**TESTIMONY OF**
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**LEGISLATIVE DIRECTOR**

**ON BEHALF OF**
**THE CONSUMER FEDERATION OF AMERICA. CENTER FOR RESPONSIBLE LENDING, CONSUMER ACTION, CONSUMERS UNION, NATIONAL CONSUMER LAW CENTER (ON BEHALF OF ITS LOW-INCOME CLIENTS) AND U.S. PIRG**

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

**REGARDING**
**MODERNIZING CONSUMER PROTECTION IN THE FINANCIAL REGULATORY SYSTEM: STRENGTHENING CREDIT CARD PROTECTIONS**

**FEBRUARY 12, 2009**

Chairman Dodd, Ranking Member 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 Center for Responsible Lending,[2] Consumer Action,[3] Consumers Union, the publisher of Consumer Reports,[4] the National Consumer Law Center,[5] on behalf of its low-income clients, and U.S. PIRG.[6] I appreciate the opportunity to offer our comments on the harmful effects on consumers of some current credit card industry practices, as well as our recommendations on how the Senate can strengthen protections for consumers. Such

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

[2] The **Center for Responsible Lending** (CRL) is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, which consists of a credit union and a non-profit loan fund focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to purchase homes. Self-Help has provided over $5 billion in financing to more than 60,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across the United States. Another affiliate, Self-Help Credit Union, offers a full range of retail products, and services over 3,500 checking accounts and approximately 20,000 other deposit accounts, and recently inaugurated a credit card program.

[3] **Consumer Action**, 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.

[4] **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.

[5] The **National Consumer Law Center**, Inc. (NCLC) is a non-profit 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 and regularly updates a series of sixteen practice treatises and annual supplements on consumer credit laws, including Truth In Lending, Cost of Credit, Consumer Banking and Payments Law, Foreclosures, and Consumer Bankruptcy Law and Practice, 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 tens of 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 comprehensive comments to the federal agencies on the regulations under these laws.

[6] The **U.S. Public Interest Research Group** is the national lobbying office for state PIRGs, which are non-profit, non-partisan consumer advocacy groups with half a million citizen members around the country.

action is more urgent than ever because taxpayers are now propping up major national credit card issuers through several enormously expensive government programs. If the government is going to invest in the credit card industry and attempt to spur the extension of credit, it is essential that it ensure that the loans that this industry is offering to Americans are fair and sustainable.

We applaud the Committee for examining many questionable practices in the credit card industry, including the terms and conditions of credit card contracts, unjustified fees and interest rates and marketing and credit extension practices. It is obviously very important in the midst of a serious economic recession that Congress act fast to rein in these abusive practices. Despite the fact that credit card lenders have recently cut back on the amount of new credit they offer and started reducing credit lines for some borrowers, years of aggressive and irresponsible lending have helped put borrowers in a very vulnerable financial position. More Americans are now late or in default on their loans than at any time since the recession of 2001 and 2002. Based on the loss trends that major card issuers are reporting, it is quite possible that 2009 will be one of the worst years on record for credit card consumers.

For fifteen years, CFA and many others have warned that credit card issuers were irresponsibly pushing cardholders to take on more debt than they could afford, and then using unfair and deceptive tactics to increase debt loads and issuer profits. The Credit Card Accountability, Responsibility and Disclosure (CARD) Act, introduced by Chairman Dodd and a number of co-sponsors, is a comprehensive proposal that will end the most arbitrary, abusive, and unfair credit card lending practices that trap consumers in an unsustainable cycle of costly debt, such as sharply escalating "universal default" interest rates that can double some cardholders' interest rates or monthly payments overnight. The Credit CARD Act also targets a number of damaging practices not addressed by federal banking regulators in their recent credit card rule, such as the irresponsible extension of credit to young consumers with little income, and exceedingly high penalty fees charged for minor cardholder mistakes.

These tricks and traps have always been unfair, but now, at a time of economic crisis when consumers can least afford it, they produce devastating financial repercussions. Moderate-income families with little flexibility in their budgets, or those who have experienced a serious loss in income, are particularly hard hit if they have to pay more in unjustifiable fees and credit card interest. The meltdown of the sub-prime mortgage market demonstrates the importance of ending abusive lending practices when warning signs arise. Congress should take steps now to rein in these practices to forestall an even greater economic crisis.

