AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

S. HRG. 110–904

EXAMINING THE BILLING, MARKETING, AND DISCLOSURE PRACTICES OF THE CREDIT CARD INDUSTRY, AND THEIR IMPACT ON CONSUMERS

HEARING

BEFORE THE

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

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

ON

STRENGTHENING REGULATIONS AND THE RESPONSE BY REGULATORS TO AVOID THE UNINFORMED USE OF CREDIT BY CONSUMERS WHILE PROTECTING AGAINST INACCURATE AND UNFAIR CREDIT BILLING AND CREDIT CARD PRACTICES

THURSDAY, JANUARY 25, 2007

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

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

U.S. GOVERNMENT PRINTING OFFICE

50–307 WASHINGTON : 2009

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

CHRISTOPHER J. DODD, Connecticut, *Chairman*

TIM JOHNSON, South Dakota
JACK REED, Rhode Island
CHARLES E. SCHUMER, New York
EVAN BAYH, Indiana
THOMAS R. CARPER, Delaware
ROBERT MENENDEZ, New Jersey
DANIEL K. AKAKA, Hawaii
SHERROD BROWN, Ohio
ROBERT P. CASEY, Pennsylvania
JON TESTER, Montana

RICHARD C. SHELBY, Alabama
ROBERT F. BENNETT, Utah
WAYNE ALLARD, Colorado
MICHAEL B. ENZI, Wyoming
CHUCK HAGEL, Nebraska
JIM BUNNING, Kentucky
MIKE CRAPO, Idaho
JOHN E. SUNUNU, New Hampshire
ELIZABETH DOLE, North Carolina
MEL MARTINEZ, Florida

SHAWN MAHER, *Staff Director*
WILLIAM D. DUHNKE, *Republican Staff Director and Counsel*
ALEX STERNHELL, *Professional Staff*
LYNSEY GRAHAM REA, *Counsel*
MARK OSTERLE, *Republican Counsel*
JONATHAN V. GOULD, *Republican Counsel*
JOSEPH R. KOLINSKI, *Chief Clerk and Computer Systems Administrator*
GEORGE WHITTLE, *Editor*

C O N T E N T S

THURSDAY, JANUARY 25, 2007

	Page
Opening statement of Chairman Dodd	1
Opening statements, comments, or prepared statements of:	
Senator Shelby	4
Senator Carper	5
Senator Bennett	7
Senator Akaka	8
Senator Allard	10
Senator Brown	10
Senator Crapo	11
Senator Tester	12
Senator Sununu	13
Senator Menendez	14
Senator Casey	16

WITNESSES

Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School	18
Prepared statement	58
Robert D. Manning, Ph.D., Research Professor of Consumer Finance, and Director, Center for Consumer Financial Services, E. Philip Saunders College of Business, Rochester Institute of Technology	21
Prepared statement	66
John G. Finneran, Jr., General Counsel, Capital One Financial Corporation	23
Prepared statement	99
Response to written questions of:	
Senator Dodd	174
Senator Shelby	174
Senator Reed	178
Senator Tester	181
Senator Crapo	185
Carter Franke, Chief Marketing Officer, Chase Bank U.S.A., N.A	26
Prepared statement	104
Michael D. Donovan, Partner, Donovan Searles, LLC, also on behalf of The National Consumer Law Center and The National Association of Consumer Advocates	27
Prepared statement	108
Richard Vague, Chief Executive Officer, Barclays Bank Delaware	31
Prepared statement	127
Response to written questions of:	
Senator Dodd	188
Senator Shelby	188
Senator Reed	192
Senator Tester	195
Tamara Draut, Director, Economic Opportunity Program, Demos	33
Prepared statement	131
Travis B. Plunkett, Legislative Director, Consumer Federation of America	35
Prepared statement	151

Page

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

Robert Berner, *BusinessWeek,* "CAP ONE'S CREDIT TRAP; By offering multiple cards, the lender helps land some subprime borrowers in a deep hole and boosts its earnings with fee income," article dated November 6, 2006 199
Prepared statement of Edward L. Yingling, on behalf of the American Bankers Association 202

EXAMINING THE BILLING, MARKETING, AND DISCLOSURE PRACTICES OF THE CREDIT CARD INDUSTRY, AND THEIR IMPACT ON CONSUMERS

THURSDAY, JANUARY 25, 2007

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

The Committee met at 9:34 a.m., in room SD–538, Dirksen Senate Office Building, Senator Christopher J. Dodd (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

Chairman DODD. The Committee will come to order.

First, I want to thank our witnesses for being here this morning and thank my colleagues for coming out this morning.

Before we begin this hearing on examining the billing, marketing, and disclosure practices of the credit card industry and their impact on consumers, I want to recognize the fact that Senator Shelby, my colleague and friend, the Ranking Member here, held an excellent hearing on this subject matter already before, and I commend him and thank him for having done that.

Senator Schumer, who I think will be joining us shortly, is the father of the Schumer Box. We recognize his longstanding interest and involvement in this.

Senator Carper, my friend from Delaware, has a strong interest in this. He has talked to me repeatedly over the last number of days about his interest in this subject matter.

Dan Akaka has introduced legislation in the past on this, and Bob Menendez as well. And, Sherrod, I presume you have had a strong interest in this as well in the other body over the years. So we thank all of our members here for their interest in this subject matter.

Let me share some opening comments, if I can. I will then turn to the Ranking Member for any opening comments he has, and then we will turn to our witnesses for some opening statements.

Let me say in advance that we would like you to try and keep your opening comments, if you can, down to 5, 6 minutes or so, so we can get through all of you. We have got a crowded panel here this morning, and then we will turn to questions, and I will try and keep the questions down to about—I will try and do about 7 minutes per member, and really that is tight as it is, because some-

times setting up the question takes a few minutes. But we will try and move this along so everyone is involved.

Anyway, today is the first in a series of hearings on the subject matter that I believe is of critical importance, that is, the subject matter of credit cards. It is my hope that through these hearings this Committee, in a careful, thorough, and open manner, will begin to examine both the positive and negative impacts that this important financial tool plays in the lives of millions of American consumers in our Nation's economy. It is my hope that this hearing, entitled "Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry, and Their Impact on Consumers," will help us to better understand the many complex issues regarding credit card practices.

A number of members of this Committee have a strong interest in this matter, and I encourage their active participation today and in the coming weeks and months.

At the outset of this hearing, let me say this about credit cards. I support them. I strongly believe in the product and its potential to give consumers greater convenience and access to capital. They are an important component of a financial services industry that is the most dynamic and innovative in the world. And that statement cannot be stated strongly enough. I believe it very strongly. And I support the notion that consumers must share the responsibility to better understanding the terms and conditions of their credit card agreements and take personal responsibility for their financial decisions.

Let me add here an aside, if I can. Someone last evening I was talking to talked about financial literacy. That is something I hope we might encourage our Committees on Education and other schools across the country to begin early on with young people and to educate them about the importance of the responsibilities in financial matters.

But this morning I would like to put the credit card industry on notice as well, and issuing banks as well, and associations, that if you currently engage in any business practice that you would be ashamed to discuss before this Committee, then I would strongly encourage you to cease and desist that practice. Irrespective of the current legality of such practices, you should take a long, hard look at how you treat your customers, both in the short term and in the long term.

Credit card use has grown dramatically over recent years. Over 640 million credit cards are issued by more than 6,000 credit card issuers, currently in circulation in this country. Between 1980 and 2005, the amount that American consumers charged to their credit cards grew from $69 billion a year to more than $1.8 trillion per year. Credit cards have played an important role in supporting entrepreneurship and have helped to provide consumers in building credit histories. But in far too many instances, in my view, they can harm, not help, a consumer's ability to move up the economic ladder.

I would like to outline a few of my concerns regarding credit cards that I believe this Committee must examine. One of the trends that greatly troubles me is the exponential rise in consumer debt and the role that credit cards have played as part of that

trend. The recent level of credit card debt in the United States is at a record height. Total consumer debt in America is nearly $2.4 trillion. Out of that, $872 billion is revolving debt, which is essentially credit card debt.

The average American household—the average American household—has over $9,300 worth of credit card debt. Let me repeat that. The average household has more than $9,300 of credit card debt. In comparison, the median household income was about $46,000 in 2005.

Additionally, Americans have never paid more in interest, paying nearly 15 percent of their disposable income on interest payments alone, despite the current historically low interest rate environment.

Another area which I believe deserves examination is the massive increase in targeting of credit card solicitations. According to the Federal Reserve, an estimated 6 billion direct mail solicitations were sent by credit card issuers in 2005 alone. Many of the solicitations target students, persons currently on the economic edge, senior citizens on fixed incomes, and persons who have recently had their debts discharged in bankruptcy.

I have long believed that we have an added responsibility to protect the most vulnerable in our society, and I believe that examining the targeting of these groups is critically important.

I also have concerns with the amount, type, and disclosure of certain fees imposed on consumers. Over the past 2 years alone, the amount of money generated by credit card fees has simply skyrocketed. In fact, the term "skyrocketed" may be something of an understatement. Banks are expected to collect $17.1 billion from credit card penalty fees in 2006, a 15.5–percent rise from 2004. According to R.K. Hammer, a bank advisory firm, this is a tenfold increase from 1996 when credit card companies raised $1.7 billion in revenues and fees. In 10 years, $1.7 billion to $17.1 billion. We need to take a close look at these fees and how they fundamentally impact consumers.

We must closely examine the current disclosure regime as well. The current system of disclosure is outdated. It has not kept pace with a variety of credit card practices, and consumers have little understanding of the terms and conditions of their credit card contracts. Despite the significant work of many, including a number of the Members of this Committee, to provide consumers with clear, understandable, and consistent information, consumers are consistently becoming confused and intimidated.

The Truth in Lending Act is the primary Federal law pertaining to the extension of consumer credit. TILA, as it is called, and Regulation Z, which implements the act, require creditors offering open-ended credit plans, such as credit card accounts, to disclose costs and other terms. The purpose of the act is, and I quote the purpose of the act here for you, "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him in the marketplace and avoid the uninformed use of credit; and, two, to protect the consumers against inaccurate and unfair credit billings and credit card practices."

The Federal Reserve is currently conducting a review of the open-ended credit rules of Regulation Z. It is my hope that the review will result in greater clarity and comprehensibility for consumers. Let me also add that the OCC issued an advisory letter in September of 2004 to alert the national banks to the agency's concerns regarding certain credit card marketing and account management practices. The OCC's letter outlines three credit card practices that, and I quote them, "may entail unfair or deceptive acts or practices and may expose a bank to compliance and reputation risks."

While the OCC has deemed these practices unfair and deceptive, the agency has to this point declined to prohibit them. With the increase in the pervasiveness of credit cards and the number of consumers who utilize them, the OCC, in my view, should recommit itself to protecting consumers. We must, in my view, redouble our efforts to ensure that consumers have a complete and accurate understanding of the debts that they will enter into with credit card issuers. Examining the law and regulations that protect consumers will be a very important part of this Committee's oversight work.

Additionally, there are many credit card practices that the American public has raised significant concerns with, not simply with the disclosure but the underlying rationale and justifying them. For example, double-cycle billing, universal default, and the methodology of penalty increases and interest rates, and the issuance of multiple low-limit cards with exorbitant fees are just some of the controversial practices that are pervasive in the industry.

I would also say here that "caveat emptor" or "buyer beware" should not be used, in my view, to defend the myriad of confusing, misleading, and in some cases predatory practices which have become standard operating procedures for some in the credit card industry.

And, last, I would be remiss if I did not mention one issue that is not likely to be explored today: credit card interchange fees. These fees are imposed on merchants and consumers by banks and credit card associations when a credit or debit card is used to pay for a purchase. Interchange fees are growing exponentially, and the costs associated with these fees are expected to be between $30 and $40 billion this year alone. These opaque fees are assessed on merchants and passed on, in part or in whole, to consumers who have no knowledge or understanding that a fee is even a part of the cost of the bread, milk, or whatever other purchase they make. I believe that this is another area that this Committee should examine as part of a series of hearings on credit cards, and we will do that.

With that, I would like to introduce the—I will get to the witnesses in a minute. Let me turn to my colleague from Alabama for any opening statement he wants to make, and then I will introduce our witnesses. But, again, I thank all of you for being here today, and I thank my colleagues for their participation.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Mr. Chairman. I want to commend you for holding this important hearing. You have touched on a lot of things.

Over the last 30 years, there has been considerable change in our Nation's credit markets. In the past, card issuers offered fixed-rate, fee-based cards to consumers with only the best credit ratings. Today, the use of risk-based pricing allows issuers to offer a wide variety of cards to a greater number of consumers by using different rates, fee structures, and credit limits.

While it is clear that such innovation has greatly and positively affected the cost and availability of credit, it is also clear, Mr. Chairman, that these changes have led to some troubling practices as well. Generally speaking, more complex credit card products involve more conditions and variables, making it harder for the average consumer to fully understand their rights and their responsibilities. Large numbers of consumers, in fact, do not understand the basic terms that can affect rates and fees.

For example, many are surprised when the rate on their card is raised even though they have made every payment in full and on time. Through the practice known as universal default, credit card issuers maintain the right to raise rates when they discover that a consumer was late or missed a payment on any of the consumer's other credit accounts.

The marketing of credit card products has also changed dramatically in recent years. From the Internet, to college campuses, to the mailbox, credit card solicitations are everywhere. The marketing campaign does not stop when a consumer already has an issuer's card or even when the cardholder is having trouble making payments. In fact, some issuers extend additional credit to troubled borrowers with full knowledge of their credit difficulties.

At the outset of this hearing, I think we must recognize the integral role credit cards play in the financial lives of almost all adult Americans. Nearly half of all Americans use credit cards to conduct transactions worth billions of dollars. And with that in mind, this Committee has a responsibility to not only identify abuses and questionable practices by issuers, but also to highlight the positive aspects of the credit card marketplace, while emphasizing the responsibilities of the individual cardholder.

I believe that credit must not only be used responsibly but extended responsibly as well. The key to achieving both of these goals is access to accurate and understandable information. I look forward to hearing from today's panel on the state of the credit card business and how Congress can continue to be a constructive influence in a dynamic and necessary sector of our financial services industry.

Mr. Chairman, I have an article here that appeared in *BusinessWeek* Magazine, November 6, 2006, and it is entitled "CapOne's Credit Trap." I think it is very instructive, and I ask unanimous consent it be made part of the record.

Chairman DODD. It will be made part of the record.

Senator SHELBY. Thank you, Mr. Chairman.

I am going to ask each of our panelists here if they would like to make a couple of opening comments. Senator Carper.

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. Let me just start off by saying, Mr. Chairman, thanks not only for calling the hearing but also thank you for

working with us to make sure we have a fair and balanced hearing where all sides can be heard in a respectful way. I am very grateful for that.

I want to thank each of the witnesses for joining us today, and some of you have family members here, and I see one 13-year-old back there behind Mr. Donovan, and especially welcome to you. You are good to miss school today to be here to back up your Dad.

[Laughter.]

Chairman DODD. He can help them out with the math, maybe.

Mr. DONOVAN. He can pass me the notes.

Senator CARPER. We are going to look carefully, Mr. Donovan, and see if we can see your son's lips move while you speak.

[Laughter.]

Senator CARPER. That is the way it is in our family.

I especially want to welcome Richard Vague, who is here today, whom I have known for some 20 years. He came to Delaware a number of years ago and created a credit card bank called M Corp. It grew into First USA, which was, I think, at the time maybe the largest Visa credit card issuer in the world with some 60 million credit cards. We were fortunate that he came to our State. He now heads up Barclaycard USA, which acquired Juniper Bank, and we are just glad that they are in our State on the riverfront. If you ever come through Delaware on the train, right by the riverfront you will see Barclays Bank, and that is the bank that Richard and his colleagues, including Clint Walker, who is here, head up. We thank you for coming.

I say to our witnesses, we just finished last week legislation dealing with ethics, ethics reform. You probably were following it in the press. And as it turns out, most of the folks, I think, sitting—well, all the people sitting up here on this panel, and even those that are not here today, are what I would call "White Hats" in this business. As it turns out, not everybody who happens to serve in the U.S. Congress wears a white hat, and one of the reasons why we have taken up ethics reform legislation and enacted it in the House and in the Senate is because of the misdeeds of a number of our colleagues, not in the Senate so much as in the House of Representatives in recent years. And we need to clean up our own act and police our own act, and that is what we are endeavoring to do.

And, by the same token, there are a lot of White Hats in this industry, too. I think they happen to be sitting here at this table, and there are others that are not at this table. But we know, by the same token, that there are folks who follow practices that are, I think, inappropriate, in some cases abusive, and what we need to do as a Committee is to put a spotlight on that behavior, on those practices, and at the same time put a spotlight on the practices of those whose behavior we think is appropriate and commendable.

I think there is a lot that we agree on in this panel. We agree on the need for better disclosure, not just more detailed disclosure, but actually disclosure that people can read and understand. Christopher Cox, who is the head of our SEC, comes before us from time to time. One of the great virtues that he brings to this witness table is he actually speaks in language that we can understand, and he is trying to convince the rest of the SEC to speak and write in plain English. And we think that kind of approach is needed in

a lot of, frankly, the way we probably give speeches and also in the way we disclose matters that relate to credit cards that some of you issue.

Financial literacy. We are proud of the work that we are doing in Delaware in financial literacy. We need to do a better job in, frankly, every State of making sure that the people who receive—whether it is a credit card application in the mail or a form dealing with refinancing a mortgage, we need to make sure that people understand what they are getting into, and that is a big part of our responsibility.

The last thing I want to say—and I think Senator Shelby may have referred to this, but I remember the first credit card I got. I was in the Navy. I was a naval flight officer. It was during the Vietnam War. I got a credit card, and there was a limit on how much I could charge. There was a monthly fee that I had to—or an annual fee that I had to pay. I do not think there was an interest rate on what I was charging. And things have certainly changed a lot, but it was helpful to me to have that card then. And today I think I have three or four credit cards in my wallet. One I use for my personal use. Another I use for matters that are official Senate dealings, charges that I make. Another deals with my campaign, charges that are reimbursable by my campaign. And it is very helpful to me to manage my finances to have those credit cards.

In my State, in Delaware, we used credit cards rather extensively for State employees to provide a paper trail so that we could follow the charges that they were making. It was actually quite helpful for our auditors to ferret out abuses that might occur. We do a similar kind of thing with Federal employees.

So I would say that as we look at this hearing today and we look forward, Mr. Chairman, we all know that there are certainly improvements that can be made. Everything I do I can do better. I am sure that is true for this industry. And we hope that today will be a good place to start us on that trail to clearing up some of the abuses that occur, putting a highlight or a spotlight on those that are doing the right thing, and maybe we will all be better for it.

Thank you.

Chairman DODD. Thank you very much.

Senator Bennett.

STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Thank you, Mr. Chairman. I appreciate the opportunity to be here and look forward to the witnesses.

Putting it into a little bit of a historic note, I note that back in 1990 the average interest rate on credit cards was 18 percent, and a good percentage of them charged an annual fee. In 2005, the average interest rate is 12 percent, and most of them do not charge an annual fee. So the pressures of competition to make it better for consumers have produced this kind of change, and I think we should recognize that the market does work. The market has produced better situations for consumers. And while I am still troubled about some of the same issues you are, Mr. Chairman—the solicitation issue, the entrapment, if you want to call it that, of people who will have difficulty meeting their credit card charges—I

think we need to be careful as we go forward to make sure we do not have some of the problems that other countries have had that have tried price caps on interchange fees and discovered that the result has been the drying up of opportunities for credit cards.

So I think you have a balanced panel of witnesses here, and I look forward to hearing from them.

Chairman DODD. Thank you very much, Senator.

Senator Akaka.

STATEMENT OF SENATOR DANIEL K. AKAKA

Senator AKAKA. Thank you very much, Mr. Chairman. I am happy to be back on the Committee, and I look forward to working with you and the Members of the Committee. I also want to welcome our witnesses. Thank you for conducting this important hearing. It is imperative that we make consumers more aware of the long-term effects of their financial decisions, particularly in managing credit and debt.

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

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

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 included a requirement that credit card issuers provide information to consumers about the consequences of only making the minimum monthly payment. However, this requirement fails to provide the detailed information on billing statements that consumers need to know to make informed decisions.

The bankruptcy law will allow credit card issuers a choice between disclosure statements. The first option included in the bankruptcy bill would require a standard minimum payment warning. The generic warning would state that it would take 88 months to pay off a balance of $1,000 for bank cardholders or 24 months to pay off a balance of $300 for retail cardholders. This first option also includes a requirement that a toll-free number be established that would provide an estimate of the time it would take to pay off the customer's balance. The Federal Reserve Board would be required to establish a table that would estimate the approximate number of months it would take to pay off a variety of account balances.

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

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

The minimum payment warning included in the first option underestimates the costs of paying a balance off at the minimum payment. If a family has a credit card debt of $10,000 and the interest rate is a modest 12.4 percent, it would take more than 10–1/2 years to pay off the balance while making minimum monthly payments of 4 percent. Shortly, I will be introducing the Credit Card Minimum Payment Warning Act. The legislation would make it very clear what costs consumers will incur if they make only the minimum payments on their credit cards.

If the Credit Card Minimum Payment Warning Act is enacted, the personalized information consumers would receive for their accounts would help them make informed choices about their payments toward reducing outstanding debt.

My bill requires a minimum payment warning notification on monthly statements stating that making the minimum payment will increase the amount of interest that will be paid and extend the amount of time it will take to repay the outstanding balance. The legislation also requires companies to inform consumers of how many years and months it will take to repay their entire balance if they make only minimum payments. In addition, the total costs in interest and principal, if the consumer pays only the minimum payment would have to be disclosed. These provisions will make individuals much more aware of the true costs of their credit card debt.

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

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

In a report on customized minimum payment disclosures released last April, the Government Accountability Office found that consumers who typically carry credit balances found customized disclosures very useful and would prefer to receive them in their billing statements. We must provide consumers with detailed per-

sonalized information to assist them in making better informed choices about their credit card use and repayment.

Our bill makes clear the adverse consequences of uninformed choices such as making only minimum payments and provides opportunities to locate assistance to better manage credit card debt.

Mr. Chairman, I look forward to working with you and the rest of the Committee to improve credit card disclosures so that they provide relevant and useful information that hopefully will bring about positive behavior change among consumers. Consumers with lower debt levels will be better able to purchase homes, pay for their child's education, or retire comfortably on their own terms.

Mr. Chairman, I thank you for giving me this time, for conducting this hearing, and for your leadership on these issues. Thank you very much.

Chairman DODD. Thank you, Senator Akaka. You have been involved in these issues for a long, long time, and we welcome your continued involvement.

Senator Allard.

STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. Mr. Chairman, I think at this point most that needs to be said has already been said, and so I am going to just say that I see a fundamental change in credit card use from a philosophical standpoint. You know, years ago it used to be a matter of convenience. And today I think more and more young people and young families are looking at it as a way of establishing credit, where historically I think consumers used to go to the bank for long-term credit and now they are looking for short-term credit means, and there are a lot of traps in it. And I applaud you for having this hearing to make consumers and lenders, in this case many times a credit card, to understand, you know, the traps that happen out there. We all need to be made aware of them, and I thank you for holding this hearing.

Chairman DODD. Thank you very much.

Senator Brown.

STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Mr. Chairman, and, Senator Shelby, thank you, and thanks to all the panelists, especially Dr. Warren and your contribution on all of these issues over many years. Thank you for that.

Ohio State University, the largest university in my State and the Nation, tells its students on its financial aid website to "avoid credit card debt while you are a college student." Yet go to any college campus in my State, Bowling Green or Miami or Cincinnati or Kent State or Akron U. or Toledo, and almost any campus across this country, you see that college students are inundated with credit card applications.

I question a business model that markets credit card debt to young people who do not have the means to pay the debt back. And I question the business model that markets lifetime debt to working families and elderly Americans.

According to a study at Ohio State, more and more retirees are struggling with credit card debt that they will simply never be able

to fully repay. There is a fine line between sales tactics and scams, between product promotion and unrelenting pressure. Of course, the goal of this Committee's work today is not to block consumer access or hamstring the credit card industry. The goal is to explore how we can set up a better system where informed consumers can make the best decisions possible regarding credit card debt.

I am looking forward to hearing how billing and disclosure practices can empower the American consumer to make the right decision.

Chairman DODD. Thank you very much, Senator.

Senator Crapo.

STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. Thank you very much, Senator. I will try to be brief as well. I associate my comments with those of some of my colleagues here today who have talked about not only the concerns that we look at to make sure that the industry is operating properly and that there are not inappropriate marketing practices, but also the value that credit cards and the credit system in the United States has brought to the American consumer and to the American economy.

I note that between the years of 1980 and 2005, the amount that consumers utilized in terms of credit cards grew from $69 billion to more than $1.8 trillion. And there is a tremendous benefit to citizens in the United States and our economy to having such a robust and dynamic system of credit. But we must make sure that that system of credit does not create abuses or allow for circumstances of abuse. And I think that is the focus of this hearing.

You know, I was just listening to Senator Brown talk about the college situation. I have got kids in college right now, and I made sure every one of them had a credit card, but that they knew how to use it. My kids use their credit cards the way I think most consumers use their credit cards, and that is, they pay them off every month. But they are able to use that credit card to significantly increase the flexibility of their legitimate consumption needs and to participate in a vibrant, dynamic economy.

So I make that point just to indicate that there is really a balance that we have got to reach here because the utilization of credit in this Nation can be a tremendously strengthening force for our economy and an empowerment to our citizens, while at the same time if wrongly utilized can be something that drags them down into a mire of debt.

We need to make sure that we in this Nation have a credit system that works to the advantage of our individual citizens and to the advantage of our economy, or we will again see a circumstance in our Nation where we as a Nation are losing in some of the international competitive strengths that we used to have in our economy.

So it is that balance that I am going to be looking for, and I appreciate the witnesses' coming here today to share with us their understanding of these different types of issues.

Chairman DODD. Thank you very much, Senator. That was very well said, and I think you will hear all of us make similar statements. This is a very important industry and critically important

to consumers, and striking that balance is truly what we want to do in these hearings and try to solicit some good information and some changes that will assist in achieving that balance that we want.

Senator Tester.

STATEMENT OF SENATOR JON TESTER

Senator TESTER. Thank you, Chairman Dodd, Senator Shelby. Thank you for having this hearing on this topic that affects millions and millions of Americans' pocketbooks every day—the billing, marketing, and disclosure practices of the credit card industry. And thank you, panelists, for coming today.

The average American is trying to make ends meet, we all know that—providing for their kids, paying for their mortgage, buying their prescription drugs, saving for a rainy day, hopefully. They have little time at the end of the day to decipher the many inserts to their credit card statement and the fine print in the credit card solicitations.

You know, when my wife and I took over the farm, one of the ground rules my folks laid out is you are not going to have any credit cards, something that, quite frankly, we despised at that point in time. That was in the late 1970's. It was a different time than now, but still and all, it would have been handy to have them.

But as my kids were growing up—and my daughter is 26 and married and has two kids, and my son is 21 and in college—I found out exactly firsthand why my parents laid those stipulations down. Quite frankly, I believe in personal responsibility, but there has to be education, there has to be balance, and there has to be fairness. And when we put young people's futures in a position where they are going to have a difficult time saving for that rainy day or when their kids go to college, we are making a huge mistake.

I can give you the examples where they went around with credit card companies to the point where I took them out of my pocket and cut them up myself. Now, in this day and age, you have got to have some. When you fill up with gas, sometimes it is tough. They do not take cash, so you have to do it. They certainly do not take your check. But the fact of the matter is if we do not educate our young people and give them the opportunity to know what they are stepping into when they get these cards, really as free money—I mean, it has been 30 years ago since I graduated from college. But if somebody would have sent me a plastic card and said, "Here, you have got 5,000 bucks, go ahead and spend it," I would have probably done it because I did not have the personal discipline at that point in time to know what it was getting me into. And my folks pounded financial security into our heads.

So I think it is critically important. This is such a critically important issue, and it really troubles me that we are putting our young people and our young families behind the eight ball before they even get going in life financially. And I cannot tell you how much this issue hits to the heart of giving young folks a chance, whether they are in college or whether they are out of college raising their families.

So I am very interested in this hearing and in the testimony today from the credit card industry and consumer groups and dis-

tinguished scholars. And I know that there are very few issues that are black and white, but the fact is I am eager to learn what we can do to make the playing field fair and let folks know what they are getting into and the ramifications of that before they make the wrong step financially and it really does put them in a difficult financial situation for decades, if not their entire life.

Thank you very much, Mr. Chairman.

Chairman DODD. Thank you very much, Senator.

Senator Sununu.

STATEMENT OF SENATOR JOHN E. SUNUNU

Senator SUNUNU. Thank you, Mr. Chairman.

I have been on this Committee now for 4 years, and in the 4 years that I have been here, we have had a number of very good hearings, and most of them really bipartisan, dealing with the various aspects of the financial service industry. And we have seen people testify—even when they come from different sides of an issue, they testify about the growth and opportunity in the industry, competition in the industry, mutual funds, retirement services, annuities, insurance products. And with a lot of the reform legislation that was passed in the late 1990's and in the 2000 timeframe, we have seen great growth and competition in those industries. And consumers have been well served in those areas by healthy and strong competition.

I think as we begin this series of hearings and look at the credit card industry, we want to continue to push for honest practices and honest disclosure. And I think if we have those things, consumer interests are going to be particularly well served. Where we see fraudulent practices, we also need to make sure that we have strong, severe penalties for those practices. And I think that is one of the things I am interested to hear about today from those that have been victims of fraudulent practices, that have seen the impact of fraudulent practices. How did they manifest themselves? And what are the appropriate penalties?

On the other side of the coin, I think we always have to be worried about establishing the proper remedies, because even well-intended remedies for a problem we see in the industry can have unintended consequences. And we have seen that not just in financial services, but in so many areas of our legislation where we attempt to solve a problem that bothers us and the country and consumers a great deal, but it has unintended consequences. Price controls and other caps of that nature we have seen in the past, restricting innovation, even restricting access to consumers that are intended to benefit from the products.

So I think that is the one thing we need to be aware of. Set the right penalties for fraudulent activity. Make sure we have honest practices and full, honest disclosure. We all, I think, have credit cards or experience with credit cards, and the one thing I find most baffling about credit cards are the disclosure statements. They tend to be very long. They can be written in legalese—although, ironically, some of those requirements are put on them by us, by Congress, or by the States or by other regulatory bodies. So, you know, that probably bears some investigation at this hearing and at subsequent hearings, how to make sure that when we are disclosing

information to consumers—not just that it is in the envelope, but that it is actually in a form that means something and that connects with the public.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much.

I would just note—and you may hear this from some of our witnesses—that in 1980 the average contract for a credit card was one-page long. Today it is 30 pages, 25 years later. So the average consumer is sitting here trying to determine what is going on.

Senator BENNETT. We have met the enemy, and he is us.

[Laughter.]

Senator SHELBY. Mr. Chairman, I wonder how many people read a 30–page document.

Chairman DODD. That is the intention.

Senator SHELBY. Nobody.

Chairman DODD. Senator Menendez.

STATEMENT OF SENATOR ROBERT MENENDEZ

Senator MENENDEZ. Thank you, Mr. Chairman. Let me congratulate you. This is the first formal time I have been at the Committee with you as the Chair. In your chairmanship of the Committee, we look forward to working with you and Ranking Member Shelby in the same bipartisan way that Senator Shelby led the Committee with Senator Sarbanes. And I appreciated it when he did that, and I am sure you will do the same.

I want to thank both of you for holding this hearing today on the credit card industry practices and their impacts on our constituents. I think credit is very important. I think the industry provides a great service and lots of opportunity for people to establish credit, to have the values that can flow from it. It is obviously in this economy a very important economic and financial factor. But there are also challenges, and I hope that the industry—above all from this hearing, I hope the industry will work with us to meet some of those challenges.

There is another industry, which I will fail to mention but it has a great presence in New Jersey, that years ago I raised with them before a certain issue before the Congress became an issue, that if they, in fact, sought an industry response to some of the rising challenges within their industry and the consumer base, that they would be much better with an industry response than with a legislative response. And having convened all of them together, they all agreed, and then they went and they, for one reason or another, failed to have an industry response. And the consequences that flowed from that, quite a bit, both in the hundreds of millions of dollars they spent on the issue and having a black eye to what was a revered industry for producing good products that improved the quality of life.

So I hope if nothing else for today that it is in that spirit that the industry will look at this hearing because there are challenges. Families across this country face a growing problem of rising credit card debt. In 2004, the average American household had about $9,300 in credit card debt, up from $3,200 just 12 years earlier. More and more Americans are using credit card debt to manage daily living expenses as basic living costs, medical bills, house or

automotive repairs. And for college students—and this is one of the areas that I have the greatest concern, having had two college students—well, still one—the incredible, aggressive solicitation of a universe that in many respects does not have the income to ultimately provide the payment for the credit cards that they somehow not only are solicited but then take, and the consequences from that are very significant. I have talked to families who absorbed the debt because they did not want their kids to have bad credit early on in their life. And I have talked to families who could not absorb the debt, and at the end of the day had their kids start off with bad credit.

Now, I have a stack in my home this high—I should have brought it today—of the solicitations my kids received, and the reality is that they were not gainfully employed to be able to pay the solicitations. But, in fact, they would have easily, I think, received a credit card.

As a matter of fact, 2 years ago, Augustino Joseph Chairvolotti, one of my constituents in New Jersey, received his very first solicitation for a pre-approved credit card at the age of 2. He is my State Director's son. Evidently, if you have a pulse and a Social Security number, you can get a credit card offer, at least.

So the real question is: How do we go about making sure that issues like that are dealt with in a way that provides an opportunity for credit for those who can handle it and those who should have it, but at the same time deals with the reality that too many of our young people are already finding themselves with a history of default that will have a real consequence, especially after the last bankruptcy law? And at the same time, how do we watch the targeting of people who are likely to default, people who are like these college students, older Americans, minorities, people who, in fact, do not have the wherewithal to provide the payments for the credit lines they are given?

And so we have introduced some legislation, Mr. Chairman, and I will just include it for the record. But my hope is that we can actually find a way in which we can work with the industry to deal with some of these challenges so that we can balance the interests of the industry and the interests of consumers in having access to credit—questions of universal default, questions of the incredibly aggressive nature of going after college students, those who have not the wherewithal to pay, questions of offering a credit card to someone under one set of terms and then sending them a totally different credit card under another set of terms. These are things I think the industry would well be suited to work with us and others to move in a direction that would, in essence, make sure that the great positive aspect of the industry is preserved, and at the same time balance with the interests of consumers so that we can continue to move forward directly.

It is in that spirit that I come to this issue, Mr. Chairman, and I look forward to working with you and others to try to achieve some success.

Chairman DODD. Thank you very much, Senator. I mentioned before you came in your strong interest in the subject matter. I have enjoyed working with you on it for many years.

Senator Casey, welcome to the Committee once again. Thank you for being here. Just a quick opening statement you may have before we——

STATEMENT OF SENATOR ROBERT P. CASEY

Senator CASEY. Mr. Chairman, thank you very much. I will be extraordinarily brief. I may be the last today, so we want to get to the testimony. But I want to make two points.

One, to you, Mr. Chairman, and Senator Shelby and the Members of the Committee, I think the fact that we are sitting here today about to engage in a very important hearing that involves not only families across America, and certainly many of those in my home State of Pennsylvania, but the fact that we are here talking about this issue is in many ways testament to your leadership, Mr. Chairman, to focus on issues that have real consequences to the real lives of real people. And I appreciate that because this Committee, the reach of this Committee is so broad and so important that when we have hearings like this that get us into the real world, so to speak, we are in your debt for that, and I appreciate that.

As many people here know, we are engaging in the Senate right now in a debate about the minimum wage, which, in my judgment, is much more simple than some people in Washington want to make it. The subject matter of this hearing today is more complicated and more difficult in my judgment. I come from a State where we have a very strong financial services sector of our economy, a very strong and significant part of our economy. I also come from a State where families have been devastated by the costs in their lives.

I was on the floor the other day talking about the minimum wage and talking about it in the context of costs that have gone up in the lives of families across America the last decade. That is extraordinary when you look at the costs of education and food and home heating oil and health care. Health care costs are up almost 100 percent in the last 10 years. And the worst thing that could happen to a family, as everyone here knows, in addition to confronting all of those cases, is to have their head—and I am being figurative here, but to have their head in another vice grip out of which they cannot extricate themselves because of the costs that they have to bear with regard to credit cards in addition to all those other costs.

So I want to be cognizant of that real-world concern that families have, and I think this hearing and the hearings like it will bring some light and will hopefully illuminate the problem so that families across America can listen, as we must do as Senators, listen and learn even as we might have some conflicts about how to get to the solution.

But, Mr. Chairman, I appreciate this opportunity, and I really appreciate this hearing being so early in this new Congress and your chairmanship.

Chairman DODD. Well, thank you very much, Senator, and we will turn to our witnesses. And I hope the witnesses—let's take a little time to do this this morning, to hear from—I do not know how many Senators we have heard from, but almost the full Com-

mittee here. I think there is a value in it. This is an important subject matter, and we have new Members of the Committee, new Members of the U.S. Senate, and while we want to hear from you, obviously, because you bring a lot of expertise to this, I think the conversation is important.

As I said at the outset, this is one in a series of hearings we will have on this subject matter, and, again, I want to underscore the point that Senator Menendez has made, and Senator Sununu and others have made here this morning, and that is, I do not think any of us are interested in necessarily writing legislation unnecessarily here at all. We would rather get something done without having to go through all of that process if we can. So it is an invitation as well for ideas and concepts that may actually -we could undertake almost immediately. In fact, some of our witnesses here have already made some decisions on their own fairly recently on what we will be talking about this morning that I commend them for in dealing with some of these issues. And that is the way in a sense we can respond to some of these questions. So I thank you. I thank all of my colleagues for being here. This is an indication of the importance of this issue. Having served on this Committee for 25 years, in many cases it is the Chairman and the Ranking Member that are at hearings. We may have a good size panel, but sometimes the interest in the subject matter may not be as great. The fact that so many have turned out here this morning indicates, I think, to all of you here as witnesses how important this subject matter is.

With that, let me also point out we are going to have a vote starting at some point here fairly quickly. What I am going to do is we will rotate out here. I am going to maybe ask my colleagues here if they will assume the chair here for a few minutes while I run over and vote so we can keep the process moving and not break the flow of the testimony.

Elizabeth, thank you. Elizabeth Warren is—truth in advertising here—a friend and someone I admire immensely, and I thank you for coming back to the Committee. She is the Leo Gottlieb Professor of Law at Harvard Law School, author of the book "The Two Income Trap: Why Middle Class Mothers and Fathers Are Going Broke." The National Law Journal named her one of the 50 most influential women lawyers in America, and Harvard students, maybe more importantly, have voted her the Sacks-Freund Award for Teaching Excellence. So we welcome you back to the Committee again, Elizabeth. Thank you once again for your involvement.

John Finneran is the President of Corporate Reputation and Governance of Capital One Financial in McLean, Virginia. We welcome you to the Committee. And let me point out that Mr. Finneran—where are you? There you are. We thank you immensely. Capital One offered to be here. We noticed a hearing, and they let us know right away they wanted to be here to participate, and we welcome your participation, and thank you for your willingness to step up here and be a part of this today.

Mr. FINNERAN. Thank you, Mr. Chairman.

Chairman DODD. Robert Manning is Research Professor and Director of the Center for Consumer Financial Services at Rochester Institute of Technology, and the author of the widely acclaimed

book, "Credit Card Nation." Dr. Manning's research is regularly cited and quoted in major publications, and he has testified frequently on Capitol Hill, including at this Committee, and we welcome you back as well, Doctor. There you are.

Carter Franke is the Executive Vice President of Marketing for JP Morgan Chase & Company, whose credit card operation is based in Wilmington, Delaware. He testified previously before the Committee in 2005 on this issue, and we welcome you back to the Committee. Thank you very much.

Michael Donovan is the founding member of the firm Donovan & Searles, has litigated in a number of very key, significant consumer justice cases, including cases in front of the United States Supreme Court, the New Jersey Supreme Court, the U.S. Court of Appeals for the Third Circuit, and we welcome you to the Committee as well.

Richard Vague is the Chief Executive Officer of Barclaycard US, also based in Wilmington, Delaware. We welcome you to the Committee this morning.

Tamara Draut is the Director of Economic Opportunity Programs at Demos, a public policy center based in New York, and the author of "Strapped: Why America's 20- and 30–Somethings Can't Get Ahead." Her research is often cited in major U.S. publications, and she frequently comments on television news programs and magazines. And we welcome you to the Committee. There you are. Thank you. Thank you for being with us.

Travis Plunkett is the Legislative Director of Consumer Federation of America in Washington. The Consumer Federation is a nonprofit association of 300 organizations and a regular witness, I might point out, at the Committee hearings. Once again, we welcome your participation.

We will have you testify in the order that I have introduced you, if that is OK, and then also all of your testimony, any documentation you think would be valuable for this Committee to have, I will tell you will be included in the record. And to the extent you can try and keep your remarks down to—let's try and make it 5 or 6 minutes here. I am not going to hold you rigidly to that number, but so you keep that in mind to get it out as fast as you can here so we can get to the Q&A period.

Thank you, Elizabeth.

STATEMENT OF ELIZABETH WARREN, LEO GOTTLIEB PROFESSOR OF LAW, HARVARD LAW SCHOOL

Ms. WARREN. Thank you, Senator Dodd, thank you, Senator Shelby, for having me here today. Thank you, Members of the Committee.

I am someone who believes deeply in free markets, but I am here today to talk about a market that is not working—at least not working for millions of Americans who find themselves on the wrong end of a credit card deal. Quite simply, the credit card market is broken.

The basics of a credit card are pretty simple: Pay by plastic. Get a bill. Pay the bill. So why, as Senator Dodd notes, has the average credit card agreement gone from about a page long in 1980 to more than 30 pages long today?

The answer is that these new pages reflect a business model that has changed from its earlier simple roots. Card companies still make money like they always did, with merchant fees and annual fees, a tidy $11 billion last year. Not bad. But they make their big-time profits from interest and penalties—an astonishing $79 billion from people who are paying minimum payments over time.

Today's successful credit card company puts its product in the hands of as many shoppers as possible, pulling in decent profits on each one, but always hoping for the sweet spot: the customer who stumbles but does not quite collapse. That is the customer who misses a deadline or misses a payment or goes over limit and ends up paying 29 percent interest, $39 late fees, $49 over-limit fees, and anything else the credit card company wants to pile on.

Credit card contracts have grown to 30–plus pages to make room for tricks and traps that will ensnare anyone who gets into even a modest financial problem. After years of on-time payments, a single stumble can create a cascade of credit defaults and trap a customer for years, even a lifetime, as Senator Casey noted, in a cycle of payments that will never pay off these debts.

Some people do not worry about credit card tricks and traps. About half of all American families pay off their credit cards in full every month, and they rarely notice things like the mysterious fees for charges when it takes 9 days for a credit card payment to make it across country. Others enter the credit card market as a gladiator once entered battle, looking for leverage and the zero interest and grace period floats, and taking pride in their ability to carry a credit balance while dancing around the ever present traps.

But for 51 million American families who are juggling mortgages and car payments and health insurance bills and grocery bills, the credit card companies are imposing a huge tax. And for the 23 million of those Americans who are making only the minimum monthly payments, and sometimes not that, the tricks and traps keep them on the financial ropes, collectively shelling out billions to the credit card companies and never quite getting back on their feet.

This, Senators, is where the market breaks down. In a perfectly competitive market, both firms and consumers would be given the information they need to make sound economic decisions. Given the complexity of today's credit card terms, 30 pages of incomprehensible text is not the same as understanding the terms of your credit card, especially now that the credit card companies routinely reserve the right to change the terms of your credit card on 15 days' notice with another incomprehensible insert into your bill.

Sorting out safe cards and dangerous cards is almost impossible. As one industry expert just explained last month, bank products are "too complex for the average consumer to understand." Senators, I think it is clear. Card agreements are not designed to be understood.

Be clear. This is not about risk-based pricing. A risk-based pricing model is about the lender's assessment of the likelihood of repayment at the inception of the loan with subsequent calibration as more information comes due. Anyone who has a small child, as Senator Menendez noted, or a dog or a deceased relative knows that the initial pre-approved credit card solicitation is not risk based. Instead, the model is based on putting as many credit cards

into the hands of as many human beings—and dogs if they will take them—and then when any of them stumble, trip, make the slightest misstep, load them up with tricks and traps and maximize profits at that point.

Charges for late fees or over-limit fees reflect the price the credit card company thinks that it can charge and not have the customer cancel the card. That is what it is calibrated to, not to risk assessment. These tricks and traps are profit taking, pure and simple, nothing more.

One of the few bits of protection for consumers was eroded with the change in the bankruptcy laws in 2005. Prior to that time, any customer who was facing outrageous interest charges or penalty fees at least could credibly threaten to file bankruptcy and try to initiate a negotiation. This threat had the effect of curtailing at least some of the most aggressive practices.

With the change in bankruptcy laws, however, many consumers no longer see bankruptcy as an option. Whether they are right or wrong does not matter. What matters is that even though they remain eligible for bankruptcy, some now listen to debt collectors who bully them and tell them that bankruptcy has become illegal. Others are discouraged by the increases in fees that make it more expensive for the poorest Americans to file for bankruptcy. As a result, lenders can sweat them for payments longer, keeping them trapped in a monthly cycle that these customers can never pay off. After the new bankruptcy law went into effect, a market that was already broken got a lot worse for families in trouble.

Safer cards can turn a handsome profit, but because they give up the mega-dollar sweet spot created by the tricks and the traps, they will not produce the bloated profits of dangerous cards. If more people turned away from such cards, the market would quickly sort itself out. But if the consumer cannot tell a safe card from a dangerous one, then the marketplace will not reward safe cards.

Consumers bear terrible risks today when they use their credit cards. Some will do OK, but some will get trapped. It does not have to be that way. No one has to be an engineer to buy a toaster in America. No one has to be a crash test expert to buy a car. These are markets that have soared with innovation over past decades, but they have also been supported by national safety standards that kept burst-into-flames toasters and crumple-on-impact cars out of the marketplace.

Government and industry joined forces to develop meaningful guidelines in other industries. Cheap shortcuts that would boost profits but leave consumers at risk have been banned from those markets, with the result that competition has intensified for the things consumers can readily see, like price and convenience and color. And consumers, most importantly, have safer products at lower prices.

It is time for safety regulation in credit cards as well. There are 51 million American families who need your help, Senators, and they do not have much longer to wait.

Thank you.

Chairman DODD. Thank you very much, Elizabeth. Thank you for your testimony.

A vote has started, I say to my colleagues here. What I am going to do is introduce our next witness. I want to skip out the door, and I will come right back. And, Senator Carper, if you would like to take the gavel for 10 minutes, I will try and get back so that you can make the vote and others who may want to slip out and come right back. I will leave that up to you.

Bob Manning, Bob, where is he? There you are. Thank you very much, Doctor, for being here. I will let you start your testimony, and I will come right back. You just continue with your testimony so we can move along.

STATEMENT OF ROBERT D. MANNING, PH.D., RESEARCH PROFESSOR OF CONSUMER FINANCE, AND DIRECTOR, CENTER FOR CONSUMER FINANCIAL SERVICES, E. PHILIP SAUNDERS COLLEGE OF BUSINESS, ROCHESTER INSTITUTE OF TECHNOLOGY

Mr. MANNING. Well, thank you, Chairman Dodd and Ranking Member Shelby. It is certainly a pleasure to be invited back, and I am particularly pleased to hear that there is a growing awareness of many larger consequences than rather simply the length of the contract that is to be discussed here today.

I saw my role today as to look at what has happened in terms of some pretty profound changes, not only in terms of the role of consumer credit cards in Americans' lives, but also how the change in this industry has profoundly exposed and increased the vulnerability not only to our Nation, comprised of millions of distressed American consumers, but also in terms of larger global issues. I want to conclude with that point about America's dependence on cheap credit.

I think one of the first issues to emphasize is that there is a real misunderstanding about how much consumer credit card debt there is and also the pricing structure of the system, what I have referred to as the "moral divide." We do not have an installment lending program where some people pay zero interest, usually the most affluent, and those who are most financially distressed essentially pay the financial freight for those who have financial means.

Similarly, we constantly see an effort to reduce the aggregate amount of consumer credit card debt. I have heard the term $9,300 is the average household debt, but of the three out of five households that actually carry a debt, it is over $13,000. And I presented a brief simulation if we did not have such extensive refinancing in the housing market, I estimated that it would clearly be at least $18,000 today. And it is. It has simply been reclassified because of the opportunity to consolidate these debts into home mortgages.

The other issue that I think is really important to understand is that the market has become more segmented in recent years. I would identify at least four distinct segments: the high-net-worth card that most of us are familiar with, the Amex black card; the more traditional card, certainly facing stress in terms of saturating its market, its traditional market, going aggressively after more marginal consumers, such as college students. My recent work shows more aggressive marketing to high school students, those of modest financial means where family members know that their children can get credit cards and put pressure on them to borrow

while they are in college; and also increasing marketing to the handicapped, which I find truly extraordinary that there is no debate about the business ethics behind that particular marketing campaign.

We have seen a third tier that has emerged of the private issue cards which shows the financial distress of Americans that are willing to pay a 5- to 7–percent interest rate premium on their Home Depot or furniture card just to free up some free lines of credit on their Visa or MasterCard in case they have that unexpected emergency.

The fourth tier is the sub-prime market, and I have been involved in several class action lawsuits, and it is extraordinary to see that the business model for these firms has revenues based on about 70 percent—70 to 75 percent based on fees. And it is disconcerting that these are not the small morally challenged businesses like Cross Country Bank. We are now seeing some major companies, such as HSBC with their Orchard Bank, or even Capital One.

