, and discuss ways to improve Hispanic access to affordable credit. Participants included regulators, credit counselors, and individuals who collect Hispanic consumer complaint information. (A transcript of the roundtable discussion, *A Conversation on Latino Credit Card Use*, is available at www.nclr.org/creditcards)
- **Interviewed scholars, experts, and consumer advocates.** NCLR staff interviewed experts in the field to gather information and perspectives on the credit card industry. The following individuals were among the experts NCLR consulted: Elizabeth Warren, Leo Gottlieb Professor of Law at Harvard Law School; U.S. PIRG; the National Consumer Law Center; Demos; Consumers Union; and Consumer Action.
- **Conducted a site visit.** NCLR staff visited the Office of the Comptroller of the Currency's Consumer Assistance Group in Houston, Texas. The purpose of the visit was to develop a better understanding of the consumer complaint process, including receiving, addressing, and documenting

complaints made by Hispanic consumers. The visit also provided an opportunity to learn about the Consumer Assistance Group's marketing efforts.

- **Compiled and reviewed the research.** NCLR conducted a thorough assessment of authoritative research in the field, including reports published by the federal government, consumer advocacy organizations, and academics, and articles in newspapers, trade journals, and business magazines.
- **Conducted data analysis.** Staff from the Federal Reserve Board Consumer Education and Research Section, Division of Consumer and Community Affairs tabulated data for NCLR from the 2004 Survey of Consumer Finances (SCF), the Survey of Consumers by the Survey Research Center at the University of Michigan, and a household survey designed by Demos and the Center for Responsible Lending (CRL) for use in NCLR's report. These data sets were chosen because they are generally widely accepted as leading sources of household financial information and include data by race and ethnicity. The race and ethnicity sample sizes varied considerably between these surveys. Although the information could have been useful, NCLR chose not to use data from the Survey of Consumers because of its limited Hispanic sample size. Although not perfect, the SCF and the Demos Hispanic sample offered the best quality data available at the moment.

  The SCF is a triennial survey conducted by the Federal Reserve Board with the cooperation of the Statistics of Income Division of the Internal Revenue Service. The survey is designed to provide information on U.S. household balance sheets, pensions, income, use of financial services, and other demographic characteristics. The 2004 SCF included 4,519 respondents. More information about SCF content and weighting methods is available at www.federalreserve.gov/scf/.

  The Demos/CRL survey was conducted over the telephone between February and March 2005 and included 1,150 respondents. The purpose of the survey was to determine how American households are using credit cards and how they are managing their debt. Respondents were low- to middle-income heads of households who had at least three months of credit card debt. For more information on the Demos/CRL survey, please see *The Plastic Safety Net: The Reality Behind Debt in America*, Demos and the Center for Responsible Lending, October 2005, available at www.demos.org.
- **Submitted a draft of the paper for external peer review.** Gail Hillebrand, Consumers Union, and Ed Mierzwinski, U.S. PIRG, reviewed a draft of the report for accuracy and style.

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May 17, 2007

The Honorable Carolyn Maloney
House of Representatives
Washington, DC 20515

The Honorable Paul E. Gillmor
House of Representatives
Washington, DC 20515

Dear Madam Chairwoman and Ranking Member Gillmor,

During the credit card hearing on April 26, 2007 before the Subcommittee on Financial Institutions and Consumer Credit, you both specifically inquired, among other things, whether the industry had suggestions for improving the disclosure regime currently in place.

As I stated at the time, there seems to be broad agreement that the disclosures currently provided to consumers about the terms of their credit cards simply do not work. Significant changes in the marketplace, which have led to lower prices and broadened access to credit, have also led to more complex pricing structures. While many card companies have taken steps to simplify disclosures so that they can be more effective and informative for consumers, current federal disclosure requirements and fear of litigation over imprecise language limit just how useful these disclosures can be. This was the primary conclusion reached by the General Accountability Office in its recent study on credit cards.

The Federal Reserve Board is currently engaged in an in-depth review of the current disclosure regime, and we understand a proposal may be made public in the very near future. We applaud that effort and look forward to providing comments to the Board. We have also engaged in an effort with our member card companies – as part of both the rulewriting comment process and congressional inquiries on the subject – to develop suggestions on what an effective disclosure approach should look like. In view of your specific interest in the subject, we wanted to provide you with our proposed framework for how to approach this issue.

Disclosures need to be simple, clear and capable of comparison. They also need to be flexible enough to evolve with the changing needs of consumers. And most importantly, they need to be based on what consumers say they find useful, not solely on what lawyers, industry and advocacy groups propose.