## A. CARDHOLDERS ARE SHOWING SERIOUS SIGNS OF ECONOMIC STRESS

As the economy has worsened and home foreclosures have increased to record levels, consumers are increasingly having serious difficulty paying their credit card bills. One widely watched measure of financial health, the amount of credit card debt paid off by Americans monthly, is now at one of the lowest levels ever recorded.[7] 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 most of the last thirteen years and are now

[7] Chu, Kathy, "November Credit-Card Payoff Rate Fell Sharply," *USA Today*, February 8, 2009. The monthly payment rate fell by 2.5 percentage points to 16.1 percent in November 2008, according to CardTrak.com.

approaching the highest levels on record. 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.[8] They increased to more than 4 percent in the fourth quarter of 2006 and broke 4 percent again during the later half of 2007. Since then, charge-offs have escalated sharply to 5.62 percent in the third quarter of 2008. There is a very good chance that charge-offs will keep rising because the number of delinquent credit card payments – an early sign of payment difficulty – are also approaching historically high levels. Thirty-day credit card delinquencies are now at their highest point in six years, since the last economic recession ended.[9] Moreover, a number of major issuers have reported fourth quarter charge-offs that indicate that borrower defaults and issuer losses will exceed those of the last two recessions.[10] The difficulty that many families are having affording their credit card bills has been exacerbated by the mortgage crisis. As home values have dropped sharply, Americans have been unable to use home equity loans and home refinancing to pay off their credit card debts.[11] Moreover, despite rising credit card delinquencies, there is evidence that some families are attempting to stay current on their credit card loans but not their mortgage payments, a shift in behavior from past economic crises.[12]

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[8] Federal Reserve Board, "Charge-Off and Delinquency Rates on Loans and Leases at All Commercial Banks," available at www.federalreserve.gov/release/chargeoff. 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.

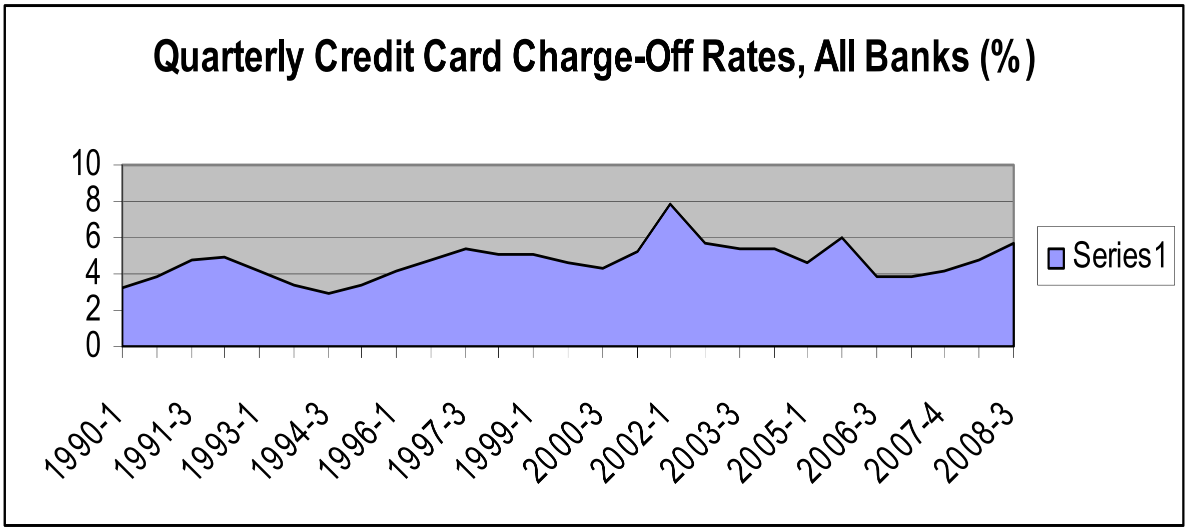
[9] 30-day credit card delinquencies during first three quarters of 2008 were between 4.79 and 4.88 percent, the highest levels since 2002. Federal Reserve Board, "Charge-Off and Delinquency Rates on Loans and Leases at 100 Largest Commercial Banks" "U.S. Credit Card Delinquencies at Record Highs – Fitch," *Reuters*, February 4, 2009.