Liz pointed out, of course, the problem now that many Americans are finding, that bankruptcy is not an option. And as we had this debate over the last 7 years before its enactment, look at the statistics of profitability. In 2004 to 2005, before the law was implemented, the industry had record profitability. Pre-tax profits jumped 30 percent, and even though the argument was that consumers were discharging debt they should not, credit card discharge rates actually declined in 2005.

Clearly, deregulation and access to credit has elevated people's standard of living, but one point we have neglected is to see how the fluidity between these categories and the manipulation of pricing of housing just because of interest rates, where we saw the financial laws of gravity defied, where real family income declined in the 2000's, and yet the average metro housing price doubled.

Many Americans were seduced into refinancing into adjustable-rate and interest-only loans, and we are going to see how vulnerable they are when they are exposed to these resets.

I think what was striking in terms of preparing my research for this testimony was that looking at the wealth formation versus debt formation of the average American, we are an optimistic society and culture, and most Americans are willing to go in debt based on their perception of the future. But if we look at what happened to wealth formation with the correction of the stock market after 2000 and now the correction of the housing market, it looks like for the bottom 60 percent of Americans, nearly all of their net wealth formation will be erased with this housing adjustment.

Finally, I want to emphasize the fact that we are seeing the emergence of what I have called the "near bankrupt Americans," people who do have jobs who are finding themselves in a situation where maybe they are eligible for bankruptcy filing, but they find themselves caught between a system that says they repay all of their debt or none of their debt. And yet in our pilot program in Texas, we find that there are Americans that are willing to go into a lawyer-supervised partial payment repayment program of anywhere from three-quarters of a percent to one and three-quarters of a percent, desperately trying to do the best they can to pay their

bills. And yet even with the support of Governor Huntsman in Utah and the Utah State Legislature, we are not finding that major credit card collection executives are willing to discontinue their adversarial debt collection strategies, even when it is in their financial interest to seek a partial payment recovery.

The final point is that with my research on the global deregulation of financial services, we are seeing a very strong association that those countries that have deregulated their markets are seeing a sharp decline in their savings rates. And this is going to have very severe issues in terms of our ability and our dependence on cheap credit, that clearly we are going to be more vulnerable to global financial markets, that we certainly cannot expect other countries to reduce their standard of living simply to support our own, and that with the housing correction we see already what the average American's dependence on cheap credit really means.

Thank you.

Senator CARPER [presiding]. Dr. Manning, thank you very much for your testimony.

We began 13 minutes ago a 15–minute vote, which gives me 2 minutes to get to the Senate floor to vote. I am pretty fast, but I do not know that I am that good. In my youth, I probably could have made it. They have sort of like a 5–minute extended period that we have to use. So if I get there in the next roughly 6 minutes, my vote will count.

What I am going to do, rather than call on Mr. Finneran to begin his testimony and have to stop in a minute or so into the testimony, I am just going to suggest that we recess briefly, and my colleagues will begin pouring back in here, and I think our next witness will be Mr. Finneran, and he will be followed by Mr. Donovan.

So if you will just sit back, relax, have a long cold drink of water, we will be right back. Thanks very much.

[Recess.]

Chairman DODD. Can I bring you back to the witness table? I just saw one of our witnesses scurrying down the hall, but I presume she will be coming back. I hope I did not say anything here to cause a witness to go scurrying down the hall.

I apologize to you, but many of you have been here before, and you know this can happen with votes on the floor of the U.S. Senate that we will be interrupted. We try and do this in a way that does not break up the flow, but it gets harder each time. And I gather now we have, of course, heard from Elizabeth Warren, we have heard from Dr. Manning. I am going to turn to John Finneran at this point. John, thank you very much. Again, thank you for being here. We are very grateful to you, as I said earlier. When we first announced these hearings, Capital One—I do not know whether you contacted us or we contacted you, but you agreed immediately that you wanted to be here to be a part of this hearing this morning, and we appreciate that very, very much. Very important. The floor is yours.

STATEMENT OF JOHN G. FINNERAN, JR., GENERAL COUNSEL, CAPITAL ONE FINANCIAL CORPORATION

Mr. FINNERAN. Great. Thank you very much, Chairman Dodd and Members of the Committee. Good morning, and we do really

appreciate the opportunity to be here to address the Committee. I would just echo for a few minutes the comments of many of the members. We do believe that it is an important dialog and one that certainly we as a member of the industry, do not want to shy away from. Indeed, we welcome the opportunity to have these kinds of conversations.

Today, the credit card is among the most popular forms of payment in America. It is valued by consumers and merchants alike for its convenience, efficiency, and security. As the GAO noted in their recent report on this topic, the past decade has seen substantial change in the availability and pricing of credit cards. A little over a quarter of a century ago, less than a third of American consumers were able to obtain credit cards. Today, 75 percent have them. As recently as the early 1990's, everyone paid the same high interest rate and annual membership fee regardless of their risk profile. Today, as the GAO found, interest rates have come down significantly for the majority of consumers and most pay no annual fees. At the same time, pricing for risk has become more targeted. Those consumers who exhibit riskier behavior typically pay higher rates than those who do not, or may be charged fees for paying late or going over their credit limit. Consumers who choose to pay in full each month, as more than half of all credit cardholders do, pay no interest.

Importantly, the GAO also found that during this period of time industry profits remained stable, suggesting that changes in credit card pricing have indeed reflected changes in how the industry prices for risk.

The benefits of more discrete, targeted, and accurate pricing of credit cards have come, however, at a cost, and that is, increased complexity. I think that is a topic that has been noted by many in this debate. For this reason, Capital One has submitted to the Federal Reserve a proposal that would significantly revise the disclosures required in the Schumer Box to make it easier for consumers to both better understand the terms of any particular offer and to compare one product to another. A copy of Capital One's unique proposal was included as an attachment to my written testimony.

While we await these changes from the Federal Reserve, however, Capital One has already implemented a comprehensive new set of disclosures, written in plain English, which go substantially beyond the legal requirements of the Schumer Box. These include a food-label style disclosure and a customer Q&A that present our policies in simple terms. These disclosures are included in all of our marketing materials.

The increased complexity of credit cards has also brought rising criticism of the industry in recent years. Capital One continuously reviews and makes changes to its practices in light of changing consumer preferences. One area of change is in repricing where Capital One has simplified and strictly limited the circumstances in which we may increase a customer's interest rate if they default on the terms of their credit card agreement.

I want to be very clear. We do not engage in any form of universal default. That has been our longstanding policy. We will not reprice a customer if they pay late on another account with us or with any other lender or because their credit score goes down for

any reason. In addition, Capital One will not reprice customers if they go over their limit or bounce a check. There is only one circumstance in which a customer might be subject to default repricing—that is, if they pay us late, more than 3 days late, twice in any 12–month period. We clearly disclose all of these policies in our marketing materials and provide customers with a prominent warning on their statement after their first late payment.

Even then, the decision to reprice someone is not automatic. For many customers, Capital One chooses not to do so. If we do reprice someone for paying late twice, we will let them earn back their prior rate by paying on time for 12 consecutive months. That process is automatic.

While introductory or teaser rates can provide substantial benefits to cardholders, they have also come under criticism if they are subject to repricing during the introductory period. Capital One has adopted strict policies regarding their marketing and treatment. Capital One does not reprice introductory rates for any reason, even for repeated late payments. The specific period for which these rates are in effect is fully disclosed multiple times in our marketing materials. We also disclose the long-term rate that will take effect if and when the introductory rate expires.

Similarly, another practice that may cause customer confusion is double-cycle billing. Capital One has never used double-cycle billing.

Senator, I want to address something that Senator Shelby, although he is not here at the moment, mentioned in his opening statement. He mentioned a recent article in Business Week Magazine about Capital One. I must admit it, it was not a very flattering article, and I can also admit that if one were to read it, one could draw, an understandable conclusion about our business practices. Let me just say a couple things.

We take very seriously any situation where a customer may be experiencing difficulties and constantly evaluate our practices to make sure that we do not extend more credit than our customers can manage responsibly. This article does not describe our business model. It does not describe our policies or our intent.

Many customers choose to have multiple credit cards for a variety of reasons, as Senator Carper noted himself in his opening statement. Some like to have both a Visa and MasterCard. Some like to have multiple cards in order to segregate expenses or for security or for different features like rewards. Like our competitors, we hope they will choose us to fill those needs. Eighty-five percent of our customers have only one card with us, although they may very well have cards with our competitors. Less than 4 percent of our customers have more than two cards with Capital One. We only offer an additional card to a customer if that customer is in good standing with respect to his existing card with Capital One. And for any customer who has more than one card at Capital One, they have the option, if they choose, to consolidate their accounts into one card.

In conclusion, as our industry has changed, so have we. Capital One is continuously adapting its practices and policies to keep up with consumer demand, the rigors of competition, and the standards of sound banking. We are fortunate to have over 30 million

credit card customers, the vast majority of whom have a good experience with our product. When they don't, we regard that as our failure, and we seek to find out why.

Thank you, and I look forward to answering any questions you may have.

Chairman DODD. Thank you very much, Mr. Finneran.

Ms. Franke, thank you for being here. This is the order I think I introduced you, and I apologize. It is not exactly the order you are lined up here, but I promised I would introduce you in that order.

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

Ms. FRANKE. Mr. Chairman, Members of the Committee, good morning. My name is Carter Franke, and I am the Chief Marketing Officer at Chase Card Services in Wilmington, Delaware. I am proud to represent today more than 16,000 Chase employees around the country who serve the needs of over 100 million Chase credit card customers.

I am also proud to be part of an industry that has become central to American life and is one of our economy's principal engines of growth, including growth of business over the Internet. Without credit cards, there would virtually be no business over the Internet. The relationship between American consumers and businesses, both large and small, which has grown through the use of credit cards is one of the great economic success stories over the last several decades.

Before answering any questions you may have this morning, I would like to make three important points about the credit card business at Chase.

First, we believe our success, like that of all businesses, is based on our relationship with our customers. The great majority of Chase customers fall into the "super-prime" and "prime" categories. This means that they, regardless of their level of income, are the most responsible and knowledgeable credit users in the country. We want them to have the best possible experience with Chase and have devoted service people and technology to help them understand and manage their accounts. Many of our customers take advantage of our array of services like Chase online access and manage their accounts online with us.

We also have a really great new product called "Free Alerts," which will send customers an e-mail, a voice-mail, or a text message to let them know it is time for them to make a payment or that they are getting near to their credit limit.

Second, we believe that financial literacy is critical for all Americans, particularly for credit card users. This goes hand in hand with financial responsibility, which is a necessity for all credit card users. Chase has made well over $100 million in the past 2 years in grants and donations to fund financial literacy programs and credit counseling services. We want to do our part to support customers' efforts to be responsible.

Third, the importance of customer relationships is a key driver of many of our business decisions. For example, a missed payment on a non-Chase card does not result in any automatic repricing of

a Chase account. In reality, as you have heard many times today, the American consumer enjoys a credit card offering far more attractive than a generation ago. According to the recent GAO report, 15 years ago the average interest rate was roughly 20 percent. Today, says the GAO report, the average interest rate is 12 percent. And, in addition, nearly 75 percent of credit cards have no annual fees. And the annual fees that exist are there to support the rewards that are provided through the credit card such as miles.

Consistent with the conclusion of the GAO report, Chase believes that an important issue facing the credit card industry today is disclosure. Disclosure is one of the keys to a successful credit card relationship, and we are committed to keeping our customers informed of every aspect of their account. We look forward to reviewing the submission of suggested changes that have been made by Cap One and working collaboratively to improve the customers' understanding of their credit card terms and conditions. We would welcome the opportunity as well to work with regulators to make any significant improvements that are required.

Mr. Chairman, we look forward to working with you and the other Members of the Committee today to answer your questions and to address any concerns that you may have. Thank you very much for this opportunity.

Chairman DODD. Thank you very much, Ms. Franke. We appreciate your testimony.

Mr. Donovan, thank you.

STATEMENT OF MICHAEL D. DONOVAN, PARTNER, DONOVAN SEARLES, LLC

Mr. DONOVAN. Good morning, Mr. Chairman, Members of the Committee. I want to thank you for the opportunity to appear before you to explain some of the current abuses and credit card practices that I have seen and experienced among my clients that I represent in Pennsylvania and elsewhere. I am a lawyer, gentlemen, and I represent the real consumers, and I have represented consumers since 1993. I argued the Smiley v. Citibank case before the United States Supreme Court and obtained the decision in the Rossman v. Fleet Bank, which was rendered by the Third Circuit, that held that a credit card issuer cannot change a no-annual-fee card to an annual-fee card, at least within the first years after it issued that card.

I want to agree with Professor Warren when she said that this credit card market now is broken. The banks, Senator Bennett, with respect, no longer compete based upon the annual percentage rate, which was the whole shopping mechanism identified in TILA on which the banks should be competing. Instead, what the banks now do is advertise and solicit based upon low APRs and then employ back-end trip wire pricing, such as high back-end penalties, increased booby trap penalty charges, and universal default rates that increase from the initially solicited rate to often rates as high as 30, 35 percent. All of these booby traps are placed in the cardholder agreements and in small print underneath the Schumer Box so that it is almost impossible for any consumer to decipher them.

Now, I heard Mr. Finneran describe Capital One's practices, and he said that, in fact, they do not reprice for a late payment, they

do not reprice for an over-credit-limit, they do not reprice for an instance in which you default on another card that they have issued to you.

Well, in 2006, their disclosures, if I may read them to the Committee, underneath the Schumer Box in their very solicitations—and these apply to their existing accounts now. Perhaps their No Hassle card is somewhat different, but for all their 30 million accounts now, this is the disclosure that Capital One charges, including to my clients: "All of your APRs may increase to a variable default rate of up to 18.74 percent plus prime, currently"—this was back in 2006—"24.99 percent, if you fail to make a payment to us when due"—just one payment, that is—"exceed your credit line, or your payment is returned for any reason." Now, that is not what Mr. Finneran said their current practice is, but this is what applies to 30 million accounts currently. "In addition, default APRs will be effective starting the billing period immediately after the occurrence of any of the specified events. Factors considered in determining your default rate may include your general credit profile"—I am not quite sure I know what that means—"existence, seriousness, and timing of the defaults under any card agreement you have with us, and other indications of the account usage and performance."

Gentlemen, the credit card is one of the only contracts throughout the common law of the United States and the common law of any country in which the superior bargaining entity has the right to change its terms at any time. In fact, the credit card issuers can unilaterally change the terms on that agreement any time, any reason.

Granted, the banks have an interest in protecting themselves from interest rate risks. They sold and have sold securities that are securitized by these credit card receivables, so they want to protect themselves from interest rate increases and spikes in interest rates. We all understand that. They deserve to make a profit. I think the banks should make a profit because it is a worthwhile product. However, they do not have a monopoly on the difference between—on protecting themselves from interest rate risks.

Frankly, my clients, middle-class consumers, have the exact same interest in protecting themselves from interest rate spikes and interest rate increases. That is why they use the credit cards. They have as much interest in it as anyone else does, just as the banks do.

I do not think this is a question of financial literacy, and it will never be a question of financial literacy. If, in fact, the more powerful entity always retains for itself the right to unilaterally change the terms of a contract, unlike any other contract that we are familiar with, and can impose those terms on the existing balance, then that entity, no matter what financial literacy we raise the country to, will always have an unfair advantage. And that is where we are right now.

Now, if they wanted to protect themselves from interest rate spikes, there are simple solutions. Issue cards with shorter expiration periods. Issue a card that does not expire 5 years from now. Issue a card that expires 1 year from now. And when it expires, you send out a notice and say, "We are going to change this. If you

do not like it, you do not have to accept a new card from us, and you can pay off your balance at the existing terms. If you do want another card from us, well, here are the new terms." That is the way we deal with businesses. That is the way we deal with leases, with cars, with renting anything, with purchasing anything on credit, other than with a credit card.

Let me give you some examples, everyday examples right in my back yard in Pennsylvania. Many of the clients I see every week come in with a letter, a collection letter, claiming that they owe thousands of dollars for delinquent credit card debt. Almost all of those clients come in with the same facts as the court examined in *Discover Bank v. Owens.* In that case, an Ohio court found that Ms. Owens, an elderly woman who depended on Social Security Disability payments, had more than repaid the principal balance on her Discover Card, and yet the bank was suing her to collect $5,000 in penalty interest, late fees, and other so-called credit protection plan charges. Now, this person was on disability. The credit protection plan did not help her at all, yet she was charged that every month to the tune of tens of dollars every month, and that built up a big part of this balance. The court said it was unconscionable, you are not going to collect that amount of money. After all, Ms. Owens had paid you back practically double what she borrowed principally. So the court found that that was unconscionable.

Let me give you an example in North Philadelphia. Ms. C. also subsists on a monthly SSI check, $600. She first got a card from Providian Bank. Providian Bank is a bank that had been characterized as the "poster child of abusive lending practices" by not me, by not anybody else in the consumer group here, but instead by the former general counsel of Citigroup's credit card practices and credit card—North American and European credit card issuing practices.

Well, in any case, my client, Ms. C., started out with this Providian card, borrowed $1,000 on it. That was her credit limit. And guess what else was charged on that card? A credit protection fee of up to $47.40 every month. She never knew what it was for. I do not know what it is for, particularly when it is issued to somebody who is on SSI. It never pays off. It is some sort of insurance that would pay off, arguably, a monthly payment if you lost your job, if you had health problems. But the reality of it is this woman was already on SSI, so she was never going to have the benefit from this charge—$47.40, a lot of money.

So, in any case, she attempted to keep up with this card and three other cards that she has had. As of August 2006, the APR on this card, which is now owned by WAMU, Washington Mutual—they bought Providian's accounts. The APR on that account is 31.49 percent. In August, she had a monthly payment due on that card of $247. On her three other cards, she had a monthly payment of $67 on one and $80 on the two others. Her monthly SSI check is $600. So as of August, $400 was coming due on credit card bills that she was receiving, which she attempted to cover with her $600 SSI check.

The reality of it is—and we did the calculations—that the vast majority of those charges that had accrued on all of those accounts were attributable to penalty interest rates that had increased from

the original 15 percent on the Providian card, the completely worthless credit protection fee, and back-end late fees and over-limit fees because almost all of these cards were up at their limit.

Now, Ms. C. has not really used these cards for 3 years. Every now and then when she gets it underneath the credit limit, she will go and use the card to buy prescriptions or to buy gas. And you can see it. I looked at her account statements. And then she is right back in it.

So the reality of it is that this is a situation in which universal default pricing has basically caused and impoverished somebody, and this is the exact same facts that the court found in Discover Bank v. Owens.

Let me give you another example.

Chairman DODD. Try and get through it. Your time is up.

Mr. DONOVAN. Real quickly, Your Honor—you can tell I am a litigator.

[Laughter.]

Mr. DONOVAN. You knew that was going to happen.

Chairman DODD. We get called a lot of things, but "Your Honor" is not one of them here.

Mr. DONOVAN. I saw you were called—or maybe it was Senator Biden who was called "President" last night.

Senator SHELBY. Well, he might be Mr. President, but not yet.

[Laughter.]

Chairman DODD. Let's move on here.

Mr. DONOVAN. In any case, let me just tell you one other story. I know that members of this Committee, in fact, have received, because I now represent these clients, many complaints from very sophisticated small businesses, small businessmen. They have received complaints from doctors, they have received complaints from lawyers, complaining about the trip wire pricing, the universal defaults, and the basically indecipherable disclosures issued by the credit card banks. You know why I know that? Because I, in fact, now end up representing some of these people who have written to Members of the Committee.

One person, Mr. S. from York, Pennsylvania, started out with two cards—a Chase card and a U.S. Bank card. In March 2005, the U.S. Bank unilaterally increased his interest rate from 9.9 percent to 21.9 percent. Chase increased his interest rate from 11.9 percent to 27.9 percent. Both of these banks explained to my client that the reason they increased his interest rate, even though he had never paid late ever, never gone over the limit, had been a super-prime customer of these banks, was that they had reviewed his FICO score and that his FICO score had declined recently, and, therefore, he was an increased risk so we are unilaterally increasing your interest rate.

On top of that, do you know what Chase did? It said, Oh, by the way, we are going to cap your credit limit. You are not going to be able to charge anymore. This is your credit limit here. They capped it at the exact outstanding balance. Well, I do not think you need to be Stephen Hawking to realize that if you cap it at the outstanding balance, guess what is going to happen? The next day, when you add on the daily finance charge, you, Bank, have unilaterally caused him to go over the limit, on which you impose an

over-limit fee. So that Chase in that instance by its own action caused him to go over the limit by its unilateral practice.

Now, the absurd thing about it——

Chairman DODD. I am going to stop you right there, OK.

Mr. DONOVAN. These are some of the practices——

Chairman DODD. This is not the Supreme Court here. We are going to have to move on.

[Laughter.]

Chairman DODD. Very, very good. We will take the rest of your testimony. We will come back to you in questions.

Mr. DONOVAN. Very good. Thank you.

Chairman DODD. Thank you very much.

Mr. Vague.

STATEMENT OF RICHARD VAGUE, CHIEF EXECUTIVE OFFICER, BARCLAYS BANK DELAWARE

Mr. VAGUE. Thank you, Chairman Dodd, Ranking Member Shelby, and Members of the Committee. I serve as CEO of Barclays Bank Delaware, a credit card issuer with approximately $4 billion in receivables. The majority of our cards are issued in partnership with other organizations who license us to use their brands and solicit their members as customers. We partner with a variety of organizations, such as airlines and retail stores. We are the 13th largest credit card issuer in the United States and one of the fastest growing. Mr. Chairman, I applaud you and this Committee for examining this important issue and for considering ways to improve consumer understanding of credit cards. I also want to thank and acknowledge my own Senator, Senator Carper, from the State where our business for his leadership on these issues, and thank and acknowledge Senator Casey, from the State where I reside.

It is fair to say that, in the realm of consumer finance, the credit card is one of the great developments of this past century. It is widely recognized that credit cards represent the democratization of credit. Today, consumers can use credit cards around the world and on the Internet to make purchases at millions of merchants. Not only do credit cards give consumers this purchasing convenience, but consumers also have the option to use their credit cards as a mechanism to obtain an interest-free loan simply by paying their bill in full each month. Consumers who use credit cards also receive enhanced consumer protections compared to cash and checks, and a detailed periodic accounting of their spending to boot. Given the enormous consumer benefits associated with credit cards, it is no surprise that the Federal Reserve Board staff studies consistently suggest that 90 percent of consumers are satisfied with their credit card issuer.

It is also important to note that the vast majority of credit cardholders use credit cards responsibly. It is in nobody's interest to provide credit cards to consumers who cannot repay the money they have borrowed. For that reason, we and all other issuers strive to provide credit cards only to consumers who can handle the credit offered to them. Banks that lend indiscriminately to consumers obviously will not be in business for long.

Having said all this, Mr. Chairman, credit card products have become more diverse over the years because of the intense competi-

tion and wide choice. Most cards are no longer priced with a 19.8–percent APR and a $20 annual fee while only being made available to consumers at the higher end of the credit spectrum. Credit card issuers have become much more sophisticated with respect to providing a wide variety of consumers with cards that have a wide availability and variety of features. Now consumers can find credit card products with a variety of interest rates, benefits, rewards, and fee schedules. Importantly, the average rate has gone down over the years. This is a result not only of increased sophistication but, as mentioned, also of the intense competition within our industry and from other payment providers. Without a doubt, these innovations are positive developments. With these increased product offerings, however, we agree, Mr. Chairman, comes the need to ensure that consumers understand the features of the various credit card products offered to them.

We believe that credit card disclosures can be greatly improved. We think most other credit card issuers agree. And we need to participate and help to make these things happen. Credit card issuers must comply today with complicated, detailed, and lengthy regulatory requirements, meaning that disclosures tend to be complicated, detailed, and lengthy.

In reference to some of the earlier comments, our card member agreement is five pages long. It used to be one-page long. Our typical card member agreement is five pages long. Everything that is in this agreement we are required to put in there by law. We would love, frankly, to simplify this agreement, including putting in something like the Schumer Box, which we think was a tremendous innovation in our industry.

Every time there is a new litigation, it seems like another legal disclosure needs to be added. We need a new, clear, and simple disclosure structure that allows us to draft our disclosures in plain English—not lawyerspeak—highlighting the terms consumers find important in a manner they find easy to understand.

A recent updating of disclosure regulations appears to be the sole recommendation of the GAO in the context of its broader study of credit card disclosure issues. Focusing consumer disclosures on key terms is not a new concept. It is the basis for the existing Schumer Box disclosures that we mentioned. Card issuers that comply with this new structure should also be protected against a barrage of new lawsuits and the resulting lawyerspeak that would inevitably creep back into the disclosures as a result.

Mr. Chairman, I firmly believe that effective disclosures are the key to ensuring that consumers understand the material terms and features of credit card products. An informed consumer can then decide whether a credit card is right for him or her. After all, there is no shortage of credit card issuers and products from which consumers can choose if the practices of any given issuer, or any of the terms of that given issuer, do not meet that consumer's liking. I would caution Congress against the adoption of legislation that would have the effect of imposing price controls or similar limitations with respect to credit card products. Price controls do not work. They would likely result in an increase in other costs associated with credit cards, reduced benefits, or more probably the reduction of credit availability to those who are on the lower end of

the credit spectrum with a corresponding adverse impact on the U.S. economy. We do not want to return to the days of relatively uniform card offerings available only to a limited number of consumers.

Mr. Chairman, this concludes my testimony, and I would be happy to answer any questions you have.

Chairman DODD. Thank you very, very much.

Ms. Draut.

STATEMENT OF TAMARA DRAUT, DIRECTOR, ECONOMIC OPPORTUNITY PROGRAM, DEMOS

Ms. DRAUT. Thank you, Chairman Dodd and Ranking Member Shelby, for holding this hearing and inviting Demos to participate.

Demos began studying the growth of credit card debt out of an overall interest in the economic well-being of low-and middle-income households, many of which are young people just starting out their lives. Before I address some of the industry practices, I want to give you a sense of the very households that the abusive lending industry practices are impacting the greatest.

In March 2005, Demos conducted a survey of low- and middle-income households who had credit card debt. The goal of the survey was to better understand why these households were going into debt, how long they have been in debt, and what, if any, impacts this debt was having on their economic well-being. What we now know is that the average low- and middle-income household with credit card debt has been in debt, on average, for 3–1/2 years and that they are carrying an average balance of about $8,700. One-third of low- and middle-income households are actually carrying balances greater than $10,000.

Now, while our pop culture and popular perception often demonize credit card debtors as irresponsible spendthrifts, these images are more the stuff of stereotype than reality. To that point, the most often cited reasons for going into credit card debt were to pay for car repairs, home repair, medical bills, or to deal with a job loss.

In addition to asking about specific expenses that led to these households' credit card debt, we asked if the household had ever in the past year used their credit cards to pay for basic living expenses such as the rent, the mortgage, the utilities, or things like groceries.

I am sorry to say that one out of three low- and middle-income households reported using credit cards in this manner and doing so, on average, 4 out of the last 12 months. In fact, those households that had medical expenses reported significantly higher credit card debt than those who did not.

Now, of course, we know that using revolving credit can be very beneficial. It gives households the ability to pay off large, unexpected expenses over time and allows them to prevent more disruption to their family budget. It also helps during job loss so that indeed families can keep the lights on and food in the fridge.

The problem is that this beneficial access to credit, which we all agree on, becomes all too destructive due to widespread, abusive, and capricious industry practices. As households have become more reliant on credit cards to make ends meet as a result of the greater

instability of our economy and rising costs, the practices of this industry further threaten their economic security.

I want to focus the rest of my testimony on three of these practices, all of which make it very difficult for these households to pay down their debt.

I also want to say from the outset that Demos fully understands and supports the idea of risk-based pricing, but these practices are not risk-based pricing, although they often are called such.

The first one I want to talk about has already been mentioned. That is universal default, the practice of raising a cardholder's interest rate either for being late on a payment with another creditor or for some change in their credit history. It is time that we finally prohibit this practice.

The second practice I want to draw your attention to revolves around the definition and treatment of late payments. All the major issuers today consider a payment late if it arrives past 1 or 2 p.m. or whatever the specified hour is, even if, as we say, the check is in the mail. In our survey, about half of the low- and middle-income households had paid a late fee in the last year and indeed reported being late or missing a payment.

What happens with this sort of zero tolerance policy about late payments is that means that a run-of-the-mill tardy payment can result in an average fee that now is anywhere from $32 to $39 and a rate increase that is often double or even triple the original APR. And, again, it is not unheard of for these penalty rates to top 30 percent.

I want to underscore that these rates are being paid by people who are not technically in default on their account. They are simply 1 hour, 1 day late. And yet they are often paying the same default rates as those who are 3 months behind on their payments.

Finally, I want to draw attention to the retroactive application of penalty rate increases. Whether a rate is increased because of a run-of-the-mill tardy payment or due to universal default, that new rate is applied to the cardholder's existing balance. By applying this higher rate to previous purchases or services made with the card, essentially the credit card companies are now raising the cost of every item purchased prior to the rate increase. We believe that card companies should be held accountable to the original terms of their contract and that any rate increases should be applied only going forward from that point.

These severe default rates levied on customers who are paying their bills in good faith, if not always in perfect time, constitute an enormous and undue increase in the cost and length of debt repayment. Demos urges Congress to consider much of the recommendations that have been made today and, again, I would like to recognize that there has been legislation introduced by many Members of this Committee already, such as Senator Dodd and Senator Menendez, that would address many of the practices I cite.

I will conclude there. Thank you, and I look forward to your questions.

Chairman DODD. Thank you very much, Ms. Draut.

Mr. Plunkett, you are our last witness here. We thank you.

STATEMENT OF TRAVIS B. PLUNKETT, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA

Mr. PLUNKETT. Good morning. Thank you very much, Chairman Dodd, Senator Shelby, and all the Senators who have closely followed this issue. Senator Carper, Senator Menendez, in particular, you have shown real leadership on this issue, and we appreciate it.

I am testifying today on behalf of the Consumer Federation of America, the national organization Consumer Action, and Consumers Union, the publisher of Consumer Reports. I applaud you for calling this important hearing on the impact of credit card industry practices on consumers, and I would agree with statements that have been made today about the importance of credit cards to consumers, to the economy, and the importance of consumer education. In fact, CFA over the years has worked with a number of credit card issuers on consumer education projects.

But because of what you have heard today, because of the unjustifiable fees, the highly questionable interest rates, and the abusive lending practices you have heard about, there is no industry in America that is more deserving of the kind of oversight you are providing here. And, I might add, there are very few industries that are the subject of more complaints or are held in lower esteem by the American public.

For example, in 2004, the U.S. Better Business Bureau reported that problems with credit cards were the third most common source of all consumer complaints that they received. A public opinion survey by the polling firm Public Opinion Strategies last year found that only 15 percent of all Americans had a favorable opinion of credit card companies, putting them in the same league with payday lenders and bill collectors—and, by the way, with a far, far lower favorability rating than Congress.

Credit card companies are still aggressively expanding efforts to market and extend credit at a time when Americans have actually become more cautious in taking on credit card debt. This runs contrary to conventional wisdom, but we document it in our testimony. We now have about $873 billion in revolving debt. Our analysis shows that aggressive and even reckless lending by issuers has played a big role in pushing this debt higher.

Since 1999, creditor marketing and credit extension—I am talking about the amount of credit that is offered, not the amount of credit that is accepted—has increased twice as fast as credit card debt taken on by consumers. That is why there is a growing credit gap between creditor supply and consumer demand. In fact, the amount of credit made available, total credit made available, those unused credit lines and used credit lines, now exceeds an astonishing $4.6 trillion, or just over $41,000 per household. Of that amount, only 19 percent has been taken on as debt by consumers.

Meanwhile, as Chairman Dodd pointed out, the number of solicitations mailed by issuers has increased more than sixfold since 1990, to over 6 billion last year. That is about 50 per household, and this massive credit expansion has had a disproportionately harmful effect on the least sophisticated, highest-risk, lowest-income families.

You have heard about a number of questionable practices today: universal default, retroactive interest rate increases, double-cycle billing, in which the issuer actually charges interest on balances that have already been paid off, high hair trigger fees that can be assessed for even minor problems. And let me point out, with fees, we are not talking about a small number of Americans who pay these fees. The GAO report that has been mentioned said that 35 percent of all credit card accounts they examined of the six largest issuers were assessed a late fee in 2005—just in 2005. You heard from Ms. Draut that their survey of low- and moderate-income consumers showed an even higher percentage had paid a late fee.

Now, if you take that 35 percent and you divide it by the number of cards that are out there, that is 242 million cards that paid in 1 year a late fee. I am not saying that all of these fees were illegitimate. I am pointing out how widespread these payments are.

A couple of other issues to keep in mind. You have heard about interest rates. An important fact that has not been mentioned, 85 percent plus of all credit cards now are variable rate cards, and the interest rates on those cards are significantly higher. Cardweb.com, a source for a lot of information that has been put out today, says that right now the average interest rate on variable rate cards is 16.55 percent. Also, let me point out that the GAO report that was mentioned, their finding on interest rates, it has not been cited that they said that the Federal Reserve, an important Federal Reserve study, identified a significant reason for lower interest rate costs, the lower cost of funds.

Finally, multiple low-balance cards, this has been an issue addressed in regards to Capital One's practice. Mr. Chairman, Senator Shelby, we agree with you this is a very troubling practice. At least based on media reports, it looks like a number of sub-prime consumers are getting multiple offers from Capital One of low-balance cards. It looks by all appearances as an attempt to pump up fee volume, and that obviously has a negative impact on the finances of these consumers.

We have often heard from credit card representatives that all of these practices are simply risk-based pricing. But the pricing, as you have heard, does not appear to be proportional to the risk or the costs incurred by issuers. So it is hard to agree with that when somebody is hit with a late fee of $35 and a default interest rate of 29 percent because of one or even two payments that are a day or two late.

Moreover, for consumers who are truly higher risk, if all of their credit card companies are doing the same thing—they are increasing their interest rates, and they are hitting them with late fees—obviously, that increases their risk of default and delinquency, and it is a serious problem for those consumers financially.

We also do not see evidence that this so-called risk-based pricing moderates, leads to lower interest rates, when underlying costs for the issuers decline. For example, in 2006, for three straight quarters, charge-offs—the amount of credit card debt written off by issuers—declined. And I have not seen any evidence that there was a moderation or decline in interest rates as a result.

And, finally, retroactive interest rates cannot be justified, as you have heard, as risk-based pricing. And I do not know of another

business in this country that can get away with raising the price on a service or a good after that service or good has been purchased.

So, Senator Dodd, you put out some quite good legislation during the last Congress, Senator Menendez as well, Senator Akaka. We hope the Committee will start to examine the specific provisions in this legislation and start to consider it because this is an important conversation to have this year.

Thank you.

Chairman DODD. Thank you very, very much, and let me thank all of our witnesses. You have been very, very patient this morning, staying a long time, but I am grateful to you for your counsel and advice to the Committee, and to my colleagues as well for their patience in all of this.

What I am going to do is ask the clerk to set the clock here on 7 minutes on each one of us here so we can kind of move through this as quickly as we can here and not tie people up.

Let me pick up, if I can, to the industry people, on some of the comments that Mr. Plunkett has made here. The universal default issue and the double-cycle billing, those are two issues that have been talked a lot about here this morning. There were other issues, but I want to focus on those two in my time, if I can. And I know there have been some changes in practices that have occurred. I know JP Morgan just in the last few days announced that it was no longer—on double-cycle billing, no longer would it engage in that practice at all.

Again, as I understand it—and you correct me if I am wrong—what happens with this in sort of example terms, you owed $1,000, you paid off $900 of it, you still owe $100. The fees you were being charged were based—even though you had paid off $900 of it, they were still based on the $1,000 obligation until the entire amount was paid off. Is that roughly a good example how that happened?

Ms. FRANKE. Yes. The only further explanation to that would be it really affected the population that had typically been paying their balance in full and then determined that they would like to borrow from any issuer going forward.

Chairman DODD. But you have stopped the practice.

Ms. FRANKE. That is correct. JP Morgan——

Chairman DODD. Why did you stop the practice? It is a good profit-making operation. Why would you stop it?

Ms. FRANKE. Well, Chairman Dodd, we constantly review the pricing policies that we have across our customer base and are continually trying to make sure we are doing the right thing for the customer. And we found, back to the disclosure on clarity, that consumers really did not understand this. So as a result, the consumer did not understand it——

Chairman DODD. How about being unfair? How about being unfair?

Ms. FRANKE. I believe it is a fair practice, Chairman Dodd.

Chairman DODD. It is a fair practice?

Ms. FRANKE. I do believe it is a fair practice.

Chairman DODD. They charge you an interest rate based on an amount—even if you have paid off $900 of $1,000, you should be charged an interest——

Ms. FRANKE. Yes, let me try to explain to you really what it is. If you go into a bank and you take a loan, you are charged for that loan from the date that you take it out. Interest is accrued from the moment that you are charged in that loan. It is nothing different here. You borrowed from us. You decided that you wanted to not pay it in full, and it would then be charged interest. I believe that is a fair practice. It was confusing to the consumer. As a result of that, we decided to no longer do it.

Chairman DODD. Ms. Warren, do you want to comment on that?

Ms. WARREN. Well, it is not the same as going to a bank and borrowing money. The amount of money that was borrowed was $100, and interest was paid on $1,000. It is just that straightforward. Consumers were confused because nobody could believe that a reputable business would charge the——

Ms. FRANKE. I would like to say one thing. The way this really works—and I apologize, because it is a very complicated process, which is one of the confusions that consumers have and that these ways we calculate finance charges as an industry are complicated. But what would happen, and the best way to describe it, is if you had a billing cycle that went from July 1st to July 31st, and you had always paid your bill in full. You would have had $1,000 that you had a balance at the end of July -you had made that purchase at July 12th. So the billing period was the 1st to the 31st, and you charged $1,000 on July 12th.

All of a sudden on August 15th, instead of paying the $1,000 that you had typically done by paying in full, you paid $500. When you paid $500, you then had a balance that you were carrying from July -whatever I said—12th to August 15th that you needed to pay interest on. So you were only being charged interest from the date that you made that transaction because you determined to borrow.

We can certainly, you know, go into greater detail on this, but I do believe it is a fair practice. It was a confusing practice, and because of that and because we always want to ensure that our customer is being treated with all of the clarity that we can, we decided to move away from it. And I think that is a very good thing, and a good thing JP Morgan Chase did for our customers.

Chairman DODD. Mr. Finneran, does Capital One engage in double-cycle billing?

Mr. FINNERAN. Sir, this will be a very short answer. We don't. We never have.

Chairman DODD. And why not?

Mr. FINNERAN. For some of the reasons that Ms. Franke just alluded to. It is a challenging thing to explain to a customer exactly how the interest rate was calculated, and it just always struck us as not the right balance in trying to balance what is good for the company versus what is good for the customer.

Chairman DODD. So you would charge them basically on what they owed.

Mr. FINNERAN. We charge on the average daily balance in the month in question.

Chairman DODD. Logistically, that is not a difficult thing to do in terms of the technology that is available today to make the determination as to what a consumer owes.

Mr. FINNERAN. I am sorry. It is not a difficult thing to——

Chairman DODD. Technologically not difficult for Capital One to determine what that consumer owes today.

Mr. FINNERAN. No, it is not, sir.

Chairman DODD. All right. How about Barclay's card, Mr. Vague? What is their policy on——

Mr. VAGUE. We do not use that policy.

Chairman DODD. And do you want to explain why?

Mr. VAGUE. For the very reason that these two individuals have suggested. It is a very confusing thing. It is not something that we have endeavored to deploy.

Chairman DODD. Let me ask you about the universal default issue here. Again, what is the policy on Barclay's card with regard to universal default?

Mr. VAGUE. For the vast majority of our customers, we do not use universal default. However, I think our first and foremost obligation as a bank is safety and soundness. So for a very small number of our customers, we do look to their credit record, which, by virtue of our relationship with them, we have. And if there are three instances of adverse behavior with other issuers, we believe that that is evidence from our responsibility in safety and soundness to take action to price in the risk that that consumer has exhibited.,

Chairman DODD. And let me ask you the question that was raised, and I have raised it a number of times in the past myself. Do you then apply that interest rate to previous purchases or to new purchases?

Mr. VAGUE. You apply it on a going-forward basis.

Chairman DODD. So past contracts, past purchases would not be affected by that increased rate.

Mr. VAGUE. That is right.

Chairman DODD. Mr. Finneran, what is the policy at Capital One?

Mr. FINNERAN. Again, Mr. Chairman, we do not engage in universal default.

Chairman DODD. With any of your customers?

Mr. FINNERAN. With any of our customers.

If I may just also allude back to some of the comments that Mr. Donovan made. I believe Mr. Donovan, that was an old disclosure that you read from. We did change our entire file. All customers have the repricing policy that I described in my opening statement.

But just to go back, with respect to universal default, we do not engage in universal default. And for us, that means we will not default reprice a customer if they go late on their electric bill or if they go late on one of our competitor's cards. We will not default reprice them if they go late on another account that they may have with Capital One. It is only the individual account in question. Nor will we reprice them by looking at their credit bureau to see whether their FICO or credit score has gone down.

The only default repricing that we have for our entire file now is if a customer pays us late twice, and at least 3 days late in each case, twice in a 12–month period. The first time they go late, we send them a statement notice indicating that they went late and reminding them of the policy that if they go late again they could be subject to repricing.

Chairman DODD. I heard you say earlier that if, in fact, in the coming months they then maintain the timely payments, then automatically the rate is reduced?

Mr. FINNERAN. Yes, if someone is repriced after paying us late twice and then have on-time behavior for 12 months, they will go back to the prior rate automatically.

Chairman DODD. I should ask that same question of you, Mr. Vague. Is that the policy with those?

Mr. VAGUE. After 6 months of timely payments, we will make a downward modification in their price.

Chairman DODD. Automatically?

Mr. VAGUE. Yes, sir.

Chairman DODD. How about JP Morgan regarding universal default?

Ms. FRANKE. JP Morgan Chase has a very, as I had described in my opening comments, high credit-worthy population. So we have a super prime and prime population.

The vast majority of our customers maintain the same interest rate they have over an annual period. 87 percent of our customers start the year with one APR and end the year with the same APR. 5 percent of our customers have their rate go down because we have been able to offer them a better value than they currently had. 8 percent of our customers have had a deteriorating credit profile. As a result of that, we have made changes in their pricing.

There are two ways we do that. One is what we call penalty pricing, where we clearly disclose that if you are late with us, if you do go over your limit, or if you write us a check that there are not sufficient funds for, we will increase your rate.

Now what is interesting to note is that we have the ability to do that, but in only 15 percent of the instances where we make that decision because we are able to use our intuition, excuse me, our insights into what their real credit risk is to limit the times that we need to increase their rate.

We increase their price so that we can continue to provide the best value to the majority of consumers. The majority of our customers have very low rates and do not pay penalty fees. Less than 10 percent of our customers would pay a penalty fee on a monthly basis. So we are able to provide——

Chairman DODD. Ms. Franke, this is very confusing.

Ms. FRANKE. I am sorry.

Chairman DODD. The confusion on my part, and my time is up here. But my point is we have all—listening to you, these are very confusing practices we are talking about here, for consumers to understand.

Ms. FRANKE. Let me tell you one thing that we do that we think, at Chase, helps a lot. We send out to our customers on a regular basis communication that tells them how they can protect their low rate and how they can make sure that they avoid penalty fees. There are many tools that we provide for them to do that. That is providing them free alerts, allowing them to sign up for automatic payments, allowing them to pay their bills online.

So we want our customers to make their payments on time and maintain the low rates and avoid penalty fees.

Chairman DODD. Thank you very much. My time has expired.

Senator Shelby.

Senator SHELBY. Thank you, Senator Dodd.

I would start out myself believing that the market, not the regulators or the Congress, should set the price of credit or money. But having said that, there are some serious issues been raised here today of abuse, exploitation of a large segment of our population. And that is why we are here.

Dr. Warren, you were clear, concise, unambiguous and forceful in your testimony. You know this issue, as I assume everybody else here does.

Why, in your judgment, would a credit card issuer send me, for example, three successive credit cards if I had a balance on one that I may have been struggling to pay? Why would they do that? And I had not applied for one, or the second one or the third one.

Ms. WARREN. There can be no reason except to increase the revenues for the credit card. That is all this is about, plain and simple. By sending you multiple, low-level, capped cards, they increase the odds——

Senator SHELBY. They manipulate the system.

Ms. WARREN [continuing]. That you will run over one of your limits, that you will pay penalty fees if you get into any kind of financial trouble, multiple times. It is just nothing more than a trick to increase profits.

Senator SHELBY. So what Mr. Donovan referred to as the trip wire?

Ms. WARREN. Yes, Senator.

Mr. DONOVAN. That is one of the trip wires.

Senator SHELBY. Just one.

Mr. Plunkett, as part of the Bankruptcy Reform Bill that you are very familiar with, the Federal Reserve was directed to make some changes in the Truth In Lending Act Regulation Z with respect to minimum payment disclosures, teaser rate disclosures, and late payment disclosures. It is my understanding that the Federal Reserve is now working on these changes as part of a large review of the Truth In Lending Act Regulation Z disclosure.

What do you believe are the most important aspects of that review? And what changes, if any, do you believe should be made as part of that process that would help this situation in the credit card industry today?

Mr. PLUNKETT. Senator, let me start first with the minimum payment disclosure. There is a major problem with the law, in my opinion. It does not require that the disclosures be personalized—that is, specific to the actual balances of the individuals—unless that person calls a toll-free number. The truth is that consumers are harried and most will not. In fact, most who could probably benefit from the information, will not.

So Senator Akaka mentioned his legislation. It would require the kind of targeted personalized disclosure, not only how long it would take to pay off at the minimum payment rate, but also the total costs. The total costs are not covered, either, even if you call that toll-free number to learn about how much would it take me over so many years—excuse me, how much would it cost over so many years to pay off at the minimum balance?

So the first point is that unfortunately, the statute, in our opinion, will not be terribly helpful with that particular disclosure.

Regarding your question on other disclosures that would be helpful, you have heard, I think, consistently from the consumer folks here that disclosure is important. But it is not going to be enough to solve the problems that we have identified. But we think there needs to be better disclosure in a very concise——

Senator SHELBY. Why wouldn't disclosure, pure unambiguous language, simple English and so forth—it might not be enough in most instances, but it would certainly help market forces continue to work, would it not?

Mr. PLUNKETT. It would help consumers understand what they are getting into. But the problem with this back end fee structure that you have heard about, Senator, is that consumers do not shop, they do not shop around, based on an assumption that they are going to pay a—make a payment a day late.

They are overly optimistic, and research from behavioral economists has shown this, about their ability to meet their financial obligations. So the market is not constructed so that people shop actively for these back end fees. They look at interest rates. They look at annual fees. And it is true that many cards now do not include an annual fee. They do not look at the back end fees.

Even with better disclosure, I would say some might, but many still will not.

The other issue is you need to level the playing field so some of these unjustified back end practices do not provide a competitive advantage to certain issuers. It is a good thing that JP Morgan Chase is no longer going to do double cycle billing. But others who might choose to do so get a competitive advantage and income if they decide to keep at it. So two problems there with disclosure.

We do have, in our testimony though, Senator, several suggestions on more readable disclosure, better disclosure about those back end fees and interest rates, and improving the Schumer box, improving the information. This is the most widely identifiable part of the credit card solicitations and disclosures that consumers see. They know about the Schumer box.

Some of this information needs to be in that Schumer box so that people can be aware, before they get a credit card, of these fees and interest rates.

Senator SHELBY. Is the five page legal document that is sent out that we all sign or accept, is that mandated by law or regulation or both? Or is this just something that lawyers have come up with?

Mr. PLUNKETT. It is a little of both. As the GAO report points out, there are some requirements in TILA that are in these contracts that are incomprehensible and not necessarily relevant to the fees and interest rates that consumers pay now. So that is a very important issue for you all to evaluate. But there is also language in there to protect issuers from legal liability. It is both problems.

Senator SHELBY. I think the question before us—I know my time is up, Mr. Chairman—would be how do we continue to let the market work? Because the credit card industry is so important, legitimately so, to our economy, to just about every American, without

the abuse and the exploitation that we see even today? That is the question for us.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much.

Senator Carper.

Senator CARPER. Thank you.

I want to again thank each of our witnesses for taking the time out of your lives to be here with us today to give us your thoughts on what we all agree is important issues, an important industry, an important convenience in which there are abuses.

Just a little humor to start off with. I am reminded that editorial writers have been described as people who come onto the battlefield when the fighting is over and shoot the wounded. When this hearing was posted last Thursday, and it is fairly short order, and some of you actually agreed to testify, I think, as recently as a day or two ago. And you moved things around on your schedules. And I just want to say, on behalf of all of us, thank you for doing that and for your willingness to sort of put yourself in the position to be shot as one of the wounded.

We hope that has not happened. I do not think that it has.

I just want to preface my first—I want to go back a little bit and talk about the minimum payment requirements and how that has affected you and your customers and some of the issues.

Before I do that, I just want to remind us all that we, as consumers, are exposed to solicitations every minute of every hour of every day of the year. One only has to turn on our televisions or even to look at our e-mails to be solicited to buy any wide variety of foods, any kind of soft drink or beer that is out there, whatever restaurants to go to to eat, what kind of car or truck or SUV to buy, what airline to fly, what kind of house to buy or rent.

The enticements, the inducements are out there from all directions. And we all have, as consumers, some responsibility ourselves to police our behavior. I would just remind us all of that.

For our witnesses who are not here on behalf of the industry, I want to ask, they have raised a lot of issues, a lot of concerns, some of which we have heard before and some of which are new. We have heard from some of our industry changes that they have made in their own policies, which we applaud. What else should the industry be doing? And particularly, maybe what else have you done? I would direct this to our witnesses from JP Morgan, from Barclays, and from Capital One. What else should the industry be doing?