To ensure that consumers get both topical and in-depth information on credit cards, we would also propose that disclosures be provided in different levels. At the first level, we would propose that consumers be provided with a concise overview of the card's terms, since if such disclosures are not kept simple, clear and easily comparable, most consumers are unlikely to use them effectively. For example, consumers could be provided with a summary of key terms, such as interest rates, fees, and what can trigger rate changes, that they can easily compare with other credit card options. (Some examples of what these may look like are attached.) This disclosure would also provide information on where consumers can easily obtain more detailed information from the card company about the terms of the card. The second level of disclosure would involve the more detailed explanation of the full terms of the agreement, in an understandable manner.

Finally, we also believe that the Federal Government, in this case the Federal Reserve, should develop a balanced and informative guide to the "basics of credit cards" that more fully describes how credit cards work and what consumers should consider when they use a credit card. The Federal Reserve and the industry can make this guide widely available as part of broad-based financial literacy efforts aimed at empowering consumers with information that allows them to make credit choices that are right for them.

The American Bankers Association believes that this three level approach can best meet the needs of consumers. We hope that this information is helpful to you as you continue to examine the current credit card marketplace and ways of improving disclosures in a manner that empowers consumers. It is not a simple issue, but we believe the ultimate answer must be consumer-focused. We know the Federal Reserve has engaged in consumer testing, and we look forward to seeing their results.

We would be happy to discuss this and other issues as you continue your examination. Thank you for considering our views.

Sincerely,

Edward L. Yingling

cc: Chairman Barney Frank
Ranking Member Spencer Bachus

May 17, 2007

Updating Credit Card Disclosures – Making them Work for Consumers
A Framework for Discussion

The credit card marketplace has changed. The "democratization" of the credit card has expanded access to credit to Americans from all economic backgrounds and walks of life.

What was once a relatively simple card environment some 20 years ago has now evolved into a highly competitive, diverse marketplace aimed at meeting wide-ranging consumer needs. Consumers have generally been well-served by the competition, which, according to the Government Accountability Office (GAO), has resulted in lower interest rates and, in many cases, the elimination of annual fees. Consumers have not been well served by card disclosures that have not kept pace with the changing complexity of today's marketplace.

The Federal Reserve is currently working on re-writing the rules for credit card disclosures so that they can be more understandable and useful to consumers, based on actual testing with consumers. The credit card industry strongly supports those efforts.

The American Bankers Association believes that there are certain basic principles that credit card disclosures should embody. And, we believe consumers need access to more information on the basics of credit cards that permit them to make choices that are right for them.

We live in a dynamic, ever-changing marketplace, and any disclosure regime has to be equally dynamic and capable of evolving with the changing needs of consumers, and – most importantly – based on what consumers tell us they actually find useful.

I. Disclosure Principles

Disclosures need to be simple and clear. Consumers need to know what they are getting when they apply for and use a credit card, in simple and understandable terms.

Disclosures need to highlight important terms. Credit cards are loans, and consumers need to know what the important terms are that go with using the product. For example, disclosures need to highlight when finance charges or fees apply, what behaviors trigger changes in the terms of their cards, and what they can do to avoid additional costs. No surprises.

Disclosures need to be uniform and comparable. Consumers need to be able to easily compare credit card offers. Federal regulations, which are currently being revised, should include an easily readable "summary" list highlighting key terms and benefits. This disclosure could be available when the consumer applies for the card and when he or she receives it. There may be other times when such summary highlights may prove useful. Some examples of possible "summary highlights" are included in part II. We provide this to show what a clearer, more easily comparable disclosure might look like. Clear disclosures empower consumers to choose the product that is best for them.

Disclosures need to be short and to the point. Disclosures need to avoid unnecessary detail, as "too much" information will merely discourage consumers from reading and understanding what's involved with using the credit card. Brevity and clarity should be encouraged by providing companies that issue credit cards with legal protections from litigation where uniform disclosures are used.

Disclosures need to be "dynamic" and capable of evolving to meet changing consumer needs. Disclosure rules should not be set in stone. Nor should they necessarily be limited to one place in time or one vehicle for delivery. Innovative delivery mechanisms, evolving website capabilities, and changing consumer preferences need to be accommodated. There may be key times when consumers would benefit from receiving important disclosures; companies need the flexibility to provide disclosures at times that best meet their customers' needs.

Disclosures need to be based on what consumers tell us works. Most importantly, disclosures need to reflect what consumers actually find useful. And the one way to do that is to ask them. The Federal Reserve has already engaged in an extensive consumer outreach program to test what kinds of information consumers find helpful. Any disclosure regime – and any summary highlights disclosure – should be based on what consumers tell us they find works, not solely by what lawyers, industry or advocacy groups propose.