[10] Terris, Harry, "Credit Card Losses Seen Surpassing Levels of Last Two Recessions," *American Banker*, January 28, 2009.

[11] Westrich, Tim and Weller, Christian E., "House of Cards, Consumers Turn to Credit Cards Amid the Mortgage Crisis, Delaying Inevitable Defaults," Center for American Progress, February 2008.

[12] Chu, Kathy, "More Americans Using Credit Cards to Stay Afloat," *USA Today*, February 28, 2008.

Quarterly Credit Card Charge-Off Rates, All Banks (%)[13]




Although some issuers have suffered losses in the last year, over time the credit card industry has been the most profitable in the banking sector, earning a return on assets (ROA) from 1995 to 2008 that was more than three times greater than that for commercial banks overall.[14] Because of the high mortgage losses that many large banks experienced in 2007, there was more than a five-fold difference between bank and credit card profits.[15]

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[13] Federal Reserve Board, "Charge-Off and Delinquency Rates on Loans and Leases at All Commercial Banks," available at www.federalreserve.gov/releases/chargeoff/chgallsa.htm , accessed April 14, 2008.

[14] "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.

[15] ROA for credit card issuers in 2007 was 4.65%, R.K. Hammer and Associates, January 2008. ROA for commercial banks in 2007 was .86%, FDIC, "Banks and Thrifts Earned $105.5 billion in 2007," February 26, 2008.

## B. CONSUMERS HAVE SHOWN FAR MORE CAUTION IN TAKING ON CREDIT CARD DEBT THAN ISSUERS USED IN MARKETING AND EXTENDING CREDIT

It is conventional wisdom that consumer demand fueled the growth of revolving debt to about $964 billion.[16] However, a careful analysis of lending patterns by credit card companies shows that aggressive and even reckless lending by issuers played a huge role in pushing credit card debt to record levels. From 1999 through 2007, creditor marketing and credit extension increased about twice as fast as credit card debt taken on by consumers,[17] even though the rate of growth in credit card debt in 2007 was the highest it had been since 2000.[18]

The debt growth rate started slowing in the second quarter of 2008 and then experienced a rare decline in the fourth quarter.[19] This most significant reason for this drop was probably the decline in consumer spending brought on by the recession. Additionally, issuers significantly

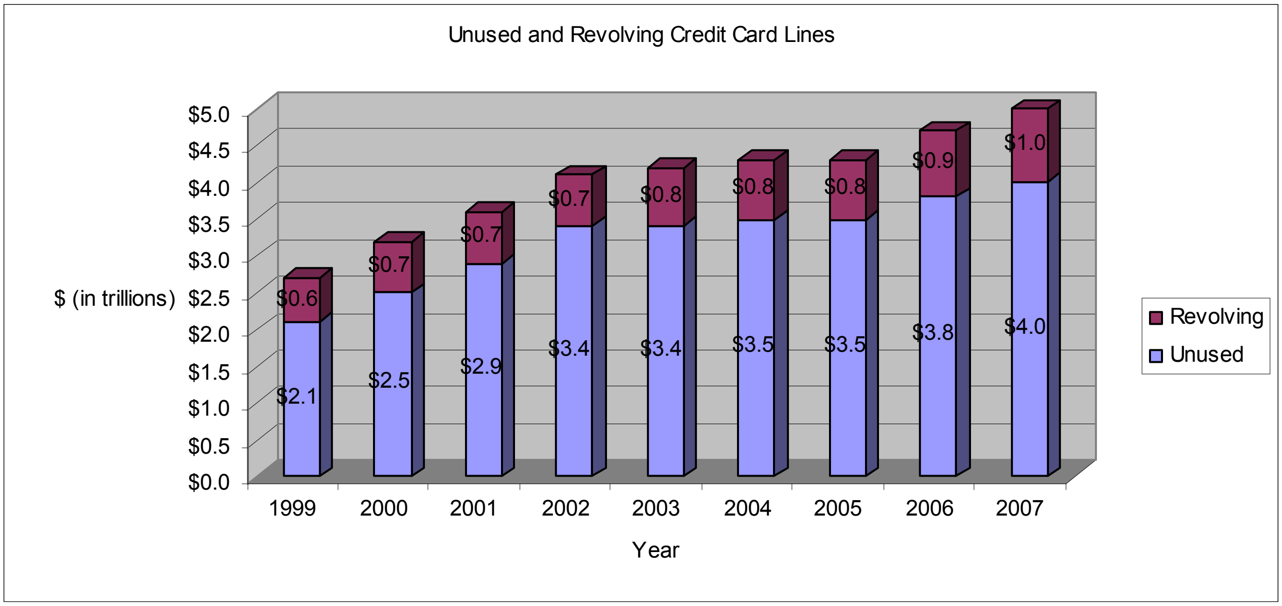
[16] As of December 2008, the amount of revolving debt held by Americans was $963.5 billion. Although this figure is often used as a proxy for credit card debt, most experts believe that outstanding credit card debt is slightly lower. First, approximately 5 percent of consumer revolving credit is not 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 $829 and $877 billion.