Mr. VAGUE. Senator, I would say that there is a lot of good that can be done by the disclosure area that we have discussed. Really, I think relative to some of the questions that have already been asked about this, consumers do respond differently based on what is in the disclosure. I mean, we know from our experience over many, many years that if the APR is one rate versus another, or if the late payment amount is one rate versus another, that consumers will respond more or less to that solicitation.

So the work this committee has done, and others in the U.S. Government have done, relative to the issue of disclosure has, in fact, made a difference. And I would respond, relative to any of

these issues, that additional disclosure would, in fact, be helpful. That is something we have advocated——

Senator CARPER. When you say additional disclosure, additional pages of disclosure? We already heard a little bit about that.

Mr. VAGUE. Your point is a good one. The five pages of disclosure we have now, we think could be simplified. So clearer disclosure is perhaps what we are after, rather than more disclosure.

And I think it is an important point, too, we have talked a little bit about minimum payment disclosure. But I believe the statistic is correct that the number of consumers that regularly make minimum payments is only about 1 percent of all customers. So if a new set of minimum payment disclosures were put out there, you are going to be confusing a whole lot of folks. And in fact, any minimum payment disclosure relative to the time in which something would be paid has to be based on assumptions that no one knows. Whether you would occasionally make a higher payment, whether your APR would be changed, and the like.

So I think in areas like that we have to move very, very carefully so that we do not end up in a situation where we are actually confusing the consumer more, disclosing things to folks that do not really—are not really affected by that, creating more expense in the system in the way of consumer complaints and calls and the like.

Mr. PLUNKETT. Senator, could I throw in a point of fact on——

Senator CARPER. I want to hear from Mr. Finneran. Let me just ask you to hold and let me hear from Mr. Finneran. And I want to hear from Ms. Franke, as well, on this question, please. If I have time, Mr. Plunkett, I will come back.

Mr. FINNERAN. Thank you, Senator.

I think there are three things that the industry can do, and I will cite a couple of examples under each. The first one, I think, as Mr. Vague said, is to continue to work with all interested parties to make disclosure better. And here I want to make a distinction between the credit card agreement and the disclosure materials. Capital One has a credit card agreement that is only about four or five pages, not the 30 pages that was cited earlier.

That agreement does not contain the disclosures that are truly important, nor does it address the issues that people have been talking about today. Those disclosures are found in the marketing materials, the Schumer box which is part of the marketing materials, the welcome kit which is also a relatively small set of materials, and then on the back and front of the periodic statement that consumers get.

So the first thing the industry can do, continue to work with the Federal Reserve Board as it undergoes its review under Regulation Z to improve disclosures. We certainly acknowledge that the industry has changed and the products have become more complex. And while as a painter you never want to go back and paint over a masterpiece like the Schumer box, the landscape has changed and it is time to really improve the Schumer box.

Senator CARPER. I just regret that Schumer is not here to hear that.

Mr. FINNERAN. Capital One has been trying to lead the industry in how the industry ought to be open to new disclosure.

The second thing that we can do is stay ahead of the game. So I will give you one example on disclosure, and I am sorry that Senator Akaka is not here. But with respect to minimum payments, we are not waiting for the Federal Reserve to come out with new disclosures. What Capital One has done proactively while we wait for the Fed, is for any customer who pays only the minimum payment three times in a row, we give them a statement notice and draw to their attention the consequences of that behavior. We have also put up a calculator on our website and we direct them to the website. It is very easy to use, so they can plug in their own assumptions. It will tell customers how much interest they will pay if they pay so much a month. It will also tell them how long it will take to pay it if they do that.

And I think, also to pick up on a comment——

Senator CARPER. I am going to ask you to hold that. I like that very much, but my time is about to expire. I just want to give Ms. Franke an opportunity. That was a very good point. Thanks. I am sorry.

Ms. FRANKE. I would say I just briefly agree with both of my colleagues and I think we need to do all we can to make sure that the customer understands the terms and agreements of their conditions with us. And that is both working with the regulators and the other issuers to make sure that the required disclosures are clear, as well as doing the things like Chase has done to on our own consistently communicate to the customer what they need to do to maintain their low rates and avoid penalty fees.

We do that on a regular basis to all of our customers and I think that is very important. We need to continue to focus on the customer, the consumer, and what their needs are.

Senator CARPER. My thanks to each of you. My time has expired.

Chairman DODD. Senator Bennett.

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

Ms. Draut, I have a statistical question that I am sure you have an answer for. But on the surface of it, it looks a little strange.

You have been quoted in USA Today as saying that the average credit card debt among households 65 and older in 2004 was $4,907. The Federal Reserve says the mean credit card debt for households between 65 and 74 is $2,200. And for those over 75, it is $1,000.

Now is this the difference between average and mean? Can you help us understand the discrepancy between the Fed's figures and your figures, because the discrepancy is very large.

Ms. DRAUT. The discrepancy is easy to explain. When the Fed publishes their average balance data, they include all of the households that carry no balance, which leads to a lower figure. When we publish our data, we very explicitly say this is the average balance among indebted 65–plus households.

Senator BENNETT. So you have different universes?

Ms. DRAUT. Yes.

Senator BENNETT. I see. USA Today did not make that clear, so I think it is essential that we have that. Thank you for that clarification.

Let me ask the—first, a question for Dr. Warren.

You said there is no disclosure between a safe card and—I do not remember, did not write down the word you used for the other kind. What is your definition of a safe card?

Ms. WARREN. A card that is not loaded with back end tricks and traps, a straightforward card that says here are the terms, here are the interest rates, and that does not have these inexplicable two-cycle billing, universal defaults, and so on. Things that customer do not and cannot read in advance and make the differentiation in terms of shopping for this product or that product.

Senator BENNETT. All right. So if I am in the business of helping someone devise a disclosure statement, it would seem to me I would want the competitive advantage of saying we do not have X and our competitors do.

The competitive marketing activity has been on APR. You have talked about that. That has pretty much disappeared. Everybody quotes roughly the same APR. All of the bombardment that I get, that we all get, the solicitations, our APR is such-and-such, only APR, and the teaser rate. You come in for an APR of 4.3 and it will last for 6 months, and then we will go to—so customers are familiar with APR.

So it would seem to me, if I am devising the marketing strategy for a credit card company, I would say forget APR because that is no longer a differential. Let us get more people on our credit card by saying our late fee is only $5, whereas the average late fee for the industry is $20, or something of that kind, to get people to use my card.

If the safe card has a significant advantage for a customer, it would seem to me if I have a safe card, Mr. Finneran, I would try to make that very clear.

Now this brings me to the core of what I think I hear from today's conversation. Where do the profits come from? When you are running a credit card company, where do you look for your profits?

Ms. Franke, I think I do understand the double-cycle billing thing, because I am a freeloader. I am a perpetual—here I am disclosing things. I have a perpetual interest-free loan on the level of several thousand dollars—I will not give you that number, I will not disclose that—because I pay off in advance of the due date 100 percent of the balance, while I am running up the same kind of balance simultaneously.

So I am taking the bank, if you will, to the tune of my multi-thousand dollar fee loan in perpetuity. I never pay any interest on it at all. And I understand the banks do refer to me as a freeloader. That is the technical, legal term of art.

Ms. FRANKE. Well, we would call you a valued customer.

Senator BENNETT. All right.

[Laughter.]

Senator BENNETT. The reason you do is because you have got interchange fees and you have got income on the other end.

So the fundamental question here is if I am starting up a credit card from scratch, and I have to have X amount of profit to keep the thing afloat, where do I look for my profit? Do I look for interchange fees? Or do I look for tricks and traps?

And you witnesses here from the three companies may not be competent to answer this question because this is basically a CEO

question, but how much do I build into my business model and my strategic example tricks and traps? And if it is a deliberate industry practice and strategy to make my money off of tricks and traps, then I am with Dr. Warren and Mr. Donovan. But if it is a fallout of the overall strategy that some people get caught in this, so that Mr. Donovan has clients, that is a very different kind of thing.

I am not burdened with a legal education, but I do get told by my lawyer friends that hard cases make bad law. And Mr. Donovan has given us some hard cases. And I want to know whether they are, in fact, hard cases and the exception to the overall business strategy or if they are caused as part of the business strategy of where we are putting.

I have gone over my time, but can you give me a quick response as to where you look for your profits to keep yourselves afloat?

Mr. FINNERAN. Senator, if I could, I would love to give you a quick response. I do not think—well, certainly Capital One and I suspect the other long-term credit card issuers, many of whom are represented in this room today, we do not build a business model on tricks and traps. We are all in the business of trying to attract and retain good customers. And it is not in our interest to give people credit that they cannot handle. Nor is it in our interest to set people up for disappointment when they figure out what their deal was, if they thought it was something else at the time we attracted them.

We work really hard to try to meet those two standards every day, because we expect to be in this business for many, many years. And if you build your business model on tricks and traps, you are not going to last in the marketplace because you are going to get outed, whether it is by you folks or by our consumer group colleagues here at this table or by litigators or by regulators. We are in the business to do a service to our customer with a focus on the long-term.

Ms. FRANKE. I would like——

Ms. WARREN. Senator, can I also give a response, 15 seconds?

Chairman DODD. Go ahead.

Ms. WARREN. Let us just look at the numbers. The credit card industry as a whole, not the three people who come in here today representing, as they say, their high-end customers in one case. The credit card industry as a whole makes $11 billion in terms of the first model you described. That is what they are making from the fees from the merchants and so on.

They made $79 billion last year in interest and fees.

Senator BENNETT. But interest and late fees are two different things.

Ms. WARREN. That is absolutely true, although——

Senator BENNETT. The late fees are the tricks and traps. The interest is a legitimate——

Ms. WARREN. A 29 percent interest rate for being a few days late is not within the range of legitimate. And what the data seems to suggest is that that is where the interest income is coming from.

Let me just give you return on assets. That is the key part. We look at all other forms of consumer lending. Pick Citibank last year, and their return on assets was 0.8.

But when you look at what they did with credit cards, their return on assets was 6.2. In other words, in terms of building a business model, building a credit card is more profitable than building any other kind of consumer lending. And within that, the revenues are coming $7 to $1 for building in interest rates and late fees where you can snag customers whenever they slip and fall at all. It is about tricks and traps.

Senator BENNETT. We do not have the time to go into that. Thank you.

Ms. FRANKE. I would like just to respond on a couple of points.

First of all, the credit card is an unsecured loan. It is the only consumer tool out there where we lend folks money and we have no collateral to collect against it. We are providing a service to the consumer to be able to facilitate payments, the vast majority of whom use our product for convenience.

As you respectfully point out, Senator Bennett, there are many, many of our customers who pay their bill in full every month and appreciate that ability to have that convenience.

We also have consumers and customers who choose to borrow from us. And we charge them a fair interest rate to borrow from us. We believe that we are treating customers and providing them a service that they want, whether it is a convenience or whether it is a loan. And we do try to make sure that we manage our risk profile so that we price appropriately for the risk that we are taking.

And in some instances, we do need to raise rates where the risk of the customer has deteriorated from the time that we entered a contract with that customer.

I believe that the credit card is a wonderful tool for the consumer, and at JP Morgan Chase we deal with the very credit worthy consumer who can afford to pay us back and appreciates the utility that we are providing them.

Chairman DODD. Thank you.

Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman.

Unlike Senator Bennett, I am burdened with a legal education, so I want to follow up from where he started, from where he was headed. I think it was very relevant.

Let me ask you, Ms. Franke, you say in your testimony that it is the bulk of the business for Chase is super prime and prime. So am I to interpret that that super prime and prime is an individual who has a good credit history that, in fact, pays their monthly balance on time within that month?

Ms. FRANKE. That would be correct.

Senator MENENDEZ. And that is the business that you go after?

Ms. FRANKE. That is correct.

Senator MENENDEZ. Now to have that business model, you would not go after someone who has no credit history?

Ms. FRANKE. We do, 1 percent of our customers are students. Listening to your opening comments, I imagine that is something of concern to you. It is a very small part of our business, but we do believe that there is a place to provide students the credit that they need, and really the utility the need for emergencies and to manage their lives. And we manage it with very low lines. And interest-

ingly, have much higher numbers of students paying us in full than the adult population.

Senator MENENDEZ. What is a pre-approved card?

Ms. FRANKE. A pre-approved card is where, based upon a review of the credit bureau, we have determined that someone is credit eligible and worthy of our extending them a line.

Senator MENENDEZ. So if Augustino Joseph Chairvolotti, who is 2 years old, got a solicitation for a pre-approved credit card, what is his credit history?

Ms. FRANKE. That would be an error. And we do, as I am sure you know, write many, many letters a day. In some instances, the data is incorrect, and we constantly are working to refine our processes. We have gotten bad data. If that is the case, we welcome anyone to tell us where we have made a mistake because that is not within our policies. That is not what we want to do.

We clearly do not market to minors, nor do we market to dogs, as someone has brought up earlier. We want to market to those that we believe——

Senator MENENDEZ. Well you, in this mistake, marketed to a minor.

Let me ask the rest of the members of the industry, is that the same business model, the one in which you are working for prime, subprime—I mean, super prime, prime, people who pay? That is the model customer, is it not, I would assume?

Mr. VAGUE. Generally, absolutely.

Senator MENENDEZ. Is that the bulk of where you are headed on your business?

Mr. VAGUE. That is right.

Senator MENENDEZ. Mr. Finneran.

Mr. FINNERAN. Senator, we lend across the entire spectrum. And let me also say that that is not unlike many of the large credit card issuers in the country. Our portfolio, according to public data, is about 30 percent in what is defined as subprime, and that is about the same percentage as most of the other big five lenders, according to the data that they file publicly.

So we market to all Americans. We use the same basic criteria, however, which is an assessment as to whether they have the capability to handle that debt and to repay that debt, and principally looking—as Ms. Franke described—to the credit bureau information that is available.

Senator MENENDEZ. Here is where my problem, my legal education, burdens me. And that is the GAO report said that, in fact, 70 percent of the credit card industry's revenues come from interest payments made by non-model customers, who cannot or simply do not repay the entire balance they owe each month.

And so the question, as a practical matter, if the GAO says 70 percent of your revenue comes from non-model customers, then those are individuals who are not paying their monthly payment on a timely basis and therefore invoke some of these different charges or higher penalties or late fees or, in fact, higher interest rates.

So if that is the case, what is the industry's incentive to undermine—if you ultimately had a fully model customer portfolio for all of the industry, eventually you would lose 70 percent of your rev-

enue. Now what is the incentive for the industry to lose 70 percent of its revenue?

Mr. FINNERAN. Senator, I am not familiar with the reference to the GAO report that you made. But if I was listening carefully, I think you defined non-model customers as providing 70 percent of the revenue including interest. I mean, someone who may not pay their balance in full can be a very, very good customer. That is part of the flexibility of the card, that people do use it, as Senator Bennett alluded to, as a transaction vehicle where they pay their balance in full every month. Many people use it as a borrowing vehicle, whether they borrow over long periods of time or whether they borrow periodically and then pay it back.

Senator MENENDEZ. But we have heard how the non-payment can, in fact, dramatically increase the rate of interest. And therefore, isn't that become far beyond what you say is a model customer. It is a customer that is somewhat in bondage.

Mr. VAGUE. I would just comment, hopefully for clarification, most of the folks that we would consider prime customers do not pay late to incur the kinds of fees that you are suggesting, but do not pay in full either. They would on time make a partial payment. So they are actually borrowing.

And so I suspect the large part of that 70 percent number you are referring to is interest received where timely payments are made by what we would consider prime customers.

Senator MENENDEZ. Well, let me ask you, this is the final question that I have. And I would like to explore this with the industry more, because 70 percent of your revenue is not insignificant.

With student loans and the whole question of—I saw the numbers of those students who took tests and clearly were not literate. Only 26 percent of 13–to–21–year-olds reported their parents actively taught them how to manage money. And less than a third of the 4,000 students who took the Jumpstart Personal Financial Survey passed the test.

Now when we are so aggressively pursuing this class of consumers, isn't there a responsibility from the industry to be more policing of itself in this context? Or in the absence of that, then find themselves with a legislative response?

Mr. VAGUE. There may very well be things that need to be done relative to lending credit cards to students. But I would reiterate what has been said by others here, and that is we do not currently make very many credit card loans to students. But I have from time to time in my career. And it has always been my experience that the delinquency rates on student programs is lower, is more favorable, than that for the general population. And I think there are some ABA statistics that bear that out, as well.

So even if there is something we could do in this area, I would love for us to be able to really look at the actual holistic or total experience of students as we do that.

Senator MENENDEZ. Thank you, Mr. Chairman.

Chairman DODD. No, thank you very much.

Senator MENENDEZ. For the students I have talked to, and their parents, I do not know how low the rate is. But there is far more than enough. I think one of our witnesses actually testified that, I think it was Professor Manning, that approximately 7 to 10 per-

cent of college dropouts occur as a result of consumer debt. That is not insignificant.

Chairman DODD. I will just tell you, from this side of the table, I suspect I am going to speak for all of my colleagues. We go back to our States and do town meetings and the like. You cannot believe how often this comes up and how many pieces of correspondence and communications we get from constituents.

Now you are talking about a very small percentage. I heard you say that, Ms. Franke. But I will tell you, there is a great deal of concern about the over-marketing, what happens, and parents, and so for and the like.

We have got a vote on. I am going to step out and come right back. I am going to turn to Senator Casey so he can get his questions in. Then I will come back so you can go vote. We will finish up here.

But that number still, in the last 10 years, to go from roughly $1 billion—and I presume that was fees and interest. In 1995 or 1996, whatever that percentage was of interest and fees, but today that number has jumped to $17.1 billion, and 70 percent of that $17.1 billion are penalty fees. That is a massive increase in 10 years.

Now that is coming from—this is not coming from your good customer. Penalties like that, they are not the person who pays a percentage off, makes that minimum thing and does that good job there. This reaching down in to this constituency that is either fixed income or low income and making it impossible, in many cases, for them to crawl out and get into the economic condition that they would all like to be, and is what greatly, greatly worries a lot of us here.

And I am not suggesting, by the way, you are major, well-respected businesses. And I respect the fact that JP Morgan—I do not like your reason, but I am glad you did it, Ms. Franke, for getting rid of the double-cycle billing, and so forth. And I am glad you do not do a lot of these default payments, and so forth. A lot do. People not at this table.

And what Senator Menendez said earlier was very, very important. There are 6,000 issuers. We have got three of you here today. And just as was mentioned earlier, we know that there are good people in this business to do a good job. That is not the point here, obviously. Laws are not written for the overwhelming majority of people who do the right thing every day. We have to write the laws to protect people against, just as Mrs. Warren talked about, the Consumer Product Safety Commission, the Food and Drug Administration.

My colleague from Delaware talked about all these things are consumer choices. They do, they have great choices because there has been someone around who said by the way, we do not expect you to be an engineer and a scientist and a pharmacist when you go out. When every one of us this morning got up and we brushed our teeth and we took our morning prescriptions, we did not agonize about whether or not we were going to be in trouble as a result of doing it. We have confidence in it.

And what we want to do is have people have confidence in the system that when they engage in a wonderful practice of the exten-

sion of credit, that they are not going to get themselves in deep trouble and never get out of it. And too many cases that is happening today. It is happening. We all know it.

So we need good advice from you on how to pass responsible legislation or to encourage the industry to do the responsible thing so we can start to make it possible for these people to begin to move up that economic ladder and enjoy the prosperity of our country.

That is really what we are driving at here. So in a sense—let me recess this for a minute. We will recess for 10 minutes and come right back. Take a break for 10 minutes.

[Recess.]

Chairman DODD. Thank you for your patience here, all of you, again. This will be relatively brief here now. We will wrap this up for all of you. You have been very generous with your time this morning. Very, very valuable, I can tell you, to have your testimony.

I am going to turn to my colleague from Pennsylvania, a member of the committee. Senator Casey, the floor is yours.

Senator CASEY. Mr. Chairman, thank you very much. And again, I want to reiterate how much we appreciate you convening this hearing and the importance of it.

Not only because Mr. Donovan is from Pennsylvania, but that helps, I want to direct my first question to him. But I also, and I do not mean to artificially create conflict here but there is obviously some conflict in this room and that is important to recognize.

It has been my experience, and I think the experience of a lot of Americans, that when there is conflict in our adversary system, in our judicial system, often, in most cases, that leads to some illumination of the truth. So I hope this helps in that regard.

I was struck by, Mr. Donovan, your testimony and the detail in your written testimony about Ms. Owens in Ohio and Mrs. C in North Philadelphia. And with the admonition of my distinguished colleague from Utah, Senator Bennett, I still think that these particular cases are very important, because they can often explain better some complicated issues.

So here is what I wanted to do. I actually know where North Philadelphia is. It is a place that I volunteered, and I know Senator Dodd was a volunteer, as well, and did it overseas. That is harder. I only did it in the United States.

But North Philadelphia, most of North Philadelphia, is very poor, as you know. Some is less so, and also I am sure there are middle income families. But it is a very tough place to make ends meet, and to do that on a $600 a month SSI payment is even more difficult.

So my question is directed at those here who are representing the industry. When you think of some of the detail, and I realize that there is a page or so of it, but here is the bottom line, as I read it. This is on page three, and I know not everyone has this. This is what Mr. Donovan testified to: by August of 2006, in the case of Mrs. C in Philadelphia, nearly $400 per month was coming due on the card she had, all of which Mrs. C attempted to pay from her monthly $600 SSI check. As of August 2006, the APR on her WAMU card had increased to a penalty rate of 31.49 percent.

The question that I have, and I know that is a long lead up, is when you hear that and you hear the other parts of his testimony, and other things that have been said today, I realize this is necessarily is not your banks and is not your particular case. But what can the industry do to make sure that the Mrs. Cs of the world do not have to endure that kind of punishment ever again?

I realize that anecdotes are not the whole story. But this is one woman in my State. And if she had called me, and I just started here. But if she had called me this year or next year, I am going to be calling you or your counterparts or your colleagues. So I want to know, how do we prevent these cases from transpiring?

I would open it to anyone on the panel?

Mr. VAGUE. I would be happy to speak to it. I very much empathize with you and agree with you the appropriateness of examining situations like this. In our organization, first and foremost, we endeavor strenuously, frankly, to avoid lending into situations where we cause distress. I mean, there is enormous amount of effort put onto that.

But in those situations where we do, such as the one you describe, we very quickly move, as we are going through the collection process, to a program where we will waive interest rates, fees, other things, go down to the principal balance. We will also forgive portions of the principal balance.

I think it is our best interest to be proactive in a situation like these to create something that is manageable. It does no one any good to do repetitive calls in situations where there is not going to be successful resolution, as perhaps is the case here.

In addition to that, there are very responsible consumer credit counseling services, and in particular the non-profit Consumer Credit Counseling Service itself, where we would very quickly refer a program like that. And that institution has historically been very responsible in helping an individual like Mrs. C to negotiate with a group of lenders simultaneously and get them into a program, often create by CCCS, as they are called, to remove some or all of the interest rates or fees, create partial payment programs, and the like.

So the continued awareness of those kind of programs, the continued promoting of institutions like CCCS, is something that we endorse.

Senator CASEY. I want to give others a chance and I want to have Mr. Donovan—he is the author of this information.

But the credit protection fee is really what—am I right, sir? That is what drove this.

Anyone else? I have a minute-and-a-half, but I am going to try to get it in.

Chairman DODD. Take a little more time, if you want.

Senator CASEY. Anyone else?

Mr. PLUNKETT. Senator, I do have a point on that, as well. I think what Mr. Vague was referring to is what is often called a workout plan, where the creditor will try to understanding the declining financial situation of the consumer and work out sort of an individualized remedy to help them.

Some creditors do it. Some do a good job of it. Often, very often, people fall through the cracks because it is not an automated sys-

tem. It is not cheap to do. I have noticed that workout plans come and workout plans go, depending on the underlying financial condition of the issuer. That is, when they are doing better financially, they might be more willing to do it, and not.

As for credit counseling, we have documented extensively that creditors have actually made it more difficult for people to lower their overall interest rate on all of their cards because they have raised the interest rates that they charge people in credit counseling over the last 8 years. Bank of America, for example, used to offer a zero percent interest rate for people in credit counseling. We applauded them. We thought it was a very responsible approach. They have raised it to just under 10 percent.

So that is the problem with credit counseling these days.

Senator CASEY. We are all for counseling and workout plans and all of that, but I am talking about why this woman was put in that position to begin with, with this fee, the credit protection fee.

But someone else from the industry who wants to respond? But I want to make sure I give Mr. Donovan a rebuttal.

Mr. FINNERAN. Well Senator, I would just add to what has been said. I think one of the keys here is in the product design at the front end that is offered to——

Chairman DODD. I cannot hear you, Mr. Finneran.

Mr. FINNERAN. I am sorry, Mr. Chairman.

I said I think one of the keys here is in the product design on the front end, and I think we talked about that this morning, about the repricing criteria that different participants in the industry apply. We have certainly tried to make that much more transparent and simpler for our customers. That may have helped in this situation. So I would just add that as a comment.

Senator CASEY. Mr. Donovan.

Mr. DONOVAN. Yes, thank you, Senator. I appreciate the opportunity.

I think one of the problems with the marketplace generally is that we now have a very mature, super competitive industry that no longer competes based upon the annual percentage rate any longer. And it is allowing freeloaders, such as Senator Bennett—which used to be accounted for with the annual fee. The annual fee was the revenue that the card holders would—that the card issuers would anticipate getting from those who would not revolve their balances.

They have given that up in order to balance their portfolios, because they use the super credit worthy in order to balance a portfolio that they securitize and sell to the industry. That is what they do. And they give up the annual fee for that. They are losing revenue on him. He is not a really great customer. He is not a super prime customer. They use money with him.

Chairman DODD. I think he is called—is he not called a deadbeat? Isn't that the word.

Mr. DONOVAN. That is what they call them.

But he is a great customer when they go to the securities markets, because he balances that portfolio so it looks like it is performing better than the portfolio really is, because he is not in default. So that they are now, they are getting the revenue from the revolvers. And in fact, Duncan McDonald, the former general coun-

sel at Citibank, explained this very problem in the American Banker 3 years ago.

And he said that revolvers are now subsidizing the rich because the interest and fees earned from them go to subsidize the frequent flier miles and the points and the cash-back programs that we give to the so-called non-revolvers, which would ordinarily not be making these companies any money.

The reality of it is if we got back to a real efficient market, what would happen would be those non-revolvers would pay some modest amount, some sort of fee, for having the right to not revolve, while the annual percentage rate for the revolvers would not spike to default penalty rates.

And I have the solution for that, and it is not disclosure, Senators. The solution has been long-established at common law in this country and from the United Kingdom. And that was penalties have to bear a reasonable relation to the risk incurred and the cost that you incur from the default. If you have a fairness-based standard, a principal-base approach, the market will work for itself. That is the market.

And this is not something unique. It was the rule with the credit card industry before 1996, before penalties were defined as interest, which was absurd.

But not only that, it is the rule in the United Kingdom and in Europe and in Japan, because the Office of Fair Trading, which governs credit card issuers in Europe, in the United Kingdom, and in fact Japan borrows from, has in fact issued calculating fair default charges in credit card contracts, the statement of the OFT's position. This is an August—an April 2006 statement, and it is enforceable in the EU, in the U.K., and in Japan. Why it is not—and in Canada.

Why it is not, in fact, followed by the industry here is simply because the industry does not want to follow these practices and it wants to get its out-sized profits, which it has gotten here.

That is it. Thank you.

Ms. FRANKE. I would like to make one point, if I could.

Senator CASEY. Sure.

Ms. FRANKE. Several times it has been said today that there is no longer any competition around interest rates. And as someone who manages the marketing activities for Chase, I would like to tell you that it is still a very competitive market on interest rates, and consumers are still making many decisions about which product they choose based upon what interest rate they are offered.

So from those of us that do this day in and day out, I can tell you that we very much compete on interest rate, and you will see a wide variety of interest rates in the market today.

And the only follow up comment I would like to make is that we very much value those customers like Senator Bennett that spend money with us but do not carry a balance. They have very low losses. And we do make some money on those customers. And we do value them.

Senator CASEY. I know we are out of time, but I would just make one final comment. A lot of what we heard today is very good testimony and very good questions. But a lot of what we heard, I think, from the industry troubles me significantly in this sense: there

seems to be a sense—and this is a broad stroke, I understand that—that one of the big problems is lack of customer or consumer understanding. And that is certainly true in any field.

But if that is going to be the focus of the industry only, in other words make sure we explain it better and all of these problems will be dealt with or mitigated, in my judgment and I think in the judgment of both sides of the aisle on this committee, that is not enough in terms of the attitude that you bring to this discussion.

So I would urge those on both sides of these issues to think more than just better disclosure, better explaining. We have got a lot more to do than that to protect people.

I am six-and-a-half minutes over time, Mr. Chairman. That is a rare thing in Washington. Thank you for the time.

Chairman DODD. Not at all. I thank you immensely, Senator Casey, for your questions. They are great questions.

I thank the witnesses, as well.

Let me just, if I can, make a couple of comments in wrapping up for all of you. It is clear, I think, from the hearing this morning and other evidence that we have gathered and will continue to gather, but certainly what we have already, that we acknowledge that we have some serious problems with a number of the practices being used by the industry as a whole.

Again, I want to emphasize here, the witnesses who have come forward, particularly Capital One and so forth, willingness to be at this table this morning, and others, Barclaycard and JP Morgan. And some of the practices you have changed. The reasons you have given I do not necessarily agree with, but nonetheless, I appreciate the fact that we are changing some of these things or you are not engaged in them at all.

But again, there are 6,000 issuers here. So we are dealing with a large universe. And I want to make clear here that we are talking about some of these practices, I think some of you agree, need to be changed, maybe for different reasons. Practices like the universal default and the double-cycle billing which have been part of the focus of the hearing are incredibly confusing and misleading to consumers at the very, very least.

In my view these practices, as well as others that we will explore in the future, must be eliminated or fundamentally changed if we are going to go forward.

It is also pretty clear to me, and again I think this was sort of universally held, although we bring different approaches to it here, that we have a broken disclosure system. At least I heard that from everybody here this morning. And we need to address that, regardless of what side of the chair they are sitting on. And I need the expertise of many of you here on how we can do a better job of this.

There is some wonderful, talented people at this table, and others who can offer us some help.

I was talking to my old and dear friend Ed Yuengling earlier. Ed has suggested he wants to sit down and talk, as well, from the ABA. And I am deeply appreciative of that offer, Ed, this morning. We look forward to that.

And Elizabeth, we are going to call on you and others to help us work our way through this in a way, if we cannot come up with

some good ideas fairly soon, so we can help craft a smarter and better way to get information to consumers. I think we all agree that that is important.

And to protect consumers outright from some of the practices that may be driving some of them deeper and deeper into debt. As I mentioned at the outset of my remarks, that is bed for consumers, it is bad obviously for business, and for our country.

And last, I would just say that while we have reviewed a number of reports over the years, statistical data, some of that can be very confusing, even contradictory in some cases. What I would like to do is leave the record open for a few days to have my colleagues address maybe additional questions that we did not get to this morning, to raise some of these issues with you, more detailed questions involving some of the data, that we might take advantage of your expertise and not confront you right here at a witness table without the ability of going back and talking to people in your own shops that can help us get accurate information.

But again, I thank all of you. This has been a very good hearing. This is my second hearing as chairman of this committee. I have cared about this issue for a long time, as my colleagues know, going back some 20 years when I was sitting about where Bob Casey is in this committee. In those days, Jake Garn, I think, was sitting here in my first term as the chairman of the committee. And then Bill Proxmire and of course Don Riegle and Al D'Amato and Dick Shelby, Paul Sarbanes.

I have sat through seven chairs in this committee and this issue has been one that has come up all the time over the years, going back to my earliest days on this committee.

So I am very interested in this subject matter. Obviously, all of you are, as well. And this is a matter that does need some serious work, in my view. So I am looking forward to the ongoing hearings and the ongoing conversations that will make it possible for us to make it possible for those 51 million American families you talk about, Elizabeth, to make sure they have the opportunity to enjoy the prosperity that this country can offer.

So with that, I thank you all for being here. And until further call of the chair, the committee is adjourned.

[Whereupon, at 1:01 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

HARVARD LAW SCHOOL
CAMBRIDGE, MASSACHUSETTS

Testimony of

Elizabeth Warren
Leo Gottlieb Professor of Law
Harvard Law School

Before the
Committee on Banking, Housing and Urban Affairs
of the United States Senate

Hearing: Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry, and Their Impact on Consumers

January 25, 2007

Thank you for the opportunity to join this discussion about credit cards. I come to you as someone who sees the value in credit cards. I use a credit card—rather frequently. I also believe deeply in the power of free markets.

But today I am here to talk about a market that is not working – at least not for the millions of Americans who find themselves on the wrong end of a credit card "deal". The credit card market is broken.

A growing number of card issuers increase their profits by loading their credit cards with tricks and traps so that they can catch consumers who stumble or mistake those traps for treasure and find themselves caught in a snare from which they cannot escape. Once they are trapped, they are bled with 29% interest rates, late fees, over limit fees, double cycle billing, disappearing grace periods, $15 phone payment charges, and every other possible way to run up the bills and keep the customer paying and paying and paying.

Credit card agreements are incomprehensible. They make it impossible for customers to avoid companies that will impose outrageous fees and penalties. The result is a race to

adopt practices that will slam consumers the hardest, knowing full well that such behavior will increase company profits dramatically while it costs the card issuers nothing as they recruit new customers.

The credit card market is broken, and consumers pay a steep price in this non-functioning market. But it doesn't have to be this way.

Why is the Credit Card Market Broken?

Substantial parts of the credit card market work. Consumers have access to a system that is convenient. Credit card issuers compete for customers' business. Innovative products permit people to earn frequent flier miles or contribute to their favorite charities when they use their cards for purchases.

But the basic structure of the credit card market is awry. Companies can make a lot of money from the basic transaction in which the customer uses a card, the company sends a bill and the customer pays in full. In 2005, such activities generated $11 billion in revenues for the card companies, and cash advance fees and enhancements added another $6 billion to the bottom line. Seventeen billion dollars would be impressive revenues in most industries in the U.S.

But the credit card companies do not stop there. These companies know they can make higher profits if the customers finance their purchases over time, paying their credit card bills a little at a time—some of them for a lifetime. And the companies knew that they could make truly extraordinary profits if the customers stumbled and the company loaded up on default rates of interest and penalty fees. In 2005, interest and penalty fee revenues alone added up to a staggering $79 billion.[1]

Although some credit card issuers focus the business model on revenues from interchange payments and annual fees, it is clear that the sweet spot is the customer who stumbles and pays late fees and high rates of interest. Nearly nine out of every ten dollars of revenue comes from the customers who cannot pay off their bills in full every month.

---

[1] Currently, credit card companies earn revenues from six sources:

Interest	$71.13 billion
Interchange fees	20.62 billion
Penalty Fees	7.88 billion
Cash-Advance Fees	5.26 billion
Annual Fees	3.26 billion
Enhancements	0.85 billion
Total	$109.00 billion

Source: *Cards & Payments*, reproduced in *Bank Card Profitability, 2005-2004*, CardWeb (2006)

To capture this high-yield customer, many credit card issuers now use a two-tier business model. First, they place as many credit cards in the hands of as many customers as possible. Last year the companies mailed more than six billion pre-approved solicitations, in addition to widespread advertising and direct marketing on college campuses, in suburban malls, and especially around military bases. They also purchased the customer accounts of other card issuers, paying prices that ranged from $200 to $1800 per customer just to have the chance to put their own cards in the wallets of these customers. For each of these customers, the card issuer can count on a stream of revenue—money from the merchants each time the customer used the credit card, annual fees from some of the customers, and a chance to sell enhancements, such as credit insurance and tax preparation assistance. It is a profitable business.

But the most valuable customers are not those who pay in full each month. Instead, the customers who generate the real profits for the credit card companies are those who stumble and slide, who make payments and miss payments, and who end up paying default rates of interest and penalty fees. To maximize profits from this group, the credit card issuers have a second tier to their business model: they load their initial card agreements with tricks and traps so that they can maximize income from interest rates and fees.

This is where the market breaks down. In a perfectly competitive market, both firms and consumers have the information they need to make sound economic decisions. Because these tricks and traps are effectively hidden from customers—invisible until they bite, that is—credit card issuers face no economic penalty in the marketplace for including them in card agreements. If the consumer can't tell a safe card from a dangerous one, then the marketplace will not reward the safe card issuer by increasing volume. It is a little like selling all cars in big black boxes that the customers could open only after they take them home. Luxury cars and go-karts without brakes would sell for the same price. There might be a big difference in use and safety down the line, but when consumers can't tell which they have before a crash, then the market cannot reward a manufacturer who produces a safer product.

The tricks and traps list is lengthy, but it includes universal default, default rates of interest, late fees, over-limit fees, fees for payment by telephone, repeated changes in the dates bills are due, changes in the locations to which bills should be mailed, making it hard to find the total amount due on the bill, moving bill-reception centers to lengthen the time it takes a bill to arrive by mail, misleading customers about grace periods, and double cycle billing—just to name the most easily understood.

The GAO has identified just a handful of these practices,[2] concluding that the companies themselves keep customers in the dark: "Contrary to usability and readability best practices, disclosures buried important information in the text, failed to group and label related material, and use small typefaces." Little wonder that the GAO interviews with consumer revealed that "many failed to understand key aspects of their cards, including

[2] Government Accountability Office, *Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers* (September 2006).

when they would be charged for late payments or what actions could cause issuers to raise rates."

The vice-president of Booz Allen Hamilton, Inc., a top-line international business consulting group, summarized the current state of bank products as "too complex for the average consumer to understand."[3] He was correct. Anyone who has ever tried to read a credit card agreement knows that the terms are simply incomprehensible. The inserts sent along with monthly bills to amend the card agreements are filled with language even a lawyer would have difficulty parsing. In such an environment, the average consumer doesn't have a prayer.

Customers are kept in the dark about these practices, until it is too late. According to the Wall Street Journal, in the early 1980s, the typical credit card contract was a page long. But by the early 2000s, that contract had grown to more than 30 pages of incomprehensible text.[4] The additional terms were not designed to make life easier for the customer.

This is not risk-based pricing. A risk-based pricing model is about the lender's assessment of the likelihood of repayment at the inception of the loan, with subsequent calibration as more information is available. Anyone who has a small child, a dog, or a dead relative who has received a pre-approved credit card offer understands that the initial loan is not risk-based. Instead, the model posits putting cards in the hands of every consumer, then maximizing revenues with every possible trick and trap once the customer has begun using the card. Charges for late fees or over-limit fees reflect a price the company believes it can charge without causing the consumer to cancel the card. Interest rate increases may be related to changes in credit, but they may also be related to factors that bear no relationship to the likelihood of repayment or, in some cases, to no change at all in the customer's risk profile. The tricks and traps are profit-taking, pure and simple.

One of the few bits of protection for consumers was eroded with the change in the bankruptcy laws in 2005. Prior to that time, any customer who was facing outrageous interest charges and penalty fees could credibly threaten to file bankruptcy. This threat from consumers had both the effect of curtailing some of the most aggressive credit practices and it encouraged lenders to do some—albeit limited—screening before issuing pre-approved credit cards. With the change in the bankruptcy laws, however, many consumers no longer see bankruptcy as an option. Whether they are right or wrong doesn't matter. Even though most of them remain eligible for bankruptcy, some now listen to debt collectors who bully them and tell them that bankruptcy is illegal and others are discouraged when they encounter higher attorneys fees and filing fees. As a result, the lenders can sweat them for payments longer, keeping them trapped in a monthly

---

[3] Booz Allen Hamilton, Inc., *Innovating Customer Service: Retail Banking's New Frontier*, Strategy + Business, Knowledge@Wharton (December 22, 2006) (quoting Alex Kandybin, Vice President, Booz Allen Hamilton, Inc.).

[4] Mitchell Pacelle, Putting Pinch on Credit Card Users, Wall Street Journal (July 12, 2004) (citing industry consultant Duncan MacDonald, formerly a lawyer for the credit-card division of Citigroup Inc.).

payment cycle that these customers can never pay off. After the new bankruptcy law went into effect, a market that was already broken got worse for the family in trouble.

Is This Just a Problem of Consumer Mis-Use?

Many people don't worry about credit card tricks and traps. About 40% of families pay in full every month,[5] and they rarely notice the mysterious increase in interest rates or the unexpected charges when a payment takes nine days to make it across country. Others enter the credit card market as a gladiator once entered battle, looking for leverage in zero-interest teaser rates and grace period floats and taking pride in their ability to carry a credit balance while dancing around the ever-present traps. But for the 23 million of those who are unable to make more than the minimum monthly payments on their cards,[6] the tricks and traps keep them on the financial ropes, collectively shelling out billions to the credit card companies and never quite getting back on their feet.

Credit cards are unsafe. Part of the reason rests with the consumer: Just as people can drive cars too fast or stick firecrackers in toaster, they can behave irresponsibly with credit cards. Spending sprees and living beyond one's means can leave someone in a deep hole with credit card debt. For those mistakes, people need to take responsibility. I cannot emphasize this point enough.

But credit cards are unsafe for another, very different reason: They are unsafe because they are designed to be unsafe. The customer who has paid on time for years can – through misstep or misfortune - find themselves hit with increases in interest rates and fees that will cost them dearly and, unless they are very lucky, can cause them to lose their financial footing.

Occasionally the economics of credit cards are exposed in public records. Mrs. Josephine McCarthy provides one example. Twenty-four months before she ended up in court, she owed her credit card company about $2200 dollars. In the ensuing two years, she made payments of $2000. But with interest charges and fees, her new balance was $2607. Mrs. McCarthy could pay nearly 100% of what she owed every year for the rest of her life, and thanks to the traps built in to her credit card, she would keep paying until she died—and still not pay off her card.[7]

---

[5] Estimate calculated from these data: Between 2000 and 2004 the percentage of cardholders who paid their card debt off in full and on time fluctuated between 38 and 44 percent. See CardTrak, Free Loaders (Apr. 8, 2005), http://www.cardweb.com/cardtrak/news/2005/april/8a.html.

[6] Cambridge Consumer Credit Index (March 7, 2005). In 2004, 46% of American families reported carrying a balance on their credit cards. Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finance, Table 11. Family Holdings of Debt, Federal Reserve Bulletin (2006). The two data sources combine to suggest that approximately 51 million households are carrying credit card debt, and approximately 23 million families are making the minimum monthly payment.

[7] In re McCarthy, Case No. 04-10493 (N.D. Va. 2004).

Ms. McCarthy is not alone. A court case in North Carolina for eighteen credit card holders showed an even more egregious pattern: For every dollar that the credit card companies said their customers owed two years ago, they now demanded two more dollars in interest and penalty fees.[8]

This isn't about irresponsibility. This is about customers who slipped and then could not free themselves from the credit card trap.

For many consumers who carry a credit card balance, debt was not the natural result of too many trips to the mall or too many nice vacations. A new report by Demos, for example, documents that 29% of families carrying credit card debt explain that medical expenses contributed to their debt loads.[9] Families with medical problems had credit card debts that were, on average, about $4,000 larger than their counterparts with no medical problems. Families with children and families with no health insurance were particularly hard hit.

Students trying to finance an education are also struggling with credit card debt. As the costs of a college education has risen and grant aid has fallen, more students are taking on more debt of all kinds. From 2001 to 2006, student credit card debt balances increased by 24%.[10] Older Americans were also targeted, with the result that they have the dark distinction of being the fastest growing age group filing for bankruptcy.

Credit card debt is the single most-often listed debt in bankruptcy, comprising a huge fraction of the non-mortgage debts these families are carrying. Why are these families in credit traps? Two-thirds explain that they lost their jobs, half had a serious medical problem and about one in five has suffered through a divorce or death in the family.[11] Once again, families with children are particularly vulnerable.[12]

For some, the story of credit card debt is one of profligacy. For others, the story is misfortune. Others could tell stories of misplaced optimism—starting a small business or believing the promise that a layoff was nearly over and new job offer was in the works. For still others, the problem is less about volition, and more about living. Credit card companies have become masters at probing every human trait—failure to scrutinize bills, willingness to try to help an alma mater, inability to make correct calculations on present discounted value of various card terms. The card companies employ teams of people whose sole job is to jigger and re-jigger credit card terms so that more money drains out of consumers' pockets—and, with a little luck, the consumer won't even notice until it is too late.

---

[8] In re Blair, Case No. 02-11400 (W.D. N.C. 2004).
[9] Cindy Zelman and Mark Rukavina, *Borrowing to Stay Healthy: How Credit Card Debt Relates to Medical Expenses* (Demos 2007).
[10] Analysis by Experian for USA Today, reported in Mindy Fedderman and Barbara Hansen, *Young & In Debt*, USA Today (August 2006)
[11] Elizabeth Warren and Amelia Warren Tyagi, The Two-Income Trap: Why Middle Class Mothers and Fathers Are Going Broke (Basic 2003).
[12] Families with children file for bankruptcy at about three times the rate of families without children. Id.

In a world in which real incomes are not rising, while mortgage costs, health insurance, child care and transportation continue their upward climb, credit card debt is not just about the profligate. It is about hard-working, play-by-the-rules families who are doing their best but who, in the ups and downs of everyday life, sometimes need credit. Only after they have seized the rope offered by the credit card companies, do some of them discover that the other end is tied to an anchor.

How Much Do the Tricks and Traps Cost?

The United States Supreme Court joins with nearly all economists in explaining that real interest rate includes both charges denominated as interest and the penalty fees that are imposed for late payments. While the 29% default rate of interest charged many customers today is breath-taking, it is important to remember that the real rate of interest is much higher. For a $100 balance with 29% default rate plus $39 late fee, the real rate of interest is 68%. Add in a $49 over-limit fee, and the real rate of interest jumps to 117%. Hit the debtor with compound interest on the fees and with over-limit fees for two or three months in a row, and the interest rates swell to 400% and higher.

The profitability of credit card operations is astonishing. One of America's largest credit card lenders, Citigroup, gives us an apples-to-apples comparison. For 2006, the company reported after-tax profits on their combined real estate mortgages, student loans, and car loans of 0.79%. The after-tax profits on their credit card operations—net of advertising, bad loans, and every other expense—was 6.17%. In other words, dollar-for-dollar, Citi earned nearly eight dollars on its credit card operations for every dollar it earned in other lending. The other operations were profitable enough for Citi to stay in business, but the credit card profits outshine every other part of their consumer operations.

Be clear: I picked Citi because the company is well known and they have large lending operations of different kinds, providing an apples-to-apples comparison on profits. But the company is neither the most profitable credit card operation nor are they the most aggressive lender. Many other lenders have tapped into the extraordinary profits of the credit card sweet spot.

Are There Solutions?

There are multiple approaches to repairing the broken credit card market. One starting place is to outlaw the most egregious practices. In no functioning market, should credit card issuers be able to change the terms of an agreement at will or to calculate interest due on money already paid. The Credit Card Accountability Responsibility and Disclosure (Credit CARD) Act of 2005 that Senator Dodd introduced is an important first step to reign in abusive lending practices. Recent changes in the law that limit total interest rates charged to military families are another important step. These laws and proposals acknowledge that there are simply some practices that are wrong and should be banned.

Current regulatory oversight is weak, in part because regulators have not chosen to exercise their powers to protect consumers from the financial institutions they regulate. When asked, for example, about why the Office of the Controller of the Currency had not been more aggressive in developing basic consumer protection, the agency spokesperson responded, "We tend not to mandate things."[13] Encouraging more vigorous oversight from regulatory commissions so that they use the tools at their disposal more effectively would make a difference.

Existing regulation should also be strengthened. Conceptually, the current patchwork of multiple regulators, each with oversight of only a subset of credit card issuers creates a kind of regulatory arbitrage in which institutions can play off regulators and shift operations to different subsidiaries in order to choose the regulatory environments they find most congenial. So long as we have a fractured oversight, this problem will continue. Combining oversight of consumer credit products in a single regulatory commission would avoid the patchwork that currently exists, while it would also permit a single agency to develop expertise on all the new and emerging credit practices.

The industry has an important role to play. Today there are many providers of safe credit cards, but their voices are often lost among the very aggressive campaigns of their more dangerous counterparts. The industry can take steps to begin cleaning up itself and developing its own best practices. No company needs to wait for government intervention to begin giving Americans a safer credit card.

Improving the quality and effectiveness of consumer disclosures may improve this marketplace somewhat as well, but here it is important to add a note about what will not work. Adding more pages to the current 30-plus pages of credit card agreements helps no one. The limits of disclosure as an effective way to improve markets are becoming clear. No one needs to be an engineer to buy a toaster. No one needs to be a crash test scientist to buy a car. And no one should need to be a lawyer to take on a credit card.

Americans benefit from markets that work. If Congress repairs the busted credit card market, then Americans—consumers and businesses alike—will benefit as well.

---

[13] Plastic Shock, USA Today (January 2006) (quoting Barbara Grunkemeyer of the Office of the Comptroller of the Currency).