II. Some Examples -- Summary Disclosure Form

Some possible examples of what a "summary highlights" form might look like are attached. There may be numerous variations to these models, dependent upon the terms of the card (e.g., whether or not they include variable rates, introductory rates, or other important terms). These are provided as illustrations of what such a form could look like, recognizing that there may be different perspectives on the contents of such an overview form.

III. Additional Steps

The credit card industry is committed to both helping consumers better understand the benefits and responsibilities of using credit cards, and in helping those who find themselves under financial stress. That is why the industry believes the following effort is also important to promoting responsible credit card use:

Disclosures need to be supplemented by a Basic Guide to Credit Card Use. Credit card disclosures are an important piece of the financial puzzle for consumers. But given the need for brevity and conciseness that goes with such disclosures, more needs to be done to educate consumers on what is involved with using a credit card. Government agencies should distribute a Credit Card Guide that helps provide consumers with the "basics" about credit cards. The Guide should be available in both on-line and printed form, be available in different languages, and should include:

- Plain language explanations about the important concepts related to credit card use, such as the fact that credit card advances are "loans" that must be paid back, that they may involve potentially significant finance charges and fees, and how such costs can be avoided by acting in an informed manner.

- Easy-to-understand descriptions of typical card terms, such as annual percentage rates (APRs), late and over-the-limit fees, introductory rates, and balance transfers, so that consumers know the potential implications of their choices. Importantly, descriptions should be provided over how finance charges may apply to various types of card transactions (e.g., purchases, cash advances, and balance transfers), how such charges are calculated, and why such terms may change.

- Explanations that emphasize the benefits and drawbacks that responsible or problem use of credit cards can have on an individual's financial future, such as how it may affect a consumer's credit score, gain access to affordable home and auto loans, or impact their future employment options. Further tips that promote financial literacy and sound financial management skills should also be included.

- Advice for borrowers who come under financial stress, such as ways to manage current budgets, the availability and benefits of financial counseling, and the benefits of contacting their financial institution for assistance.

What Consumers Need to Know About Their Credit Card: Example 1

KEY ITEMS

Interest Rates

ANNUAL PERCENTAGE RATE (APR)

Purchases	9.9%
Cash Advances	15.99%
Balance Transfers* **Payments applied **first** to low-rate balances*	3.99%

SPECIAL FEATURE APR (*if applicable*)

Introductory Offer Rate	3.99%
Expiration Date	6 months
Future Rate	12.99%

Can Interest Rates Change?

Indexed Rate	Yes
Changes in Credit History	Yes
For example:	
• *You had payment problems with us*	Yes
• *You had payment problems with other creditors*	No
• *Your credit score changed*	Yes

Fees*

Late Payment	$___
Over Limit	$___
Cash Advance	$___
Balance Transfer	$___
Annual	$___

** In some instances, fees may be a percentage of the transaction amount. In addition, there may be other fees related to the account; please see the detailed explanation of the account for further information.*

Other Important Terms

"Grace" period (*date payment is due after end of billing cycle*)	At least 20 days
Finance Charge Applies	
If you **pay your balance in full** for prior billing cycle	No
If you have an **outstanding balance** *(If "yes," finance charge applies to prior **and** new purchases)*	Yes

For more detailed explanation of the account, see **xxx.xxxx.xxx**

For general explanation of credit cards and their terms, go to **www.frb.gov/creditcard**

What Consumers Need to Know About Their Credit Card: Example 2

KEY ITEMS

Interest Rates

ANNUAL PERCENTAGE RATE (APR)	
Purchases	9.9%
Cash Advances	15.99%

Can Interest Rates Change?

Indexed Rate	Yes
Changes in Credit History	Yes
For example:	
• *You had payment problems with us*	Yes
• *You had payment problems with other creditors*	No
• *Your credit score changed*	Yes

Fees*

Late Payment	$___
Over Limit	$___
Cash Advance	$___
Balance Transfer	$___
Annual	$___

** In some instances, fees may be a percentage of the transaction amount. In addition, there may be other fees related to the account; please see the detailed explanation of the account for further information.*

Other Important Terms

"Grace" period (*date payment is due after end of billing cycle*)	At least 20 days
Finance Charge Applies	
If you **pay your balance in full** for prior billing cycle	No
If you have an **outstanding balance** *(If "yes," finance charge applies to prior **and** new purchases)*	Yes

For more detailed explanation of the account, see **xxx.xxxx.xxx**

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