[17] VERIBANC, Inc. (www.VERIBANC.com) and Federal Reserve Consumer Credit Outstanding. According to Federal Reserve figures, consumer revolving debt grew by 50 percent from $627.5 billion in December 1999 to $941.4 billion in December 2007. According to VERIBANC, unused lines of credit grew at almost double the rate (90.5 percent) that consumers increased their use of credit card lines, increasing from $2.1 trillion in 1999 to just under $4.0 trillion ($3,983,200,614) at the end of 2007.

[18] The amount of revolving debt increased by 7.8 percent in 2007, which was the sharpest increase since revolving debt grew by 11.6 percent in 2000. Federal Reserve, Statistical Release, "Consumer Credit Outstanding," Table G.19.

[19] The amount of credit card debt in the fourth quarter of 2008 dropped by 5.4 percent, from $976.7 billion to $963.5 billion. Federal Reserve, Statistical Release, "Consumer Credit Outstanding," Table G.19.

reduced their marketing of new credit and started reducing some existing credit lines in the latter half of 2008.[20]




Source: VERIBANC, Federal Reserve.

A similar trend is evident when examining the consumer response to massive increases in marketing by creditors that started in 1990. 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.[21]

[20] Wolfe, Daniel, "Top Issuers, with Less Appetite for Risk, Slashing Credit Lines, *American Banker*, December 2, 2008. Banjo, Shelly, "Credit Card Companies Slash Credit Limits," *The Wall Street Journal*, January 5, 2009.
[21] Vertis Inc., press release, "Financial Direct Mail Readers Interested in Credit Card Offers," January 25, 2005; "Card Marketing 101," *CardTrack*, September 2002.

Issuers increased the number of mailed credit card offerings six-fold from 1990 to 2005, from just over 1.1 billion to a record 6.06 billion.[22] Since then, solicitations dropped to 5.8 billion in 2006, 5.2 billion in 2007, and 3.8 billion in 2008.[23] Wealthier families receive the highest number of credit card mailings, but low-income families are more likely to open the solicitations they receive.[24] The table at right indicates that issuer interest in marketing credit cards grew much faster than consumer interest in accepting new cards. The consumer response rate to mail solicitations declined seven-fold from 2.1 percent in 1990 to .3 percent in 2005, picking up slightly to .5 percent in 2006 and 2007. 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.

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[22] Synovate Mail Monitor, press release, "Mail Monitor Reports Record Six Billion Credit Card Offers Mailed in U.S. during 2005," April 27, 2006.
[23] Synovate Mail Monitor, press release, "U.S. Credit Card Mail Volume Declined to 3.8 billion in 2008," January 30, 2009.
[24] 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.

| | Solicitations (billions)[25] | 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% |
| 2006 | 5.8 | .5% |
| 2007 | 5.2 | .5% |

## C. ISSUERS ENCOURAGE THE LEAST SOPHISTICATED AND RISKIEST HOUSEHOLDS TO RUN UP UNSUSTAINABLE LEVELS OF DEBT

The growth of revolving debt in this country to $964 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.[26] According to the Federal Reserve Board, about 42 percent of cardholding households pay their credit card bill

[25] Synovate Mail Monitor
[26] Cardweb.com

in full every month,[27] which means that the remaining 50 million or so families that carry debt owe an average of about $17,000.[28]

Moderate and lower income households that are more financially vulnerable shoulder a higher level of debt relative to their incomes. In the current economic climate, these households are also under financial pressure from many external factors, such as flat wages, rising unemployment, skyrocketing home foreclosures and increasingly unaffordable health insurance. In other words, the "democratization of credit" has had serious negative consequences for many Americans, putting them one unexpected financial emergency away from bankruptcy.