Prepared Statement of

Robert D. Manning, PhD
Research Professor of Consumer Finance and
Director of the Center for Consumer Financial Services
E. Philip Saunders College of Business
Rochester Institute of Technology

Hearing on "Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry, and Their Impact on Consumers"

Before the U.S. Senate Committee on
Banking, Housing, and Urban Affairs
The Honorable Christopher J. Dodd, Chairman

9:30 a.m., Thursday, January 25th, 2007 – 538 Dirksen Senate Office Building

I would like to thank Chairman Christopher J. Dodd for providing this opportunity to share my views with the Committee on the increasingly important issue of deceptive credit card marketing and consumer contract disclosures during this rapidly changing period of banking deregulation and the increasingly negative impact of the unprecedented high consumer debt levels. This Committee has a long tradition of examining and protecting consumer rights in the realm of financial services and I hope that this hearing will produce new relief to financially distressed and overburdened households as they cope with the increasingly complex credit card policies and practices. In this endeavor, I have had the pleasure of contributing to now retired Senator Paul S. Sarbanes' investigation of consumer debt among college students and the lack of financial literacy/education programs for America's financially vulnerable youth. In addition, I applaud the legislative initiatives of Senator Christopher Dodd, who has championed credit card marketing restrictions on college campuses along with critically needed financial education programs as well as directing greatly needed attention to ambiguous contract disclosures and deceptive marketing practices. Also, it is a pleasure to acknowledge the State of New York's senior Senator, Charles E. Schumer, whose efforts to protect consumers from deceptive marketing and contract disclosure practices of the credit card industry has simplified our lives through the summary of our key credit card contract information in our monthly statements. The twin issues of rising cost and levels of consumer debt together with shockingly low levels of financial literacy among our youth and their parents have grave implications to the continued economic well-being of the nation—especially as Americans age into debt and watch the erosion of their Social Security benefits. For these and many other reasons, I commend the Committee for accepting the daunting task of examining the increasingly serious problems that will be addressed today.

As Research Professor of Consumer Finance and Director of the Center for Consumer Financial Services at Rochester Institute of Technology, I have spent the last 21 years studying the impact of globalization and U.S. industrial restructuring on the standard of living of various groups in American society. Over the last 15 years, I have been particularly interested in the role of consumer credit in shaping the consumption decisions of Americans as well as the role of retail banking in influencing the profound transformation of the U.S. financial services industry. In regard to the latter, I have studied the rise of the credit card industry in general and the emergence of financial

services conglomerates such as Citigroup during the deregulation of the banking industry beginning in the late 1970s.

In terms of the former, my research includes in-depth interviews and lengthy survey questionnaires with over 800 respondents in the 1990s and nearly 1500 in the 2000s. The results of this research are summarized in my book, *CREDIT CARD NATION: America's Dangerous Addiction to Consumer Credit (Basic Books, 2001)* and a forthcoming series of research articles. More recently, I completed a book length report sponsored by LendingTree.com, *LIVING WITH DEBT* (2005), which examined changing attitudes and behaviors toward consumer credit and debt over six specific life-cycle phases through a series of 12 focus groups with nearly 150 people. Furthermore, I have been studying the global expansion of deregulated consumer financial services with particular attention to comparative governmental policies that enforce consumer rights in Europe, Asia, and Latin America. My next book, *GIVE YOURSELF CREDIT* (Alta Mira/Taylor Publishers, 2007, presents an updated analysis of the deregulation of the credit card industry, major public policy issues, and practical guidance for consumers for more prudent use of consumer credit. These interests in public policy and financial literacy have inspired the development of my own internet-based financial literacy/education programs at www.creditcardnation.com. In addition, I have collaborated on the development of a documentary, *IN DEBT WE TRUST: America Before the Bubble Bursts,* that examines the impact of the deregulation of consumer financial services (especially credit cards) on different economic groups in American society. In association with the national release of the movie, RIT's Center for Consumer Financial Services is organizing a "Fair and Responsible Lending" campaign that seeks to promote consumer friendly lending policies with banks and enhanced personal financial literacy/awareness skills among consumers.

LIVING WITH DEBT IN AMERICA:

Soaring Household Liabilities, Rising Costs, and Declining Consumer Protections

In early 2006, the approximately 190 million bank credit cardholders in the United States possessed an average of about 7 credit cards (4 bank and 3 retail) and they charged an average of $8,500 during the previous year (Cardweb,com, 2004a; Card Industry Directory, 2006). In 2005, about 75 million (2 out of 5 account holders) were

convenience users or what bankers disparaging refer to as *deadbeats* because they pay off their entire credit card balances each month.[1] In contrast, nearly 3 out of five cardholders or over 70 million are lucrative debtors or *revolvers*; they typically pay more than the minimum monthly payment (previously 2% and transitioning to 4% of outstanding balance as per a recent OCC "advisory") while nearly 45 million struggle to send the minimum monthly payment (Cardweb.com, 2004a, Card Industry Directory, 2006).

Over the last 10 years, 1996-2005, which includes the longest economic expansion in American history, the total number of bank credit cards increased 46.2 percent, total charge volume doubled (from $798.1 to $1,618.0 billion), and "gross" outstanding credit card debt climbed 75 percent (Card Industry Directory, 2006, Ch 1). See Table 11. Today, late 2006, approximately three out of five U.S. households account for almost $770 billion in outstanding, "net" bank credit card debt plus over $100 billion in other lines of credit (Card Industry Directory, 2006; Cardweb.com, 2004a; U.S. Federal Reserve, 2006). This reflects a meteoric rise in credit card debt—from less than $60 billion at the onset of banking deregulation in 1980.

Furthermore, it is important to note that the complexity of the deregulated lending environment is reflected in technically "discrete" categories of consumer debt that were previously homogeneous—like mortgage debt—but now are essentially composite categories of a wide range of consumer loans. This is due to the sharp decline mortgage rates and underwriting standards of the 2000s—especially 2001-05—that were driven by the growth of asset-backed securities by Wall Street (usually "sister" firms within the major financial services companies) that are resold on the national and international secondary investor markets. This is manifest in the sharp decline in the growth of "revolving" consumer credit card debt in comparison to "nonrevolving" or installment debt such as auto, furniture, and appliance loans in the 2000s. For example, between 1995 and 1999, credit card outstandings rose an average of 9.5% whereas nonrevolving rose and average of 7.3%. Following the 2000 recession, however, installment borrowing rose averaged 7.5% per year whereas the revolving average

[1] During the residential housing boom, when families were encouraged to pay off their high interest credit cards with home equity loans and mortgage refinancings, the number of convenience users technically to a high of 43-43 percent in early 2005 (CardWeb.com, 2005). The proportion of convenience users is falling with declining home prices, previous mortgage/equity loans, a difficult sellers' market, and falling real household income.

plummeted to 1.2% over the period 2001 to 2005. If "net" credit card debt had continued to increase at the same level as the late 1990s, like lower interest installment debt, it would be approximately $300 billion higher at the end of 2006. Like college students using student loans to pay down their credit card balances (Manning, 2000: Ch 6; Manning and Kirshak, 2005; Manning and Smith, 2007), homeowning families converted and thus reclassified their high interest revolving debt into lower-cost mortgage debt in the 2000s. Unfortunately, unexpectedly high lender fees and adjustable rate mortgages have sharply reduced the cost saving in these debt consolidation decisions.

Today approximately 75 percent of U.S. households have a bank credit card, up from 54 percent in 1989 (Canner and Luckett, 1992; Cardweb.com, 2004a). Approximately 10 million households do not have formal retail banking accounts and other lower income/financially distressed households use charge (debit) rather than credit cards. Overall, the average outstanding credit card balance (including bank, retail, gas) of debtor or "revolver" households with at least two adults has soared to over $13,000 This is exclusive of "nonrevolving" consumer debt such as auto, home equity, furniture, debt consolidation, and student loans, which total over $1.5 trillion at the end of 2006, plus skyrocketing mortgage debt which has now become a composite category of a wide range of household debts through home equity and mortgage refinancings/debt consolidations. Table 2 reports the sharp increase in consumer debt ("revolving" and "installment") over the last 25 years (nearly doubling over the last 10 years) and the rapid rise of credit card debt—from 18.5% of installment debt in 1980 to 41.9% in 1990 peaking at 68.9% in 1998 and dropping to 57.5% in 2006. As illustrated by these statistics, the last two decades have witnessed the birth of the Credit Card Nation and the ascension of the debtor society where the rising U.S. standard of living has been more likely financed by debt rather than household income growth and saving (Manning, 2000; Sullivan, Warren, and Westbrook, 2000; Warren and Tyagi, 2003; Manning, 2005; Leicht and Fitzgerald, 2006).

Banking Deregulation and the Ascent of Retail Financial Services: What's Consumer Debt Got to Do With It?

The debate over the origins of the consumer lending "revolution" and subsequent requests for government regulation tend to focus on either the "supply" or "demand" side of this extraordinary transformation of the American banking industry with its profusion

of new and complexity banking/insurance products. This section explores how statutory and regulatory reforms over the last three decades have fundamentally changed the structure of the U.S. banking industry and the subsequent "supply" of financial services. During this period, the institutional and organizational dynamics of American banking have changed profoundly as well as the "supply" of financial services in terms of their use, cost, and availability. Indeed, the intensifying economic pressures of globalization (U.S. industrial restructuring, Third World debt crisis, downward pressure on U.S. wages) together with new forms of competition in the U.S. financial services industry (rise of corporate finance divisions, growth of corporate bond financing, expansion of mortgage securitization) precipitated a dramatic shift from "wholesale" (corporate, institutional, government) to "retail" or consumer banking (Brown, 1993, Dymski, 1999; Manning, 2000: Ch 3). And, as explained later, consumer credit cards played an instrumental role in this process.

The basic public policy assumption of banking "deregulation" is that reducing onerous and costly government regulation invariably unleashes the productive forces of intercompany competition that yield a wide range of direct benefits to consumers. The most salient features of this "Democratization" of credit are lower cost services, greater availability of products, increased yields on investments, product innovation, operational efficiencies, and a more stable banking system due to enhanced industry profitability (Brown, 1993, GAO, 1994; Rougeau, 1996; Dymski, 1999; Manning, 2000: Ch 3, US Federal Reserve, 2006). This "free market"-based prescription for miraculously satisfying both the profit goals of financial services executives and the cost/availability interests of consumers belies the inherent political asymmetries that have militated against the distribution of industry efficiencies over the last 20 years. It is the intractable conflict between corporate profit maximizers in the banking industry and consumer rights advocates that constitutes the focus of this analysis. That is, individual choice is not to be confused with an informed consumer in this rapidly changing marketplace.

According to Jonathan Brown, Research Director of *Essential Information*, there are three systemic contradictions of *laissez-faire*-driven banking deregulation that limit "broad-based" consumer benefits. In brief, they are [1] excessive risk-taking by financial institutions that are facilitated by publicly financed deposit insurance programs (FDIC) and publicly subsidized corporate acquisitions of insolvent financial institutions (Savings

and Loan crisis of early 1980s); [2] increased industry concentration and oligopoly pricing policies (in the absence of a strong anti-trust policy) that limits cost competition over an extended period of time; and [3] diminished access to competitive, "mainstream" financial services for lower income households as corporations focus their resources on more affluent urban and suburban communities. Brown concludes by underscoring the paradox of "free market"-driven banking deregulation, "strong prudential control [by government and consumer organizations] becomes even more important because deregulation increases both the opportunities and the incentives for risk-taking by banking institutions [in the pursuit of optimizing profits rather than public use]" (Brown, 1993: 23). For our current purposes, the latter two trends merit further discussion.

The first distinguishing feature of the early period of banking deregulation is the sharp increase in the growth and profitability of retail banking in comparison to wholesale banking. During the early 1980s, wholesale banking activities experienced a sharp decline in profitability, especially in the aftermath of the 1982-83 recession. These include massive losses on international loans, large real-estate projects, and energy exploration/extraction companies. Furthermore, traditional bank lending activities faced new and intensified competition such as Wall Street securities firms underwriting cheaper bond issues, corporate finance affiliates offering lower-cost credit for "big ticket" products (automobiles), and the integration of home mortgage loans into the capital market via the sale of asset-back securities (mirrored in the explosive growth of Fannie Mae) which contributed to downward pressures on bank lending margins. In addition, many consumers with large bank deposits shifted their funds into higher yield mutual funds that were managed by securities firms. This increased the cost of bank funds since they were forced to offer certificates of deposits (CDs) with higher interest rates which further reduced their profit margins (Brown, 1993; Nocera, 1994; Manning, 2000).

As astutely noted by Brown, the response of U.S. banks to these intensifying competitive pressures was predictable, "[F]inancial deregulation tends to lower profit margins on wholesale banking activities… where large banks have suffered major losses on their wholesale banking operations, the evidence suggests that they tend to increase profit margins on their retail activities in order to offset their wholesale losses" (Brown, 1993: 31). Indeed, corporate borrowers have been the major beneficiaries of banking deregulation over the last two decades. This is evidenced by the sharp increase in the

cost of unsecured consumer debt such as bank credit cards; see Manning (2000:19) for a cost comparison of corporate-consumer lending rates in the 1980s and 1990s.[2]

The magnitude of this shift in interdivisional profitability within large commercial banks is illustrated during the 1989-91 recession. For example, Citicorp reported a net income of $979 million from its consumer banking operations in 1990 whereas its wholesale banking operations reported a $423 million loss. Similarly, Chase Manhattan's retail banking activities produced $400 million in 1990 whereas its wholesale banking activities yielded a $734 loss (Brown, 1993: 31). Not unexpectedly, bank credit cards played a central role in fueling the engine of consumer lending in the 1980s. The average "revolving" balance on bank card accounts jumped six-fold--from $395 in 1980 to $2,350 in 1990 (Manning, 2000:11). According to economist Lawrence Ausubel, in his analysis of bank profitability in the period 1983-88, pretax return on equity (ROE) for credit card operations among the largest U.S. commercial banks was 3-5 times greater than the industry average (1991:64-65). Hence, the ability to increase retail bank margins in the early 1980s led to the sharp growth in consumer marketing campaigns and the rapid expansion of consumer financial services directed toward middle and then more financially insecure and marginal groups in the late 1980s such as college students, seniors, and the working poor (Mandell, 1990; Nocera, 1994; Ausubel, 1997; Manning, 2000; Sullivan, Warren, and Westbrook, 2000; Manning, 2005; Leicht and Fitzgerald, 2006). This symbiotic relationship between finance divisions and producers/retailers, which has served historically to moderate consumer effective demand and/or reinforce consumer loyalty such as the Ford and General Motors during the Great Depression (cf. Calder, 2000), underlies the shift in profitability within the American corporation during the contemporary period of post-industrial capitalism. This is illustrated by the rise of the Target owned bank credit card which has rapidly grown to become the tenth largest issuer in 2006.

Not incidentally, the escalating demand for increasingly expensive consumer credit was not ignored by nonfinancial corporations. Growing numbers of manufacturers and retailers established their own consumer finance divisions such as GMAC, GE Financial, Sears, Circuit City, Pitney Bowes, and Target. In many cases, like the dual profit

[2] The real cost of credit card borrowing, exclusive of introductory or low "teaser" rates and inclusive of penalty fees and interest rates, has nearly tripled for consumer "revolvers" since the initial phase of banking deregulation in the early 1980s.

structures of the banking industry, the traditional operations of these major corporations (manufacturing, retailing) encountered mounting competitive pressures through globalization and subsequently experienced sharp declines in their "core" operating margins. Escalating revenues in their financing divisions (especially consumer credit cards) compensated for these declines and, in especially aggressive corporations like General Electric, were spun-off into enormously profitable global subsidiaries such as GE Financial (Manning, 2000: Ch 3). In fact, the financing units of Deere & Co. and General Electric accounted for 21 and 44 percent, respectively, of corporate earnings in 2004 and all of Ford's pretax profits in 2002 and 2003 (Condon, 2005). In 2005, financial companies account for 30 percent of U.S. corporate profits, up from 18 percent in the mid-1990s and down from its peak of 45 percent in 2002 (Condon, 2005).[3] As a result, there is growing concern that shrinking bank profits derived from commercial loans to corporate borrowers, together with declining profits from the speculative "carry trade" (long-term hedging of short-term interest rates such mortgage bonds), will exacerbate pressure to increase profits on retail lending activities and thus raise the cost of borrowing on consumer credit cards.

As the consumer lending revolution shifted into high gear in the late 1980s, rising profits and rapid market growth (number of clients and their debt levels) fueled the extraordinary consolidation of American banking and especially the credit card industry. In 1977, before the onset of banking deregulation, the top 50 banks accounted for about one-half of the credit card market (Mandell, 1990). This is measured by outstanding credit card balances or "receivables" of each card issuing bank. Fifteen years later, 1992, the top ten card issuers expanded their control to 57 percent of the market, prompting a formal U.S. Congressional inquiry into the "competitiveness" of the credit card industry (GAO, 1994). Over the next decade, bank mergers and acquisitions proceeded at a breakneck pace, propelling the concentration of the credit card industry to oligopolistic levels.

---

[3] The success of corporate finance operations has led to more aggressive involvement with high-risk, speculative investments including "junk" bonds. For example, the sharp decline in the Federal Reserve's "discount" interest rate in 2001 led many of these finance divisions to invest heavily in the "carry trade" whereby companies borrow at low, short-term rates and invest in higher yield, long-term bonds or asset-backed (e.g. mortgages, credit cards) securities. Today, with interest rates rising, the enormous profits made from these bond purchases in 2002 and 2003 will soon be replaced with losses following the decline in this favorable interest rate "spread." As a result, corporate finance affiliates must offset these losses by

For example, Banc One's acquisition of credit card giant First USA in 1997 was followed in 1998 by Citibank's purchase of AT&T's credit card subsidiary--the eighth largest card issuer. Over the next eighteen months, MBNA bought SunTrust and PNC banks, Fleet merged with BankBoston, Bank One acquired First USA, NationsBank merged with Bank of America, and Citibank bought Mellon Bank. Today, the ongoing concentration of the credit card industry features the mergers of increasingly larger corporate partners. In 2003, Citibank purchased the troubled $29 billion Sears MasterCard portfolio (Citibank, 2003). This was followed in 2004 with Bank of America's acquisition of Fleet Bank (tenth largest U.S. credit card company) and J.P Morgan Chase's purchase of Bank One (third largest credit card company). As a result, the market share of the top 10 banks climbed from 80.4 percent in 2002 to 86.7 percent in 2003 and then to 88.1 percent in 2004 (Card Industry Directory, 2005). In 2005, this market concentration continued with Bank of America's acquisition of MBNA. Overall, the top three card issuers (J.P. Morgan Chase, Citigroup, Bank of America,) controlled over 61.8 percent of the market at the beginning of 2006 as defined by their proportion of outstanding credit card debt. See Table 3. This extraordinary pace of industry concentration explains the increased premiums that these major credit card companies have been paying for Private Label store credit card portfolios such Home Depot, Victoria Secret, and Macy's.

Not surprisingly, as market expansion and industry consolidation approach their statutory limits in the United States, several top megabanks have begun demanding the relaxation of market concentration restrictions in the US (e.g. Bank of America's recent request to raise the 10% limit on the national market share of consumer deposits) and abroad. This has contributed to the aggressive marketing of consumer financial services in international markets through corporate acquisitions, mergers, and joint ventures which have been facilitated by the increased membership in the World Trade Organization and its promotion of financial services liberation. These include Citibank, MBNA, Capitol One, GE Financial, and HSBC with particular attention to Europe and Southeast Asia followed by Latin America and Africa (Mann, 2006; Manning, 2007a). This is shown in Table 4. Between 2000 and 2005, the growth of bank issued credit cards in the US increased marginally (3%) whereas the expanded nearly 65% globally albeit including the bank issuance of debit cards (Card Industry Directory, 2006).

---

increasing the volume of more costly corporate loans which is problematic with current market conditions. This will increase pressure to raise lending margins on their consumer financial services.

Not only has U.S. banking deregulation transformed the market structure of the US and eventually the global financial services industry but it has also facilitated the rise of the "conglomerate" organizational form. This second distinguishing feature of the recent deregulated banking era is a profit maximizing response to the maturation of industry consolidation trends. In brief, the limits of organizational growth through horizontal integration, even with its economic efficiencies of scale and oligopolistic pricing power, entails that future growth can only be sustained by expansion into new product lines and consumer markets. This multidivisional corporate structure, guided by "cross-marketing" synergies offered by "one-stop" shopping via allied subsidiaries for the vast array of consumer financial services, was initially attempted by Sears and American Express in the 1970s and 1980s with generally disappointing results (Nocera, 1994; Manning, 2000).

By the late 1990s, two financial services behemoths sought to bridge the statutory divide between commercial banking and the insurance industry by combining their different product lines into a single corporate entity: Citigroup. Technically, the 1998 merger of Citibank and Travelers' Insurance Group was an illegal union that required a special federal exemption until the enactment of the *Financial Services Modernization Act* (FSMA) of 1999 (Macey and Miller, 20000; Manning, 2000: Chapter 3; Evans and Schmalensee, 2005).[4] With cost-effective technological advances in data management systems together with U.S. Congressional approval of corporate affiliate sharing of client information (FSMA) and the continued erosion of consumer privacy laws (*Fair Credit and Reporting Act* of 2003), Citigroup became the first trillion dollar U.S. financial services corporation that offered the "one-stop" supermarket model for all of its clients' financial needs. These include retail and wholesale banking, stock brokerage (investment) services, and a wide-array of insurance products for its customers in over 100 countries. Again, bank credit cards played a crucial role through the collection of household consumer information, the cross-marketing of Citigroup products and services, and its high margin cash flow that helped in offsetting costly merger and integration-related expenses (Manning, 2000: Ch 3). Ironically, the much faster growth and

[4]Also referred to as the Gramm-Leach-Biley Act (GLBA) of 1999.

profitability of its retail banking operations led Citigroup to sell off its Traveler's insurance divisions to Met Life in 2005.[5]

A third distinguishing feature of banking deregulation is the widening institutional gap or bifurcation of the U.S. financial services system. That is, the distinction between "First-tier" or low-cost mainstream banks and "Second-tier" or 'fringe' banks such as pawnshops, rent-to-own shops, "payday" lenders, car title lenders, and check-cashers. This widening institutional division between these consumer financial services sectors has dramatically increased the cost of credit among immigrants, minorities, working poor, and heavily indebted urban and increasingly suburban middle-classes (Caskey, 1994; 1997; Hudson, 1996; 2003; Manning, 2000: Chapter 7; Peterson, 2004; Karger, 2005). Indeed, the usurious costs of financial services in the second-tier reflect the ideological zeal of regulatory reformers whose goal is to rescind interest rate ceilings, loan "quotas" imposed on mainstream banks for disadvantaged communities, and vigorous enforcement of financial disclosure laws. Shockingly, the cost of credit typically exceeds 20 percent per month (often over 600% APR) for consumers who often earn poverty-level incomes and less although use of these services is growing among financially distressed, lower middle income households ($25,000 to $45,000 annual incomes).

The significance of this trend is two-fold. First, the systematic withdrawal of First-tier banks from low-income communities restricts the access of these residents to reasonably priced financial services. Although morally reprehensible, banks frequently justify their actions in terms of economic efficiencies and profit utility functions that are arbitrated by "free-market" forces. The political reality, however, it that this policy is a defiant rejection of the affirmative obligation standard of the *Community Reinvestment Act* (CRA) of 1977 (Brown, 1993, Fishbein, 2001; Carr, 2002). That is, the banking industry receives enormous public subsidies through (1) depositor protection programs/policies, (2) access to low-cost loans through the Federal Reserve System's lender of last resort facility, and (3) privileged access to the national payments/transactions system (Brown, 1993). The *quid-pro-quo* for satisfying this

[5] Citigroup's consumer financial services companies have outperformed the insurance division in growth and profit margins—especially after 2001. As a result, Citigroup has retreated from its one-stop, financial supermarket concept and has agreed to sell its Travelers Life & Annuity division to Metlife Inc for $11.5 billion in winter of 2005 (Reuters, 2005b).

affirmative obligation standard has been an understanding that banking institutions have a duty to provide access to financial services to disadvantaged groups within their local communities, to engage in active marketing programs for promoting these financial services and products, and, in the process, to absorb some of the administrative expenses and costs of their financial products/services. By ignoring their responsibility to CRA, First-tier financial institutions have invariably increased the population of "necessitous" consumers whose limited resources exacerbates their reliance on "Second-tier" financial services and their vulnerability to predatory lenders.

Second, the tremendous price differential between the two banking sectors increases the financial incentive for First-tier banks to abandon low-income and minority communities and return directly or indirectly through financial relationships with Second-tier financial institutions (Hudson, 1996; 2003; Manning, 2000:Ch 7; Peterson, 2004; Karger, 2005). This is becoming an increasingly common practice of the largest banks. For instance, Citibank purchased First Capital Associates in 2000 which had been penalized by federal regulators from the Office of the Comptroller of the Currency (OCC) for its past predatory lending policies and was again recently chastized by the Federal Reserve for originating predatory home mortgages, HSBC's purchase of Household Bank in 2000 was delayed following the negotiation of a $400 million predatory lending settlement, and Providian Bank was fined $300 million by the OCC in 2000 for its unfair and deceptive practices in the marketing of its "subprime" card cards (Manning, 2001; 2003; Hudson, 2003; Peterson, 2004).

As the growth rate of traditional, middle-class financial services markets stagnates, the U.S. credit card market has become clearly segmented into at least 4 distinct strata: [1] high net worth such as American Express' *Black Card* whose revenues are nearly exclusively fee-based (merchant fees); [2] mainstream or traditional credit cards for middle-income households with competitive interest rates dominated by the Big Three card issuers; [3] the less competitive, higher interest Private Label cards such as Home Depot or department store cards which feature an interest rate premium of 5-7 percentage points (dominated by Citibank, GE Financial, Chase); and [4] subprime credit cards for the most financially distressed which feature low credit lines (typically less than $250) with fees accounting for 70-80 of total revenues among major issuers such as Capital One, Cross Country Bank, HSBC's Orchard Bank, and First Premier Bank.

Furthermore, major banks are aggressively promoting "subprime" consumer lending programs with triple digit finance charges (effective APRs) such as HSBC's partnership with H&R Block's Rapid Advance Loan (RALs) and Capital One Bank's fee-laden credit cards such as its "EZN" card which imposes $88 in fees for $112 line of credit. It is the desperation of consumers who depend on credit for household needs, especially after personal bankruptcy or an economic calamity (job loss, medical expenses, divorce), that leads them to "trustworthy,' major financial institutions whom they expect to offer the best financial rates on consumer loans. However, instead of receiving "No Hassle" credit cards with moderate interest rates, unsuspecting Capital One customers often receive subprime cards with little credit and unjustifiably high fees.[6] In the case of First Premier Bank, the $250 line of credit at 9.9% features $178 in fees.[7] With such small loans offered to households that are specifically identified/marketed by these banks through the purchase of mass mailing information from the major three credit reporting bureaus (CRBs), it is not surprising that this small market niche is the most profitable of the industry with its major costs associated with marketing, debt collection activities, and fighting civil litigation filed on behalf of aggrieved consumers.

Although the professed rationale for the passage of the more stringent Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 was consumer abuse of the Chapter 7 liquidation codes that increased costs to financially "responsible" consumers due to higher credit card charge off rates and downward pressure on corporate profits (cf. Warren, 2002), the financial health of the credit card industry has never been better. In fact, the year that the BAPCPA was enacted, credit card charge-offs declined 4% (from $36.4 to 35.1 billion). Furthermore, the credit card industry has reported a succession of record profits. In 2003, pre-tax profit (Return on Investment) of $17.1 billion climbed 32.4% from 2002 even though interest revenue declined slightly from $66.5 to $65.4 billion (Card Industry Directory, 2005). According to the June 2003 FDIC report on bank

---

[6]See *Foster v. Capital One Bank, et al* for ongoing class action lawsuit regarding deceptive marketing and excessive fees for the "*Capital One* Visa Permier" credit card that features O% introductory APR on all purchases and a variety of fees including $39 annual membership and $49 "refundable security deposit.

[7]See *Paul T. Finkbiener, et al, v. First Premier Bank, et al* (filed in 2003) for example of deceptive marketing, disclosures, and excessive fees for the "*First* Permier" credit card that features 9.9% introductory APR on all purchases with a variety of fees including $39 annual membership and $49 "refundable security deposit. Maximum line of credit is $250 before deducting activation and membership fees.

profits, [First Quarter 2003] "is the largest quarterly earnings total ever reported by the [banking] industry... [and] the largest improvement in profitability was registered by credit card lenders [with] their average Return-On-Assets (ROA) rising to 3.66 percent from 3.22 percent a year earlier;" The Card Industry Directory (2004) reports 2003 ROA at 4.02 percent and credit card industry analyst R.K. Hammer Investment Bankers report it at an even more impressive 4.40 percent. The extraordinary profitability of consumer credit cards is illustrated by comparing the ROA of credit card issuers with the overall banking industry. According to the FDIC, the increase in the ROA for the banking industry rose from 1.19% in 1998 to 1.40% in 2003 (First Quarter) or 17.6% while the U.S. Federal Reserve Board reports that ROA for the credit card industry was 2.13% in 1997 and has risen impressively to 2.87% in 1998, 3.34% in 1999, 3.14% in 2000, 3.24% in 2001, 3.5% in 2002, and 3.66% in 2003. This is largely due to lower cost of borrowing funds (widening "spread" on consumer loans), decline in net charge-offs ($911 million or 18.5 percent lower in 2003 than 2002),[8] decline in delinquent accounts ($919 million or 14.3 percent lower in 2003 than 2002), cross-marketing of low-cost insurance and other financial services, and dramatic increase in penalty and user fees. For 2005, the most recent period that financial data is publicly available, the industry had another record year of profitability—a pre-tax profit/ROA of $18.5 billion. As shown in Table 5, the after-tax profit/ROA of $12.0 billion was an astounding 30.55% increase from 2004—even before the implementation of the new consumer bankruptcy codes. This was driven by lower charge-offs, smaller fraud losses, higher merchant fees (especially growth of debit transaction fees), higher finance charges, and especially consumer fees (annual, penalty, cash advance) that totaled $16.4 billion (Card Industry Director, 2006).

---

[8] Historically, about 60% of bad consumer debt or bank "charge-offs" is due to unsecured credit card or "revolving" loans. According to the *Card Industry Directory* (2004: 11), card industry "charge-offs" declined from $35.4 in 2002 to $33.2 billion in 2003 or less than one-half of total bank charge-offs. This constitutes about 5 percent of net outstanding credit card balances at the end of 2003 (Cardweb, 2004). Note, this is not the same as the outstanding loan principal "charge-offs" since banks typically do not classify delinquent debt as in "default" until 90 to 120 days. For example, based on the following conservative estimates, one-third of this gross "charge-off" amount is attributed to: [a] delinquent interest rates over the last 4 months (about $2.0 billion at 23.9% APR) plus [b] late fees (about $0.9 billion at $35 per month) together with [c] overlimit and cash advance fees ($0.3 billion at $35 per month and 3% per transaction) plus [d] 12 months of interest prior to delinquency ($4.5 billion at 17.9%APR) and [e] legal/collection fees ($0.8 billion at $140 per account). In addition, recently "discharged" credit card debt is selling for 6.5 to 7.0 percent "face value" on the secondary market (*Card Industry Directory*, 2004: 11). Overall, the data suggest that the "true" loss of capital to the major credit card issuing banks is approximately 60 percent of the reported "charge-off" value. These estimates assume that at over one-fourth of these "charge-off" amounts are due to late fees, overlimit fees, accrued finance charges, and collection related fees which are subsequently sold on the secondary market.

One of the most striking features of the deregulation of the U.S. banking industry is the sharp increase in the cost of "revolving" credit (Ausubel, 1991; 1997; Manning, 2000). For instance, the 'real' cost of borrowing on bank credit cards has more than doubled due to widening interest rate "spreads" (doubled from 1983 to 1992) in addition to escalating penalty and user fees. The former is a result of the 1978 US Supreme Court (Marquette National Bank of Minneapolis v. First National Bank of Omaha) decision that permitted banks to relocate their corporate headquarters simply to find a "home" where they could essentially "export" high interest rates across state boundaries and effectively evade state usury regulations (GAO, 1994; Rougeau, 1996; Manning, 2000; Evans, and Schmalensee, 2001; Lander, 2004). The largest credit card issuers, led by Citibank, swiftly moved to states without interest rate ceilings. This relocational strategy of major nationally chartered banks has essentially eliminated a publicly legislated lending rate or state "usury" cap. See Appendix A for the state headquarters of the largest credit card issuers. The dramatic increase in fee revenues is attributed to the 1996 U.S. Supreme Court decision, Smiley v Citibank, which ruled that credit card fees are part of the cost of borrowing and thus invalidated state imposed fee limits (Macey and Miller, 1998; Evans and Schmalensee, 2001; Lander, 2004). Overall, penalty and cash advance fees have climbed from $1.7 billion in 1996 to $12.0 billion in 2003 to $16.4 billion in 2005.. The average late fee has jumped from $13 in 1996 to over $30 in today. Incredibly, combined penalty ($7.9 billion) and cash advance ($5.3 billion) fees of $13.2 billion exceed the "net" after-tax profits of the entire credit card industry ($12.03 billion) in 2005. See Table 5.

In conclusion, banking deregulation has produced an economic boom for the U.S. financial services industry. In the 1990s, it recorded eight successive years of record annual earnings (1992-1999) and rebounded with five successive years of record profits since the end of the 2000 recession, (FDIC, 2004; Daly, 2002). In fact, the assets of the ten largest U.S. banks total $3,552 billion at the end of June 2003—an astounding increase of 509 billion from 2002 (16.7%). Overall, the assets of the ten largest U.S. banks exceed the cumulative assets of the next 150 largest banks (American Banker, 2003). And, this trend does not appear to be abating. Today, rising interest rates (most credit cards feature variable interest rates where retroactive rate increases can be easily triggered unilaterally by the card issuer), growth of POS transaction fees (credit and debit) for low cost items (under $5), higher fee schedules, improving debt "quality," and

the 15-18% price premiums for the sale of asset-backed or "securitarized" credit card debt portfolios in the secondary market to American and global investors. This latter trend is especially disconcerting as it reflects a market concentration outcome whereby major card issuers have become less concerned about consumer debt/income capacity issues since the robust housing market has led to declining credit card debt charge-offs and they are reaping huge profits through portfolio sale premiums and account processing for investors. My concern is that major lenders are becoming more concerned about satisfying the performance of these securities to investors than working closely with financially distress consumers who fall behind in their payments. In some cases, we are seeing investors reluctant to work directly with delinquent debtors since a specified default rate is already priced into the sale price of the security. This could have major implications as we examine the relationship between credit card and mortgage debt.

IN DEBT WE TRUST:

Seduction, Indulgence, or Desperation?

The increasing societal dependence on consumer credit since the onset of banking deregulation in the late 1979s is staggering. Between November 1980 and November 2005, revolving "net" credit card debt has climbed fiften-fold, from about $51 billion to over $770 billion at the end of 2006. Similarly, installment debt has jumped from $297 billion in 1980 to $1,520 billion today. Overall, U.S. household consumer debt (revolving, installment, student loan) has soared from $351 billion in 1980 to nearly $2,200 billion in 2006. Together with home mortgages, total consumer indebtedness is crossing the $15 trillion mark—with the vast majority--about $13 trillion--in "mortgage" debt (U.S. Treasury, 2006). This trend is especially significant since the U.S. post-industrial economy has been fueled by consumer related goods and services that account for almost 70% of America's economic activity (Gross Domestic Product). In fact, U.S. households have continued to accumulate soaring levels of consumer debt even though real wages have declined between 2000 and 2005 with some positive relief in 2006. This compares with moderate wage growth in the preceding five years (1995-2000) which demonstrates a startling lack of association between family income and household debt accumulation trends (Mishel, Bernstein, and Allegreto, 2007). See Table 6. As a consequence, the U.S. personal savings rate has plummeted to negative levels since summer 2005—the first time since the Great Depression in 1933. See Appendix B.

Several factors help to explain the record-setting debt burden of American households—especially middle class families. First, as measured by share of disposable household income, the 1980s and 1990s feature the unprecedented growth of consumer debt—from 73.2 percent of personal income in 1979 to a staggering 131.8 percent in 2004. As shown in Table 7, the overwhelming proportion (95.8%) of household debt obligations is accounted by home mortgages ((Mishel, Bernstein, and Allegreto, 2007); between 1979 and 2001, the share of discretionary household income allocated to housing jumped from 46.1 percent in 1979 to 85.0 percent in 2003 (Mishel, Bernstein, and Allegretto, 2005). This pattern reflects two key trends. First, the "democratization" of consumer credit led to an extraordinary, post-2000 recession phenomenon: the suspension of the financial laws of gravity as real family income declined while housing prices soared—average metropolitan housing prices doubled between 2000 and 2005 (cf. Manning, 2005: Ch 1). As some scholars have persuasively argued, this reflects the rational calculus of middle and upper income Americans to purchase home with the best public schools, public services, and quality of life (cf. Warren and Tyagi, 2003). Second, the enormous increase in housing costs has diverted previous discretionary income that was used for other personal or family needs. Although mortgage debt is the least expensive consumer loan, this sharp increase has squeezed the ability of middle income households to pay for lifestyle needs and/or finance unexpected expenditures such as health care or auto repairs. This deficit spending model produced high interest credit card balances that were frequently reclassified as home mortgage/equity loan debt through home refinancings and other secured debt consolidation loans. This accounts for soaring mortgage debt levels (about $6 trillion in 1999 to nearly $13 trillion today) and home equity loans accounting for over one-tenth (11.6%) of household disposable income (Mishel, Bernstein, and Allegreto, 2007). See Appendix C.

As the negative economic consequences of globalization and the reduction of the US welfare state continued in the 1990s and 2000s, most American households steadfastly fought to maintain their fragile standard of living by financing their expenditures with lower personal savings and higher credit card and installment loans. In fact, as the U.S. personal savings rate fell to record lows in the late 1990s—near zero in 1998 (See Appendix B)—credit cards became the financial "safety net" for financially distressed and economically vulnerable households (cf. Warren and Tyagi, 2003; Demos/CRL, 2005). In 1980, over four-fourths (81.5%) of nonmortgage consumer debt

was financed through low-interest, "secured" installment loans such as for autos, furniture, and electronics. For the first time, during and immediately after the 1989-91 recession, banks relaxed their credit card underwriting standards and consumer balances soared—from 36.2% of installment debt in 1989 to 52.8% in 1992. This was accompanied by mass marketing campaigns that promoted credit card use for "needs" as well as "wants" such as groceries, rent and mortgage payments, and even income taxes not to mention the incredibly successful "PRICELESS" MasterCard advertising campagns. By 1998, outstanding credit card debt was 68.9% of outstanding installment debt. This proportion has fallen due to new debt consolidation options such as mortgage refinancings, home equity loans, and aggressive marketing of low-interest auto loans. Indeed, home equity loans were not even available to consumers until the late 1980s as a response to tax changes arising from the enactment of the 1986 Tax Reform Act.

In the decade since the end of the 1989-91 recession, during the longest economic expansion in US history, "net" credit card debt surged from about $251 billion in 1992 to about 770 billion today while installment debt jumped from $532 billion to over $1.5 trillion (U.S. Federal Reserve, 2007). See Appendix D. Significantly, scholars disagree over whether these new debt levels can be restrained. Juliet Schor (1998; 2005), has received national attention for asserting that a large proportion of consumer debt is avoidable since the pressures of competitive consumption are social and thus can be resisted by embracing traditional values and household budgeting/lifestyle behaviors such as thrift, frugality, and material simplicity that discourage discretionary consumption. Hence, Schor contends that "keeping up with the Jones" is a voluntary, personal decision that can be rejected by "downshifting" to a simpler, less expensive lifestyle. On the other hand, Elizabeth Warren and Amelia Warren Tyagi (2003; 2005) argue that the debt arising from the "two-income trap" is primarily due to the soaring costs of middle-class necessities such as housing, automobiles, medical care, education, and insurance. Their highly influential work contends that households have no recourse but to assume higher debt burdens as a rational response to increasing economic pressures such as health care, job loss/interruption, family crises, insurance, and education-related costs.

The role of structural factors in influencing the decision of middle class households to assume higher levels of debt is suggestive. Two other measures of financial distress as measured by the U.S. Federal Reserve Board are households with

high debt burdens (40% or more of household income) and late payment (60 days or more) of bills. Between 1989 and 1998, the lower income, middle-class reported the most economic difficulty. For instance, the high debt service burdens of modest income households ($10,000 to $24,999) rose from 15.0% to 19.9% while moderate income households ($25,000 to 49,999) rose from 9.1% to 13.8%; households with incomes over $50,000 increased marginally to about 5% while those under $10,000 rose from 28.6 percent to 32.0 percent. Similarly, late payments increased marginally among households with at least $50,000 annual income to about 4.4 percent (most increase since 1992) while the $25,000 to $49,999 group nearly doubled from 4.8 percent in 1989 to 9.2 percent in 1998; households with modest income ($10,000 to $24,999) remained unchanged at 12.3 percent (Mishel, Bernstein, and Boushey, 2003). In 2004, the strain of soaring household consumer debt among middle- and upper middle income households is most pronounced. For instance, the middle income households (41% to 60%) experienced the sharpest increase in delinquent bills—from 5.0% in 1989 to 10.4% in 2004—followed by upper middle-income families that rose from 5.9% to 7.1%, respectively. Significantly, the highest income households reported a sharp decline in bill payment delinquencies (Mishel, Bernstein, and Allegreto, 2007). See Table 8.

Since the sharp decline in consumer interest rates beginning in late 2000, lower finance costs have provided some measurable financial relief to American households. However, the greatest beneficiaries of this low interest rate period have been the highest income households. Between 1992 and 2001, middle-income households ($40,000 - $89,000) experienced an aggregate increase in their debt service burden (as a share of household income) whereas upper income households experienced a significant decline (28.6%)—from 11.2 percent to 8.0 percent. Overall, the debt service burden of the upper income earning households is about one half of the lower- and middle-income households in this period (8.0% versus 16.0%). This is consistent with the cost of credit card debt during the current era of financial services deregulation whereby convenience users receive free credit (plus loyalty rewards such as free gifts and cash) and revolvers pay double-digit interest rates and soaring penalty fees. In comparison, the working poor have witnessed a modest decline in their debt service burden, from 15.8 percent in 1992 to 15.3 percent in 2001 (Mishel, Bernstein, and Allegretto, 2005). During the 2000s, however, US household debt service obligations climbed to historic levels and are most burdensome to lower and middle-income households. The lower middle (21%-40%) and

middle income families (41 to 60%) registered the steepest increases in household debt service as a share of Household income. Between 1989 and 2004, lower income families paid from 13.0% to 16.7% while middle income families saw their debt service rise from 16.3% to 19.4% (Mishel, Bernstein, and Allegretto, 2005). See Table 9. Clearly, banks recognized that the best customers in the risk-averse regulated, consumer lending system were those that could repay their loans whereas today the best customers are those that may never pay off their debts. Indeed, is previous estimates of household credit card debt accumulation are accurate, the average revolver household would have over $18,000 in credit card debt if not for the aggressive marketing of low-interest, home equity/house refi debt consolidation loans in the 2000s. Nevertheless, consumer debt is not necessarily a problem is the asset side of the household financial ledger is robust. Hence, a key question is whether asset formation is growing faster than debt accumulation among America's middle classes which would obviate many of the negative consequences of the middle class debt "bulge."[9]

As consolidation of the credit card industry accelerated at a rapid pace over the last two decades, banks responded by increasing their consumer credit card portfolios by increasing the debt capacity of existing clients and aggressively marketing bank and retail credit cards to traditionally neglected groups, such as college students and the working poor. For example, the Survey of Consumer Finance reports that the largest increase in consumer credit card debt was among households with a reported annual income of less than $10,000. Between 1989 and 1998, the average credit card debt among debtor households soared 310.8 percent for the poorest households and 140.9 percent among the oldest households (Draught and Silva, 2003). The overall average for all debtor households during this period is 66.3 percent. Similarly, credit card debt jumped sharply among college students and young adults.

During the late-1980s, when banks realized that students would use summer savings, student loans (maximum limits raised in 1992), parental assistance, part-time

[9] it is important to note that many important sources of financial liabilities are not included by the Federal Reserve in its reports on outstanding nonmortgage consumer debt and thus understates the degree of household economic distress—especially among lower income families. These include car leases, payday loans, pawns, and rent-to-own contracts. For example, a household that rents an apartment, acquired furniture from a rent-to-own store, leased its car, and took a payday loan to pay for groceries has a zero debt-to-income ratio—hardly an accurate measure of its financial distress.

employment, and even other credit cards to service their consumer debts, the spike in college credit limits contributed to the surge in "competitive consumption" across college campuses that has redefined the lifestyle of the "starving" student and provided an opportunity for college administrators to continue increasing the cost of higher education (Manning, 1999; 2000: Ch. 6; Manning and Kirshak, 2005; Manning and Smith, 2007) Today, credit card issuing banks are aggressively competing in this new "race to the bottom" marketing campaign as the moral boundary that has traditionally impeded brazen solicitations of teenagers has been broached with sophisticated marketing campaigns aimed at high school and even junior high students (Manning, 2003(b); Mayer, 2004; Manning and Smith, 2005; Ludden, 2005). Long gone are the days (late 1980s and early 1990s) when parents were required to co-sign a credit card account. Instead, banks have learned that students will assume higher levels of consumer debt at a much faster rate if their consumptive behavior is shielded from their parents. My recent research shows that the fastest growth of credit card use is among 16-18 year olds and the marketing of gift cards (especially during the holidays) serves to collect important demographic information that can be used in future marketing campaigns for minors (Manning, 2003). Furthermore, my most recent survey of credit and debt among minority college students found that a large proportion of lower income college students are being pressured by family members/friends to take out loans for them through their access to credit cards with a large proportion reporting low or partial repayment rates (Manning and Smith, 2007).

Although credit card industry sponsored research has sought to minimize the social problems associated with rising student consumer debt levels, typically with flawed quantitative methodologies that are based on propriety data that "unfriendly" researchers are not permitted to examine (c.f. Barron and Staten, 2004; Manning and Kirshak, 2005), the growth of consumer debt at younger ages are undeniable trends among America's youth. For parents and higher education professionals, this intensifying marketing of credit and gift cards to high school students provides both an opportunity to introduce/expand personal financial literacy programs as well as pose a daunting challenge in confronting college age social problems that are rapidly expanding into secondary schools. As a result, the marketing of credit cards to high school seniors and college freshmen suggests that their debt capacities will be stretched at much earlier ages which will increase the likelihood of not completing college as well as the

possibility of consumer bankruptcy in their early to mid-twenties with its age-specific biases such as the nondischargeability of student loans. Recent studies suggest that the fastest growing groups of consumer bankruptcy filers are those that have previously registered the lowest rates: senior citizens and young adults under 25 years old (Sullivan, Warren, and Westbrook, 2000; Sullivan, Thorne, and Warren; 2001; Manning and Smith, 2005).

A final factor concerns consumer confidence and perception of household wealth. Over the last two decades, middle class households have become active participants in the stock market, either indirectly through their employer pension portfolios or directly through personal investment accounts. When consumers are optimistic about the future, such as their job prospects or accumulation of wealth, they are likely to spend more financial resources--even if their current economic situation is unfavorable. As the stock market soared in the late 1990s, especially the NASDAQ, the psychological "wealth effect" encouraged many families to assume new financial obligations that exceeded their household income. Over the last five years, until recently, the "wealth effect" among middle income families was more likely shaped by rising housing/property values and investment in the equity markets. This is illustrated in Table 10 which reports stocks, other assets, total debt, and net worth by wealth class from 1962 to 2004.

The data is surprising. It reveals that only a small proportion of the US population has benefited from the enormous wealth that was generated during the longest economic expansion in U.S. history (Wolff, 2003). For example, between 1989 and 2001, the bottom 40 percent of American households increased their stock holdings from an average of only $700 to $1,800 while the next 20% (the middle income (41%-60%) households) increased modestly from $4,000 to $12,000 or about $667 per year. In comparison, the upper middle income families (61% - 80%) experienced an increase of from $9,700 to $41,300 in stock assets. Between 2001 and 2004, moreover, all income groups reported a decline in the asset value of their stock holdings. However, this was counterbalanced by the rise in reported "other assets" which is primarily housing appreciation. During this three-year period, this asset value climbed 32.3% for the bottom 40% of American families, 30.7% for middle income families, 30.7% for upper middle- income families, 30.8% for the next highest 10% of households, and 27.6% for the top 1% of families by income. More important, however, is the much higher rate of

growth of household financial liabilities: 34.9% for bottom 40%, 46.7% for middle income families, and 55.0% for upper middle income families. This trend has substantially reduce household wealth formation. Overall, the respective growth in household "net worth" increased -24.1% for lowest 40% of families, 9.1% for middle income families, 13.1% for upper middle income families, and 17.1% for the affluent households (Mishel, Bernstein, and Allegretto, 2007. In view of the growing number of adjustable and interest only loans that are are resetting over the next three years, most households will find themselves with higher interest debts and lower property values that will erase their asset formation gains of the 2000s. Indeed, a 10% decline in property values could eliminate the wealth gains for nearly 60% of American households during the housing boom of the last five years. Furthermore, due to home equity and mortgage refis, most Americans will find that the rising cost of homeownership will result in increasing credit card balances that will trigger higher finance rates.

With falling property values, I expect that a distinguishing feature of the post-bankruptcy reform period is that homeownership—which previously enabled families to avoid financial insolvency through unexpected robust price appreciation--will propel increasing numbers of middle income households into a much more costly and less sympathetic Federal Bankruptcy Court system. It is this failure to reform the existing consumer bankruptcy system—especially the traditional dichotomy of either repaying all (Chapter 13) or little/none (Chapter 7) that fails to recognize the reality of a new group of middle income debtors. This trend became apparent in the late 1990s when robust economic growth and falling underemployment rates coincided with soaring bankruptcy rates which many scholars directly and indirectly attribute to rising credit card debt and interest rate levels (Ausubel, 1997; Sullivan, Warren, and Westbrook, 2000; Manning, 2000). See Appendix E. First, the soaring growth of unsecured credit card debt takes off in the mid-1980s and is accompanied by the dramatic increase in consumer bankruptcies; between 1985 and 1990, consumer bankruptcy filings more than doubled from 343,099 to 704,518. In the aftermath of the 1989-91 recession, consumer bankruptcy filings closely follow the effect of rising unemployment through 1992 (steadily rising to 946,783) and then fall moderately with declining unemployment rates through 1995 (843,941). In 1995, however, consumer bankruptcy filings exhibit a profoundly different relationship with fluctuations in the rate of unemployment. Indeed, this underscores the second salient feature of contemporary American bankruptcy filing trends: an inverse correlation

with unemployment levels. That is, the robust economic expansion of the late 1990s, which generated over 220,000 new jobs each year, produced a substantial drop in U.S. unemployment AND a sharp increase in U.S. consumer bankruptcy filings. This historically unprecedented relationship persisted through 1998 when bankruptcies registered an all-time high of 1,418,954. Since 1999, the traditional relationship between macro-economic conditions and consumer bankruptcy resumed, as filings fell to 1,376,077 in 2001 and then steadily rose to1,493,461 in the aftermath of the 2000 recession. Following the sluggish economic recovery, however, consumer bankruptcies have risen to new record highs of 1,638,804 in 2003 and 1,624,272 in 2004 while unemployed has dipped (U.S. Bankruptcy Courts, 2005). The dramatic increase in consumer bankruptcy rates is underscored when the number of eligible bankruptcy filers per capita is calculated during this period. Between 1985 and 2004, it soared from less than 200 filings per 100,000 to over 1,000 per 100,000.