Lower-Income and Minority Households

Close to half of all minority families in the U.S. carry credit card debt.[29] Although lower and moderate-income households are less likely to have bank credit cards than more affluent families, they are more likely to carry over debt from month-to-month. Sixty one percent of the lowest income households with a card carry balances, compared to 45 percent of higher income families.[30] 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

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[27] 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, vol. 92, February 2006, pg. 31.
[28] CFA calculation based on estimated credit card (as opposed to revolving) debt of $850 billion. If a conservative estimate of 75 percent of 114.4 million households have credit cards, and only 58 percent of these households carry debt, then the remaining 49.7 million households have an average of $17,103 in debt.
[29] 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*, vol. 92, February 2006, pg. 24.
[30] Board of Governors of the Federal Reserve System, "Report to the Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and their Effects on Consumer Debt and Insolvency," submitted to the Congress pursuant to section 1229 of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, June 2006 at 9 Table 6.

year owed 14.3 percent of their income in credit card debts, those earning between $20,000 and $29,999 owed 13.3 percent and those earning between $30,000 and $39,999 owed 11.0 percent. Compare this to the 2.3 percent of their income owed by families earning over $100,000.[31] 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.[32]

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.[33] Since Dr. Manning's report for CFA in 1999, this issue has been the subject of much public and media scrutiny. 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.[34] Americans under 35 are less likely to pay off their credit card balances every month than average Americans,[35] are paying more for debt

[31] Gallup Poll News Service, "Average American Owes $2,900 in Credit Card Debt," April 16, 2004.
[32] 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 spent 40% or more of their income on debt payments.
[33] 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
[34] Trigaux, Robert, "Generation Broke: New Grads Bear Heavy Load," *St. Petersburg Times*, November 22, 2004.
[35] 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.

obligations than in the past and are increasingly likely to pay more than 40 percent of their incomes on credit card debt.[36] Not surprisingly, more young Americans are declaring bankruptcy than in the past.[37] Moreover, there is increasing evidence that issuers are now targeting high school students with credit card offers.[38] 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.[39]

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.[40] The number of seniors filing for bankruptcy more than tripled from 1991 to 2001.[41] 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

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[36] *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.
[37] 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.
[38] 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.
[39] Ludden, Jennifer, "Credit Card Companies Target Kids," *All Things Considered*, National Public Radio, February 6, 2005.
[40] Demos, "Retiring in the Red," January 19, 2004 at 3.
[41] 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.

risen steadily over the past decade[42] while about one in seven senior households paid more than 40 percent of their income towards their debts in 2001.[43]

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 of older Americans also have lower incomes.[44] 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.[45] Monthly minimum payment rates were reduced from around 5 percent of principal

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[42] 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.

[43] *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.

[44] Hanway, Steve, "Do Credit Card Habits Improve with Age?" Gallup News Organization, 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% of those aged 50-64.

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

owed in the 1970s to just over 2 percent by the turn of the century.[46] In 2005, 19 million credit card borrowers make only the minimum payments.[47]

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.[48] 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.[49] Moreover, payment habits for many cardholders are not static over time. 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 (OCC) 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.[50] CFA

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[46] Kim, Jane J., "Minimums Due on Credit Cards are on the Increase," *Wall Street Journal*, March 24, 2005.
[47] Der Hovanesian, Mara "Tough Love for Debtors," *Business Week*, April 25, 2005.
[48] Opinion Research Corporation, "Consumer Financial Services Survey," November 3-7, 2005.
[49] Credit Research Center, McDonough School of Business, Georgetown University.
[50] 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

has concluded that reduced minimum payments were a significant cause of increasing bankruptcies in the last decade.[51]

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.[52] Such a personalized disclosure is, unfortunately, not included in the recent bankruptcy law, which requires consumers to call a toll-free number to get information about how long it would take to pay off their balances.[53] 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.[54] Many major credit cards began increasing their minimum payments requirements in 2005, including

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Banking Practices, Chicago, June 3, 2003, in "Speeches and Congressional Testimony," *OCC Quarterly Journal*, Vol. 22, No. 3, September 2003 at 107.