Today, we will see the emergency of an increasingly financially fragile group of middle income households with high levels of debt being forced through rising credit card interest rates and aggressive debt collection policies into bankruptcy debt relief programs. At the Center for Consumer Financial Services at the Rochester Institute of Technology, we are currently conducting a pilot "Responsible Debt Relief" project in Texas and California that examines the debt accumulation experiences and ability of what we call the "near bankrupt" families to satisfy a creditor approved, debt payment program (Manning, 2007b). These families could qualify for Chapter 7 bankruptcy relief but would prefer to pay somewhere between ¾ to 1 ¾ percent of their current outstanding consumer debt through a lawyer supervised, three-year repayment program that could recover from 20% to 45% of their total, unsecured consumer debts over a three-year period. Significantly, such a program would not entail any creditor litigation/collection expenses and the average return is comparable to the price that major banks resell their Chapter 13 bankruptcy repayment obligations in the secondary market. Although this project has received approval from the Utah state legislature and Governor Huntsman, and a major credit card issuer affirmed that it would return a higher yield to the bank, we have not received an enthusiastic response from the credit card issuing companies. If the realities of this new heavily indebted household are not addressed by the bank/debt collection practices, we will see a domino effect on the forced sale/foreclosure of residential homes and sharp rise in the consumer bankruptcy rate. Furthermore, these

"near bankrupt" households that are exposed to sharply rising and capricious credit card pricing policies, may increasingly find that the bankruptcy court is their inevitable destination—not necessarily due to higher debt levels but due to sharply rising credit card interest rates—which will make it even more difficult to make their minimum payments after paying for rising mortgage payments.

A final point concerns the international expansion of the deregulation of consumer financial services and the global growth of the credit card industry. As previously reported in Table 4, the future growth of the credit card industry will occur outside of the United States. This is due to the limits of American household debt capacity as well as the lack of "unbanked" groups that are suitable for marketing consumer credit cards. This has two very important and potentially disastrous consequences for the United States. First, America's share of consuming global commerce reaching its apex in 2000 and has declined since the end of the U.S. recession. This is due to the enormous aggregate growth of global trade as well as the rising debt service burdens of American households. This means that the future growth of global commerce and trade will occur in a multipolar international economy such as the rise of EU, China, and Latin America (Mann, 2006). America's relative importance to global trade will decline over time as consumer debt service costs rise and household savings rise in preparation fot the Baby boomer retirement. This could result in more favorable lending policies to promote trade will emerge to the disadvantage of the United States in other parts of the world (Manning, 2007a).

Second, as shown in Table 11, the aggressive marketing of consumer credit cards together with pressure on state governments to reduce their expenditures on public social-welfare services has led to a sharp decline in the national savings rates of these countries—especially those that enthusiastically embraced free-market/deregulated banking policies. For example, between 1985 and 2005, the household savings rate declined from 15.8% to 1.4% in Canada, from 9.8% to 4.4% in the United Kingdom, from 28.8% to 11.5% in Italy, and from 18.5% to 6.9% in Japan. The notable exception is the strong, cultural resistance to consumer credit and debt in Germany; the savings rate dipped slightly from 12.1% to 10.5%. As a larger share of global commerce is consumed through lower savings rates and borrowed money, it is clear that this will eventually impact global capital markets which can only lead to upward pressure on domestic

lending rates—especially with a negative, national savings rate (combined household, public, business). This suggests that America's dependence on cheap energy could be eventually dwarfed by its voracious demand for cheap credit/capital with potentially serious foreign policy consequences. Imagine the impact on the housing market if the Chinese suddenly liquidate their US mortgage bond and currency holdings in retaliation for America's relations with Taiwan. Furthermore, it is unlikely that the United States will be able to continue to enjoy its debt dependent standard of living while encouraging other societies to participate in the international consumer culture that is integral to this phase of America's global economic dominance. At some point, a decline in these national savings rates will require the US to compete through higher interest rates for increasingly scarce loans in the global capital markets. What will be the impact on the U.S. consumer economy that is increasingly sensitive to fluctuations in household borrowing rates?

Assessing the Consumer Lending Revolution:
Rising Tides and Sinking Ships

The distinguishing features of the deregulation of consumer financial services include: (1) the profound shift in bank lending activities from corporate to consumer loans, (2) fundamental transformation of the industry structure (consolidation, conglomeration), dominant institutional form (conglomerate such as Citigroup), and geographic location, (3) profound shift from state to national regulatory system (US Congress, Office of Comptroller of the Currency) with the ascension of Federal Preemption (Manning, 2003(c) Furletti, 2004; Lander, 2004), (4) dramatic increase in the aggregate levels of household debt, (5) sharp increase in the inequality of the cost of unsecured consumer loans such as credit cards (especially in comparison to installment loans), (6) institutional pressure to continue rapid growth of unsecured consumer loans by expanding into new demographic markets such as students, seniors, and the working poor; and (7) the historically unprecedented growth of consumer bankruptcies which has produced a more stringent statutory reform—a trend counter to the rest of the world.

Over the last 25 years of banking deregulation, bank underwriting standards and the cost of unsecured consumer loans have changed dramatically. Today, household debt "capacity" is stretched by extended repayment schedules (from 15 to 40 year mortgages) and, more instructively, by multiple sources of household wealth/revenues: two or more

incomes, asset formation through home ownership (housing equity), and wealth accumulation through stock market investments. Unlike the pre-1980 regulated era, American households can leverage three or more sources of revenue to qualify for secured and unsecured consumer loans. This explains how aggregate household debt—as measured by its share of disposable income—has climbed an extraordinary 56.4 percent over this period: from 73.2 percent in 1979 to 114.5 percent in 2003 and 131.8% in 2004 (Mishel, Bernstein, and Allegretto, 2005). The major problem for most families is that it is easier to secure a loan than it is to generate greater revenues (with the exception of selling one's home which is yield a much lower return than a year ago). For households perilously close to insolvency, both large (job loss, medical care, divorce) and small (rising interest rates, high energy costs, medications) economic factors can precipitate a financial collapse.

For consumers in debt extremus, banking deregulation has produced a plethora of new and recently less costly financial products for middle income families. Yet, it has come with a price. "Risk-based pricing" policies that enable banks to unilaterally raise the cost of credit/debt for relatively minor changes in credit worthiness, decline of state regulatory power (federal preemption) that means only the US Congress can mandate fairer pricing policies and clearer contract disclosures, imposition of mandatory binding arbitration clauses which seek to preclude class-action lawsuits which may be the only way to force banks to change their unfair policies, anti-competitive practices (against consumers and merchants) that are leading to a new organizational structure of the major credit card associations (MasterCard, Visa) as the become private corporations and limit the liability of their member banks, and a clear lack of regulatory and financial accountability for personal consumer information. Indeed, my recent experience with Citibank highlights the one-sided nature of the pricing system of the credit card industry. In December, my payment was received late for the very first time. Upon contacting the company, I was told that they had decided to raise my "fixed rate" of 3.99% to 32.24% and would not consider lowering my interest rate for five months. I immediately paid off the balance and asked them if they would reconsider the interest rate since there was no longer an outstanding balance and thus had demonstrated my credit worthiness. No, I was informed that they could not consider a review of my account for five months—regardless of the payments that had been received.

Furthermore, the credit issuing banks assured the U.S. Congress and consumer groups in 2003 that they would vigorous protect consumer information during the hearings for the reauthorization of the Fair Credit Reporting Act. Instead, we have a crisis in the failure to protect and be held accountable for the personal and financial costs of identity theft and fraudulent use of credit card accounts. The underpublicized hacking into debit card accounts of hundreds of thousand of consumers last year underscored the ease and desirability of criminal syndicates to compromise the debit card systems of several major banks. It is the responsibility of the U.S. Congress to hold one of the most profitable industries in the United States accountable for its recent shift away from consumer friendly policies—indeed its fundamental promise of consumer relationship building for the sale of multiple financial services products—that underlies the conglomerate structure and cross-marketing synergies of the ascent of the "one-stop" financial services company.

Bibliography

The American Banker, "Largest Banks, " 2003 at www.americanbanker.com/

Lawrence M. Ausubel. (1997). "Credit card defaults, credit card profits, and bankruptcy," *American Bankruptcy Law Journal*, Vol. 71, Spring, 249-270.

Lawrence M. Ausubel. (1991). "The Failure of Competition in the Credit Card Market," *American Economic Review*, Vol. 81, No. 1, March, 50-81

John M. Barron and Michael E. Staten. (2004). Usage of Credit Cards Received through college-marketing programs. *Journal of Student Financial Aid.* Vol 34, 3, 7-28.

Bell, Daniel, Cultural Contradictions of Capitalism, New York, Basic Books, 1996.

Braun, Denny, The Rich Get Richer: The Rise of Income Inequality in the United States and the World, Chicago: Nelson-Hall Publishers, 1997.

Brown, Jonathan, Financial Deregulation: The Need for Safeguards, Washington, DC: Essential Information Inc, 1993.

Bucks, Brian K., Arthur B. Kennickell, and Kevin B. Moore, "Recent Changes in U.S. Family Finances: Evidence From the 2001 and 2004 Survey of Consumer Finances," Federal Reserve Bulletin, (2006):1-38.

Calder, Lendol, Financing the American Dream: A Cultural History of Consumer Credit, Princeton: Princeton University Press, 1999.

Card Industry Directory 2005 Edition, Thompson Publishers, June 2006.

CardWeb.com. "Free Loaders," April 8, 2005.

Cohen, Lizabeth, A Consumers' Republic: The Politics of Mass Consumption in Postwar America, New York: Alfred A. Knopf Press, 2003.

Citizens for Tax Justice, "Fiscal 2003 Deficit Sourced as Income Taxes Fell to Lowest Level in Six Decades," Washington, D.C, 2003.

Condon, Bernard, "Fools Paradise," Forbes, February 14, 2005: 23-26.

Cross, Garry, An All-Consuming Century: Why Commercialism Won in Modern America, New York: Columbia University Press, 2000.

Daly, James J., "A little Help From Uncle Sam, Government Intervention Never Looked Better Than It Did in 2001," Credit Card Management, March 2002, pp. 3-7.

Der Hovanesian, Mara, "Tough Love for Debtors," BusinessWeek, April 14, 2005; 37-41.

Demos and Center for Responsible Lending, "The Plastic Safety Net: The Reality Behind Debt in America," New York: Demos Final Report, 2005.

Draught, Tamara and Javier Silva, "Borrowing to Make Ends Meet: The Growth of Credit Card Debt in the 90s," New York: Demos Final Report, 2003.

Dymski, Gary, A., The Bank Merger Wave: The Economic Causes and Social Consequences of Financial Consolidation, Armonk, NY, M.E. Sharpe, 1999.

Evans, David and Richard Schmalensee, Paying with Plastic The Digital Revolution in Buying and Borrowing, Cambridge: MIT Press, 2005.

Ewen, Stuart, Captains of Consciousness: Advertising and the Social Roots of he Consumer Culture, New York: Basic Books, 2001.

Federal Deposit Insurance Corporation (FDIC), Evaluating the Consumer lending Revolution, September 23, 2003.

Federal Deposit Insurance Corporation (FDIC), The FDIC Quarterly Banking Profile, "Commercial Bank Performance—Second Quarter 2003," pp.1-2 at www.fdic.gov.

Fox-Piven, Frances and Richard A. Cloward, The Breaking of the American Social Compact, New York: New Press, 1997.

Furletti, Mark, "Debate Over the National Bank Act and the Preemption of State Effots to Regulate Credit Cards," Temple Law Review, Volume 77 [c], 2004: 1-39.

Galbraith, James K., Created Unequal: The Crisis in America Pay, Chicago: The University of Chicago Press, 2002.

Hawke, Jr., John D., "Remarks by Comptroller of the Currency Before the American Bankers Association," New York, New York, October 4, 2004.

Hudson, Michael (ed), "Banking on Misery," special issue of Southern Exposure, summer 2003.

Karger, Howard, Shortchanged: Life and Debt in the Fringe Economy, Berrett-Koehler Publishers, 2005.

Langley, Monica, Tearing Down the Walls (Wall Street Journal Books, 2003).

Lears, Jackson, Fables of Abundance: A Cultural History of Advertising in America, New York: Basic Books, 1994

Leicht, Kevin T. and Scott Fitzgerald, Post-Industrial Peasants: The Illusion of Middle Class Prosperity, New York, Worth Publishers, 2006 (forthcoming).

Luden, Jennifer, "Credit Card Companies Target Kids," *All Things Considered,* National Public Radio, February 6, 2005, http://www.npr.org/templates/story/story.php?storyId=4488488.

Macey, Jonathan R. and Geoffrey P. Miller, Banking Law and Regulation, New York: Aspen Publishers, 2000.

Mandell, Lewis, The Credit Card Industry: A History, Twayne Publishers, 1990.

Ronald J. Mann, Charging Ahead: The Growth and Regulation of Payment Card Markets (Cambridge University Press, 2006).

Mann, Bruce H., Republic of Debtors, Bankruptcy in the Age of American Independence, Cambridge: Harvard University Press, 2002.

Manning, Robert D., "Neoliberalism and the Global Expansion of the Consumer Economy: The Decline of US Economic Hegemony?" in Robert D. Manning (ed.), Globalization and Democracy: American Leadership or Autocracy in the New World Order?), Rochester, Carey Rochester Institute of Technology Press, forthcoming 2007a.

Manning, Robert D., "THE NEAR BANKRUPT: Responsible Debt Relief and The Plight of the Financially Distressed in America," working project, Center for Consumer Financial Services, Rochester Institute of Technology, 2007b.

Manning, Robert D., and Dana Smith, "Credit Cards and African American Students: A Case-Study of College Seniors at Fisk University, working paper, RIT: Center for Consumer Financial Services, forthcoming 2007.

Manning, Robert D., LIVING WITH DEBT: A Life Stage Analysis of Changing Attitudes and Behaviors, Charlotte, N.C.: LendingTree.com, 2005

Manning, Robert D. and Ray Kirshak, "Credit Cards on Campus: Academic Inquiry, Objective Empiricism, or Advocacy Research?," Journal of Student Financial Aid, Volume 35, No. 1 (Winter 2005): 39-48.

Manning, Robert D., Prepared Statement and response to questions, *The Importance of Financial Literacy Among College Students.* Hearing Before the Committee on Banking, Housing, and Urban Affairs, United States Senate, September 5, 2002. Washington, D.C.: U.S. Government Printing Office, June 2003(b): 14-18, 41-53.

Manning, Robert D., "Perpetual Debt, Predatory Plastic: From Company Store to the World of Late Fees and Overlimit Penalties," Michael Hudson (ed.), Special Issue on Predatory Lending, "Banking on Misery," Southern Exposure, A Journal of Southern Studies, June 2003(a):15-19.

Manning, Robert D., Credit Card Nation: The Consequences of America's Addiction to Credit, New York: Basic Books, 2000.

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

Mishel, Lawrence, Jared Bernstein, and Heather Boushey, The State of Working America 2002-2003, Ithaca: Cornell University Press, 2003.

Mishel, Lawrence, Jared Bernstein, and Sylvia Allegreto, The State of Working America 2005-2006, Ithaca: Cornell University Press, 2007

Nocera, Joseph, A Piece of the Action: How the Middle Class Joined the Money Class, New York, Simon & Schuster, 1994.

Organization for Economic Cooperation and Development, Economic Outlook Report, 2003.

Peterson, Christopher, Taming the Sharks: Towards a Cure for the High-Cost Credit Market, Akron, University of Akron Press, 2004.

Piven, Frances Fox and Richard A. Cloward, The Breaking of the American Social Compact, New York, New Press, 1997.

Punch, Linda, "Fading Pay," Credit Card Management, June 2003: 40-43.

Queenan, Joe, "Only One Life to Spend and Spend," The New York Times, December 1, 2003.

Sanders, Bernie. "Modern Day Loan Loan Sharks Disguised in Plastic," The Atlanta Journal-Constitution, December 3, 2004.

Schor, Juliet B., The Overspent American: Why We Want What We Don't Need, New York: Harper Perennial, 1998.

Schudson, Michael, Advertising, The Uneasy Persuasion Its Dubious Impact on American Society, New York: Basic Books, 1986.

Skeel, David A. Debt's Dominion, A History of Bankruptcy Law in America, Princeton: Princeton University Press, 2001.

Stavins, Johanna, "Credit Card Borrowing, Delinquencies, and Personal Bankruptcy," New England Economic Review (July/August 2000):1-30.

Sullivan, Theresa A., Elizabeth Warren and Jay Lawrence Westbrook, The Fragile Middle Class: Americans in Debt, Yale University press, 2001.

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

Tucker, David M., The Decline of Thrift in America: Our Cultural Shift from Saving to Spending, New York: Praeger Publications, 1991.

Uchitelle, Louis, "Why Americans Must Keep Spending," The New York Times, December 1, 2003.

U.S. Federal Reserve, Historical Data, 2003 at fedreserve.gov.

U.S. Federal Reserve Board, Survey of Consumer Finances, 1995, 1998, 2001, and 2004.

U.S. Federal Reserve Board, The Profitability of Credit Card Operations of Depository Institutions, An Annual Report submitted to U.S. Congress, June 2006.

U.S. Federal Reserve Board, Report To Congress On the Practices of the Consumer Credit Industry In Soliciting and Extending Credit and Their Effects on Consumer Insolvency, Washington, D.C: U.S. Federal Reserve, June 2006 http://www.federalreserve.gov/boarddocs/rptcongress/bankruptcy/bankruptcybillstudy200606.pdf

U.S. Department of Treasury, "OCC Alerts National Banks on Unacceptable Credit Card Marketing and Account Management Practices," Advisory from Office of the Comptroller of the Currency, September 14, 2004.

U.S. General Accountability Office (GAO), Credit Cards, Increased Complexity In Rates and Fees Heightens Need for More Effective Disclosures to Consumers, Washington, D.C.: GAO, 2006. http://www.gao.gov/new.items/d06929.pdf

Warren, Elizabeth, "The Market for Data: The Changing Role of Social Sciences in Changing the Law, The Wisconsin Law Journal, (2002):1-42.

Warren, Elizabeth and Amelia Warren Tyagi, The Two-Income Trap, New York: Basic Books, 2003.

Testimony of John G. Finneran, Jr., General Counsel, Capital One Financial Corporation before the United States Senate Committee on Banking, Housing and Urban Affairs
January 25, 2007

Chairman Dodd, Ranking Member Shelby and Members of the Committee, good morning. My name is John Finneran and I am the General Counsel of Capital One Financial Corporation. Thank you for this opportunity to address the Committee. Capital One is the 11th largest diversified financial institution in the country and the 5th largest issuer of credit cards.

Today, the credit card is among the most popular forms of payment in America. It is valued by consumers and merchants alike for its convenience, efficiency and security.

As the GAO noted in their recent report on this topic, the past decade has seen substantial change in the availability and pricing of credit cards. A little over a quarter century ago, less than a third of American consumers were able to obtain credit cards. Today, 75% have cards. As recently as the early 1990s, everyone paid the same high interest rate and annual membership fee regardless of their risk profile. Today, as the GAO found, interest rates have come down significantly for the majority of consumers and most pay no annual fees. At the same time, pricing for risk has become more targeted. Those consumers who exhibit riskier behavior typically pay higher rates than those who do not, or may be charged fees for paying late or going over their credit limits. Consumers who choose to pay in full each month, as more than half of all credit card holders do, pay no interest.

Importantly, the GAO also found that, during this period of time, industry profits remained stable, suggesting that changes in credit card pricing have indeed reflected changes in how the industry prices for risk.

The benefits of more discrete, targeted and accurate pricing for credit cards have come at some cost – increased complexity. For this reason, Capital One has submitted to the Federal Reserve a proposal that would significantly revise the disclosures required in the Schumer Box to make it easier for consumers to both better understand the terms of any particular offer and to compare one product to another. A copy of Capital One's unique proposal is included in my written testimony.

While we await these changes, Capital One has implemented a comprehensive set of new disclosures, written in plain English, which go substantially beyond the legal requirements of the Schumer Box. These include a food-label style disclosure and a customer Q&A that present our policies in simple terms. These disclosures are included in our marketing materials.

The increased complexity of card products has also brought rising criticism of the industry in recent years. Capital One continuously reviews and makes changes to its practices in light of changing customer preferences. One area of change is in repricing, where Capital One has simplified and strictly limited the circumstances in which we may increase a customer's interest rate if they default on the terms of their credit card agreement.

I want to be clear that we do not do any form of "universal default." This has been our long-standing policy. We will not reprice a customer if they pay late on another account with us or any other lender, or because their credit score goes down for any reason. In addition, Capital One will not reprice customers if they go over their limit or bounce a check. There is only one circumstance in which a customer might be subject to default repricing – if they pay us more than 3 days

late twice in a 12 month period. We clearly disclose all of these policies in our marketing materials, and provide customers with a prominent warning on their statement after their first late payment.

The decision to reprice someone is not automatic. For many customers, Capital One often chooses not to do so. If we do reprice someone for paying late twice, we will let them earn back their prior rate by paying us on time for twelve consecutive months. This process is automatic.

While introductory or "teaser" rates can provide substantial benefits to cardholders, they also have come under criticism if they are subject to repricing during the introductory period. Capital One has adopted strict policies regarding their marketing and treatment. Capital One does not reprice introductory rates for any reason, even for repeated late payments. The specific period for which these rates will be in effect is fully disclosed multiple times in our marketing materials. We also disclose the long-term rate that will take effect if and when the introductory rate expires.

Similarly, another practice that may cause customer confusion is double-cycle billing. Capital One has never used double-cycle billing.

The overwhelming majority of Capital One's customers use their accounts responsibly and enjoy the many benefits this form of payment offers. It is in everyone's interest for us to provide only the amount of credit our customers can handle. Unfortunately, at times, some of our customers have difficulty managing their credit. Capital One looks for early indications that a particular customer may be experiencing challenges. For example, any customer who pays us only the minimum for three consecutive months receives a notice on their statement that emphasizes the consequences of this practice and encourages them to pay down their balance more quickly. Capital One also provides them with a web address where they can use our online calculator to see for them themselves the

cost of paying only the minimum, as well as the benefits of paying additional principal.

In conclusion, as our industry has changed, so have we. Capital One is continuously adapting its practices and policies to keep up with consumer demand, the rigors of competition and the standards of sound banking. Capital One has over 30 million credit card customers, the vast majority of whom have a good experience with our product. When they don't, we regard that as a failure and seek to find out why. In a highly competitive market, we must continuously strive to improve our products and services if we are to attract and retain the best customers.

Thank you and I look forward to answering any questions you may have.

From Capital One Comment Letter to the Federal Reserve 03/28/05
Regulation Z, TILA

PRICING & FEES

X%min-X%max Variable	Purchase APR after Month/Year	X% Variable	Balance Transfer APR after account opening
X% Variable	Intro Purchase APR until Month/Year (PRIME + XX.XX%)	X% Variable	Intro Balance Transfer APR
		X% or $X	Balance Transfer Fee
$X min-$X max	Initial Credit Line	X% Variable	Cash Advance APR
		X% or $X min.	Cash Advance Fee
$X (frequency)	Membership Fee	$XX	Minimum Finance Charge
$X	Late Fee	X% or $X	Minimum Payment
		XX days	Interest-Free Period for Purchases if balance is paid in full monthly
$X	Overlimit Fee	$XX	Return Check Fee

REASONS YOUR RATES MAY CHANGE

You pay late or you pay less than the minimum requested.	**• [Up to] XX% Default APR(s) • (creditor specific information for reduction or elimination of default APR)**
You break a rule on another account with us.	• [Up to] XX% Default APR(s) • (creditor specific information for reduction or elimination of default APR)
You break a rule on an account with another creditor.	**• [Up to] XX% Default APR(s) • (creditor specific information for reduction or elimination of default APR)**
You have negative information show up on your credit report.	• [Up to] XX% Default APR(s) • (creditor specific information for reduction or elimination of default APR)
Your transactions go over your credit limit.	**• [Up to] XX% Default APR(s) • (creditor specific information for reduction or elimination of default APR)**
Your check is returned – unpaid.	• [Up to] XX% Default APR(s) • (creditor specific information for reduction or elimination of default APR)
Your terms may change from time to time due to market conditions or other reasons.	**• Changes will be made in accordance with applicable law and the Card Agreement that will be sent with your card.**

Lender includes any reasons that the rates of this product may change.

ADDITIONAL INFORMATION ABOUT YOUR ACCOUNT

Your APR is a variable rate that changes monthly based on (Rate Index + XX.XX%).

Your payments and credits will be applied to balances with lower APRs before balances with higher APRs.

Please visit our website: www.creditcards.com or call us at 888.123.4567 for additional information.

This Standard Fact Sheet is used by all creditors. Please use it to make an informed decision.

STATEMENT OF
CARTER FRANKE
CHIEF MARKETING OFFICER
CHASE BANK U.S.A., N.A.
U.S. SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
JANUARY 25, 2007

Mr. Chairman, Members of the Committee, good morning. My name is Carter Franke; I am the chief marketing officer at the Wilmington, Delaware-based Chase Card Services division of Chase Bank U.S.A., N.A.

I am proud to represent, today, more than 16,000 Chase employees around the country who serve the needs of more than 100 million Chase credit card customers.

I am also proud to represent an industry that has become integral to American life and is one of our economy's principal engines of growth. Last year, credit cards were used to purchase nearly $2 trillion worth of goods and services from more than 25 million merchants. This inter-reliance among American consumers and businesses, both large and small, is one of the great economic success stories of the last several decades.

It is also important to note that credit cards have been absolutely critical to the rapid development of business over the Internet, one of the fastest growing and most exciting market places in history.

The credit card business at Chase, like other businesses, is based on our relationship with customers. The great majority of Chase customers fall into the "super-prime" and "prime" categories. This means they are the most responsible and knowledgeable credit users in the country. Well over a third of them pay their balances in full, enjoying the convenience of an interest free loan every month – something that is unique to credit cards. And more than 90 percent of our payments are for more than the minimum. We appreciate our customers, and we believe our success is based on maintaining a good relationship with every one of them.

That is why more than 80 percent of our employees are devoted to directly serving customers, and why we are continually developing technology to bring customers closer to the information they need in order to see, understand and manage their accounts.

Customers have asked us to help them avoid late and "over-the-limit" fees and maintain the best interest rate available. So Chase developed a service called "Free Alerts." Customers can choose a telephone, email or text message alert that reminds them when a payment is due and when a payment has been posted to their account – or notifies them when their spending has reached their self-determined limit.

We continue to see increased usage of our online service, which has recently been improved again, in order to give customers the ability to manage their accounts. Now, they have increased ability to make fast, free electronic payments and sign up for Chase

Automatic Payments on the exact day they are due, to avoid late fees and retain access to their funds for the maximum amount of time.

We have developed supplemental materials for customers that clearly state the "rules of the road" of their credit card so that they will have clear information to guide them in avoiding fees and having their interest rates raised.

We believe all consumers, customers or not, need to increase their financial literacy. That is why we have made more than $20 million in grants to community based organizations to help fund credit education programs over the past two years. We have donated almost $80 million to fund credit counseling services, create online financial education and credit and debt management tools. We believe the responsible use of credit cards by our customers helps develop the best, long-term relationship with them. We want to do our part to support their efforts to be responsible.

With this in mind, we are measured in our approach to student lending, which is a relatively small portion of our portfolio. Our objective is to establish long-term relationships with students so they will continue to do business with us all their lives. Approached with care, we find that students have proven to be good customers, capable of handling credit card borrowing responsibly. We support several financial education programs for students that we believe have helped in developing the responsible behavior of these young people.

The importance of customer relationships is a key driver of many of our business decisions. For example, a missed payment on a non-Chase card does not result in an automatic re-pricing of any Chase account. Only a small segment of our customers will have a change in credit worthiness. When they do, we deal with them fairly and responsibly.

For example, if a customer's overall credit profile deteriorates significantly, and therefore exposes us to an increased risk that their balance will not be paid, we provide that customer with an "opt out" option. This means that the customer may reject any change in terms, close their account, and pay off the balance under their existing terms.

We believe the vast majority of our customers feel they are being treated fairly. This is an extremely competitive industry, and customers have many attractive credit card offers to choose from. Still, a relatively small percentage of our customers leave us each year for our competitors.

Because of the competitive nature of the industry, the American consumer today enjoys a credit card offering far more attractive than a generation ago. According to the recent GAO report, fifteen years ago the average interest rate was roughly 20 percent and cards had annual fees of $20 or more. Today, says the GAO, the average interest rate is 12 percent and, in addition, nearly 75 percent of credit cards do not have annual fees. And to the concerns raised in many quarters that consumers pay ever higher fees, the GAO report found that the total annual and penalty fees were roughly the same in 2004 as they

were in 1990 – reinforcing the point that consumer fee levels have remained under control. In fact, according to the report, half of all card holders pay their bill in full every month, paying no fees and no interest.

Because of competition, consumers enjoy lower interest rates and much wider access to credit cards than ever before. We have moved from a "one size fits all" credit card pricing structure to a much more risk-based approach to pricing that – let us be very clear – rewards the responsible credit card user with low rates and the ability to avoid fees.

Now, having mentioned some of the data from the GAO report, let me address the issue that report, and many others, have raised. The GAO concluded that, in the words of its title, there is a "Need for More Effective Disclosures to Consumers."

At Chase, we are working on this. We believe that disclosures are the key to a successful customer relationship, and we are committed to keeping our customers fairly informed of every aspect of their accounts. Well-informed customers are the most likely to understand and appreciate our products, and to use them wisely.

We pay strict attention to the standards that the Federal Reserve Board has set for credit card disclosures including the level of detail we are required to provide and the specific language they suggest.

However, we believe that the volume and types of disclosures mandated by federal and state laws have not led to greater clarity. Our customers are telling us that today's disclosure lacks sufficient clarity.

We would like to see more effective disclosures that help customers understand the aspects of the credit relationship that are most important to them. As the GAO report acknowledged, the credit card industry, including Chase, has advocated various ways to improve disclosures.

First, I'd like to say that better disclosures may not mean *more* disclosures. Disclosure language should be simple, clear and focused on the most relevant terms and conditions consumers need to understand.

There is required language that we must use to describe the terms of our customers' relationship with us. Sometimes that legal language is difficult to understand.

So in addition to that language, we have developed supplemental language designed to help customers understand how they can best use their credit cards and avoid fees and having their interest rates raised.

We also believe that regulators and the industry need to work together to improve the clarity and understandability of the mandated language as well.

We not only welcome, but also actively seek, the opportunity to work with regulators to make significant improvements that provide consumers with clearer, more effective disclosures.

Mr. Chairman, we look forward to working with you and the Members of the Committee today to answer your questions and address your concerns.

Thank you.

Written Testimony

Of

Michael D. Donovan

Partner

Donovan Searles, LLC
Philadelphia, PA 19103

also on behalf of

The National Consumer Law Center and
The National Association of Consumer Advocates

Before the

SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

January 25, 2007

INTRODUCTION

Chairman and members of the Committee, thank you for the opportunity to speak about some of the current abuses in the credit card industry and to describe the problems and experiences of the everyday consumers I represent in Pennsylvania and elsewhere. This testimony also is presented on behalf of the low-income clients of the National Consumer Law Center and the National Association of Consumer Advocates.[1]

I started my career in 1984 as a trial and appellate attorney at the Securities and Exchange Commission here in Washington, D.C. After working at the Commission, I entered private practice at a firm in Philadelphia, PA. Since about 1993, I have concentrated my practice on consumer matters, which has included cases challenging credit card company practices, cases against debt collectors for violations of the Fair Debt Collection Practices Act, cases against predatory lenders for unfair and deceptive lending practices and cases against finance companies for bait and switch schemes and illegal loan packing.

[1]The National Consumer Law Center, Inc. (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of sixteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending*, (5th ed. 2003) and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (3d ed. 2005) and *Foreclosures* (1st ed. 2005), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of the all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws. The National Association of Consumer Advocates (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers. This testimony was co-written by Alys Cohen, staff attorney at the National Consumer Law Center.

I argued before the U.S. Supreme Court in the case of *Smiley v. Citibank,* which concerned whether late fees are "interest" under the National Bank Act. I also obtained a landmark decision from the Third Circuit Court of Appeals in *Rossman v. Fleet Bank,* holding that the Truth in Lending Act prohibits bait and switch marketing schemes and does not allow a credit card issuer to change a "No Annual Fee" card to an annual fee card, at least within the first years after the card was issued. I am one of the co-chairs of the Consumer Law Subcommittee of the American Bar Association's Litigation Section and I am a former chair of the National Association of Consumer Advocates.

REAL WORLD CREDIT CARD NIGHTMARES

Penalty Fees/Default Accounts

Practically every week a client brings in a collection letter claiming that the client owes thousands for a delinquent credit card debt. The client typically describes facts that mimic those described by the Court in *Discover Bank v. Owens.* In that case, an Ohio court found that Ms. Owens, an elderly woman who depended on a monthly Social Security Disability ("SSD") check, had more than repaid the principal balance plus interest that she had borrowed on a Discover credit card. The court rejected Discover's attempt to collect an additional $5000 in late fees, penalty interest and credit protection costs, because those charges were, in the court's view, unconscionable.

Many of the clients I see every week are just like Ms. Owens. They usually depend on a monthly SSI or SSD check or are on very tight budgets because of job conditions, a recent divorce or a family catastrophe. An example is Ms. C., who lives in North Philadelphia and has received SSI payments of about $600 per month for the past 14 years.

Ms. C. started with a Providian card in 1997, with a $1,000 credit limit and an APR of about 15%. The Providian card has since become a Washington Mutual Card, because Washington Mutual purchased the Providian card portfolio. Every month, Ms. C's card had charged to it a "credit protection fee" of as much as $47.40. Ms. C. had no idea what the fee was for. Her multiple written attempts to eliminate the fee were ignored by the bank.

Ms. C. has attempted to keep up with the minimum payments on the WAMU card and three other cards she has, but she has fallen off the treadmill. Her last minimum payment for one card was $247; for another $67; and about $80 for the two others. By August 2006, nearly $400 per month was coming due on the cards, all of which Ms. C. attempted to pay from her monthly $600 SSI check. As of August, 2006, the APR on her WAMU card had increased to a penalty rate of 31.49%.

Ms. C. has rarely used any of the credit cards for at least the past three years. From time to time, she has used them to buy gas or prescriptions, but for the most part they have been at or above their credit limits. On the original Providian card, Ms. C has repaid at least double what she actually borrowed, if you ignore the worthless "credit protection" fees she was charged over the years.

These facts are virtually identical to the facts in *Discover Bank v. Owens*, where the Court found that Ms. Owens had repaid over $3,400 on an original debt of $1,900 but was still assessed a monthly late fee and credit protection fee. Both borrowers – Ms. C in Philadelphia and Ms. Owens in Ohio – allegedly still owed the banks over $5,000 in penalty interest, fees and charges despite having repaid all principal borrowed plus a very handsome return to the banks.

Had Ms. C been less scrupulous and had just stopped paying years earlier, the penalty rates and fees probably would have stopped when the bank wrote off the debt. In fact, it has been my experience that it is the conscientious – those who earnestly try to keep up with their payments – that are most hurt and frustrated by the escalating fees and penalties.

Universal Default

Even consumers who always pay on time cannot avoid the pricing abuses. Mr. S, a consumer client from York, PA, is an example. He had two credit card accounts: one at U.S. Bank; the other at Chase. He always paid these accounts on time and diligently. Nonetheless, in March 2005, U.S. Bank increased the APR on his account from around 9.9% to about 21.9%. The Bank told Mr. S in writing that a review of his credit report indicated he had too much total credit outstanding and, therefore, his APR was being increased. At about the same time, Chase also increased the APR on his account, from about 11.9% to about 27.9%. But Chase went even further; it also lowered his available credit line. Like U.S. Bank, Chase told Mr. S that his lower FICO score caused the increase in his APR and the reduction in his credit line. Incredibly, Chase lowered the available line to the exact amount of the outstanding balance on Mr. S's credit card. So, when Chase added the daily finance charge to the account, it caused the account to go over the reduced credit limit, which then caused automatic over-limit fees to be charged as well. Mr. S did not learn of this bank-caused over-limit "default" until his statement arrived just days after the letter telling him about the reduced credit line.

What was even more frustrating for Mr. S is that the information that caused his credit report to change was itself incorrect. Apparently, one of the credit bureaus had

reported an unpaid tax lien. But there was no tax lien. In fact, Mr. S was owed a municipal tax refund. The credit bureau evidently misread or overlooked one of the columns on the municipal tax lien records.

In sum, two separate credit card companies imposed default penalty rates on Mr. S even though he had never missed or been late with any payment on the cards. For Mr. S, the imposition of universal default was an indisputable mistake, but neither bank ever reimbursed him for the months of extra-contractual charges they collected.

Still another client, Ms. M. from Murraysville, PA, had a similar experience. She transferred a balance from another card to her MBNA card, which had a lower 8.9% rate. She always paid her MBNA bill on time and 90% of the time paid more than the monthly minimum. But a few months after the balance transfer MBNA increased the card's APR to 18.49%. Ms. M is sure she never received any change in terms notice from MBNA. When she called MBNA about the increase, they said they had reviewed her credit history and that the higher rate was imposed because of her high debt ratio. MBNA then offered to connect her to their home equity loan department. Ms. M believes she was deceived by MBNA's balance transfer offer because she would not have accepted it if she knew MBNA could or would impose an even higher rate than the other card did before she transferred the balance.

For Ms. M and many other clients we have seen, universal default amounts to a classic unfair and deceptive practice, because the banks go back on the very promises and commitments they made when the consumers agreed to accept the card or transfer the balance.

Application of Payments

Similar problems occur with the application of payments by credit card issuers. Another consumer client, Mr. W, applied for a Capital One credit card advertising a 1.9% APR for balance transfers. Upon transferring over $7,000 to the new account, Mr. W was assessed a balance transfer fee of about $250. The balance transfer fee was recorded as a "purchase," and the standard APR of 18.9% for purchases was then applied to that fee. After Mr. W had made several payments, he noticed that the outstanding balance on the transfer fee was actually above $250. Apparently, only a tiny fraction of his monthly payment was being applied to the balance transfer fee, so the balance on that charge was actually increasing under the 18.9% APR while the balance on the transferred amount at the much lower APR was declining. Mr. W determined that if he had continued paying the amounts he was paying on the card, the Purchases balance would not have been paid off for over three years, and he could have paid nearly $250 in additional interest on the transfer fee of $250. The true cost of the balance transfer was far different from the 1.9% advertised by Capital One. The true cost of credit was about 7.9%, which was not all that different from the APR on the card from which he had transferred the balance. Even worse, after about ten months, Capital One sent a notice to Mr. W that it was increasing the APRs on all of its accounts and that Mr. W had to reject the proposed increase within 15 days. Mr. W missed the deadline for rejecting the change in terms because he was away on vacation and had assumed, incorrectly, that the envelope was just another one of the many solicitations he continued to receive for a Capital One credit card.

THE ESCALATING PROBLEMS WITH CREDIT CARD DEBTS

The Industry and its Abuses Keep Growing

As the above stories demonstrate, a significant amount of the debt load facing American households is caused not so much by consumer borrowing, but by the harsh – and exorbitantly expensive – tactics of the credit card industry. A significant contributor to the snowballing credit card debt of American consumers is the enormous increase in both the number and amount of non-periodic interest fees charged by credit card issuers. These "junk" fees include both fees considered to be finance charges (cash advance, balance transfer, wire transfer fees) and non-finance charge "other" fees. Most important among the latter are late payment and over-limit fees. Other abuses include penalty interest rates (where rates are raised due to late payments or exceeding credit limits on the card or simply if the consumer's credit score decreases below a certain number), deceptive marketing and establishing cut-off times for payment postings that cause borrowers to incur a late fee even if the payment arrives on its due date (for example, by posting all payments at 11 a.m. so that any payment received in the afternoon mail is considered late).

From 1978 to 1995, credit card debt increased six-fold to $378 billion.[2] In 1996, the Supreme Court paved the way for credit card banks to increase their income stream even more dramatically. In *Smiley v. Citibank (South Dakota), N.A.*, the court approved of the Office of Comptroller of Currency's definition of interest that included a number of credit card charges, such as late payment, over-limit, cash advance, returned check,

---

[2] *See* Fed. Res. Bull., *available at* http://www.federalreserve.gov/releases/g19/hist/cc_hist_mt.txt.

annual, and membership fees.[3] As a result, national banks and other depositories can charge fees in any amount to their customers as long as their home-state laws permit the fees and so long as the fees are "interest" under the Office of the Comptroller of the Currency ("OCC") definition. Uncapping the amount of fees that credit card banks can charge nationwide has resulted in the rapid growth of and reliance on fee income by credit card issuers.

After *Smiley*, banks rushed to increase late charges, over-limit fees, and other charges. The average late payment fee has soared from $14 in 1996 to over $32 in 2004.[4] Over-limit fees have similarly jumped from $14 in 1996 to over $30 in 2004.[5]

Now banks impose these fees, not as a way to curb undesirable behavior from consumers – which used to be the primary justification for imposing high penalties – but as a significant source of revenue for the bank. Since *Smiley*, penalty fee revenue has increased nearly nine-fold from $1.7 billion in 1996 to $14.8 billion in 2004.[6] The income from just three fees – penalty fees, cash advance fees and annual fees – reached $24.4 billion in 2004.[7] Fee income topped $30 billion if balance transfer fees, foreign exchange, and other fees are added to this total.[8] Concurrently, card issuer profits,

---

[3] Smiley v. Citibank (S.D.), Nat'l Assn., 517 U.S. 735, 116 S. Ct. 1730, 135 L. Ed. 2d 25 (1996). The OCC definition of interest is found in 12 C.F.R. § 7.4001(a).

[4] Cardweb.com, *Late Fees* (Jan. 28, 2005), *at* http://www.cardweb.com/cardtrak/news/2005/january/28a.html.

[5] Cardweb.com, *Over-limit Fees* (Feb. 2, 2005), *at* http://www.cardweb.com/cardtrak/news/2005/february/2a.html.

[6] Cardweb.com, *Fee Party* (Jan. 13, 2005), *at* http://www.cardweb.com/cardtrak/news/2005/january/13a.html.

[7] *Id.*

[8] *Id.* If merchant-paid fees are combined with consumer-paid fees, the total fee income is estimated at $50.8 billion.

though declining somewhat between 1995 to 1998, have steadily increased between 1999 and 2004. These profits rose from 3.1% in 1999 to 4.5% in 2004.[9]

Not only has the size of fee income for credit card issuers grown enormously, the types of fees have mushroomed as well. The Federal Reserve Board provides a list of fees to consumers in a brochure titled "Choosing a Credit Card."[10] The most common fees incurred in credit card transactions include:

NAME OF FEE	DESCRIPTION OF FEE
Annual fee (sometimes billed monthly).	Charged for having the card. Fees range from zero to $130.
Cash advance fee.	Charged when the card is used to obtain a cash advance; the fee is usually 3% of the advance, with a minimum of $5 and no maximum.
Balance-transfer fee.	Charged when the consumer transfers a balance from another credit card. Fees range from 2% to 3% of the amount transferred, with a minimum.
Late-payment fee.	Charged if the consumer's payment is received after the due date. Fees range from $10 to $49.
Over-the-credit-limit fee.	Charged if the consumer goes over the credit limit. Fees range from $10 to $39.
Credit-limit-increase fee.	Charged if the consumer asks for an increase in her/his credit limit.
Set-up fee.	One-time fee, charged when a new credit card account is opened.
Return-item fee.	Charged if the consumer pays the bill by check and the check is returned for non-sufficient funds.
Expedited payment fee.	Charged when the consumer makes a payment over the phone. Fees range from $10 to $14.95.
Expedited delivery fee.	Charged when the consumer requests an additional credit card and requests that it be delivered in an expedited way.

[9] Cardweb.com, *Card Profits 04*, (Jan. 24, 2005), at http://www.cardweb.com/cardtrak/news/2005/january/24a.html.

[10] Federal Reserve Board, *Choosing a Credit Card*, at http://www.federalreserve.gov/pubs/shop,

Replacement card fee.	Charged when the consumer's credit card is lost, stolen, damaged, or otherwise needs to be replaced.
Additional card fee.	Charged when the consumer requests a card for a family member or otherwise wishes an additional card.
Other fees.	Some credit card companies charge a fee to cover the costs of reporting to credit bureaus, reviewing the consumer's account, or providing other customer services.

The problem with these punitive charges, especially in combination with the penalty interest rates, is that they exacerbate the problems of consumers who have hit hard times. Too often these charges drive consumers into bankruptcy, resulting in cascading losses to individuals, families and neighborhoods—of lost savings, lost homes, forced moves, with all of the consequential financial and emotional tolls.

It is not just one or a handful of credit card companies that engage in abusive practices, but a great number of the top ten credit card issuers. [11] It is this pattern of heavy-handed and manipulative conduct by an entire industry that shows that credit card issuers have altered their fundamental treatment of consumers from a fair, respectful business relationship to an abusive, exploitative one.

Credit card companies were not always so free to engage in reprehensible behavior. Credit card deregulation, and the concomitant spiraling credit card debt of Americans, began in 1978, with the Supreme Court's decision in *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*[12] This case gave national banks

---

[11] For example, *see* information about the civil penalties assessed against Providian and other issuers, http://www.pirg.org/consumer/bankrupt/bankrupt2.htm; and the recent suit initiated against Capital One by the state of Minnesota, http://www.ag.state.mn.us/consumer/PR/PR_041230CapitalOneBank_FSB.htm

[12] Marquette Nat'l Bank of Minn. v. First of Omaha Serv. Corp., 439 U.S. 299, 99 S. Ct. 540, 58 L. Ed. 2d 534 (1978).

the green light to take the most favored lender status from their home state across state lines, and preempt the law of the borrower's home state. As a result, national banks and other depositories established their headquarters in states that eliminated or raised their usury limits, giving them free rein to charge whatever interest rate they wanted.[13] Therein lies the reason why so many of those credit card solicitations sent by mail every week come from Delaware or South Dakota: credit card issuers moved there to export those unregulated states' *lack* of consumer protections nationwide.[14] As of 1978, credit card debt had grown to $50 billion, up from just $5.3 billion when the Truth in Lending Act was passed.[15]

Industry executives also have recognized escalating pricing and advertising problems in the U.S. credit card market. In 2003, Duncan MacDonald, the former general counsel for Citigroup's North American and European credit card businesses, wrote about the credit card pricing mess in the American Banker.[16] Mr. MacDonald observed that the Office of the Comptroller of the Currency – the primary regulator of

---

[13] Other depository institutions obtained the same most favored lender status when Congress enacted § 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (codified at 12 U.S.C. § 1831d).

[14] South Dakota and Delaware, at the beginning of the explosive growth of the financial services industry around 1980, sought to attract that industry as part of their economic development strategy. They wanted to "provide [their] citizens with the jobs and benefits a large national credit card operation can provide (attracted by the ability to export limitless credit card rates to other states)," while, it should be noted, protecting their local banks from competition with the exporting banks. Indep. Cmty. Bankers' Ass'n of S.D. v. Board of Governors, Federal Reserve Sys., 838 F.2d 969, 975 (8th Cir. 1988). *Cf.* Richard Eckman, *Recent Usury Law Developments: The Delaware Consumer Credit Bank Act and Exporting Interest Under § 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980*, 39 Bus. Law. 1251, 1264 (1984).

It worked, too. South Dakota's tax revenue from banks went from $3.2 million in 1980 to almost $27.2 million in 1987, with the comparable figures for Delaware rising from $2.4 million to almost $40 million. The Economist, July 2, 1988, at 26.

[15] Diane Ellis, *The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-Offs, and in the Personal Bankruptcy Rate,* FDIC--Division of Insurance, Bank Trends, 98-05 (Mar. 1998), *available at* http://www.fdic.gov/bank/analytical/bank/bt_9805.html.

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

national banks – had "turned a blind eye to [the] lawlessness" of certain credit card issuers. He described one particular issuer, Providian, as being "well known in the card industry as the poster child of abusive consumer practices."

Among Providian's more shocking abuses was its imposition a $29 per month charge for unrequested "credit protection" insurance that was worthless to the vast majority of cardholders. Even more shocking was Providian's use of bar-coded return payment envelopes that used the wrong zip code for the company's billing center. The payment envelopes practically guaranteed that cardholder payments would arrive late and, in turn, generate a late fee on the cardholder account.

Sadly, the abuses were not (and are not) limited to Providian. Mr. MacDonald also decried "The Frankenstein" (his word) that had been created by the Supreme Court's *Smiley* decision. He noted that credit card penalty fees were becoming a "substitute for APRs," and that the industry had devolved into "trip wire pricing," in which any cardholder misstep would set off a series of booby trap rates and penalty fees. He further observed that card pricing had become a massive subsidy for the rich. The penalty fees and rates charged to less well-off cardholders -- who usually revolve their balances -- were subsidizing the cash back and frequent flyer perks used to entice the super-creditworthy, who typically do not carry monthly balances.

Credit card debt has caught millions of households in a trap they simply cannot extricate themselves from without feeling the pressure to file bankruptcy. At the same time, credit card earnings have been consistently higher than returns on all commercial bank activities.[17] The problem is not the profits, it is simply that these profits are based

---

[17] Board of Governors of the Federal Reserve System, *The Profitability of Credit Card Operations of Depository Institutions* (June 2004), *available at*

on abusive practices, and resulting harm inflicted upon American households. The root of these problems is that credit card transactions in this nation are now completely unregulated – and this must change.

Mandatory Arbitrations Clauses Limit Access To Justice

Additionally, many credit card companies are now using mandatory arbitration clauses to circumvent basic due process protections and to obtain default judgments against consumers in distant forums. In Pennsylvania, for example, several credit card issuers obtained default arbitration awards against dozens of consumers from a Minnesota arbitration company, the National Arbitration Forum, that they attempted to have enforced by the Pennsylvania courts. The courts found that the method of service for the arbitrations and the distant forum did not comply with basic due process rules, analogizing the arbitrations to long-outlawed confessions of judgment. The courts then proposed and adopted a rule requiring such collection matters to first be filed in court.

Other courts have concluded that the prohibition of class actions is unconscionable. In truth and in economic reality, few if any consumers can take on an allegedly deceptive credit card practice individually. The stakes are just not high enough for any one consumer, and the time commitment alone far outweighs any potential economic award. No lawyer can handle an individual consumer credit card complaint, because his or her factual investigation will nearly always exceed in time and money the amount that could be recovered for the individual consumer.

---

http://www.federalreserve.gov/boarddocs/rptcongress/creditcard/2004/ccprofit.pdf. While the profitability of the credit card industry as a whole has fluctuated somewhat over these years, this is largely due to the changeability of the group of banks included in the sample. *Id.* at 2.

Credit Card Debt Pushes Borrowers Into Bankruptcy

Almost two years ago, Congress enacted draconian and unbalanced bankruptcy legislation. As a result of this new law, bankruptcy relief is now more complicated and more expensive for everyone who needs it. Despite the breathtaking scope of the new law, it did not place a single constraint on abusive practices by creditors. Yet, a large body of evidence links the rise in consumer bankruptcies over the last 20 years or so to a direct increase in consumer debt. And, as the examples in this statement demonstrate, a substantial portion of that consumer debt can be attributed to sky high interest rates, penalties and fees that credit card companies tack on to the bills of consumers each month.

Regrettably, all too often it is the growing interest, penalties and fees that force struggling families into bankruptcy. Just this week, a front-page article in USA Today[18] on debt and retirees made the link between credit card fees and bankruptcy. A woman from Palm Beach, FL who lives on $1,100 a month from a pension and Social Security said that she was struggling to pay off $6,000 in medical expenses charged to her credit card when it occurred to her that she may never pay off the debt because of the monthly interest charges. She is being charged nearly 30 percent interest, and despite not using the card for any other purchases, she cannot make a dent in the principal because her monthly payment gets eaten up by interest charges.

After a year of experience with the new bankruptcy law, Congress should consider eliminating some of the unnecessary and costly burdens it has placed on financially struggling families seeking relief from debts they cannot pay.

---

[18] Kathy Chu, *Retirees Up Against Debt,* USA Today (Jan. 23, 2007) at A1.

PROPOSED SOLUTIONS

More Disclosure Is Not the Answer

Because of the deregulation of bank credit, virtually no state regulation on creditor conduct applies to the practices of the credit card industry.[19] While there are some – very few – limits placed on the most outrageous abuses of consumers by banks by the federal banking regulators, the Truth in Lending Act ("TILA) is the primary regulatory structure applicable to the relationship between credit card issuers and their customers. The TILA was intended to be – and remains – primarily a disclosure statute. Through its enactment and enforcement, Congress intended to enable consumers to compare the costs of credit.[20] However, the TILA was never intended to stand on its own – to be the sole and primary means of regulating and limiting a powerful industry vis-à-vis the individual consumers who borrow money for personal, family or household purposes. Indeed, when the TILA passed in 1968, state usury and fee caps applied to credit card transactions.

Uniform and accurate disclosures *are* useful for consumers, but they cannot substitute for real regulation. The best proof of this is the unbalanced and dangerous situation that the American consumers find themselves in with the open-end credit industry today.

Disclosures are only useful for consumers when all of the following conditions exist –

---

[19] For example, when the state of California tried to address the issue of tiny minimum payments by requiring creditors to provide information to each consumer on how long it would take to pay off a sample credit card balance if only the minimum payment was paid each month, a federal district held the statute was preempted by federal banking statutes. American Bankers Association v. Lockyer, 239 F. Supp.2d 1000 (E.D. Cal 2002).

[20] 15 U.S.C. § 1601(a).

- The consumer has the opportunity to read the disclosures fully;
- The disclosures are unambiguous and understandable;
- The disclosures are true and apply to the entire term of the contract;
- The consumer has the knowledge and sophistication to understand the meaning of the information provided in the disclosures;
- The consumer has the opportunity to make choices based on the information gained through the disclosures.

Moreover, disclosures alone are not sufficient to protect consumers from over-reaching creditors. This is because --

- Consumers lack equal access to information – most consumers will not have the knowledge to understand the legal consequences of the terms of credit.
- Consumers lack equal bargaining power – no consumer has the market power to call up a credit card company and negotiate either the basic terms or those in the adhesion contract.
- The credit card market does not provide real choices. With the increasing consolidation of credit card providers, the industry guarantees *less* meaningful competition. There is generally competition only on the surface, on a few prominently-advertised terms such as the periodic rate and annual fee. Consumers have little or no meaningful choices on the terms that create the bulk of the cost of open-end credit.
- Without some basic substantive regulation, there will continue to be competition between industry players only as to which can garner the most profit from the most consumers – regardless of the fairness, or the effects on consumers.

Recommendations for Statutory Reform

The credit card market in the U.S. is now very mature. To increase market share, industry participants must be more aggressive in their pricing strategies. Because the APR is the primary measure of competitiveness, back-end penalty fees will continue to increase to offset the risks in credit card marketing plans. Consumers do not, however, shop for credit cards based on their penalty fees, and no real competition will ever exist to damper the escalation of those fees. To restore real competition based on the APR, all bank penalties should be controlled by the longstanding common law rules on penalties – the fees are capped by the actual or reasonably expected cost to the bank from a

cardholder's breach. This is the principles-based standard reiterated for such fees by the Office of Fair Trading in the United Kingdom and Europe, and it should be applied here as well. Without such an approach, we will continue to see a race to the bottom for backend penalties while the banks deceptively tout unrealistically low APRs.

Accordingly, it is time for the re-regulation of credit card transactions. Real, substantive limits on the terms of credit, and the cost of the credit, including the interest rate and all fees and charges, must be re-imposed. These include:

- A cap on all periodic interest rates, for example, prime plus 10%.
- A cap on all other charges, whether considered a finance charge or not, to an amount the card issuer can show is reasonably related to cost.
- No unilateral change-in-terms allowed.
- No retroactive interest rate increases allowed.
- No penalties allowed for behavior not directly linked to the specific card account at issue.
- No over limit fees allowed if issuer permits credit limit to be exceeded.
- No improvident extensions of credit–require real underwriting of the consumer's ability to pay.
- No mandatory arbitration, either for consumers' claims, or for collection actions against consumers.
- Meaningful penalties for violating any substantive or disclosure requirement that provide real incentives to obey the rules.
- A private right of action to enforce section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive practices by businesses, including banks.

It is no longer a question of balancing the appropriate regulation with the need to assure access to credit. The increasing mountain of debt held by American consumers, coupled with the growing number of abusive practices by the credit card companies, illustrate amply de-regulation has not worked. Since biblical times government has recognized that consumers need strong, enforceable limits placed on the power of lenders to exert their far greater bargaining power in the marketplace. The age old protection of borrowers from over-reaching lenders needs to be reinstituted. We look forward to

working with Chairman Dodd and other members of this committee to develop strong, effective credit card legislation.

TESTIMONY OF RICHARD VAGUE
CEO, BARCLAYS BANK DELAWARE
BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

"Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry, and Their Impact on Consumers"

January 25, 2007

Good morning Chairman Dodd, Ranking Member Shelby, and members of the Committee. My name is Richard Vague and I am CEO of Barclays Bank Delaware. Barclays Bank Delaware is a credit card issuer with approximately $4 billion in receivables. The majority of our cards are issued in partnership with other organizations who license us to use their brands and to solicit cards to their members or customers. We partner with a variety of organizations, such as airlines, stores, and charities. We are presently the 13th largest credit card issuer in the United States and one of the fastest growing. I appreciate the opportunity to appear before you today to discuss credit cards and consumers. Mr. Chairman, I applaud you and this Committee for examining this important issue and for considering ways to improve consumer understanding of credit cards. I also want to thank my own senator, Senator Carper, for his leadership on these issues.

It is fair to say that, in the realm of consumer finance, the credit card is one of the greatest developments of the 20th century. It is widely recognized that credit cards represent the democratization of credit. Although we take credit cards for granted today, it was quite phenomenal to develop a product that allows a consumer to present a card and obtain merchandise with no money physically changing hands. Today consumers can use credit cards around the world and on the Internet to make purchases at millions of merchants. Not only do

credit cards give consumers this purchasing convenience, but consumers also have the option to use their credit cards as a mechanism to obtain an interest-free loan simply by paying their bill in full each month. Consumers who use credit cards also receive enhanced consumer protections compared to cash and checks, and a detailed periodic accounting of the consumer's spending to boot. In short, credit cards provide consumers with convenient and safe options to make purchases and to borrow money. Given the enormous consumer benefits associated with credit cards, it is no surprise that Federal Reserve Board staff studies consistently suggest that 90% of consumers are satisfied with their credit card issuer.

It is also important to note that the vast majority of credit cardholders use credit cards responsibly. It is in nobody's interest to provide credit cards to consumers who cannot repay the money they have borrowed. For that reason, issuers strive to provide credit cards only to consumers who can handle the credit offered to them. Banks that lend indiscriminately to consumers obviously will not be in this business for long.

Having said all of this, Mr. Chairman, credit card products have become more diverse over the years. No longer are most cards priced with a 19.8% APR and a $20 annual fee while being made available only to consumers on the higher end of the credit spectrum. Credit card issuers have become much more sophisticated with respect to providing a wide variety of consumers with cards that have a wide variety of features. Now consumers can find credit card products with a variety of interest rates, benefits, rewards, and fee schedules. Importantly, the average rate has gone down over the years. This is a result not only of increased sophistication, but also of intense competition within the credit card industry and from other payment providers

as well. Without doubt these innovations are positive developments. With these increased product offerings, however, comes the need to ensure that consumers understand the features of the various credit card products offered to them.

I believe that credit card disclosures could be greatly improved. I think most other credit card issuers would agree. But we need help to make this happen. Credit card issuers must comply with complicated, detailed, and lengthy regulatory requirements, meaning that disclosures tend to be complicated, detailed, and lengthy. Additionally, every time there is new litigation, it seems another legal disclosure needs to be added. We need a new, clear, and simple disclosure structure that allows us to draft our disclosures in plain English—not lawyerspeak—highlighting the terms consumers find important in a manner that is easy to understand. In fact, an updating of disclosure regulations appears to be the sole recommendation of the GAO in the context of its broader study of credit card disclosure issues. Focusing consumer disclosures on key terms is not a new concept. In fact, it is the basis for the existing Schumer box disclosures. Card issuers that comply with this new structure should also be protected against a barrage of new lawsuits and the resulting lawyerspeak that would inevitably creep back into the disclosures as a result.

Mr. Chairman, I firmly believe that effective disclosures are the key to ensuring that consumers understand the material terms and features of credit card products. An informed consumer can then decide whether a credit card is right for him or her. After all, there is no shortage of credit card issuers and products from which consumers can choose if the practices of any given issuer, or the terms of any given offer, do not meet the consumer's liking. I would

strongly caution Congress against the adoption of legislation that would have the effect of imposing price controls or similar limitations with respect to credit card products. The fact is this: price controls do not work. They would likely result in an increase in other costs associated with credit cards, reduced benefits, or a reduction of credit availability to those who are on the lower end of the credit spectrum with a corresponding adverse impact on the economy. Nobody wants to return to the days of relatively uniform card offerings available only to limited numbers of consumers at higher prices.

Mr. Chairman, this concludes my testimony and I would be happy to answer any questions you or members of the Committee may have.

Testimony of Tamara Draut,
Director of the Economic Opportunity Program, Dēmos

Before the United States Senate Committee on Banking, Housing and Urban Affairs

"Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry, and Their Impact on Consumers"

January 25, 2007

Chairman Dodd and Ranking Member Shelby, thank you for the opportunity to testify today on issues facing households in credit card debt. I am here representing Dēmos, a nonprofit, nonpartisan research and public policy organization working on issues related to economic security. Over the last several years, Dēmos has produced several research studies on the growth of credit card debt and possible factors driving the rapid rise in credit card debt among the entire population as well as certain sub-groups. Our concern with the growth in unsecured debt was borne out of overarching interest in the state of family economic well-being in the midst of a changing economy. Our research points to an increased reliance on credit cards as a way families have coped with rising basic household costs in the face of slow or stagnant income growth. The rise in credit card debt, however, also raises additional concerns about the ability for families to build assets and savings, particularly as high interest rates and fees are siphoning additional money out of the family paycheck. In researching and documenting the rise in credit card debt, Dēmos became aware of the role that credit card industry practices play in the ability of indebted families to pay down their credit card debt and get back on the path to financial stability.

Many consumer organizations have long been concerned with the widespread use of abusive lending practices by credit card companies and other lending institutions. Dēmos applauds the work of the Consumer Federation of America, US PIRG, the National Consumer Law Center, and many others for their vigorous championing of reforms to protect consumers. Dēmos seeks to add to this perspective how the growth in credit card debt threatens family economic well-being and, by extension, the consumer-driven economy at large. During my testimony, I will specifically address the following issues related to credit card debt and industry practices:

1) Trends in credit card debt among households, highlighting groups of the population that are particularly strained by rising debt such as low- to middle-class households; seniors, and young adults;
2) The rise in fees and interest rates charged by card companies after two Supreme Court cases which resulted in the deregulation of the credit card industry;
3) The capricious use of penalty rates and fees that result in a cardholder's interest rate doubling or tripling, including the practice of raising a cardholder's interest rate due to payment history with other credit accounts (commonly known as universal default); and
4) The application of interest rate changes retroactively, which results in consumers paying off their purchases at a rate different from the one in which they based their purchasing decisions under; and

The Growth of Credit Card Debt

Between 1990 and 2001, revolving consumer debt in America more than doubled, from $238 billion to $692 billion. Credit card debt continued to rise in the new century--increasing by 7.2 percent from $703.9 in 2001 to $754.8 billion in 2004. The 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.[1] As a result of rising credit card debt, each year more children now suffer through a parent's bankruptcy than through a divorce.[2] Despite record levels of mortgage refinancing, historic low interest rates, and unprecedented appreciation of home values, household debt service burdens have reached record highs. By the third quarter of 2006, household debt payments represented 14.49 percent of disposable income, according to data from the Federal Reserve.[3] The financial obligations ratio, which provides a more accurate snapshot of household burdens of Americans, is at a record 18.5 percent.

These aggregate level trends illustrate that American households are accumulating increasingly higher amounts of credit card debt, with rising numbers suffering a total financial collapse. To better understand how these aggregate trends have played out at the household level, Dēmos has researched credit card debt trends among various demographic groups using data from the Federal Reserve Board's Survey of Consumer Finances (SCF) and by commissioning a national household survey of families with credit card debt.

---

[1] American Bankruptcy Institute. "U.S. Bankruptcy Filings 1980-2005."
[2] Elizabeth Warren and Amelia Warren Tyagi. *The Two-Income Trap: Why Middle Class Mothers and Fathers are Going Broke.* (New York: Basic Books) 2004.
[3] Federal Reserve Board, available online at http://www.federalreserve.gov/Releases/housedebt.

My testimony today highlights only a few key findings. For complete details on the growth of debt please see Dēmos reports, *Borrowing to Stay Healthy: How Credit Card Debt is Related to Medical Expenses; The Plastic Safety Net: The Reality Behind Debt in America; Borrowing to Make Ends Meet: The Growth of Credit Card Debt in the 1990s* and *Retiring in the Red: The Growth of Debt Among Older Americans*. They are available on our website, www.Dēmos.org.

Major Trends in Credit Card Debt, 1989-2004

Our research has found that four groups have experienced the most rapid rise in credit card debt since 1989. These four groups are senior citizens, adults under age 34, and low- and moderate-income households. As Table 1, illustrates, 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. Prevalence of Debt and Average Amount of Debt, by Income Group (2004Dollars)

Family income group	Families holding credit cards in 2004	Cardholders reporting debt in 2004	Average credit card debt in 2004	Percent increase in debt 1989-2004
All Families	75%	58%	$5,219	89%
< $10,000	36%	65%	$2,750	77%
$10,000 - $24,999	53%	59%	$3,378	121%
$25,000 - $49,999	75%	65%	$4,831	95%
$50,000 - $99,999	92%	58%	$4,667	63%
$100,000 or more	98%	46%	$7,691	31%

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

Credit Card Debt Among Different Income Groups. American families across all income groups rapidly accumulated credit card debt in the 1990s. According to the Survey of Consumer Finances, three-quarters of American families hold credit cards, with 58 percent of cardholders carrying debt on their cards. The growth of credit card debt over the last decade was not evenly distributed among income groups. As Table 1 shows, the greatest growth in credit card debt occurred among low- to moderate-income households. Among the low-income households (annual incomes between $10,000 and $24,999) credit card debt grew 121 percent between 1989 and 2004, to an average of $3,378.

The second-highest increase was among moderate-income households (incomes between $25,000 and $49,999), rising by 95 percent to $4,831 in 2004.

Credit Card Debt by Race/Ethnicity. When we examine credit card debt trends by race/ethnicity, two important findings emerge. First, both Black and Hispanic households are less likely to have credit cards than are White Households. Second, both Black and Hispanic cardholders are more likely to be in debt than their White cardholding counterparts (Table 2).

Table 2. Prevalence of Debt and Average Amount of Debt, by Race/Ethnicity. (2004 dollars)

Race/Ethnicity	Percent holding credit cards in 2004	Percent cardholders reporting debt in 2004	Average debt in 2004
All Families	75%	58%	$4,126
White Families	82%	54%	$5,631
Black Families	52%	84%	$3,379
Hispanic Families	54%	79%	$3,838

Dēmos' calculations using 1989, 1992, 1995, 1998, 2001 and 2004 Survey of Consumer Finances

Credit Card Debt Among Older Americans. 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).

Credit Card Debt Among Young Adults. In *Generation Debt*, part of Dēmos' six-part series on the economic challenges confronting young adults, we examine trends in credit card debt among young Americans as they try to establish their careers, start families and buy homes. 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.

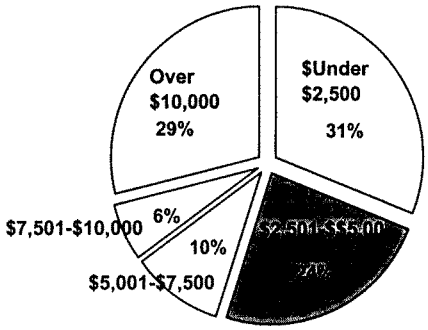
The percentage of credit card indebted young households experiencing debt hardship has grown considerably—22 percent of young Americans experienced debt hardship in 2004—up from 12 percent in 1989.

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

The rapid rise in debt among American households over the last decade is well documented, but it is not well understood. Existing data sources tracking debt, such as the Federal Reserve Board's triennial Survey of Consumer Finances, provide only a limited picture of household indebtedness. Existing data sources don't answer basic questions about household credit card debt, including how long the average household has been in debt and what types of purchases led to outstanding balances. To better understand the factors contributing to household indebtedness, Dēmos along with 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.

This survey (full findings available in *The Plastic Safety Net*) reveals that the average low- to middle-income household has been in credit card debt for three and half years, and are carrying credit card debt average $8,650. One-third of these households has credit card debt over $10,000, while another third has credit card debt lower than $2,500. (See Chart 1).

Chart 1. Percent of Households by Level of Credit Card Debt



The majority of low- to middle-income indebted households (59 percent) had been in credit debt for longer than one year. The duration of credit card debt did not vary much across demographic groups, though not surprisingly, households with higher levels of credit card debt were more likely to have been in debt for longer than a year: 75 percent for those with credit card debt higher than $5,000 compared to 39 percent for those with less than $2,500 in credit card debt.

For 45 percent of households, the amount of credit card debt they had at the time of the survey was less than it was three years ago, while 42 percent of households reported their debt was more than it was three years ago. But regardless of whether their current credit card debt was higher or lower than three years before, nearly half of households (47 percent) reported having swings in the level of credit card debt—that is, after periods of paying down their debt, events happened that caused them to run up the debt again. This finding makes sense given the increased volatility in the income of U.S. middle-income households; the average annual income swing of almost $13,500 has

doubled since the 1970s.[4] Among the remaining households, 17 percent reported having "a high level of credit card debt for a long time," and 20 percent reported this being "the first time their credit card debt was this high" at the time of the survey. Another 13 percent said that they were carrying debt to build up their credit score.

Factors Contributing To Credit Card Debt. 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 (see Table 2). **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 3: 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

[4] Peter G. Gosselin, *The New Deal: If America is Richer, Why Are Its Families Much Less Secure?,* Los Angeles Times (October 10, 2004).

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.

The Role of Medical Expenses in Credit Card Debt. 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. Within this "medically indebted" group,

- Forty-three percent had credit card debt over $10,000 and 56 percent had credit card debt higher than $5,000.
- Average credit card debt was 46 percent higher ($11,623) than for low- and middle-income indebted households without a major medical expense or medical expenses contributing to their credit card debt ($7,964).
- Average credit card debt was 32 percent higher for those without health insurance ($14,512) than for those with health insurance ($11,006).
- Average credit card debt was 20 percent higher for households with children ($12,840) than for those without children ($10,669).
- Sixty-two percent have been called by bill collectors, as compared to 38 percent of indebted households without such medical expenses.

Compared to other age groups, young adults had the highest level of average credit card debt, and the percent increase in debt for medically-indebted versus non-medically indebted people was greatest among young adults. Average credit card debt was 79 percent higher among medically indebted low- and middle-income Americans between the ages of 18 and 34 than for non-medically indebted 18 to 34 year-olds. ($13,303 versus $7,450).

The Role of Industry Practices

The availability of credit to weather economic shortfalls can be beneficial for households. Using revolving credit to pay off large expenses such as car repairs allows

families to spread the payments out over several months, providing less disruption to the monthly family budget. Using credit to supplement a family's income during a job loss can help ensure the family stays afloat, allowing them to allocate precious financial resources to maintaining mortgage and rent payments.

Unfortunately, as households have become more reliant on credit cards to make ends meet as a result of greater instability in the economy and rising costs, the credit card industry has engaged in several practices that make it extremely difficult for indebted families to pay down their debt. The rest of my testimony will examine the changing practices of the industry and the deregulation that helped fuel the widespread exploitative practices used by lenders today.

Deregulation and Changes in Industry Practices

Beginning in the late 1970s, the banking and financial industry has been steadily deregulated. For consumers, this wave of deregulation has been a mixed blessing. It has expanded the availability of credit to many consumers formerly denied access to credit, but at a very high cost. This high cost, the result of finance charges, penalty fees, and increased credit lines, helped usher in the decade of debt.

Deregulation of the industry began with a Supreme Court ruling in 1978. In *Marquette National Bank of Minneapolis v. First Omaha Service Corp* (hereafter *Marquette*) 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.[5] As a result, regional and national banks moved their operations to more lender-friendly

[5] Vincent D. Rougeau, "Rediscovering Usury: An Argument for Legal Controls on Credit Card Interest Rates," *University of Colorado Law Review*, Winter 1996.

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.[6]

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 effect of this ruling had tremendous impact on the growth of the credit card industry and its profitability. Before *Marquette*, complying with 50 different state laws represented a high cost burden for the credit card companies. 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.[7]

Credit card interest rates began to soar in the high-inflation post-*Marquette* environment, reaching averages of 18 percent, and have remained relatively high in comparison to drops in the federal funds rate (see Chart 2).[8] Several economists have remarked on the reasons why consumers continue to pay, and card companies continue to

---

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

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

[8] See *Federal Deposit Insurance Corporation (FDIC)*: Bank Trends – The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-Offs, and the Personal Bankruptcy Rate. *http://www.fdic.gov/bank/analytical/bank/bt_9805.html*. May 1998, p 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.

charge, exceptionally high interest rates. Some point to the high consumer transaction costs involved in switching,[9] while others point to a lack of competition in the credit card marketplace (market share by the top issuers has gone from 50 percent by the top 50 issuers the year before *Marquette*, to 78 percent by the top 10 issuers in 2002).[10] Whatever the reason, credit card companies did not lower their rates when inflation slowed and national interest rates came down. As a result, the card companies' "spread"—the amount charged above what it costs them to loan the funds—has remained consistently high, consistently at or above 10 percent over the last 15 years.

This trend has continued in the past decade, even as the federal funds rate and the prime rate dropped to historic lows. For example, in 2001 the Federal Reserve lowered rates eleven times, from 6.24 percent to 3.88 percent.[11] But these savings didn't get passed on to consumers: during the same period, credit card rates declined only slightly from 15.71 percent to 14.89 percent.[12]

The rise in credit card debt during the 80s and 90s reveals how quickly this transformation occurred: In 1999 dollars, from 1980 to the end of 1999, credit card debt grew from $111 billion to nearly $600 billion.[13]

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

---

[9] See Vincent D. Rougeau, "Rediscovering Usury: An Argument for Legal Controls on Credit Card Interest Rates," *University of Colorado Law Review*, Winter 1996.
[10] Robert D. Manning, *Credit Card Nation: The Consequences of America's Addiction to Credit,* (Basic Books: New York), 2000.
[11] Federal Reserve, Federal Funds Rate, Historical Data. Released April 28, 2003. http://www.federalreserve.gov/releases/h15/data/afedfund.txt
[12] US Census Bureau, *Statistical Abstract of the United States: 2002*, p 728.
[13] Robert D. Manning, *Credit Card Nation: The Consequences of America's Addiction to Credit,* (Basic Books: New York), 2000, pp 12-13. Figures adjusted to 1999 dollars.

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. For example, before Smiley late fees averaged $16. Now, it's typically $39.

Industry Practices that Penalize Responsible Debtors

There are several practices that I would like to bring to the attention of the Committee during my testimony. The lack of national regulations regarding fees and interest rates, and the hobbling of state enforcement of their own laws, has resulted in consumers being unprotected from excessive fees and interest rates. The following practices are employed by all the major issuers and cost families billions of extra dollars every year.

1. Rate hikes and fees for late payments

All the major issuers now raise a cardholder's interest rate to a "default rate" when their payment arrives late—often to 30 percent or even 34 percent. Late payment penalties affect millions of cardholders of all credit risk levels, as there is no longer a late payment grace period. A payment is considered "late" if it arrives after 1:00 or 2:00 on the specified due date. Issuers have also begun systematically mailing statements closer to the due date, giving customers less turn-around time. The new default rates are applied retroactively—rather than to all new purchases. In addition to raising the interest rate on the card, issuers also charge the consumer a late fee, now typically between $29 and $39.[14] According to one survey nearly 60% of consumers had been charged a late

[14] Ibid.

fee in the past year.[15] According to R.K. Hammer Investment Bankers, a California credit card consulting firm, banks collected $14.8 billion in penalty fees in 2004, or 10.9 percent of revenue, up from $10.7 billion, or 9 percent of revenue, in 2002, the first year the firm began to track penalty fees.

Congress should amend the Consumer Protection Act or the Truth in Lending Act to define the parameters of "late payment" to ensure consumers are being treated fairly and appropriately. A late payment grace period of 3 to 5 days would be reasonable and ensure responsible cardholders are not unduly penalized. Penalty rates should be limited to an amount above the original annual percentage rate no higher than 50 percent of the original rate. (E.g., if the original APR is 9 percent, the penalty rate cannot be above 13.5 percent.)

2. Universal Default Policies

Card issuers now routinely check their cardholders' credit reports and will raise the interest rate on the card if there has been a change in the consumer's score. Known in the industry as "universal default",," these "bait and switch" policies are little more than preemptive penalties levied toward responsible debtors. For example, if a Bank One Visa cardholder is late on their Citibank MasterCard, Bank One will now raise the cardholder's interest rate—even if that cardholder has never missed a payment with them. Interest rate increases can also be triggered when a cardholder's profile has changed due to the addition of new loans, such as a mortgage, car loan or other type of credit.[16] These universal default practices should be prohibited.

---

[15] Ibid.
[16] Amy C. Fleitas, "20 Sneaky Credit Card Tricks." Bankrate.com. www.bankrate.com/brm/news/cc/20021106a.asp.

3. Retroactive Application of Interest Rate Changes

The practice of raising a cardholder's rate to a "default rate" for payments that arrive hours after a mail pick-up, or for activity with another creditor is made worse by the fact that the new higher rate is applied to the cardholder's *existing* balances. By applying the rate change to previous purchases, card companies are essentially changing the terms retroactively on consumers, and in essence, raising the price of every item or service purchased previously with the card. Take, for example, a cardholder who buys a new computer under the pretense that she will be paying back the price of the computer at the APR on her card at the time of purchase, which may be 9.99 percent. After one day-late payment on her account, the interest rate on her card is raised to 27.99 percent. As a result, this cardholder is now paying off the loan for her computer under drastically different terms than which she purchased the item. These severe default rates, levied even on customers who are paying their bills in good faith, if perhaps not in perfect time, constitute an enormous and undue increase in the cost and length of debt repayment for revolvers.

I have included in my testimony a copy of a credit card solicitation from Bank One. Like all standard agreements, the solicitation contains the following language:

> "We reserve the right to change the terms (including APRs) **at anytime for any reason**, in addition to APR increases which may occur for failure to comply with the terms of your account." [my emphasis]

In terms of a contract, consumers are already at an extreme disadvantage because the card the terms can be changed at any time.

Card companies should be held to the terms of the original contract for all purchases up to the initiated change. Any change made to the terms of the cardholder agreement in terms of increases in the annual percentage rate (or decreases if that may be the case) should be limited to future activity on the card.

A bill introduced by Senator Dodd (S.499), The Credit CARD Act of 2005 provides for the prohibition of retroactive application of interest rates, among other sensible reforms. Similarly, a bill introduced by Senator Menendez (S. 2655) by prohibiting unilateral changes in terms would end retroactive application of price increases.

Conclusion

In the face of rising costs for essential goods and services, many families have turned to credit cards as a solution for maintaining living standards during periods of income loss or stagnation. The credit card companies have responded to the increased financial vulnerability of many American households by further strapping customers with a high-cost combination of "gotcha" penalty interest rates and fees. In absence of stronger federal regulations or industry-driven reforms, the levels of debt accumulated by American households in the past decade may very well prove unsustainable on a number of fronts. Industry practices that make it harder for indebted households to pay down balances in reasonable amounts of time threaten the health of U.S. households, the health

of our consumer-driven economy, and eventually, the health of the consumer lending industry itself.

Attachment:

Credit Card Offer from Bank One for a Visa Card.

Credit Card Offer
from Bank One (Visa)

RATE, FEE AND OTHER COST INFORMATION

Annual Percentage Rate (APR) for purchases (including balance transfers, excluding overdraft advances)	[illegible] Any rate 7.99% [illegible]
Other APRs	Cash Advance APR 19.99% [illegible] Default rate 24.99% [illegible] Closed account rate 24.99% [illegible] Overdraft Advance APR 13.99% [illegible]
Variable rate information	The following APRs may vary monthly based on the Prime Rate: Purchase APR equals the Prime Rate plus 3.99 [illegible] but not less than 4.99% Cash advance APR equals the Prime Rate plus 15.00 [illegible] but not less than 18.99% Default rate and closed account rate equal the Prime Rate plus up to 20.00%
Grace period for repayment of purchase balances	At least 20 days [illegible]
Method of computing the balance for purchases	[illegible]
Annual fee	None
Minimum finance charge	$1.00
Transaction fee for convenience checks	3% of the amount of each transaction, but not less than $0.00 nor more than $10.00
Transaction fees for cash advances	ATM cash advances: 3% of the amount of the advance, but not less than $10.00 All other cash advances: 3% of the amount of the advance, but not less than $15.00

Late Payment fee: $15.00 on balances up to but not including $200, $35.00 on balances of $200 [illegible] However, if you exceed, that is, make one or more late payments within your 12 month period, $35.00 regardless of the amount of your balance. **Over-the-Credit-Limit fee:** $35.00

Language addressing change in terms

[illegible] APRs are not guaranteed. This means that 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 reserve the right to change the 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 [illegible]

Consumer Federation of America
1620 I Street, N.W., Suite 200 * Washington, DC 20006

Consumer Action
Education and Advocacy Since 1971

TESTIMONY OF

TRAVIS B. PLUNKETT,
LEGISLATIVE DIRECTOR

ON BEHALF OF
THE CONSUMER FEDERATION OF AMERICA AND
CONSUMER ACTION

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

THE EFFECT OF CURRENT CREDIT CARD INDUSTRY PRACTICES ON CONSUMERS

JANUARY 25, 2007

Mr. Chairman, Senator Shelby, and Members of the Committee, my name is Travis Plunkett and I am the legislative director of the Consumer Federation of America (CFA.)[1] I am testifying today on behalf of CFA, the national consumer protection organization, Consumer Action,[2] and Consumers Union, the publisher of Consumer Reports.[3] I appreciate the opportunity to offer our comments on the effect of current credit card industry practices on consumers.

Given the dramatic changes that have occurred in the credit card industry in recent years – and the negative impact that some of these changes have had on consumers – no industry in America is more deserving of oversight by Congress. For example, agencies that receive consumer complaints regularly report that credit card problems are a major concern. The U.S. Better Business Bureau reported more than 17,000 complaints about credit cards in 2004, the third highest source of consumer complaints after cellular phone services and new car dealers.[4] There is clearly a need to examine many questionable practices in the industry including marketing, credit extension, the terms and conditions of credit card contracts and rising fees and interest rates. We applaud you for calling this important oversight hearing and look forward to working with you and the committee to enact legislation that will make this industry more consumer-friendly. In particular, Mr. Chairman, we urge this Committee to consider and to move your legislation, S. 499 of 2005, which will address many of the abuses I will speak about today.

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

---

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

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

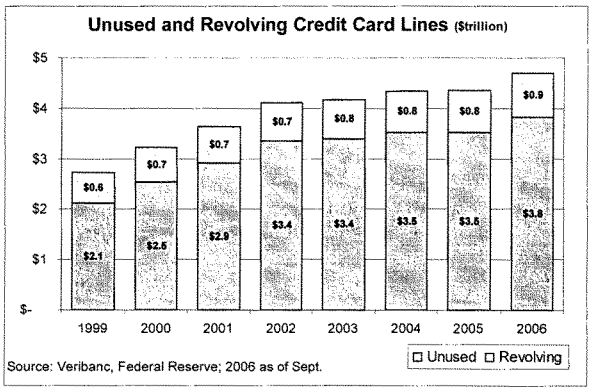
[3] **Consumers Union** is a nonprofit membership organization chartered in 1936 under the laws of the state of New York to provide consumers with information, education and counsel about good, services, health and personal finance, and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports with more than 5 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[4] The U.S. Better Business Bureau received fewer credit card complaints in 2005, but the number – over 10,000 – still ranked credit card problems in the "top ten." U.S. Better Business Bureaus, Complaint & Inquiry Statistics, 2005, Complaint Rank 2005, March 01, 2006.

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

A. AS CONSUMERS EXERCISE MORE CAUTION IN TAKING ON NEW DEBT, ISSUERS ARE ESCALATING THEIR MARKETING AND INCREASING THE AVAILABLITY OF CREDIT

It is conventional wisdom that consumer demand has fueled the growth of revolving debt to just under $873 billion.[5] However, a careful analysis of lending patterns by credit card companies shows that aggressive and even reckless lending by issuers has played a huge role in pushing credit card debt to record levels. Since 1999, creditor marketing and credit extension has increased about twice as fast as credit card debt taken on by consumers.[6] Moreover, when consumers become more cautious in taking on new revolving debt, as they have in recent years, issuers often sharply increase their marketing and credit in an attempt to entice reluctant consumers to exercise riskier behavior. That is why there is a growing credit "gap" between creditor supply and consumer demand.



[5] As of November, 2006, the amount of revolving debt held by Americans was $872.6 billion. Federal Reserve, Statistical Release, Consumer Credit Outstanding, Table G.19, January 8, 2007. Although this figure is often used as a proxy for credit card debt, most experts believe that outstanding credit card debt is slightly lower. First, approximately 5 percent of consumer revolving credit is not on credit cards. Second, between 4 to 9 percent of the debt does not truly revolve. It is repaid to the credit card issuer before the next billing cycle starts. Taking these two factors into account, outstanding credit card debt is likely to be between $750.8 billion and $794.4 billion.

[6] Veribanc, Inc. and Federal Reserve Consumer Credit Outstanding. According to Federal Reserve figures, consumer revolving debt grew by 41.6 percent from $609 billion in December 1999 to $861 billion at the end of the third quarter of 2006. According to Veribanc, unused lines of credit grew at more than double the rate consumers increased their use of credit card lines, increasing from $2.1 trillion in 1999 to $3.8 trillion at the end of the third quarter of 2006.

The total amount of credit made available by issuers now exceeds an astonishing $4.6 trillion.[7] The average amount of credit available per household is $41,441.[8] Of that amount, only 18 percent has been taken on as debt by consumers. According to figures from Veribanc Inc., there were more than $3.8 billion in unused credit lines in the fiscal quarter ending in September 2006. Between December 1999 and September 2006, revolving debt grew by 41.6 percent, but unused credit card lines made available by creditors grew by 81.4 percent, about twice as fast.[9] As a result, revolving consumer credit has *declined* as a share of total outstanding credit lines from 22.3 percent to 18.6 percent of total credit lines – a 17.0 percent decline.[10]

A similar trend is evident when examining the consumer response to massive increases in marketing by creditors. The most significant form of marketing for creditors remains solicitation by mail. Over half of credit cards held by consumers are the result of mail solicitation.[11]

	Solicitations (billions)	Response Rate
1990	1.1	2.1%
1991	0.99	2.4%
1992	0.92	2.8%
1993	1.5	2.2%
1994	2.5	1.6%
1995	2.7	1.4%
1996	2.38	1.4%
1997	3.01	1.3%
1998	3.44	1.2%
1999	2.54	1.0%
2000	3.54	0.6%
2001	5.01	0.6%
2002	4.89	0.5%
2003	4.29	0.6%
2004	5.23	0.4%
2005	6.06	0.3%

Issuers have increased the number of mailed credit card offerings by six-fold since 1990, from just over 1.1 billion to a record 6.06 billion in 2005.[12] The number of solicitations mailed by issuers in 2006 likely exceeded this amount.[13] CardTrak estimates that each household receives nearly 50 credit card solicitations in the mail each year. Wealthier families receive the highest number of credit card mailings, but low-income families are more likely to open the solicitations they receive.[14] The table at right indicates that issuer interest in marketing credit cards has grown much faster than consumer interest in accepting new cards. The consumer response rate to mail solicitations has declined seven-fold from 2.1 percent in 1990 to .3 percent in 2004. This means that for every 250 solicitations consumers receive, they reject more than 249. The tiny response rate demonstrates that the vast majority of consumers are being responsible when offered unsolicited credit.

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

---

[7] Veribanc, Inc. and Federal Reserve Consumer Credit Outstanding, Table G.19.
[8] There are 111 million households in the U.S., U.S. Census Bureau, "American's Families and Living Arrangements: 2003," November 2004, at 2.
[9] Veribanc, Inc. and Federal Reserve Consumer Credit Outstanding, Table G.19.
[10] CFA calculation based on Veribanc, Inc. and Federal Reserve figures.
[11] Vertis Inc. press release, "Financial Direct Mail Readers Interested in Credit Card Offers," January 25, 2005; "Card Marketing 101," *CardTrack*, September 2002.
[12] Synovate, press release, "Mail Monitor Reports Record Six Billion Credit Card Offers Mailed in U.S. during 2005," April 27, 2006.
[13] Consumers received 4.2 million direct mail pieces during the first half of 2006 compared to 3.9 million during the same period in 2005. This calculation includes acquisition, cross-selling and follow up mailings. "Mintel Comperemedia Reports Higher Credit Card Mail Volumes for First Half of 2006," September 7, 2006.
[14] Kidane, Amdetsion and Sandip Mukerji, Howard University School of Business, "Characteristics of Consumers Targeted and Neglected by Credit Card Companies," *Financial Services Review*, Vol. 13, No. 3, 2004 at 186.

Issuers also spend extremely large sums on many other forms of marketing and advertising, through television, telemarketing, the internet, radio, print and even outdoor billboards. *Nielsen Monitor* reported that credit card companies were among the top advertisers nationally and the fastest growing segment of purchased advertising in 2004, with credit card television advertising growing to $1.7 billion in 2004, a $438 million and 32.4 percent increase over 2003.[15] These figures are before the fourth largest credit card issuer, MBNA, started its first national advertising campaign during the 2005 Super Bowl.[16]

Credit cards also promote and advertise their cards by establishing significant networks of co-branded affinity relationships, which offer credit cards with the logo and affiliation of a sports team, university, association or non-profit. Credit card companies gain access to mailing lists, market the credit card branded with the group's logo directly to the group's membership. Organizations are paid a bounty for each account that is opened as well as revenue from any open balances on the affinity cards. Once a consumer relationship is established with the affinity card, the credit card issuers can market other lending products including student loans, home equity loans or auto loans to their affinity card customers.[17]

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

The growth of revolving debt in this country to $873 billion has obviously not affected all Americans equally. The extraordinary expansion of the credit card industry in the 1990s was fueled by the marketing of credit cards to populations that had not had widespread access to mainstream credit, including lower- and moderate-income households, consumers with seriously blemished credit histories, college students, older Americans and minorities.

In a practice widely known as risk-based pricing, creditors charged riskier consumers more to cover potential losses, usually in the form of higher interest rates. To make the assumption of debt more attractive to these households – and to entice them into carrying debt for longer periods – creditors lowered minimum payment balances from around five percent of principal to just over two percent. As a result, an estimated eighty percent of all households now have at least one card.[18] Moreover, vulnerable households shoulder a disproportionate share of the debt burden relative to their incomes. In other words, "democratization of credit" has had serious negative consequences for many Americans, putting them one unexpected financial emergency away from bankruptcy.

---

[15] Nielsen Monitor, "U.S. Advertising Spending Rose 6.3% in 2004, Nielseon Monitor-Plus Reports," March 1, 2005.
[16] Sidel, Robin, "Card Issuer MBNA lets the Public Take a Peek at Its Hand," *Wall Street Journal*, January 20, 2005 at C1.
[17] *Ibid.*
[18] Cardweb.com

Lower-Income and Minority Households

While the share of higher income families carrying credit card debt declined between 1998 and 2001, more lower- and moderate-income families were taking on debt.[19] The share of homeowners with credit card debt declined (probably due to a large increase in "cash out" refinancings that were used to pay down credit card debt), but the number of renters with debt increased. While fewer white families accumulated credit card debt, more minority households did.[20] Moreover, although minority households are less likely to have credit cards than white families, they are more likely to have credit card debt.[21] The amount of credit card debt held by minority households has also increased compared to white households.[22]

Credit card debt also represents a significant portion of lower-income families' income. A 2004 Gallup poll found that families with credit card debt earning under $20,000 a year owed 14.3 percent of their income in credit card debts, those earning between $20,000 and $29,999 owed 13.3 percent and those earning between $30,000 and $39,999 owed 11.0 percent. Compare this to the 2.3% of their income owed by families earning over $100,000.[23] The increase in credit card debt has contributed to alarmingly high overall levels of debt for many of these lower and moderate-income families. More than one-quarter of the lowest income families spent over 40 percent of their income on debt repayment in 2001.[24] The proportion of lower income families falling behind on their debts is also increasing.[25]

---

[19] Aizcorbe, Ana M., Arthur B. Kennickell and Kevin B. Moore, "Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances," *Federal Reserve Bulletin*, January 2003 at 22-23 Table 11. The percentage of families earning the lowest 60% of income grew by 10.5% from 38.5% of these families in 1998 to 42.5% of the lowest earning families in 2001. The share of families with credit card balances earning the top 20% of incomes fell by 12.6% from 47.7% of top earning families in 1998 to 41.7% of these families in 2001.

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

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

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

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

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

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

Younger and Older Americans

Starting in the early 1990's, credit card issuers targeted massive marketing efforts at college campuses throughout the country, resulting in a sharp growth of credit card debt among college-age and younger Americans. CFA and Dr. Robert Manning were among the first to document the serious consequences of this trend.[26] Since Dr. Manning's report for CFA in 1999, this issue has been the subject of much public and media scrutiny. One of the few Congressional oversight hearings of the credit card industry in recent years was conducted by this committee and focused on financial literacy among college students and the extension of credit cards on campus.[27]

And yet, Americans under 35 years-of-age continue to show more signs of trouble managing credit card debt than any other age group. The amount of credit card debt held by students graduating from college more than doubled to $3,262 between the mid-1990s and 2004.[28] Americans under 35 are less likely to pay off their credit card balances every month than average Americans,[29] are paying more for debt obligations than in the past and are increasingly likely to pay more than 40 percent of their incomes on credit card debt.[30] Not surprisingly, more young Americans are declaring bankruptcy than in the past.[31] Moreover, there is increasing evidence that issuers are now targeting high school students with credit card offers.[32] They are also marketing branded debit cards to adolescents, in part to encourage these young consumers to use similarly branded credit cards when they are older.[33]

The growth of credit card debt among older households is also troubling. Although these households were long thought to be the most frugal and resistant to consumer debt, changing economic conditions – especially declining pension and investment income coupled with rising health care and prescription costs – have made credit card debt a more serious financial issue for older Americans. Between 1992 and 2001, Americans over age 65 saw their credit card debt nearly double from $2,143 to more than $4,000.[34] The number of seniors filing for bankruptcy

---

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

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

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

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

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

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

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

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

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

more than tripled from 1991 to 2001.[35] Other warning signs are also evident. The proportion of income spent to pay off debts by households headed by individuals 65 to 74 years of age has risen steadily over the past decade[36] while about one in seven senior households paid more than 40 of their income towards their debts in 2001.[37]

Seniors have fewer credit cards than other age groups and are more likely to pay their credit cards in full every month, but a greater proportion also have lower incomes.[38] This means that credit card debt has a more severe impact on this age group. For example, credit card debt can threaten older homeowners, who stand to lose their home – and their most significant hedge against poverty – if they use home equity to pay off credit card debt.

The Downsizing of Minimum Payments

As credit card issuers dramatically expanded their marketing and extension of credit in the 1990s, they lowered monthly minimum payment amounts. By reducing the minimum payment, issuers could offer more credit, encourage consumers to take on more debt, and ensure that consumers would take far longer to pay off their debts, thus making them more profitable for the industry.[39] Monthly minimum payment rates were reduced from around 5 percent of principal owed in the 1970s to just over 2 percent by the turn of the century.[40] In 2005, 19 million credit card borrowers make only the minimum payments.[41]

The number of consumers paying just above the minimum rate is even larger. In a representative survey conducted for the Consumer Federation of America by Opinion Research Corporation in November of 2005, 34 percent of those questioned said that they usually pay the minimum rate or somewhat more. More than 40 percent of respondents earning less than $50,000 a year said they paid the minimum rate or somewhat more, while 45 percent of African Americans and 51 percent of Hispanics did so.[42] An examination by the Credit Research Center of 310,000 active credit card accounts over 12 consecutive months in 2000 and 2001 found similar results. Just under one-third of the accounts paid 5 percent or less per month of the total amount due.[43] Moreover, payment habits for many cardholders are not static over time.

---

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

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

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

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

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

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

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

[42] Opinion Research Corporation, "Consumer Financial Services Survey," November 3-7, 2005.

[43] Credit Research Center, McDonough School of Business, Georgetown University.

Depending on the economic circumstances of the cardholder involved, he or she could shift from fully paying outstanding balances every month to paying at or near the minimum rate.

However, paying only the minimum on credit cards can increase the length of time the debt is carried and significantly add to the interest cost of the credit card loan. Julie Williams, the First Senior Deputy Comptroller and Chief Counsel of the Office of the Comptroller of the Currency has noted that reduced minimum payments "dig borrowers into an ever deeper hole, requiring increasingly more difficult measures" for consumers to get out of debt.[44] CFA has concluded that reduced minimum payments were a significant cause of increasing bankruptcies in the last decade.[45]

One way to alert consumers to the consequences of paying off credit card balances at the minimum rate is to offer each consumer a personalized notice on the billing statement about how long it would take to pay off the balance at the minimum rate, and what would be the total costs in interest and principal. That is what Senators Akaka, Durbin, Schumer and Sarbanes proposed in the 109th Congress with S. 393. Such a personalized disclosure is, unfortunately, not included in recently enacted bankruptcy legislation, which requires consumers to call a toll-free number to get information about how long it would take to pay off their balances.[46] No specific information would be offered on the total cost of paying at the minimum rate. This bankruptcy law requirement will likely have no impact on the millions of consumers paying at or near the minimum rate who will not call a toll-free phone number.