[51] Consumer Federation of America, "Consumer Restraint Pressures Lenders to Reduce Credit Card Marketing and Credit Extension," January 18, 2000.

[52] Proposed in S. 1176 by Senators Akaka, Durbin, Leahy and Schumer.

[53] Public Law 109-8.

[54] 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.

Bank of America, Citibank, Discover and JP Morgan Chase,[55] in some cases to as high as 4 percent.[56] All issuers were required to fully phase in the changes by the end of 2006.[57]

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.[58] Since the increases took effect, consumers with interest rates above 20 percent have had to cope with payments that have roughly doubled.[59]

Targeting Consumers on the Brink of Financial Distress

Nothing illustrates the perverse incentives (and dangers) of the credit card market better than the marketing of cards to consumers with tarnished credit histories, or even worse, to those who are literally on their way to or just coming out of bankruptcy. For example, in the first half of 2007, as home mortgage foreclosures shot up and signs of a serious economic slowdown started to appear, some of the nation's largest credit card issuers increased the number of solicitations they mailed to sub-prime consumers by 41 percent compared to the first half of 2006.[60]

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[55] American Financial Services Association, "Credit Card Minimum Payments Going Up," *Spotlight on Financial Services*, April 2005.
[56] 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.
[57] Day, Kathleen and Caroline E. Mayer, "Credit Card Penalties, Fees Bury Debtors," *Washington Post*, March 6, 2005.
[58] Der Hovanesian, Mara "Tough Love for Debtors," *Business Week*, April 25, 2005.
[59] "Minimum Payments," *CardTrack*, September 6, 2006.
[60] Gavin, Robert, "Credit Card Companies Pursue Subprime Borrowers," *Boston Globe*, September 5, 2007.

Other major issuers and many smaller companies 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 sub-prime consumers will make two or three late payments a year, from which the industry can generate a separate fee, and that these fees can greatly exceed the interest payments on the small lines of credit themselves.[61]

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.[62] 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, has advertised on late-night and daytime television when more unemployed potential sub-prime customers are more likely to be watching television.[63]

In December of 2008, sub-prime card marketer Compucredit reached a settlement with federal regulators to provide at least $114 million in consumer redress and pay a $2.4 million fine for deceptive marketing of high-fee, low-limit credit cards. Among other allegations,

[61] Interview with Andrew Kahr, credit card industry consultant, "The Secret History of the Credit Card," *Frontline*, November 2004.
[62] OCC, Statement of Comptroller of the Currency John D. Hawke J., June 28, 2000.
[63] Pacelle, Mitchell, "Pushing Plastic," *Wall Street Journal*, November 5, 2004.

Compucredit was accused of marketing cards with a $300 limit, but failing to adequately disclose the $185 in fees that would be immediately charged to the card.[64]

Consumers exiting bankruptcy are often swamped with offers at prime terms – low interest rates and without annual fees.[65] Many bankruptcy attorneys believe these offers are being made because consumers leaving bankruptcy court cannot erase their debts for another six years. Under the new bankruptcy legislation consumers will not be able to wipe away any credit card debts for eight years. Some categories of credit card debt will not be "dischargeable" at all, no matter how long the consumer waits.[66]

## D. ISSUERS HAVE PURSUED ABUSIVE INTEREST RATE, FEE AND RISK MANAGEMENT POLICIES THAT HAVE A HARMFUL IMPACT ON MANY HOUSEHOLDS

There is considerable evidence linking the rise in bankruptcy in recent years to the increase in consumer credit outstanding, and, in particular, to credit card debt. For example, research by Professor Ronald Mann of Columbia University has found that an increase in credit card spending in the U.S. and four other countries has resulted in higher credit card debt, which is strongly associated with an increase in bankruptcy filings.[67] To make matters worse, credit

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[64] "Subprime Credit Card Marketer to Provide At Least $114 Million in Consumer Redress to Settle FTC Charges of Deceptive Conduct," Federal Trade Commission, Dec. 19, 2008, http://www.ftc.gov/opa/2008/12/compucredit.shtm.
[65] Mayer, Caroline E., "Bankrupt and Swamped with Credit Offers," *Washington Post*, April 15, 2005.
[66] *Ibid*.
[67] Mann, Ronald J., "Credit Cards, Consumer Credit and Bankruptcy," Law and Economics Research Paper No. 44, The University of Texas School of Law, March 2006.

card companies have become far more aggressive in implementing questionable fees and interest rate practices in recent years. 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.[68] In fact, consumers in debt trouble sometimes owe as much or more in fees and penalty interest charges, as in principal.