One positive development regarding credit card minimum payments is that regulatory guidance issued by federal banking regulators in January 2003 directed credit card lenders to set minimum payments that "amortize the current balance over a reasonable period of time" and noted that prolonged negative amortization would be subject to bank examiner criticism.[47] Many major credit cards began increasing their minimum payments requirements in 2005, including Bank of America, Citibank, Discover and JPMorganChase,[48] in some cases to as high as 4 percent.[49] All issuers were required to fully phase in the changes by the end of 2006.[50]

---

[44] OCC, Remarks by Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel before the Risk Management Association's Retail Risk Management Conference on Regulatory Concerns about Certain Retail banking Practices, Chicago, June 3, 2003, in "Speeches and Congressional Testimony," *OCC Quarterly Journal*, Vol. 22, No. 3, September 2003 at 107.

[45] Consumer Federation of America, "Consumer Restraint Pressures Lenders to Reduce Credit Card Marketing and Credit Extension," January 18, 2000.

[46] Section 1301, S. 256, Public Law 109-8.

[47] Joint Press release of Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency and Office of Thrift Supervision, "FFIEC Agencies Issue Guidance on Credit Card Account Management and Loss Allowance Practices," January 8, 2003, see attached "account Management and Loss Allowance Guidance" at 3.

[48] American Financial Services Association, "Credit Card Minimu Payments Going Up," *Spotlight on Financial Services*, April 2005.

[49] Warnick, Melody, "Credit Card Minimum Payments Doubling," *Bankrate.com*, May 3, 2005. Citibank and Bank of America have announced they are doubling their minimum payment requirements from 2% to 4% of the balance.

[50] Day, Kathleen and Caroline E. Mayer, "Credit Card Penalties, Fees Bury Debtors," *Washington Post*, March 6, 2005.

The Office of the Comptroller of the Currency (OCC) has warned banks that increasing minimum payments may need to be accompanied by a reduction in Annual Percentage Rates (APRs) or eliminating fees to ensure that cardholders can actually reduce their balances and not just tread water with higher minimum bills.[51] Rising APRs and other increasing prices – such as energy costs – are leaving many consumers with less flexibility in their budgets. Even before the industry began to raise its minimum payments, consumers were increasingly worried about making their minimum credit card payments.[52] Since the increases took effect, consumers with interest rates above 20 percent have had to cope with payments that have roughly doubled.[53] Higher minimum payments are likely to be one reason why consumers are reporting increased concern about their ability to make credit card payments. In a survey conducted by CFA and the Credit Union National Association, the number of Americans who said they were concerned about paying off their holiday spending credit card balances increased to 33 percent in 2006, compared to 25 percent the year before. Over half of all young people (52 percent) said they were concerned.[54]

Targeting Consumers in Financial Distress

Nothing illustrates the perverse incentives of the credit card market better than the marketing of cards to consumers on the brink of bankruptcy, or to those just discharged from it. Several major issuers market high-cost, "sub-prime" cards to those with blemished credit histories. This population of cardholders can be profitable for the industry. Credit card industry consultant Andrew Kahr estimates that average subprime consumers will make two or three late payments a year, that the industry can generate fees from each of those tardy payments, and that these fees that can greatly exceed the interest payments on the small lines of credit themselves.[55]

Sub-prime consumers haven't just encountered high-cost offers of credit, but deceptive marketing practices. In 2000, Providian was required to pay more than $300 million in restitution to its sub-prime cardholders for unfair and deceptive practices.[56] More recently, Cross Country Bank, the sub-prime and secured credit card issuer that has been investigated by state and federal regulators for misleading consumers about the terms of its sub-prime credit card accounts and engaging in abusive collection practices, advertised on late night and daytime television when more unemployed potential sub-prime customers are most likely to be watching television.[57]

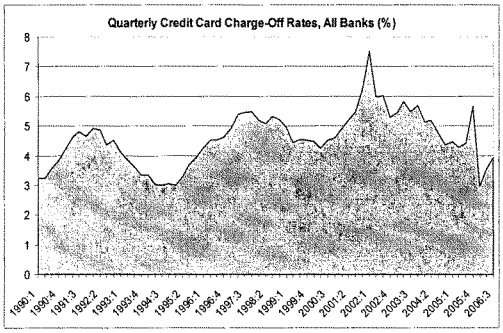
Consumers exiting bankruptcy are often swamped with offers at prime terms – low interest rates and without annual fees.[58] Many bankruptcy attorneys believe these offers are being made because consumers leaving bankruptcy court cannot erase their debts for another six

[51] Der Hovanesian, Mara "Tough Love for Debtors," *Business Week*, April 25, 2005.
[52] Gallup Poll News Service, "Average American Owes $2,900 in Credit Card Debt," April 16, 2004.
[53] "Minimum Payments," *CardTrack*, September 6, 2006.
[54] "Holiday Spending Likely to Rise Moderately in 2006, But Consumers Concerned about High Energy Costs, Debt Concerns," Consumer Federation of America, Credit Union National Association (CUNA), November 21, 2006.
[55] Interview with Andrew Kahr, credit card industry consultant, "The Secret History of the Credit Card," *Frontline*, November 2004.
[56] OCC, Statement of Comptroller of the Currency John D. Hawke J., June 28, 2000.
[57] Pacelle, Mitchell, "Pushing Plastic," *Wall Street Journal*, November 5, 2004.
[58] Mayer, Caroline E., "Bankrupt and Swamped with Credit Offers," *Washington Post*, April 15, 2005.

years. Under the new bankruptcy legislation consumers will not be able to wipe away any credit card debts for eight years. Some categories of credit card debt will not be "dischargeable" at all, no matter how long the consumer waits.[59]

C. AS ISSUERS HAVE DRAMATICALLY EXPANDED THEIR MARKETING AND CREDIT EXTENSION, THEY HAVE EXPERIENCED HISTORICALLY HIGH LOSSES AND BROUGHT IN RECORD PROFITS

Although credit card obligations, late payments and delinquencies have declined in the past two or three years, they are still higher than they were before the marketing expansion accelerated. Credit card charge-offs, the percentage of the value of credit card loans removed from the books (net of recoveries), or "written off," have been persistently high for the past decade. During the decade between the end of 1995 and the start of 2006, credit card charge-offs were not below 4 percent in a single quarter.[60] From the peak in 2002, charge-offs have been trending down overall and in 2006 charge-offs were below 4 percent for three consecutive quarters. However, most experts attribute lower charge-offs in 2006 to the surge of bankruptcy filings (and corresponding increase in charge-offs) that occurred in the third and fourth quarters of 2005. In fact, both charge-offs and the number of delinquent credit card payments – an early sign of payment difficulty – have been increasing recently. Since the beginning of 2006, credit card delinquencies have increased substantially.[61]



Despite these losses, the credit card industry is typically the most profitable in the banking sector, earning a return on assets since 1995 that is more than three times greater than that for commercial banks overall.[62] The return on assets for credit card companies has grew every year between 1988 and 2004, by a total

[59] *Ibid.*

[60] Federal Reserve Board, Charge-Off and Delinquency Rates on Loans and Leases at All Commercial Banks, available at www.federalreserve.gov/release/chargeoff, accessed January 19, 2007.

[61] Since the beginning of 2006, credit card delinquencies have increased from 4.27 percent of accounts to 4.57 percent. American Bankers Association, "Late Payments in Most Consumer Loan Categories Improve While Credit Card Delinquencies Rise," June 27, 2006; "Late Payments in Most Consumer Loan Categories Rise in the Third Quarter of 2006," January 8, 2007.

[62] "Card Profits 04," *CardTrak*, January 24, 2005; "Banner Year," *CardTrak*, February 2004; FDIC, *FDIC Quarterly Banking Profile*, Third Quarter 2006 at 5, Table I-A; FDIC, *FDIC Quarterly Banking Profile*, Fourth Quarter 2000 at 4, Table I-A. Commercial banks average return on assets between 1995 and 2004 was 1.23 percent, less than one third the size of the credit card industry average return on assets of 3.73 percent over the same period, according to R.K. Hammer and Associates.

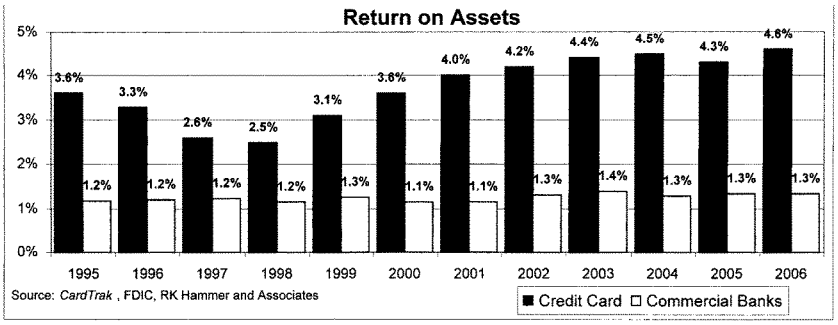
of 80 percent.[63] In 2004, the credit card industry had its most profitable year since 1988.[64] The industry exceeded these extraordinary profits in 2006, after profits and return on assets dipped in 2005 due to a large number of personal bankruptcies filed in advance of the new bankruptcy law. The industry earned $36.8 billion in profits in 2006, up nearly 80 percent from $20.5 billion in 2000.[65]

According to credit card industry consultant Andrew Kahr, the basic profitability of the credit card industry is tied to those who carry revolving debt. Borrowers who pay off their balances in full and on time each month do not earn profits for the industry.[66] With revolving debt nearly quadrupling since 1990, credit card companies' profitability should remain strong. About 90 million Americans do not pay off their cards each month,[67] and of those about 19 million usually make only the minimum payment.[68] Currently, about one-fifth of credit card debt is repaid every month. The repayment ratio has been increasing slightly in recent years, due to higher required minimum payments, the use of loans secured by homes to pay off credit card debt and smarter bill paying strategies by consumers.[69]

Second, credit card issuers earn a significant piece of their revenues from penalty fees alone. In 2004, issuers collected $14.8 billion in penalty fees, or 10.9 percent of revenue, up from $10.7 billion and 9 percent of revenue in 2002.[70] Credit card analysts have consistently predicted that the trend toward "repricing" of products and new and higher fees will continue, especially the use of higher late and over-limit fees, and universal default provisions that trigger higher penalty interest rates.[71]

---

[63] "Card Profits 04," *CardTrak*, January 24, 2005. The industry's return on assets grew from 2.5% in 1998 to 4.5% in 2004.
[64] "Card Profits 04," *CardTrak*, January 24, 2005.
[65] "Banner Year," *CardTrak*, February 2004; Ellen Cannon, "Credit Card Issuers' Profits Grew," *Bankrate.com*, January 9, 2007.
[66] Interview with Andrew Kahr, credit card industry consultant, "The Secret History of the Credit Card," *Frontline*, November 2004.
[67] Gallup 2004; McGeehan, Patrick, "The Plastic Trap," *New York* Times, November 21, 2004. CFA calculation based on Gallup 2004 poll results and number of cardholding Americans.
[68] Der Hovanesian, Mara "Tough Love for Debtors," *Business Week*, April 25, 2005.
[69] "Loss of Balance: Credit-Card Issuers' Problem: People are Paying their Bills; As Users Juggle their Debts, Revenues to Banks Fall; The Home-Equity Effect; Ms. Bode Seeks a Fresh Start," *Wall Street Journal*, May 25, 2006.
[70] Day, Kathleen and Caroline E. Mayer, "Credit Card Penalties, Fees Bury Debtors," *Washington Post*, March 6, 2005.
[71] "Card Profits 04," *CardTrak*, January 24, 2005.



Bankruptcy legislation enacted by Congress in 2005 could further improve the bottom line for credit card companies. By preventing some consumers from eliminating their credit card debts, various estimates show that credit card companies could recover an additional $3 billion to $40 billion annually from households in bankruptcy.[72]

D. ISSUERS HAVE PURSUED ABUSIVE INTEREST RATE AND FEE POLICIES THAT HAVE A HARMFUL IMPACT ON MANY HOUSEHOLDS

In recent years, credit card companies have become far more aggressive in implementing questionable fees and interest rate practices. The upshot of these practices is that penalty interest rates, high and accumulating fees and interest on fees can push consumers with high debts over the financial brink into bankruptcy.[73] In fact, consumers in debt trouble sometimes owe as much or more in fees and penalty interest charges, as in principal. Consumers also have to worry that an older industry practice – "sticky" interest rates that shoot up fast but decline much more slowly – will threaten their financial stability as interest rates increase.

High fees and interest rates can push consumers into negative amortization, where the principal on their credit card debt continues to rise despite making payments. Negative amortization in effect traps credit card borrowers on a debt treadmill that keeps moving faster. Although they are making regular payments, their debts continue to mount. In 2004, a Cleveland judge ruled against Discover Card's efforts to collect debts from a cardholder whose balance nearly tripled from $1,900 to $5,564 without making additional purchases because of fees and penalties, including $1,158 in over-limit fees alone. [74]

In another case, a bankruptcy court in North Carolina ordered a credit card company to itemize the claims it files in chapter 13 bankruptcy cases.[75] In its findings in support of the Order, the bankruptcy judge listed claims filed in eighteen separate cases broken down as

[72] Heller, Michelle, "Gauging the Bottom-Line Effects of Bankruptcy Bill," *American Banker*, April 15, 2005.
[73] Day, Kathleen and Caroline E. Mayer, "Credit Card Penalties, Fees Bury Debtors," *Washington Post*, March 6, 2005.
[74] National Consumer Law Center, "Responsible Consumers Driven into Default," February 22, 2005.
[75] *In re* Blair, No. 02-1140 (Bankrate. W.D.N.C. filed Feb. 10, 2004)

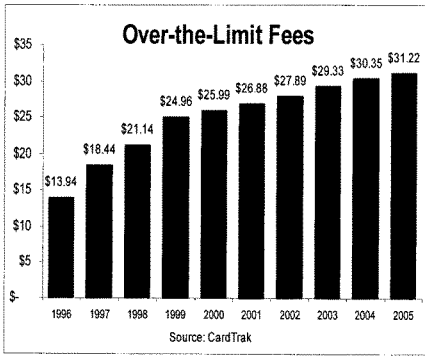
between principal and interest and fees. On average, interest and fees consisted of more than half (57 percent) of the total amounts listed in the claims. In one case, the card company filed a claim in the amount of $943.58, of which $199.63 was listed as principal and $743.95 was listed as interest and fees. In another case, a claim of $1,011.97 consisted of $273.33 in principal and $738.64 in interest and fees. It is almost certain that pre-bankruptcy payments in these cases had more than paid off the real charges made by the consumers.[76]

Penalty Fees

Traditionally, penalty fees were designed to deter irresponsible cardholder behavior, but in recent years these fees have become primarily a revenue enhancer for credit card issuers. An analysis by the United States Governmental Accountability Office (GAO) found that, "...typical cards today now include higher and more complex fees than they did in the past for making late payments, exceeding credit limits, and processing returned payments."[77] The GAO also identified several new fees that issuers have begun using in recent years, some of which they are not required to disclose to consumers in advance. One example of such a fee is for the payment of bills by telephone, which can range from 5 to 15 dollars.[78]

A substantial number of Americans are paying these fees. Thirty-five percent of the credit card accounts from the six largest issuers that the GAO examined had at least one late fee in 2005,[79] representing about 242 million credit cards.[80] Thirteen percent of all accounts – or about 90 million cards – were assessed over-limit fees in 2005.

Late fees have been steadily rising over the past decade and can easily exceed monthly payments for consumers paying low minimum balances.[81] In 1996, a Supreme Court decision prohibited states from setting limits on the fees credit card companies could charge their cardholders. Prior to this court ruling, credit card late fees were commonly around five to ten dollars, but have risen sharply since the decision.[82] The GAO analysis found that late fees jumped sharply after the court ruling. The GAO examined fee data collected by CardWeb.com and found that late fees jumped by 160 percent from $12.83 in 1995 to $33.64 in 2005. The GAO also found a sharp fee increase from data collected by Consumer Action, which showed a 119 percent



[76] National Consumer Law Center, "Responsible Consumers Driven into Default," February 22, 2005.
[77] "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, p. 18.
[78] *Ibid*, p. 23.
[79] *Ibid*, p. 1.
[80] CFA calculation based on 691 million credit cards, as reported in, *Ibid*, p. 9.
[81] "The Ugly Issuer," *Credit Card Management*, September 2004.
[82] Bergman, Lowell and David Rummel, "Secret History of the Credit Card," *Frontline*, November 2004.

increase from $12.53 in 1995 to $27.46 in 2005.[83] Even more striking, the GAO found that late fees paid by borrowers with typical balances were an average of $37 in 2005.[84] This is important to note as credit card issuers are increasingly assessing "tiered" fees based on the borrower's balance.

Credit card issuers use to reject transactions that exceeded a cardholder's credit limit, but it has become common for issuers to accept the transaction and then apply an over-limit fee on cardholders who exceed their credit limits.[85] These fees are often applied by issuers in addition to a higher "penalty" interest rate charge for exceeding the credit limit or carrying a high balance.[86] These monthly fees are charged every month a consumer carries a credit balance higher than their credit limit. According to the GAO report, data collected by Consumer Action shows a 114 percent increase in over-limit fees between 1995 and 2005.[87] Critics of this practice argue that issuers should not assess a penalty fee when they can simply enforce the credit limit if they wish to prevent consumers from exceeding it.

Penalty Interest Rates

The majority of credit card issuers also increase interest rates for credit card account holders who pay their bills late, even by a few hours. In 2005, Consumer Action found that 78.7 percent of issuers charged penalty rates for late payments on their cards.[88] For example, representatives for one large issuer told the GAO that they automatically increase a customer's interest rate if this person pays late or exceeds the credit limit. The GAO found that all but one of the 28 cards from the six largest issuers they reviewed charged default rates in 2005. The average default rate was 27.3 percent, up from 23.8 percent in 2003.[89] Some consumers with low-rate cards could have their interest rates double overnight for being late on one payment to their credit card.[90] Some issuers also say that they will charge default interest rates for exceeding the credit limit on the card or for returned payments, or that they will increase interest rates for cash advances and balance transfers for violations of card terms.[91]

---

[83] "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, p. 18.
[84] *Ibid*, p. 20.
[85] "The Ugly Issuer," *Credit Card Management*, September 2004.
[86] Bergman, Lowell and David Rummel, "Secret History of the Credit Card," *Frontline*, November 2004.
[87] "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, p. 20.
[88] Consumer Action, 2005 Credit Card Survey, "Card Companies Use Common 'Risk Factors' to Impose Unfair Rate Hikes, Finds CA," *Consumer Action News*, Summer 2005.
[89] The GAO did find that some issuers do not assess default rates unless there are multiple violations of card terms. "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, pgs. 24, 25.
[90] Bergman, Lowell and David Rummel, "Secret History of the Credit Card," *Frontline*, November 2004.
[91] "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, p. 25.

Retroactive Application of Penalty Rates

Most issuers also apply penalty interest rates retroactively to prior purchases. This has the effect of increasing the price on purchases already made but not paid off.[92] Some cards even apply penalty rates to debts that were already paid at a lower rate.[93] There is simply no legal or economic justification for assessing a penalty interest rate to an existing balance. There is no other industry in the country that is allowed to increase the price of a product once it is purchased. Issuers have already assessed a consumer's risk of not repaying the loan and presumably offered an interest rate based on that risk. Issuers should be required to allow a consumer to pay off his or her existing balance at that interest rate.

Universal Default

Universal default clauses in credit card contracts allow credit card companies to raise interest rates on debtors who have problems with other creditors or whose credit scores decline. The increases are triggered not just by a late mortgage or credit card payment to other lenders but also to payment disputes with other types of creditors, like utilities or book clubs.[94] In 2005, 44.7 percent of credit card issuers surveyed by Consumer Action reported having universal default policies in place.[95] The GAO reported that four of the six largest issuers reserve the right to impose rate increases because of behaviors related to other creditors as a change in terms,[96] which typically requires only 15 days notice under Regulation Z of the Truth in Lending Act.[97] A review of credit card disclosures issued in October 2006 by Consumer Action found six major issuers assessing universal default interest rates: Citigroup, JP Morgan Chase, HSBC, Washington Mutual and Wells Fargo. Only one – Citigroup – offered consumers advance notice of the change and the opportunity to choose not to accept the interest rate.

In 2004, the OCC sent an advisory letter to the institutions it oversees covering credit card marketing practices the OCC "regards as unacceptable," including failing to disclose the conditions for imposing unilateral cost increases for cardholders. However, disclosure will not help consumers avoid a practice that many consumers find inequitable when most major issuers pursue this practice. It is fundamentally unfair to impose a penalty interest rate on a consumer who has not made a late payment or defaulted on an obligation, especially when this rate

[92] Draut, Tamara, Director of the Economic Opportunity Program Demos, Testimony Before the House Banking Committee Subcommittee on Financial Institutions and Consumer Credit, September 15, 2004, at 16-17.
[93] McGeehan, Patrick, "The Plastic Trap," *New York Times*, November 21, 2004. Discover disclosed to its customers that it had changed the terms of its interest rates from a low of zero to 19.99% for a single late payment, but it applied that rate increase for late payments from 11 months prior to the disclosure of the changing interest rate terms.
[94] Burt, Bill, "Pay One Bill Late, Get Punished by Many," *Bankrate.com*, January 20, 2004.
[95] Consumer Action, 2005 Credit Card Survey, "Card Companies Use Common 'Risk Factors' to Impose Unfair Rate Hikes, Finds CA," *Consumer Action News*, Summer 2005.
[96] Only a few of the cards assessed by the GAO assess universal default rates automatically with no notice. The GAO also noted that some states where large issuers are based require that cardholders must be offered an opportunity to refuse or opt out of a universal default rate change. This may not be practical for many cardholders, however, if it entails a requirement to pay off the existing balance immediately in full. "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, p. 26.
[97] 12 C.F.R. Section 226.9(c)

increase is applied retroactively. Another concern with using credit reports to trigger a penalty rate is the problems with inaccuracies in credit scoring and credit reporting that CFA and other organizations have documented.[98]

Although credit card issuers contend that interest rate penalties that increase because of universal default are related to the credit risk of the borrower, the application by some issuers of these punitive rate hikes seems to believe that contention. One late payment can result in significant increases in interest rates in some cases, even though there is little evidence that a single late payment to one creditor increases the likelihood of default to all creditors. Moreover, increased fee and interest rate payments may have a similar or greater impacts on the borrower's ability to repay than modest problems with another creditor.

Pricing Tricks: Double Cycle Billing and Manipulation of Payment Order

The GAO found that two of six major creditors are using a practice called double-cycle billing, which results in illegitimate interest charges on balances that have already been paid on time.[99] With this practice, issuers consider two billing cycles in assessing interest. A consumer who begins with no balance and pays off most but not all of the purchases he or she makes in the first month would still be charged interest for the entire amount of the balance in the second month. A fair billing process would only result in an interest charge on the amount of the unpaid balance.

The GAO also determined that for 23 of the 28 large issuer cards they reviewed, cardholder payments were first allocated to the balance assessed at a lower rate of interest.[100] This practice is problematic for the many cardholders who now carry balances at different rates of interest, such as introductory "teaser" rates, cash advance rates, and balance transfer rates. The lower interest rate balances must first be paid off before the issuer will allocate payments to higher rate balances. Allocating payments to lower interest rate balances first unfairly extends the length of time it takes consumers to pay down their balances while increasing the finance charges that issuers earn.

As Variable Rate Cards Proliferate, Consumers are Vulnerable to Higher Interest Rates

For many years, analysts and observers of the credit card industry have noted a phenomenon called "sticky" interest rates. This typically refers to the fact that creditors are often slow to pass on savings when the cost of funds decline, but quicker to increase rates when cost rise. As a result, the "spread" between the credit card issuers' cost of funds and the interest rates charged to cardholders have tended to benefit the credit card companies, regardless of the direction of the interest rate changes. For example, although interest rates were at historical lows

---

[98] Consumer Federation of America and National Credit Reporting Association, "Credit Score Accuracy and Implications for Consumers," December 17, 2002. CFA and NCRA reviewed over 500,000 credit files and found that 29 percent of consumers have credit scores that differ by at least 50 points between the credit bureaus.
[99] "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, p. 27.
[100] *Ibid.*

at the turn of the century, issuers did not pass the cost savings completely through to their customers.[101]

The higher interest rate environment Americans are now experiencing will primarily impact credit card debt carried on variable rate credit cards. Variable rate cards first appeared on the market in 1991.[102] Over the past six years, it appears that the distribution of credit cards between variable and fixed rates is somewhat related to the interest rate picture. As interest rates increase, issuers tend to switch consumers over to variable rate cards. *CardTrak* reported in November 2004 that more than half (55 percent) of credit card debt was carried on variable interest rate cards, a major change from three years earlier when rates were declining and card issuers were shifting to fixed rate products.[103] This month, *CardTrak* reported that 86 percent of credit card balances were carried on cards with variable rates.[104] This trend means that more consumers will be extremely vulnerable to rising interest rates. Variable rate cards now carry an average interest rate of 16.55 percent, while fixed rate cards average only 14.67 percent.[105]

Increases in Credit Card Fees and Interest Rates Significantly Affect Consumer Debt

Penalty fees and interest made up more than three-quarters of credit card issuers revenues throughout 2002 and 2003. Credit card issuers earned $65.4 billion in interest and $7.7 billion in penalty fees in 2003 or 75.7 percent of the total $96.5 billion in revenue.[106] In 2002, penalty fees and interest made up 76.8 percent of the industry's $97.1 billion in revenues. For the approximately 88 million credit cardholding households, penalty fees and interest on their credit card debt cost an average of $830 in 2003.[107]

E. ISSUER "RISK-BASED" PRICING OFTEN LOOKS PREDATORY

Credit card issuers often claim that their interest rate and fee policies are justifiable because they are necessary to compensate for the increased financial risk of lending to borrowers with blemished or limited credit histories. It is clearly true that borrowers who pay their balance every month are receiving a valuable service at no cost in many cases. It is quite possible, in fact, that riskier borrowers who revolve their debt and pay higher interest rates and fees are subsidizing in-part the cost of services that these non-revolvers receive. It is important to note, though, that issuers still receive substantial fee income from merchant "interchange" fees and, in some cases, from annual fees.

The key question is whether interest rates and fees charged to riskier consumers are fair and can be legitimately related to the actual financial risk incurred by creditors. There is increasing evidence that the answer to this question is "no." It is becoming ever more apparent

---

[101] "The Ugly Issuer," *Credit Card Management*, September 2004.
[102] "Card Rates," *CardTrak*, September 17, 2001.
[103] "5% Prime," *CardTrak*, November 10, 2004.
[104] "Rate Gap," *CardTrak*, January 18, 2007.
[105] *Ibid.*
[106] Daly, James J., "Smooth Sailing," *Credit Card Management*, May 2004 at 31.
[107] CFA calculation from Daly, James J. 2004 and Census Bureau figures.

that many of the most abusive fees and interest rates are assessed simply because it is what the market will bear.

The amount of fees and penalty interest rates do not appear to be proportional to the risk or cost incurred by issuers. For many years, issuers have justified "sticky" interest rates that rise faster than they decline by stating that these higher interest rates were necessary to compensate for increased risk. As issuers have increased the number and amount of fees and penalty interest rates they charge, it seems that higher baseline interest rates alone are not sufficient anymore to compensate for risk. There is very little evidence that relatively modest problems, like one or two late payments – significantly increase a consumer's chances of default. It would appear to be impossible to justify charging a consumer with a reasonably good credit history with a late payment fee of $35 and a default interest rate of 29 percent on prior purchases, in addition to the finance charge the consumer would already pay on a fairly high interest rate, such as 17 percent. One sign that default rates may not be truly reflective of costs or risk incurred by issuers is that the "fixed amount" that issuers add to the index rate in setting default rates is increasing. The GAO found that this fixed amount increased from about 19 percent in 2003 to 22 percent in 2005 on the 28 large issuer cards they evaluated.[108]

A rational market would lead lenders to limit their risk by limiting credit available to consumers with riskier credit records or histories, instead of increasing this risk by leveling higher charges on consumers who may be in significant financial trouble. Allowing higher-risk consumers to continue borrowing at a more expensive, higher rate does not limit consumers' risk of default, it increases it. If the cardholders are indeed higher-risk, lenders would limit their exposure by cutting off new purchases more frequently, preventing balances from increasing and helping to keep the cardholder out of default. However, in many cases, credit card issuers are not cutting off the credit, freezing the credit limit or closing the accounts of cardholders that the issuers deem increased risk. Instead they are allowing the borrowers to rack up more credit under more expensive terms,[109] making it more likely that the consumer might suffer serious financial circumstances. This demonstrates that issuers are not particularly concerned about the financial consequences to the consumer of these higher costs since distressed customers are so lucrative and the profits earned from these consumers more than compensates for the financial risk involved.

If risk-based pricing truly reflects risk, it should decline or at least moderate as risk decreases. For example, as noted above, the amount of credit written off by issuers declined for the first three quarters of 2006, dipping below 4 percent for the first time since the end of 1995. Given that issuers have stated so frequently that they are adhering to the doctrine of risk-based pricing, it is perfectly appropriate for consumers to ask why they do not see interest rates or fees that decline or moderate in response to a more positive credit environment.

The assessment of retroactive interest rates is another sign of abusive rather than risk-based pricing. As stated above, interest rate increases that apply to past purchases cannot

---

[108] "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, p. 24.
[109] Pacelle, Mitchell, "Growing Profit Source for Banks: Fees From Riskiest Card Holders," *Wall Street Journal*, July 6, 2004.

be justified under a true risk-based pricing model. Issuers assess risk based on the best information available on a consumer's credit history. If the risk profile of the consumer declines, the only way issuers could possibly justify a rate increase would be if it were legitimately related to the customer's increased risk, if it did not violate the creditor's agreement to offer credit under certain terms for a specific length of time, and if it were applied prospectively.

Increased expenditures on marketing at a time of relative caution by consumers is also a red flag that pricing in the credit card industry is skewed. As documented above, issuers continue to increase their marketing expenditures significantly, even as consumers respond less frequently to mail solicitations and show more caution in taking on new debt. A rational market response to these dynamics would be to pull back on marketing expenditures, unless other factors existed, such as windfall profits resulting from abusive pricing.

In response to these "tell-tale" signs of price gouging, it is time for issuers to provide more information to lawmakers and the public about their true costs to demonstrate that their pricing practices are truly fair.

F. LEGISLATIVE RECOMMENDATIONS

Attached are proposed legislative reforms developed by national consumer organizations. Several of the proposals mentioned in this platform are particularly important:

1. Eliminate abusive lending by credit card companies. A good starting point would be to enact S. 499, Senator Dodd's "Credit Card Accountability Responsibility (Credit CARD) Act of 2005." This proposal would take many important steps to reign in abusive lending practices. For instance, it would mandate that issuers lend responsibly to young Americans, by either assessing an applicants ability to pay or requiring a co-signor who could pay back the amount loaned. S. 499 would also prohibit credit card lenders from attempting to collect on high-interest loans in bankruptcy that exceed the federal prime rate by more than 20 points. We also strongly support S. 2654, the "Protection of Young Consumers Act of 2006," introduced by Senator Menendez. This bill takes the important step of allowing young consumers to choose whether or not to accept pre-screened credit card solicitations. Credit card issuers are not allowed to send these marketing offers to consumers younger than 21 years-of-age unless the consumer affirmatively agrees to accept them.

2. End unjust interest rates and fees. Once again, the Credit CARD Act has a number of important provisions. S. 499 would prohibit issuers from applying interest rates retroactively to past purchases. It would also require credit card companies to take the same approach as the Internal Revenue Service (IRS) in assessing whether a customer has paid on time. Issuers would be required to accept the postmarked date as proof of on-time payment. This bill would also prohibit the abusive practice used by most issuers of assessing fees for consumer behavior allowed by the creditor, such as exceeding a credit limit. Senator Menendez's "Credit Card Reform, Debit and Check Card Consumer Protection Act of 2006 would also implement several important reforms. It would prohibit issuers from unilaterally altering the terms and conditions of a credit card agreement, ban the imposition of "universal default" interest rates based on

alleged missteps with another issuer, and require that fees be reasonably related to costs incurred by the creditor.

3. Ban deceptive and unfair practices. Issuers should not be allowed to require consumers to relinquish their legal rights and enter mandatory arbitration, in the event a dispute arises. We also encourage Congress and banking regulators to prohibit deceptive advertising and "invitation to apply" solicitations that do not require a firm offer of credit and lead consumers to believe that they are pre-approved for or have a good chance of receiving certain interest rates or terms.

4. Empower consumers with more detailed information. We strongly support S. 393, Senator Akaka's Credit Card Minimum Payment Warning Act of 2005. This legislation would provide all cardholders with personalized information on the length of time—in months and years—and the total costs of paying only the minimum payment. Congress should also take steps to prevent issuers from downplaying permanent interest rates in advertisements and solicitations, while temporary "teaser" rates are prominently disclosed. We also support requiring issuers to include an improved "Schumer Box" of key terms and conditions to all cardholder agreements. It should disclose the card's APR including fees, the credit limit, and the amount of all fees, such as late charges, cash advance fees, over-limit fees and any other applicable miscellaneous fees to the table.

5. Increase penalties to deter illegal acts by credit card companies. In particular, fines under the federal Truth in Lending Act need to be increased. We also support the inclusion of a "private right of action" to empower consumer to use the Federal Trade Commission Act to challenge unfair or deceptive practices by businesses, including banks.

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

Joint Recommendations of Consumer Groups on the Eve of the Jan. 25, 2007 U.S. Senate Banking Committee Oversight Hearing on Unfair Credit Card Practices

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.

Contacts:

ACORN, Jordan Ash, 651-503-4555
Center for Consumer Finances, Rochester Institute of Technology. Robert Manning, 585-475-4342
Consumer Action, Linda Sherry, 202-588-3440
Consumers Union, Norma Garcia, 415-431-6747
Consumer Federation of America, Travis Plunkett, 202-387-6121
Demos, Cindy Zeldin, 202-956-5144
National Association of Consumer Advocates, Ira Rheingold, (202) 452-1989
National Consumer Law Center, Alys Cohen, 202-452-6252
U.S. PIRG, Ed Mierzwinski, 202-546-9707

RESPONSE TO WRITTEN QUESTIONS OF SENATORS DODD AND SHELBY FROM JOHN G. FINNERAN, JR.

On behalf of Capital One, I am pleased to have the opportunity to respond to a number of your questions for the record. While some of the information is competitively sensitive, every effort was made to provide information responsive to the Committee's requests.

Please note that references to the U.S. Government Accountability Office (GAO) data are based on information that Capital One provided to GAO for its report, "Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers (GAO–06–929)" issued in September 2006.

In response to these questions, I am also attaching for the record a copy of Capital One's "Fact Sheet" and "Fact Pact" referenced below in response to questions regarding improved disclosure.

The "Fact Sheet" was submitted to the Federal Reserve in March 2005 as part of their request for comments on revising the open-end credit provisions of Regulation Z. The "Fact Sheet" was Capital One's proposal developed after consumer testing, as an updated and improved version of the current "Schumer Box," to give consumers clearer and more useful disclosure of credit card rates and fees, including the reasons for which rates can be changed.

The "Fact Pact" disclosures on our credit card solicitations incorporates our own ideas to the extent we are able to do so within the framework of the existing Reg Z requirements. These simple, plain English disclosures are in a food label style format for easy consumer understanding of key terms.

Q.1. What percentage of customers pay off their balances in full each month?

A.1. Company specific information on this question is considered competitively sensitive; however, the aggregated data provided to GAO by the major issuers does address this question. Specifically, the data shows that between 2003 and 2005, 47 to 48 percent of accounts did not revolve a balance from one billing cycle to the next for three or more billing cycles.

Q.2. What percentage of customers pay just the minimum payment each month?

A.2. Very few Capital One customers choose to pay the minimum payment for any prolonged period of time—fewer than 3% pay the minimum for three months in a row. For those who do, we provide a notice on their statement informing them of the consequences of doing so. In this statement, we encourage them to pay more than the minimum in order to pay down their balance more quickly. We also provide them with a web address for our online calculator (www.capitalone.com/calculator), which allows them to enter specific information, customized to their situation, and receive real-time information about how long it will take to pay off their balance.

Q.3. What percentage of accounts are charged-off?

A.3. As publicly reported, the 2006 US Consumer Card managed charge-off rate for Capital One was 3.37% of managed outstanding debt.

Q.4 What is the maximum APR that customers are charged?

A.4. In the past, certain customers who defaulted on their obligations were eligible to be repriced to a maximum rate of Prime +20.99%; this corresponds to an APR of 29.24% under the current Prime rate. Today, the maximum rate that certain customers have as their default rate is Prime + 19.9%.

Customers who have not defaulted on their payments typically enjoy far lower rates. Portfolio-wide, the average APR of all of our customers is 13.55%. Among those who have not been repriced, vast majority of accounts have rates below 20%, and the average APR is only 11.46%.

Q.5. What is the average balance on a credit card account?

A.5. At the end of 2006, Capital One's managed US Consumer Card portfolio had 37.6 million accounts with $53.9 billion outstandings, resulting in an average balance of $1,434.

Q.6. What percentage of cards are subject to double-cycle billing?

A.6. Capital One does not use double cycle billing on any of our customers' credit cards and has never engaged in this practice.

Q.7. What is the retention rate of customers in the industry?

A.7. TNS Global, in their November 2006 "State of the Card Market" report, estimated that, for Visa and MasterCard accounts, 11% closed in less than one year, 16–17% closed in 1–2 years, 16% closed in 3–4 years, and 56–57% closed in 5 or more years. The average account was open for about 6 years.

Q.8. What percentage of cardholder agreements contain universal default provisions?

A.8. None. Capital One does not engage in any form of "universal default."

Q.9. How do you define universal default?

A.9. We understand "universal default" to mean a practice in which any of the following may trigger an automatic interest rate increase on the consumer's credit card:

- Changes to information in the consumer's credit report
- Changes to the consumer's credit score
- Paying late on another account with the same or another lender
- Charging off on another loan with the same or another lender
- Any other conduct on another account with the same or another lender

In short, we define "universal default" as a practice that automatically changes the terms on a given account based on behavior on another account.

Capital One does not engage in any form of "universal default." This has been our long-standing policy. We will not reprice a customer if they pay late on another account with us or any other lender, or because their credit score goes down for any reason. As we testified before the Senate Banking Committee in January, as well as at a previous May 2005 hearing before the Committee, "there is only one circumstance in which a customer might be subject to default repricing: if they pay us more than 3 days late twice in a 12 month period." Furthermore, we explain our practices clear-

ly in our marketing materials to our customers that we do not engage in this practice.

Q.10. Do you conduct any type of interest rate repricing based on a cardholder's transactions or credit worthiness with other creditors or accounts?

A.10. No. As stated above, Capital One does not engage in any form of "universal default," which we understand to mean a practice in which a late payment or other conduct on another debt may trigger an interest rate increase on the consumer's credit card. We testified to this before the Senate Banking Committee in January, as well as at a previous May 2005 hearing before the Committee. Furthermore, we explain our practices clearly in our marketing materials to our customers that we do not engage in this practice.

Q.11. What percentage of cards use credit scores or adverse information from another creditor or account to increase rates?

A.11. Zero percent of Capital One cards use credit scores or adverse information from another creditor or account to increase rates.

Q.12. Have industry profits remained constant over time?

A.12. According to the GAO, "The largest credit card-issuing banks, which are generally the most profitable group of lenders, have not greatly increased their profitability over the last 20 years (GAO–06–929, page 67)." Additionally, aggregated data provided for the GAO report showed return on managed assets (ROMA) for the industry from 2003 to 2005 ranged from 2.3 to 2.7 percent.

Q.13. What percentage of Americans have credit cards?

A.13 The Federal Reserve has estimated that about 71.5% of families had a least one bank issued credit card in 2004 (Source: 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 at 3,6).

Q.14. What percentage of cardholders are paying penalty interest rates on their cards? How has that percentage changed over the last 20 years?

A.14. Information regarding penalty interest rate pricing is considered competitively sensitive information; however, as aggregated data provided for the GAO report showed only a small number of active cardholder accounts, 11% in 2005, had more than a 25% purchase annual percentage rate (APR). Specifically, the GAO cited in their report "Penalty interest rates and fees appear to affect a minority of the largest six issuers' cardholders. . .a small proportion of their active accounts were being assessed interest rates above 25 percent—which we determined were likely to represent penalty rates (GAO–06–929, page 32)."

Q.15. What percentage of profits come from:

a) non-penalty interest charges;
b) penalty interest charges;
c) fees, including: over-limit fees; late fees; annual fees; interchange fees; balance transfer fees; cash advance fees; stop payment fees; telephone payment fees; foreign transaction fees; and other fees?

A.15. US Consumer Card, managed:

- 2006 Net Income: $1,823MM
- 2006 Interest Income: 68% ($6,873MM) (includes past due fees)
- 2006 Non-Interest Income: 32% ($3,256MM) (includes all fees other than past due)

This is the break-down that Capital One provides in our public disclosures. We do not disclose more detail for competitive reasons.

Q.16. Please provide the Committee with data on the amount of annual revenue generated in each of the last two years from interest payments and the number of cardholders paying interest at rates of:

a) less than 15% APR;
b) from 15 to 19% APR;
c) from 20 to 25% APR;
d) from 26 to 29% APR; and
e) 30% or greater APR.

A.16. Capital One does not disclose revenue based on cardholders' interest rates. As noted in question 15, Capital One's US Consumer Card, managed profits were:

- 2006 Net Income: $1,823MM
- 2006 Interest Income: 68% ($6,873MM) (includes past due fees)
- 2006 Non-Interest Income: 32% ($3,256MM) (includes all fees other than past due)

This is the break-down that Capital One provides in our public disclosures. We do not disclose more detail for competitive reasons.

Q.17. Please provide the Committee with data on the amount of revenue generated in each of the last two years from interest payments due to:

a) repricing of interest rates due to late payments to the issuer; and
b) repricing of interest rates due to cardholder transactions or credit worthiness with other creditors or accounts.

A.17.

a) Information regarding revenue due to penalty interest rates is considered competitively sensitive information.
b) Capital One does not reprice accounts due to cardholder transactions or credit worthiness with other creditors or accounts.

Q.18. Please explain how you would "reprice" a customer with a "fixed rate" credit card. What are the criteria that would determine whether a customer is repriced? How do you determine the rate to which the customer is repriced?

A.18. Under Capital One's current policies, any credit cards marketed with "fixed" rates cannot be repriced during the period for which they are "fixed." For example, a rate marketed as "fixed for life" today would not be eligible for any form of repricing for the life of the account. Similarly, an introductory rate marketed as "fixed until April 2008" would not be eligible for any form of repricing until May 2008, at the earliest. Repricing in these instances means any rate change as a result of a default (*e.g.,* late payment) or change in market conditions (*e.g.,* an increase in interest rates generally).

It is important to note that the policies outlined above were instituted in 2004 by Capital One of its own accord. The Federal Reserve continues to define "fixed" rates as they relate to credit cards simply as any rate that is not variable (i.e., tied to an index). Thus, current law continues to permit credit card issuers to market "fixed" rates that are subject to repricing both as a result of customer default and changes in market conditions.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED FROM JOHN G. FINNERAN, JR.

Q.1.a. If issuing a credit card with a low credit line is one of the ways to reduce the risk of lending to an "at risk borrower," doesn't the issuance of multiple cards to the same individual reduce the effectiveness of this practice and actually in some cases increase the risk?

A.1.a. We minimize any increase in risk when issuing multiple cards to the same customer by applying strict controls in our marketing and approval decisions. We do not target multiple cards to "at risk borrowers." Only customers whose risk level is below a certain threshold and who are currently not over-limit or past due are eligible to be marketed a second card. Additionally, customers who have charged-off on any of our cards in last 12 months are not eligible, and we currently do not issue more that two cards to any of our customers. Lastly, we offer lines that ensure customers are only given the amount of credit that they are able to responsibly handle, whether or not they already have a Capital One card when applying for a new card.

Q.1.b. What percentage of your customers has more than one of your credit cards?

A.1.b. Customers choose to have multiple credit cards for a variety of reasons—to have both a Visa and a MasterCard, to segregate expenses, for security, or for different features like rewards. Like our competitors, we hope they will choose us to fill those needs. Eighty-five percent of our customers have only one card with us while less than four percent have more than two. We only offer additional cards to customers in good standing, as indicated above. For those customers, we give them the option to consolidate their accounts into one card, if they prefer.

Q.1.c. How would you describe the typical customer that has a low credit line but multiple cards?

A.1.c. With the great variety of cardholders at Capital One, there simply is not a "typical customer," even within the parameters of having multiple accounts and low credit lines. What can be said is that customers with lower credit lines tend to have higher risk than those with higher credit line. Regarding holding multiple cards, customers choose to have multiple credit cards for a variety of reasons—to have both a Visa and a MasterCard, to segregate expenses, for security, or for different features like rewards. There is nothing particularly notable about the fact that customers have more than one credit card, whether with one issuer or different issuers. CardWeb reports that Americans carry 6.3 bank credit cards per household. Like our competitors, we hope they will

choose us to fill those needs when they choose to have a single card or multiple cards.

Q.1.d. What percentage of your customers use multiple credit cards to remain current on their other credit card balances that have been issued by your companies?

A.1.d. We do not accept payment from one Capital One card as payment for another Capital One card.

Q.2. How does your company account for the total debt from all of the cards issued to one customer? Are these aggregate balances reported to regulators as well?

A.2. Like other credit card companies, Capital One manages the accounts of customers who have multiple credit cards in accordance with the federal banking regulators' "Account Management and Loss Allowance Guidance" published in 2003. That regulatory statement, issued by the Comptroller of the Currency, Federal Reserve Board, FDIC, and Office of Thrift Supervision, requires credit card companies to have sufficient internal controls and management information systems to aggregate the credit that is extended to customers through multiple credit cards and to analyze the performance of customers on their existing accounts before an additional credit card is offered. Credit card companies are subject to being examined for their compliance with the Account Management Guidance during the regulators' regular examinations of the companies, which can be held annually or more frequently.

Q.3. What is the typical minimum monthly payment required for credit cards? What percent of the balance represents the minimum monthly payment? Do you think this is sufficient? Do most credit card companies use a model or an algorithm to establish minimum payment? Please describe industry best practices for establishing appropriate minimum payment amounts.

A.3. For the majority of accounts, the minimum payment due is the greater of:

- 3% of the balance (some prime and super-prime accounts are 2%)
- Amount over-limit
- Amount past due
- $15.00 (some accounts are $10)

It should be noted, very few, less than 3% of Capital One customers, choose to pay the minimum payment for any prolonged period of time. For those who pay the minimum for three months in a row, we provide a notice on their statement informing them of the consequences of doing so. In this statement, we encourage them to pay more than the minimum in order to pay down their balance more quickly. We also provide them with a web address for our online calculator (www.capitalone.com/calculator), which allows them to enter specific information, customized to their situation, and receive real-time information about how long it will take to pay off their balance.

Capital One and other credit card issuers follow guidance put forth by the Federal banking regulators on minimum payment standards.

Q.4.a. Why does the industry allow credit card customers to make transactions that result in their account being over the limit?

A.4.a. While we decline more than two-thirds of such transactions, we approve transactions that allow a customer to go over-limit in certain circumstances. We do so because our research suggests that customers value the ability to use more than their credit limit in certain situations, as being declined can be both embarrassing and inconvenient. In fact, we allow customers to choose not to be authorized to go over-limit. Fewer than 1 percent have chosen to do so, even when we have made the offer at the time they are assessed the fee.

To maintain safety and soundness in our lending, we carefully consider the risk of the customer in such circumstances.

Q.4.b. Does the over-limit fee being charged adequately compensate for the risk incurred by the over-limit amount?

A.4.b. Because Capital One employs stringent standards on the approval of over-limit transactions, we believe that on a portfolio basis the aggregate amount of over-limit fee revenue adequately compensates us for the risk incurred in approving selected over-limit transactions.

Q.4.c. In situations where a customer goes over their limit after the line has been lowered due to new risk identified in their credit report, how can the fee earned adequately compensate for the risk?

A.4.c. We have strict controls in place regarding over-limit transactions after a credit line is lowered.

If the decision is made to lower a credit line, we decline all over-limit transactions for all accounts on which the credit limit has been reduced. We monitor these accounts for 60 days after a credit limit decrease.

We still see 3–4% of these accounts going over-limit due to authorizations that are less than the posted transaction amounts (*e.g.,* at gas stations), under-floor transactions, and non-network authorized transactions. To compensate for this, we credit back any and all over-limit fees assessed within 60 days of the credit line decrease.

Q.4.d. Is there a maximum amount or percentage of the line that is generally allowed to be over-limit?

A.4.d. The maximum amount that an account is allowed to go over-limit varies depending on the risk of the account and other factors. We currently have controls in place which ensure that no transactions are approved that would put an account over-limit by the smaller of 20% of the credit line or a specific dollar amount (depending on general risk characteristics of the account). These limits are seldom reached due to our transaction-specific policies.

Q4.e. What are known best practices for allowing customers to overdraw their accounts and assessing fees for doing so?

A.4.e. We believe a best-practice over-limit policy is one that takes into account the wishes of the customer, the ability of the customer to quickly return under limit, and the safety and soundness of the lender. Features commonly used to address these items include clear disclosure of fees, the ability to opt out of over-limit approvals, and tight controls for risky customers.

Q.5. How can disclosures and the delivery of disclosures be improved to ensure customers fully understand the terms of the credit card, including cash advance, over-limit, wire transfer and late fees? What are the best practices for disclosing information to the customer?

A.5. Our suggestions for improved disclosure are set out in detail in the comment letters we submitted to the Federal Reserve in response to the Advance Notices of Proposed Rulemaking that the Federal Reserve published in its process of revising the open-end credit provisions of Regulation Z (Reg Z) in 2005.

We proposed a "Fact Sheet," which we developed after consumer testing, as an updated and improved version of the current "Schumer Box," to give consumers clearer and more useful disclosure of credit card rates and fees, including the reasons for which rates can be changed.

We also proposed that an appropriately modified version of this Fact Sheet be placed on the reverse of customers' periodic statements. This would require different treatment of some disclosures that are already there, and we suggested to the Fed how those disclosures might be delivered.

Our belief is that the best thing the government can do for consumers, in light of the changing credit card industry and product design, is for the Fed to expedite its review of Reg Z and permit the use of our proposed "Fact Sheet" or some other updated disclosure that the Fed believes would be useful. Our understanding is that the Fed is working hard on that project and may publish its proposals soon.

In the meantime, we have adopted our own simple, plain English disclosures in a food label style format. These "Fact Pact" disclosures on our credit card solicitations incorporates our own ideas to the extent we are able to do so within the framework of the existing Reg Z requirements. A sample of our "Fact Pact" is included with our response.

RESPONSE TO WRITTEN QUESTION OF SENATOR TESTER FROM JOHN G. FINNERAN, JR.

Q.1. What portion of your profits comes from interest and what portion results from the fees you charge customers?

A.1. US Consumer Card, managed:

- 2006 Net Income: $1,823MM
- 2006 Interest Income: 68% ($6,873MM) (includes past due fees)
- 2006 Non-Interest Income: 32% ($3,256MM) (includes all fees other than past due)

This is the break-down that Capital One provides in our public disclosures. We do not disclose more detail for competitive reasons.

Q.2. I've been reading about universal default. It is my understanding that you can increase the interest rate of a customer who has a perfect and long-standing credit record with your company because of a late payment that he or she has made to another creditor. Is this true? How do you justify it.?

A.2. Capital One does not engage in any form of "universal default." This has been our long-standing policy. We will not reprice a customer if they pay late on another account with us or any other lender, or because their credit score goes down for any reason. We testified to this before the Senate Banking Committee in January, as well as at a previous May 2005 hearing before the Committee. Furthermore, we explain our practices clearly in our marketing materials to our customers that we do not engage in this practice.

As we testified before the Committee, Capital One has a simple default re-pricing policy. There is only one circumstance in which a customer might be subject to default re-pricing—if the customer pays us 3 or more days late twice in a 12 month period. We clearly disclose this policy in our marketing materials, and provide customers with a prominent warning on their statement after their first late payment. Moreover, if a customer is re-priced, the customer will automatically be returned to his/her prior rate after 12 consecutive months of on-time payments.

Q.3. Assuming we wanted to get all credit card disclosures on 1 page and want to pick the most salient disclosures, what do you think are the most important terms of the agreement to allow your customers to make an informed choice about the product and whether it works for them?

A.3. Our one-page version is a "Fact Sheet" that we submitted to the Federal Reserve Board as a possible replacement for the current "Schumer Box." Developed after conducting several consumer research sessions, the Fact Sheet (included with our responses) incorporates a consumer-friendly visual layout with no distinction between the table of information and footnotes, unlike the current Schumer Box. For example, repricing triggers are prominently displayed in the table rather than being relegated to footnotes as in the Schumer Box. Fees are separately broken out, clustered together and prominently displayed. We have also recommended to the Federal Reserve Board that a version of the Fact Sheet be placed on the back of every periodic statement, so that the customer will have key account terms ready at hand on a regular basis. The Federal Reserve Board has been conducting consumer research of its own, and we understand it will propose its own version of revised credit card disclosures soon.

Q.4. Didn't it used to be that if you reached your credit limit on your card you were denied the extra credit? But now, as I understand it, credit card companies allow consumers to go over the limit and then charge them a fee. What is the justification for this trend?

A.4. Capital One rejects the vast majority of over-limit transactions. Our experience tells us that customers value this flexibility as a way to deal with unexpected emergencies or avoid the embarrassment of being turned down at the point of sale. Additionally, customers can request that we remove the ability for their account to go over-limit. Where we have expressly offered this option, less than 1 percent of customers have chosen to remove this ability even when we made the offer at the time they were assessed the fee.

Q.5. Do you think that the average consumer knows they'll be hit with a fee for going over their credit limit rather than being told they have exceeded their limit?

A.5. Yes. Our fees are fully disclosed to our customers. We believe that the average customer expects an over-limit fee to be assessed when exceeding the credit limit of his or her account. When we asked our customers if they wanted us to prevent them from being able to go over the limit, less than 1% accepted this offer.

Q.6. What is an "ideal customer"?

A.6. Capital One seeks to offer credit card products that are customized to the needs of its cardholders across the credit spectrum. Our ability to do so has contributed in large measure to our success in this industry. This strategy recognizes that there is no single "ideal" type of customer, but rather a multitude of individuals with unique objectives and needs for our products. As such, we offer cards to consumers who are seeking the safety and convenience of electronic payments, but who pay their balances in full each month, as well as to consumers for whom a credit card provides a vehicle for short term borrowing needs. Therefore, any customer who manages their accounts with us responsibly is an "ideal customer."

Q.7. What percentage of your customers are in perpetual debt?

A.7. While perpetual debt is difficult to measure directly, we have observed that very few customers choose to pay only the minimum payment for any prolonged period of time—fewer than 3% pay the minimum for three months in a row. For those who do, we provide a notice on their statement informing them of the consequences of doing so. In this statement, we encourage them to pay more than the minimum in order to pay down their balance more quickly. We also provide them with a web address for our online calculator (www.capitalone.com/calculator), which allows them to enter specific information, customized to their situation, and receive real-time information about how long it will take to pay off their balance.

Q.8. Of those customers, how many would have been helped by clearer display of rates?

A.8. It is difficult to draw a connection between credit-card rate disclosures and financial distress of any particular customer, especially since the rates themselves are very prominently displayed in the current Schumer Box—that is the main strength of the current regulatory regime. Our belief, though, is that for those customers who get into financial difficulty, the main cause is not likely to be disclosure-related but rather external stresses such as job losses, illness or the like. Good disclosures are important to ensure customer satisfaction, that the customer is not surprised by rates or terms that he or she had not sufficiently appreciated when signing up for the account. For that reason, even without waiting for the Federal Reserve Board's updated disclosure regulations, we have changed our own disclosures and have adopted a "Fact Pact" disclosure on our credit card solicitations, which incorporates our own ideas to the extent we are able to do so within the framework of the existing Reg Z requirements.

Q.9. How much information can a customer get on the internet about the rates/fees of their policy?

A.9. All terms and disclosures are available in two places online as part of our internet acquisitions process. Customers can scroll through the terms and disclosures when looking at our different products, and they are displayed again during the application process. The most common terms are displayed throughout the experience.

Existing customers can see the disclosure information that is shown on the back of printed statements when viewing their statements online. The online statements also show the periodic rates and corresponding APRs for most accounts enrolled in online account servicing.

Customers will see any fees incurred on the online statement, and all account terms are communicated in print before any fees could be assessed.

Q.10. How many consumers use your internet tools, and what is their feedback on it?

A.10. About 16MM accounts are registered in the online account servicing platform that services US Card, Small Business card and Canadian card customers. About 10.8MM customers log in onto their account at least every 90 days, and we average about 7.2MM online payments each month. In addition to the most popular tools of viewing up to the past 6 statements and making payments online, we also allow customers to change their contact information, view recent transactions, and dispute transactions.

Recent feedback on our internet tools has been positive. In the Keynote Customer Experience Rankings for Credit Card Customers released on March 14, 2007, Capital One was ranked as the #1 site, with the best overall ranking across the 250+ customer experience metrics measured in the study. This survey examines the online experience of more than 1,600 credit card customers as they interacted with nine leading credit card Web sites.

Q.11. Do you expect the average educated consumer to read and understand the whole disclosure statement?

A.11. Capital One has adopted industry-leading practices with respect to disclosure, and is actively encouraging the Federal Reserve to simplify disclosure requirements as part of its rewrite of Regulation Z. While we await the Fed's changes, Capital One has revised its own disclosures into a nutrition-label style Fact Pact and Q&A format, written in plain English that explains all of our most critical policies. These policies include all circumstances under which a customer's APR may change (if at all), any fees applicable to the account, how we allocate payments, how we determine their credit line and other information. For legal and regulatory reasons, we also provide customers with a Customer Agreement document. It is important to note that this document does not contain any information regarding our repricing, fee, payment allocation or other policies discussed in the disclosures described above that in any way contradicts or negatively qualifies the information contained in these simpler disclosures.

RESPONSE TO WRITTEN QUESTION OF SENATOR CRAPO FROM JOHN G. FINNERAN, JR.

Q.1. Thank you for testifying before the Senate Banking Committee on January 25, 2007. As follow-up to an issue raised during the hearing related to an article published in *BusinessWeek*, November 6, 2006, entitled: "Cap One's Credit Trap," I would be interested in your submission for the record any response to the article provided by Capital One. As with every story, there are usually two sides and I would be interested in your response.

A.1. We appreciate your interest in the article published by *BusinessWeek*. As stated in testimony before the Senate Banking Committee in January 2007, it is not our practice, nor our intention, to offer an additional card to customers who are currently delinquent or over-limit on a Capital One card. Within our current US portfolio, the vast majority of Capital One customers have only one Capital One credit card. And, Capital One customers in good standing can choose to consolidate their accounts with us at any time.

Capital One responded to the *BusinessWeek* piece with a letter to the editor that subsequently ran in the magazine—the text of our response from Mr. Richard Woods, Senior Vice President of Corporate Affairs for Capital One is included below.

> "Last week's story about Capital One was missing key facts and could have left a false impression with your readers.
>
> First, Capital One rigorously manages credit and our charge-off rate is consistently among the lowest in the industry. It is not in anyone's interest for customers to have access to credit that they can't handle.
>
> Second, the vast majority of our customers have only one card with us and only a small fraction have more than two.
>
> Third, there is nothing particularly notable about the fact that customers have more than one credit card, whether with one issuer or different issuers. CardWeb reports that Americans carry 6.3 bank credit cards per household.
>
> Fourth, absent from your article was the fact that our customers can choose to consolidate their Capital One cards if their accounts with us are in good standing, except in very limited circumstances relating to specialized cards for small business and certain national retail partners.
>
> Finally, we do not knowingly let customers make payments on one Capital One card with another Capital One card.
>
> We are committed to delivering great products to our tens of millions of customers and to helping them manage credit responsibly. If any of our customers are struggling to meet their payment obligations, we will work with them to attempt to find a solution and we encourage them to contact us.
>
> Richard Woods
> SVP, Corporate Affairs"

From Capital One Comment Letter to the Federal Reserve 03/28/05
Regulation Z, TILA

PRICING & FEES

X%min-X%max Variable	**Purchase APR after Month/Year**	X% Variable	Balance Transfer APR after account opening
X% Variable	**Intro Purchase APR until Month/Year** (PRIME + XX.XX%)	X% Variable	Intro Balance Transfer APR
		X% or $X	Balance Transfer Fee
$X min-$X max	**Initial Credit Line**	X% Variable	Cash Advance APR
		X% or $X min.	Cash Advance Fee
$X (frequency)	**Membership Fee**	$XX	Minimum Finance Charge
$X	**Late Fee**	X% or $X	Minimum Payment
$X	**Overlimit Fee**	XX days	Interest-Free Period for Purchases if balance is paid in full monthly
		$XX	Return Check Fee

REASONS YOUR RATES MAY CHANGE

You pay late or you pay less than the minimum requested.	**• [Up to] XX% Default APR(s) • (creditor specific information for reduction or elimination of default APR)**
You break a rule on another account with us.	• [Up to] XX% Default APR(s) • (creditor specific information for reduction or elimination of default APR)
You break a rule on an account with another creditor.	**• [Up to] XX% Default APR(s) • (creditor specific information for reduction or elimination of default APR)**
You have negative information show up on your credit report.	• [Up to] XX% Default APR(s) • (creditor specific information for reduction or elimination of default APR)
Your transactions go over your credit limit.	**• [Up to] XX% Default APR(s) • (creditor specific information for reduction or elimination of default APR)**
Your check is returned – unpaid.	• [Up to] XX% Default APR(s) • (creditor specific information for reduction or elimination of default APR)
Your terms may change from time to time due to market conditions or other reasons.	**• Changes will be made in accordance with applicable law and the Card Agreement that will be sent with your card.**

Lender includes any reasons that the rates of this product may change.

ADDITIONAL INFORMATION ABOUT YOUR ACCOUNT

Your APR is a variable rate that changes monthly based on (Rate Index + XX.XX%).

Your payments and credits will be applied to balances with lower APRs before balances with higher APRs.

Please visit our website: www.creditcards.com or call us at 888.123.4567 for additional information.

This Standard Fact Sheet is used by all creditors. Please use it to make an informed decision.

Pat W. Johnston
Director of Consumer Services
Capital One

P.O. Box 30284
Salt Lake City, UT 84130-9842

Capital One
No Hassle miles

Get a response in as little as 60 seconds
and transfers in as little as 48 hours!
Call 1-800-809-4663 or
visit www.mycapitalonecard.com

<**AUTOCR**C001

Mr. and Mrs. John Doe
1345 Blueridge Dr.
Richmond, VA 29534

NO ANNUAL FEE
AND
NO TRANSFER FEES

John, enjoy a 0% intro APR on balance transfers AND purchases

Dear John,

Request the Capital One® No Hassle Miles℠ Visa® Platinum card. Once you're approved, you could save money when you transfer higher-rate balances and on everyday purchases. You can also earn great rewards, and there's no annual fee and no transfer fees.

- **Save with a 0% intro APR** on all balance transfers and purchases until December 2007.
- **Transfer up to $20,000*** from other credit cards and loans. Your transfers will be considered for approval based on credit history and application information.
- **Enjoy no annual fee.**
- **Save with no transfer fees.**
- **Earn 1 mile per $1 spent on all purchases.*** Your miles won't expire for the life of your account, and you can redeem your miles for travel, cash back, merchandise, gift cards and more.

Just call toll free 1-800-809-4663 or apply online at www.mycapitalonecard.com and get a response in as little as 60 seconds and transfers in as little as 48 hours. You can also mail in the enclosed application.

Sincerely,

Pat W. Johnston

Pat W. Johnston, Director of Consumer Services

No Hassle Facts Fast

APRs
Now until Dec. 2007
Balance Transfers: 0%
Purchases: 0%

After Dec. 2007
Balance Transfers: Variable, now 10.9%
Purchases: Variable, now 10.9%

Annual Fee: None
Transfer Fee: None

CREDIT LINE
At least $1,000, exact line upon approval

HOW YOUR ACTIONS COULD AFFECT YOUR APRs

Unlike Some Companies, We Won't Increase Your APRs Simply Because
- You pay late only once
- You go over your credit limit
- Your credit record changes with another lender

We May Increase Your APRs If:
- You pay late twice in 12 billing periods

For more information, please see the Important Disclosures

You can choose to stop receiving "prescreened" offers of credit from this and other companies by calling toll free 1-888-5-OPT-OUT. See PRESCREEN & OPT-OUT NOTICE in enclosed Additional Disclosures for more information about prescreened offers.

UPFM526 FM082403

RESPONSE TO WRITTEN QUESTIONS OF SENATORS DODD AND SHELBY FROM RICHARD VAGUE

Q.1. What percentage of customers pay off their balances in full each month?

A.1. According to the Government Accountability Office (GAO) in its October 11, 2006 report to Congress entitled "Credit Cards—Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures" ("GAO Report"), approximately 50% of the customers of the six issuers participating in the report pay-off their balances in full each month. Similarly, in 2004, the Federal Reserve reported that 55.7% of customers reported paying in full each month (See, 2004 Survey of Consumer Finances at A 31).

Q.2. What percentage of customers pay just the minimum payment each month?

A.2. Although exact figures are hard to come by it is estimated that very few customers make only the minimum payment every month. For example, a 2005 survey by the American Bankers Association (ABA) of 1,000 cardholders showed that only 4% reported that they habitually made the minimum payment each month. Also based on the results of a Federal Reserve study, cardholders who make minimum payments seem to understand the significance of doing so. Of those cardholders who reported that they sometimes or hardly ever pay more than the minimum amount due, the study found that 57.1% also reported that they do not subsequently use their credit card after making only the minimum payment. (See Federal Reserve Bulletin—2000, p. 634)

Consumers understand that making larger payments saves money, which is why an increasing percentage of credit card holders pays their bills in full or in amounts larger than the minimum. Moreover, the federal banking agencies (or at least the Office of the Comptroller of the Currency and the FDIC) have implemented new minimum payment requirements to make sure that minimum payment levels are sufficient 1) to eliminate the possibility of negative amortization, 2) to pay off balances within a reasonable time assuming minimum payments are made and 3) to provide each cardholder flexibility to decide how much of the balance they want to pay each month based on that cardholder's financial circumstances.

Q.3. What percentage of accounts are charged-off?

A.3. The Federal Reserve estimated that in the 4th quarter of 2006, approximately 3.96% of outstanding balances were charged-off (See, www.federalreserve.gov/releases/chgllsa.htm).

Q.4. What is the maximum APR that customers are charged?

A.4. We are not aware of any official statistics on this. However, according to the Federal Reserve, the average annual percentage rate for credit cards was 13.3% in the 4th quarter of 2006, down approximately 3 percentage points since 2000 and approximately 5 percentage points since 1990. (*www.federalreserve.gov/release/g19/current*)

Q.5. What is the average balance on a credit card account?

A.5. The report issued by the General Accounting Office in 2006 noted that based on data from the Federal Reserve Bank's survey of Consumer Finances that their median total household out-

standing balance on U.S. credit cards was about $2200 in 2004 among those who carried balances. Please note the reference "total household outstanding balances" as opposed to individual credit card accounts which would be somewhat smaller. The Federal Reserve has also noted that 1) credit card balances accounted for 3% of the total debt held by families in 2004, down from 3.9% in 1995, and 2) the ratio of monthly aggregate debt payment to aggregate monthly disposable income has remained relatively constant since 1990 at between 11 and 14 percent.

Q.6. Question: What percentage of cards are subject to double-cycle billing?

A.6. We are not aware of any statistics indicating the percentage of credit cards in the industry that are subject to double-cycle (two cycle) billing. We do not use double-cycle billing.

Q.7. What is the retention rate of customers in the industry?

A.7. We are not aware of any official statistics industry retention rates. We can tell you that at Barclays Bank Delaware we work very hard to attract and retain our customers. The credit card industry is a very competitive industry and our competitors are continually trying to solicit our customers away. It is therefore in our best interest to provide the best service possible and deliver the best product possible. The old adage that it is more expensive to acquire a new account than to keep an existing one is true; therefore we do everything we can to please our customers so as to keep attrition numbers as low as possible.

Q.8. What percentage of cardholder agreements contain universal default provisions?

A.8. We are not aware of statistics showing the percentage of cardholder agreements containing universal default provisions.

Q.9. How do you define universal default?

A.9. The ability of a creditor to change an interest rate based on the cardholder's default with another creditor where that behavior indicates that the cardmember has become a riskier borrower. Pursuant to federal law, if the terms of the account include a universal default provision, the default or penalty rate must be included 1) in the Schumer Box in the credit card solicitations, 2) the initial disclosure statement (which we call the Cardmember Agreement) and 3) on the periodic statement sent to the cardholder when the rate becomes effective.

Q.10. Do you conduct any type of interest rate repricing based on a cardholder's transactions or credit worthiness with other creditors or accounts?

A.10 Any repricing decisions we make are based on the cardholder's overall creditworthiness rather than on particular behaviors with other creditors. The reality is that these decisions to reprice are made on an individual cardholder basis and the overwhelming majority of our accounts never experience this type of repricing. However, although these repricing efforts typically affect only a small portion of our portfolio, they are an important tool in managing risk and ensuring that we serve our cardholders by providing them with competitive pricing. If a cardholder's creditworthiness declines significantly, that cardholder becomes a far

riskier, and therefore costlier, proposition. By repricing the cardholder's account, we are able to ensure that the cardholder pays for his or her risk rather than forcing other cardholders in our portfolio to bear the cost of that risk—a risk they did not create. An alternative step we take to control risk when a cardholder's creditworthiness declines is to close the account (*i.e.,* inform the customer he/she can no longer use the card to make purchases). Unfortunately, account closing is the best option in many instances, even though we have found that cardholders far prefer our raising rates to closing accounts. Importantly, rather than simply spread the costs of delinquency and credit losses across the entire portfolio, these repricing and account closing steps enable us to keep our pricing low for those customers who pay their bills on time, pose the lowest risk and therefore cost the least to manage.

Q.11. What percentage of cards use credit scores or adverse information from another creditor or account to increase rates?

A.11. We are not aware of any statistics on this issue. As noted above, however, our repricing decisions are based on the cardholder's creditworthiness as a whole.

Q.12. Have industry profits remained constant over time?

A.12. According to the Federal Reserve, industry profits have remained relatively stable over time with an average return on assets of 3.11 percent. Similarly, according to the GAO Report, "the largest credit card banks, which are generally the most profitable, have not greatly increased their profitability over the last 20 years" (P. 67). The GAO Report also noted that "The profits of credit card issuing banks...have been stable over the last 7 years" (p.75). It bears noting that credit card lending is a high risk business in which the lender provides an unsecured line of credit to someone the lender probably has not met, access to this credit is available around the world 24 hours a day, 7 days a week, and at the end of the year, if all goes well, the lender gets back $3 for every $100 credit extended. This return on assets is much less the return on assets of the pharmaceuticals, computer services and software, insurance and managed care, entertainment and food and drug store industries.

Q.13. What percentage of Americans have credit cards?

A.13. The Federal Reserve has estimated that 71.5% of families in the United States had at least one bank issued credit card in 2004. (See Federal Reserve Report to Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and their Effective Consumer Debt and Insolvency at 3,6).

Q.14. Question: What percentage of cardholders are paying penalty interest rates on their cards? How has that percentage changed over the last 20 years?

A.14. We are not aware of statistics showing the percentage of cardholders paying penalty interest rates. We do note that as stated previously, approximately 50% of cardholders pay their balance in full each month and therefore pay no interest. We also note that pricing based on risk, including penalty pricing, has increased consumer choice and has contributed to the lowering of credit card rates overall. Rather than give every cardholder the same rate and

spread the risk of delinquency and credit losses evenly over the portfolio, improvements in technology and credit underwriting have enabled issuers to be more granular in how they price for credit risk. This enables credit card issuers to keep rates low for cardholders who continue to pay all their bills on time and raise rates for those who do not pay all their bills on time and who therefore pose the most risk. Of course, if a card issuer misprices a consumer's risk, that card issuer becomes vulnerable to losing the cardholder as a customer because the robust competition in the credit card marketplace will likely result in the consumer receiving solicitations for products with lower rates.

Q.15. Question: What percentage of profits comes from:

a) non-penalty interest charges;
b) penalty interest charges;
c) fees, including: over limit fees; late fees; annual fees; interchange fees; balance transfer fees; cash advance fees; stop payment fees; telephone payment fees; foreign transaction fees; and other fees?

A.15. Barclays Bank Delaware is a young and growing business that has benefited from inward investment over the past few years; accordingly it is not yet profitable. According to the GAO report, approximately 70% of card issuers' revenue is derived from interest, 20% from interchange and other non "penalty" fees such as annual fees, and approximately 10% from penalty fees such as late fees and returned payment fees.

Q.16. Please provide the Committee with data on the amount of annual revenue generated in each of the last two years from interest payments and the number of cardholders paying interest at rates of:

a) less than 15% APR;
b) from 15 to 19% APR;
c) from 20 to 25% APR;
d) from 26 to 29% APR; and
e) 30% or greater APR.

A.16. We are not aware of industry statistics on this point.

Q.17. Please provide the Committee with data on the amount of revenue generated in each of the last two years from interest payments due to:

a) repricing of interest rates due to late payments to the issuer; and
b) repricing of interest rates due to cardholder transactions or credit worthiness with other creditors or accounts.

A.17. We are not aware of industry statistics on this point.

Q.18. Please explain how you would "reprice" a customer with a "fixed rate" credit card. What are the criteria that would determine whether a customer is repriced? How do you determine the rate to which the customer is repriced?

A.18. When we offer a "fixed APR" product, we inform consumers of the circumstances pursuant to which the APR might change. For example, we explain in at least two places in our solicitations for credit card accounts carrying a "fixed APR", that the term "fixed APR" means an APR which will not vary in concert with changes

to an index, such as the US Prime Rate. This is to help consumers understand that the term "fixed" is used to distinguish the rate from a so called "variable" rate product that fluctuates based on an index. If there are circumstances under which the rate may increase, we also make sure to disclose those circumstances as part of the solicitation as well. For instance, if the rate may be changed if the consumer fails to pay us on time, we disclose both that fact and the actual default rate as part of the solicitation disclosures. This ensures that the consumer receives notice of the circumstances pursuant to which the rate may change before deciding to apply for the account.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED FROM RICHARD VAGUE

Q.1. If issuing a credit card with a low credit line is one of the ways to reduce the risk of lending to an "at risk borrower," doesn't the issuance of multiple cards to the same individual reduce the effectiveness of this practice and actually in some cases increase the risk? What percentage of your customers has more than one of your credit cards? How would you describe the typical customer that has a low credit line but multiple cards? What percentage of your customers use multiple credit cards to remain current on their other credit card balances that have been issued by your companies?

A.1. We find that most consumers want multiple cards because they use them for different reasons. For instance, a consumer might want one card for business purposes and another card for personal use; a family may want a separate card for everyday purchases and another card for special projects expenses and on which they might carry a balance. I myself have multiple cards which I use for different purposes; and virtually everyone I know has multiple cards. When one of our cardholders wants a second card we want to be the bank that issues that card as long as the cardholder can manage the incremental credit safely. We try to ensure this by managing the entire amount of credit extended to the cardholder, whether on a single line or on multiple cards. In determining whether to issue an additional card, we take into account the cardholder's existing accounts with us as well as the cardholder's accounts with other creditors. We work hard to ensure that our customers do not overextend themselves. We routinely deny applications for additional card relationship with us where we determine that we are not comfortable extending additional credit to the applicant due to their existing debt burdens and credit history. We also have a policy that cardholders cannot use one card with Barclays to pay off all or part of a balance on another card of Barclays.

Q.2. How does your company account for the total debt from all of the cards issued to one customer? Are these aggregate balances reported to regulators as well?

A.2. Whenever a consumer applies for an account with Barclays Bank Delaware, we look not only at their performance with Barclays but also at their entire credit profile. Similarly, when an existing customer applies for a credit line increase or we need to make a decision concerning an existing cardholder's credit status,

we underwrite the cardmember based on the cardholder's overall relationship with us as well as with all creditors as reported in their credit reports. In other words, our credit decisions are not simply based on our cardholder's aggregate balance or exposure to us but on the cardholder's entire credit profile. We are required to report to and otherwise make available to regulators extensive information regarding our credit card portfolio. Although these reports do not provide information on a cardholder by cardholder basis, the regulators regularly examine how we manage our relationship with our cardholders, including how we manage our relationship with cardholders who have more than one account with us.

Q.3. What is the typical minimum monthly payment required for credit cards? What percent of the balance represents the minimum monthly payment? Do you think this is sufficient? Do most credit card companies use a model or an algorithm to establish minimum payment? Please describe industry best practices for establishing appropriate minimum payment amounts.

A.3. Establishing an appropriate minimum payment amount involves a delicate balance. On the one hand, cardholders typically demand that the minimum payment amount should be low enough to provide maximum flexibility to enable each cardholder to decide how much to repay each month based on that cardholder's financial circumstances. For example a relatively low monthly payment requirement allows cardholders to more easily meet their obligations in months where they have an unexpected medical or household expense, or if a seasonal worker, in those months where they are without employment. On the other hand, the minimum payment amount should be high enough to ensure reasonable amortization of the loan balance. In 2003, the federal banking agencies issued guidance regarding the required minimum payment on a bank issued credit card account. In particular the agency guidelines made it clear that the minimum payment amount should be sufficient to ensure that there is no prolonged negative amortization and that the balance will be repaid in full over a reasonable period of time assuming the minimum amount due is paid each month. It is our understanding that in connection with the guidance, the OCC and the FDIC have required many of the banks they regulate to adopt a minimum payment calculation equal to the amount of finance charges, plus late and over limit fees, plus 1% of the balance.

Q.4. Why does the industry allow credit card customers to make transactions that result in their account being over the limit? Does the over-limit fee being charged adequately compensate for the risk incurred by the over-limit amount? In situations where a customer goes over their limit after the line has been lowered due to new risk identified in their credit report, how can the fee earned adequately compensate for the risk? Is there a maximum amount or percentage of the line that is generally allowed to be over-limit? What are known best practices for allowing customers to overdraw their accounts and assessing fees for doing so?

A.4. It is our understanding that most credit card issuers allow credit card customers from time to time to make transactions that are over the limit because their customers overwhelmingly want

them to do so. It is our experience that customers almost invariably prefer being allowed to go over their credit limit and being charged a fee than to have the transaction denied. A cardholder whose card is denied authorization at a restaurant after a meal or at a grocery store after food has been bagged is not a happy customer. In other words, it is good customer relations to enable the cardmember to go over limit in appropriate circumstances. There is increased risk with exceeding the credit limit, however, and we find that we must decline the majority of over limit transactions because of the added risk. Although practices vary from bank to bank, we are aware of a number of factors that may be used to determine whether to approve or decline a cardholder's over-limit transaction request. For example, card issuers routinely consider whether the transaction would cause the cardmember to go over his/her limit by over a certain amount, whether the cardholder has exceeded his or her limit multiple times in the past or if the actual transaction itself is associated with higher risk. In many instances the fees imposed for over-limit transactions do not fully compensate for the increased risk involved. Instead the fees provide a measure of compensation which defrays the risk sufficiently to help justify accommodating the cardholder's request. Finally, one best practice is email alerts. If a cardholder gives Barclays Bank Delaware his or her email address and authorizes us to do so, we will alert the cardholder when he or she gets close to his or her credit limit. This helps the cardholder better manage the credit line and avoid going over-limit.

Q.5. How can disclosures and the delivery of disclosures be improved to ensure customers fully understand the terms of the credit card, including cash advance, over-limit, wire transfer and late fees? What are the best practices for disclosing information to the customer?

A.5. Disclosures could be greatly improved if the regulatory disclosure scheme were modified to ensure that required disclosures clearly and conspicuously convey those terms that are truly important to the consumer. We believe that this can be accomplished through a federal disclosure scheme based on a careful study of consumer behavior and preferences to ensure that the disclosures are designed to attract and focus the attention of consumers to key information that can be easily read and understood by consumers. The Schumer Box is a start, but a disclosure scheme designed by marketers and customer service specialists after testing different colors, fonts, shapes, etc., will work better than any disclosure scheme designed by attorneys. By key information we mean the various APRs, important fees (annual fees, late fees, balance transfer fees) and how those APRs and fees could change and any other terms consumers regularly consider in making decisions as to which cards to apply for. Required disclosures should be limited to only those terms most important to the consumer so as to avoid information overload. Finally, a safe harbor must be created so that credit card issuers can rely on the new disclosure standards without fear of being sued. In our experience, much of the current disclosures set forth in credit card solicitations are caused by the increasing need to include new or different language to comply with the existing regulatory scheme which can become more and more complex each time there is a new court case, regulation or law.

The Federal Reserve Board is in the process of a large scale revision of the Regulation Z disclosure requirements for credit cards. We understand that as part of this effort, the Board is currently studying how to provide consumers with the most useful information in the most understandable and noticeable way. We support these efforts and it is our hope that those studies will provide useful guidelines as to the types of information consumers believe is important information and what type of presentation of that information consumers would find most meaningful without overwhelming the consumer with information overload.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TESTER FROM RICHARD VAGUE

Q.1. What portion of your profits comes from interest and what portion results from the fees you charge customers?

A.1. At this time, Barclays Bank Delaware is a growing young business that has benefited from significant inward investment over the past few years; accordingly, is not yet profitable. Based on information made available through the GAO Report, approximately 70% of credit card income comes from interest, about 10% from penalty fees such as late and over the limit fees and 20% from interchange and other fees such as annual fees.

Q.2. I've been reading about universal default. It is my understanding that you can increase the interest rate of a customer who has a perfect and long-standing credit record with your company because of a late payment that he or she has made to another creditor. Is this true? How do you justify it?

A.2. Barclays Bank Delaware does not do what you describe. Instead we use process known as risk-based pricing in order to manage our accounts for risk. Under risk-based pricing, riskier borrowers pay more. Over time, customers' creditworthiness profiles change. Some who were low risk at the time their account was opened become higher risk. For example, cardmembers who were never late on their accounts with us sometimes default on their loans and stop paying. For these cardholders, the first sign of trouble is when they simply stop paying—either with us or with others. As a result credit card issuers began looking more closely at the cardholders' entire credit profile to determine the cardholder's risk of default and began changing their credit strategy accordingly—raising rates on cardholders who, based on a review of the credit history as a whole, posed the greatest risk. At Barclays we notify all our applicants in our solicitations about our risk-based pricing policy *before* they even apply for a card. It is important to note that for sizeable segments of our portfolio, our risk-based pricing policy never comes into play because there is no need to reprice them at all.

Although our repricing efforts typically affect only small portions of our portfolio, they are an important tool in managing risk and ensuring that we can serve our cardholders by providing them with competitive pricing. If a cardholder's creditworthiness declines significantly, that cardholder becomes a far riskier and, therefore, costlier proposition. By repricing the cardholder's account, we are able to ensure that the cardholder pays for his or her risk rather

than forcing other cardholders in the portfolio to bear the cost of that risk—a risk they did not create. An alternative step we take to control risk is to close the cardholder's account (i.e., inform the customer he/she can no longer use the card to make purchases) when his or her risk profile increases. Unfortunately, account closing is the best option in many instances, even though we have found that most cardholders far prefer our raising rates to closing accounts. Importantly, rather than simply spread the costs of delinquency and credit losses across the entire portfolio, these repricing and account closing steps enable us to keep our pricing low for those customers who pay their bills on time, pose the lowest risk and cost the least to manage. Importantly, after the rate of a cardmember is raised, if they exhibit on time payment performance, we will lower their rate.

Q.3. Assuming we wanted to get all credit card disclosures on 1 page and want to pick the most salient disclosures, what do you think are the most important terms of the agreement to allow your customers to make an informed choice about the product and whether it works for them?

A.3. Our experience with cardholders has led us to believe that consumers find that the most important terms are APR, significant fees (annual fees, balance transfer fees, late fees) and how their terms may be changed. Importantly, the Federal Reserve Board is currently testing disclosures with consumers to determine what terms consumers believe are most important and how to present those terms in a manner that consumers are likely to read and understand those terms. We support that approach. We encourage the Board to employ marketing and customer service professionals to design the format and style of disclosure—so that it is designed to attract the consumer's attention, it is easy to read and understand without overloading the consumer with information that distracts the consumer from the key terms.

Q.4. Didn't it used to be that if you reached your credit limit on your card you were denied the extra credit? But now, as I understand it, credit card companies allow consumers to go over the limit and then charge them a fee. What is the justification for this trend?

A.4. It is our understanding that most credit card issuers allow credit card customers from time to time to make transactions that are over the limit as a courtesy to their customers. It is our experience that, customers almost invariably prefer being allowed to go over their credit limit and be charged a fee for that permission to go over the limit than to have authorization denied. A cardholder whose card is denied authorization at a restaurant after a meal or at a grocery store after food has been bagged is not a happy customer. In other words, it is important for customer relations purposes to enable the cardholder to go over limit in appropriate circumstances. There is increased risk associated with exceeding the credit limit, however, and we find that we must decline a majority of over-limit transactions because of the added risk. Although practices vary from bank to bank, we are aware of a number of factors used to determine whether to approve or decline a cardholder's over-limit transaction request. For example, card issuers commonly

consider whether the transaction that would cause an account to go over the limit by a certain amount, whether the cardholder has exceeded the limit multiple times in the past or the transaction itself is associated with higher risk. In many instances, the fees imposed for over-limit transactions do not fully compensate for the increased risk involved. Instead, these fees do provide a measure of compensation which defrays the risk sufficiently to help justify accommodating the cardholder's request in appropriate circumstances. Finally, one best practice is email alerts. If the cardholder gives Barclays their email address and authorizes us to do so, we will alert the cardholder when he or she gets close to their credit limit so the cardholder can better manage his or her exposure to their line and avoid over-limit fees if possible.

Q.5. Do you think that the average consumer knows they'll be hit with a fee for going over their credit limit rather than being told they have exceeded their limit?

A.5. Yes. As noted above, it is our experience that cardholders generally prefer to be permitted to exceed their credit limit rather than having the transaction declined at the cash register. In addition the fees that cardholders pay for exceeding the credit limit are well disclosed. Indeed they must be disclosed at least three times: 1) at or with the Schumer Box provided to the consumer at account application; 2) with the disclosures provided at account opening and 3) on the monthly billing statement when the fee is imposed.

Q.6. What is an "ideal customer"?

A.6. A customer who uses their card a lot and pays their bills on time.

Q.7. What percentage of your customers are in perpetual debt?

A.7. We work extremely hard to ensure that we extend credit only in amounts that cardholders can reasonably handle and we believe that we are successful in achieving that objective. Almost none of our cardholders "perpetually" pay the minimum amount due over the life of the loan. Moreover, based on industry information, it is our understanding that a very small percentage of cardholders pays the minimum amount due every month for twelve months—roughly 2–3%. This is consistent with the recent GAO Report that roughly half of consumers pay-off their entire balance by the end of the month.

Q.8. Of those customers, how many would have been helped by clearer display of rates?

A.8. As noted above, we fully support the Federal Reserve Board's efforts to improve disclosures. In our experience however, cardholders are well informed about the rates they pay on their accounts. Those rates must be disclosed before the account is opened (and consumers know to look for the "Schumer Box" in solicitations), when the account is opened and on the billing statements sent each month. As a result, we find that a cardholder's choice to make a minimum payment is generally based on the cardholder's particular financial circumstances that month; we are not aware of any role that rate disclosures may play in a cardholder's decision to make a minimum monthly payment.

Q.9. How much information can a customer get on the internet about the rates/fees of their policy?

A.9. All information about rates and fees is available to Barclays Bank Delaware's cardholders over the Internet.

Q.10. How many consumers use your internet tools, and what is their feedback on it?

A.10. Barclays Bank Delaware's website for its cardmembers has been designed to be very user friendly and our cardholders find it very helpful. For instance, for consumers who sign up for the service, we send email alerts when their periodic statements are available online, reminder emails a couple days before the payment due date, emails when payment has been received and warning emails if the cardmember is approaching his or her credit limit. We find cardmembers greatly appreciate these email reminders and being able to look at all their transactions online. In addition we encourage our cardholders to pay their accounts online without a fee. It is notable that 61% of our cardmembers have logged into their accounts in some manner in 2006.

Q.11. Do you expect the average educated consumer to read and understand the whole disclosure statement?

A.11. It is our strong preference that cardholders read and understand the disclosures we provide to them. It is in our best interest and in the cardholder's best interest that they do so. We recognize, however, that the current credit card disclosure regime mandated under federal law has become quite complex. Although while we find that consumers have gotten accustomed to looking at information in the Schumer Box, it is generally believed that most of the other disclosures go unread. We believe that consumers need better disclosures not more disclosures. What is needed is simple clear disclosures of those terms most important to consumers, drafted in a manner likely to attract the attention of consumers; worded in a way they are likely to read and understand with a safe harbor that provides that by complying with the requirements, the issuer can not be sued (so the issuer's lawyers will not feel compelled to complicate disclosures to protect their client every time there is a new litigation).

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

CAP ONE'S CREDIT TRAP; BY OFFERING MULTIPLE CARDS, THE LENDER HELPS LAND SOME SUBPRIME BORROWERS IN A DEEP HOLE AND BOOSTS ITS EARNINGS WITH FEE INCOME

BusinessWeek, November 6, 2006

By Robert Berner

When Brad Kehn received his first credit card from Capital One Financial Corp. in 2004, it took him only three months to exceed its $300 credit limit and get socked with a $35 over-limit fee. But what surprised the Plankinton (S.D.) resident more was that Cap One then offered him another card even though he was over the limit—and another and another. By early 2006, he and his wife had six Cap One Visa and MasterCards. They were in over their heads.

The couple was late and over the limit on all six cards, despite occasionally borrowing from one to pay the other. Every month they chalked up $70 in late and over-limit fees on each card, for a total of $420, in addition to paying penalty interest rates. The couple fell further behind as their Cap One balances soared. Even so, they still received mail offers for more Cap One cards until they sought relief at a credit counseling agency this May. "I didn't open them," says Kehn, 33, who manages a truck stop and runs a carpet-cleaning business on the side. "I owe these people that much damn money and they are willing to give me another credit card? This is nuts."

Credit card experts and counselors who help overextended debtors say there's nothing crazy about it. Cap One, they contend, is simply aiming to maximize fee income from debtors who may be less sophisticated and who may not have many options because of their credit history. By offering several cards with low limits, instead of one with a larger limit, the odds are increased that cardholders will exceed their limits, garnering over-limit fees. Juggling several cards also increases the chance consumers may be late on a payment, incurring an additional fee. And if cardholders fall behind, they pile up over-limit and late fees on several cards instead of just one. "How many more ways can I fool you?" says Elizabeth Warren, a Harvard Law School professor who has written extensively on the card industry. "That is all this is about."

Consumers may not be the only ones who are unaware of Cap One's ways. Its practice of issuing multiple cards to some borrowers with low credit ratings doesn't appear well-known in the investment community. And just how much Cap One relies on fee income, vs. interest, is a mystery, since, like most lenders, it doesn't disclose that. All credit card companies have become more reliant on fee income in recent years, but in a report issued in 2002, William Ryan, an investment analyst at Portales Partners, warned that Cap One's earnings could be "devastated" if regulators cracked down on multiple cards or fees.

That hasn't happened. For now, Cap One's approach looks pretty savvy, however onerous it may be for some customers. Ronald Mann, a card-industry expert, says that by generating so much revenue from late and over-limit fees, as well as interest, Cap One likely more than offsets for the risk of card holders filing for bankruptcy. "The premise is to make money even if [Cap One] never gets fully repaid," says Mann, a law professor at the University of Texas in Austin. (Mann has been retained by a party suing Cap One in a business dispute.)

In a written response to questions, Cap One acknowledges that it offers multiple cards. "Our goal is to offer products that meet our customers' needs and appropriately reflect their ability to pay," it says. The company also stated: "Within our current U.S. portfolio, the vast majority of Capital One customers have only one Capital One credit card with a very small percentage choosing to have three or more cards." Spokeswoman Tatiana Stead declined to offer precise numbers or to say whether households with three or more cards were concentrated among "subprime" borrowers, who have low credit ratings.

UNDER THE RADAR

The nation's fifth-largest credit card issuer, with $49 billion in U.S. credit card receivables as of the end of June, McLean (Va.)-based Cap One is a major lender to the subprime market. According to Cap One's regulatory filings, 30% of its credit card loans are subprime. Representatives of 32 credit counseling agencies contacted by BusinessWeek say that Cap One has long stood out for the number of cards it's willing to give to subprime borrowers. "In the higher-risk market, no lender is more aggressive in offering multiple cards," says Kathryn Crumpton, manager of Consumer Credit Counseling Service of Greater Milwaukee. Other big card-industry

players that do subprime lending include Bank of America, Chase, and Citigroup. Representatives for Chase and Citigroup say they do not offer multiple cards to subprime customers. (BofA did not respond to inquiries.)

Last year, West Virginia Attorney General Darrell V. McGraw Jr. filed an action in state court seeking documents from Cap One related to its issuance of multiple cards, as well as other credit practices. Other than that, however, Cap One's practices do not appear to have drawn regulatory scrutiny. A spokesman for the Federal Reserve, Cap One's primary federal overseer, declined to comment about Cap One, but said that in general the regulator doesn't object to multiple cards. Still, Fed guidelines warn multiple-card lenders to analyze the credit risk tied to all the cards before offering additional ones.

If consumers were using one Cap One card to make payments on another, it could artificially hold down the company's delinquency and charge-off rates, metrics investors closely watch because they affect earnings, says Allen Puwalski, senior financial analyst at the Center for Financial Research & Analysis in Rockville, Md.

In filings with the U.S. Securities and Exchange Commission, Cap One says its delinquency and charge-off rates as of Sept. 30 were 3.6% and 2.5%, respectively, about middle of the pack for major card lenders.

In an e-mail, Cap One's Stead says: "It is not our practice—nor our intention—to offer an additional card to customers who are currently delinquent or over limit on a Capital One card." But Daniel Carvajal believes that's just what Cap One tried to get him to do. Carvajal, 38, who is confined to a wheelchair with cerebral palsy and lives with his mother in Miami, says he exceeded his $1,500 Cap One credit limit last Christmas by several hundred dollars and was late on payments in January and February. In March, he says, a Cap One representative offered him a second card, which he refused. Using the new card to catch up with his first, he suspects, "is what they wanted me do to."

Some overextended Cap One customers admit using one card to pay another. In mid-2005, Kehn, the South Dakota truck-stop manager, already over the limit on three Cap One cards with $300 to $500 limits, received an offer from Cap One for another card with a $500 limit. He transferred part of the balances from the first three cards to get them under the credit limit. When his wife got a second card in early 2006 with a $1,500 cap, the couple took expensive cash advances on it to try to help make payments on the five other Cap One cards. "I robbed Peter to pay Paul," Kehn says.

Christine Garcia, 41, of Orange, Calif., said she and her husband did the same when stretched with five Cap One cards between them. So did Bernice Thompson, 46, of Fort Smith, Ark., who, along with her husband, had seven Cap One cards. "We got caught in a circle, and couldn't get out," says Thompson.

These examples bring into question Cap One's public stance on its subprime lending. Analysts, including Carl Neff, ratings director on card securitizations for Standard & Poor's, say Cap One tells investors that it carefully controls risk by giving such borrowers only small lines of credit. Indeed, the largest percentage of Cap One's 28 million credit-card accounts, 43%, have balances of $1,500 or less, according to its SEC filings. But if many borrowers had larger aggregate balances because they have multiple accounts, that percentage would be lower, and Cap One's "underwriting wouldn't appear as conservative as it looks," says the Financial Research Center's Puwalski.

Like other big card companies, Cap One securitizes most of its card receivables as bonds, which are rated by credit agencies such as Standard & Poor's (S&P) is a unit of The McGraw-Hill Companies, publisher of BusinessWeek). Cap One's ratings are strong, allowing it to command a higher price for the bonds. But Neff of S&P says he is surprised Cap One would offer riskier borrowers multiple, low-limit accounts given what it has told the market. "If it was a very prevalent practice, that would lower [Cap One's credit] quality in our eyes," Neff says. A sampling of credit counseling agencies across the country indicates that about a third of the troubled debtors they see with Cap One cards have two or more Cap One accounts.

Ron Nesbitt, 37, a Macon (Ga.) truck driver, and his wife sought credit counseling last year. By the second half of 2004, Nesbitt says, the couple had become consistently late and over limit on six Cap One cards, generating $348 in fees alone each month. "It was out of control," he says.

Juggling Act:

How Clyde and Bernice Thompson of Fort Smith, Ark., got in trouble

— From late 1999 to early 2003, Clyde, 77, and Bernice, 46, were granted seven Capital One Visa cards and MasterCards with credit limits ranging from $200 to $700.

— In April, 2003, Clyde, a Wal-Mart greeter, and his wife, who was on medical disability at the time, missed their monthly payment on all the cards.

— They were billed $29 a card in late fees, which pushed six cards over the limit. That generated an additional $29 over-limit fee and higher interest rates on those cards.

— By late 2003, the Thompsons couldn't keep up, despite taking cash advances on the seventh card to try and pay the first six. They were paying over $400 a month in late and over-limit fees alone.

— The couple kept receiving mail offers for more Cap One cards until February, 2004. "I tore them up," says Bernice.

— Data: Interview with Bernice Thompson

Statement for the Record

By

Edward L. Yingling

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Committee on Banking, Housing and Urban Affairs

United States Senate

January 25, 2007

Statement for the Record

Edward L. Yingling

on behalf of the

American Bankers Association

before the

Committee on Banking, Housing and Urban Affairs

United States Senate

January 25, 2007

Mr. Chairman and members of the Committee, 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 submit this statement for the record 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 committee 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, Chairman Dodd, and members of this committee have all raised legitimate questions that deserve active discussion. The ABA, on behalf of our membership (which includes

[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.

all the major credit card issuers), wants to take this opportunity to state that we want to work with this committee, our 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, 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.

---

[2] GAO Report, Credit Cards: Increased Complexity in Rates and Fees Heightens the Need for More for More Effective Disclosures to Consumers, September 2006.

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.

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.

[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.

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 envisioned 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) 24 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 to 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 able to use credit scores to 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 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

[4] Staten, Michael, "Risk-based Pricing in Consumer Lending," Credit Research Center, McDonough School of

financing has grown as more people rely on it to purchase everything from homes to everyday goods. Today, debt for all purposes is now 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 suggesting that indebtedness has not severely affected the financial condition of U.S. households in general. 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 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

Business, Georgetown University, March 2005.
[5] GAO Report, page 58.

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.

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."

III. As Complexity Has Increased, Better Disclosures 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 borrowers or account holders, 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 should also consider developing a credit card users' manual to assist consumers in understanding credit cards and credit card offers.** This should be provided by the Federal Reserve 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. Lenders should not be required to provide this manual as part of the specific disclosures, as it would add to the pile of information required and again make it unlikely that the consumer will read ***any*** of the materials.

The ABA has also provided comment to the Federal Reserve on many specific and technical disclosures. We are dedicated to working with federal banking agencies, Congress, and other interested parties to improve consumer disclosures so that they are as clear and concise as possible.

Before closing, I would 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. ABA's Education Foundation provides leadership and resources to help increase financial literacy. Just this past October, Treasury Secretary Paulsen and several Congressman joined bankers in classrooms as part of the ABA Education Foundation's Get Smart About Credit Day. Coming up on April 24, thousands of bankers will enter classrooms as part of the Foundation's Teach Children to Save Day. ABA also offers consumer information on banking services, personal finances and more, through the ABA's Consumer Connection Web site.

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.

Conclusion

The story of payment cards is one of ever-broadening access, great technological advances, and trust. 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, Mr. Chairman, 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