High fees and interest rates can often result in negative amortization, where the principal owed on 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. [69]

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.[70] In its findings in support of the Order, the bankruptcy judge listed claims filed in eighteen separate cases broken down between principal and interest and fees. On average, interest and fees consisted of more than half (57 percent) of the total amounts listed in the claims. In one case, the card company filed a claim in the amount of $943.58, of which $199.63 was listed as principal and $743.95 was listed as interest and fees. In another case, a claim of $1,011.97 consisted of $273.33 in principal and

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[68] Day, Kathleen and Caroline E. Mayer, "Credit Card Penalties, Fees Bury Debtors," *Washington Post*, March 6, 2005.

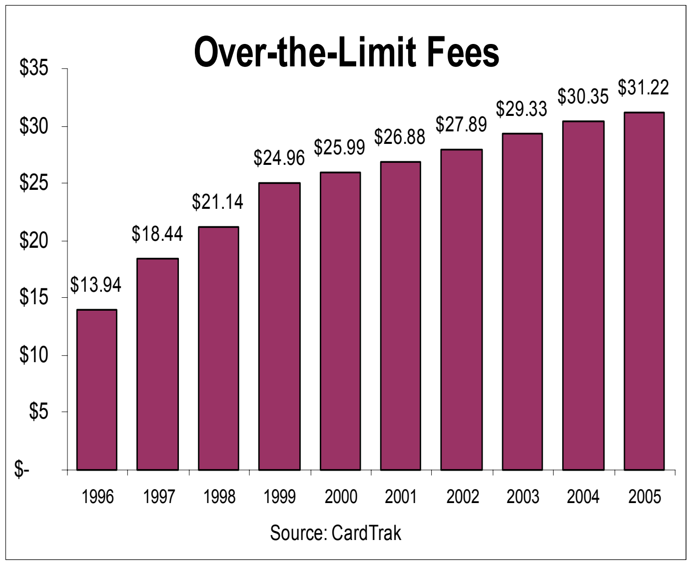
[69] National Consumer Law Center, "Responsible Consumers Driven into Default," February 22, 2005.

[70] *In re* Blair, No. 02-1140 (Bankrate. W.D.N.C. filed Feb. 10, 2004)

$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.[71]

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 Government 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."[72] 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.[73]




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

[71] National Consumer Law Center, "Responsible Consumers Driven into Default," February 22, 2005.
[72] "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.
[73] *Ibid*, p. 23.

in 2005,[74] representing about 242 million credit cards.[75] 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.[76] 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.[77] 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 increase from $12.53 in 1995 to $27.46 in 2005.[78] Even more striking, the GAO found that late fees paid by borrowers with typical balances were an average of $37 in 2005.[79] This is important to note as credit card issuers are increasingly assessing "tiered" fees based on the borrower's balance.

Credit card issuers used to reject transactions that exceeded a cardholder's credit limit, but it has become common for issuers to accept the transaction and then apply an over-limit fee on cardholders who exceed their credit limits.[80] 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

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[74] *Ibid*, p. 1.
[75] CFA calculation based on 691 million credit cards, *Ibid*, p. 9.
[76] "The Ugly Issuer," *Credit Card Management*, September 2004.
[77] Bergman, Lowell and David Rummel, "Secret History of the Credit Card," *Frontline*, November 2004.
[78] "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.
[79] *Ibid*, p. 20.
[80] "The Ugly Issuer," *Credit Card Management*, September 2004.

balance.[81] 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.[82] 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 vast 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.[83] 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. By 2008, 94% of new credit card solicitations included a penalty rate.[84] The average default rate in 2008 is 28.6 percent, up from 23.7 percent in 2003.[85] Even more striking, the spread between the

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[81] Bergman, Lowell and David Rummel, "Secret History of the Credit Card," *Frontline*, November 2004.
[82] "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.
[83] Consumer Action, 2005 Credit Card Survey, "Card Companies Use Common 'Risk Factors' to Impose Unfair Rate Hikes, Finds CA," *Consumer Action News*, Summer 2005.
[84] Frank, Joshua M., *Priceless or Just Expensive? The Use of Penalty Rates in the Credit Card Industry*, p. 10, Center for Responsible Lending (December 16, 2008), hereafter Frank, *Priceless or Just Expensive*., available at http://www.responsiblelending.org/pdfs/priceless-or-just-expensive.pdf.
[85] Id at 9. (The 2006 GAO report 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.)

penalty rate and the standard purchase rate more than doubled between 2000 (8.1%) and 2008 (16.9%).[86]

Some consumers with low-rate cards could have their interest rates double overnight for being late on one payment to their credit card.[87] 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.[88]

There is increasing evidence that those who can least afford these higher interest rates – financially vulnerable families – are most likely to be paying them. A study by the research organization Demos found that cardholders that carry debt who earn less than $50,000 a year are more than twice as likely to pay interest rates above 20 percent as the highest income Americans who carry debt. African-American and Latino credit card holders with balances are more likely than whites to pay interest rates higher than 20 percent.[89]

One recent study estimated that the cost of the penalty rate shock cost a revolver carrying the average $10,678 balance $1800 a year.[90] At a time when we are looking for ways to put money back in the hands of families, reducing this $150 a month surtax could have a real stimulative effect.

[86] Frank, *Priceless or Just Expensive*, at 9-10.
[87] Bergman, Lowell and David Rummel, "Secret History of the Credit Card," *Frontline*, November 2004.
[88] "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.
[89] Wheary, Jennifer, and Tamara Draut, "Who Pays? The Winners and Losers of Credit Card Deregulation," Demos, August 1, 2007.
[90] Frank, *Priceless or Just Expensive*, at 1.

Retroactive Application of Penalty Rates

All 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.[91] Some cards even apply penalty rates to debts that were already paid at a lower rate.[92] 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.

Even for consumers who clearly are becoming higher risk, such as those who are a full thirty days late in paying a credit card bill, it is harmful to cardholders and, ultimately, lenders to impose a retroactive rate increase on the existing balance. These families are struggling and need help getting out of debt; they should not be shoved deeper underground. Retroactive penalty interest rate hikes for these cardholders only increases the likelihood that they will completely default, which is in no one's interest. The primary effect of a punitive retroactive rate increase appears to be to escalate the proportion of the consumer's debt owed to the card issuer and to put the card issuer at an advantage over the consumer's other creditors. This

[91] Draut, Tamara, Director of the Economic Opportunity Program at Demos, Testimony Before the House Banking Committee Subcommittee on Financial Institutions and Consumer Credit, September 15, 2004, at 16-17.
[92] 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.

practice is unfair to creditors who do not escalate the debt owed by families having difficulty making ends meet.

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.[93] A review of credit card disclosures issued in October 2006 by Consumer Action found five major issuers that said they reserved the right to assess universal default interest rates. Since that time, Citigroup and JP Morgan Chase have said that they will not use the practice, although Citigroup changed this policy in the fall of 2008.[94] On the other hand, representatives for Bank of America and Discover testified before the Senate late last year that they still use consumer credit scores, at least in part, to trigger higher default interest rates.[95]

It is fundamentally unfair to impose a penalty interest rate on a consumer who has not made a late payment or defaulted on an obligation, especially when this rate increase is applied retroactively. Another concern with using credit reports to trigger a penalty rate is the problems with inaccuracies in credit scoring and credit reporting that CFA and other organizations have

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[93] Burt, Bill, "Pay One Bill Late, Get Punished by Many," *Bankrate.com*, January 20, 2004.
[94] Dash, Eric, "Despite Pledge, Citigroup to Raise Credit Card Rates, Blaming 'Difficult' Environment," *New York Times*, November 15, 2008.
[95] Credit Card Practices: Unfair Interest Rate Increases, U.S. Senate Permanent Subcommittee on Investigation, December 4, 2007.

documented.[96] Moreover, issuers who impose sharp interest rate increases on consumers who are meeting their obligations often fail to provide any rationale – much less a legitimate one -- for the increase. In January, Bank of America began increasing interest rates on some cardholders to as high as 28 percent but did not inform consumers the reason for the increase in the notification they mailed.[97]

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 belie 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 impact on the borrower's ability to repay than modest problems with another creditor.

Indiscriminate, Undisclosed Changes in Rates and Fees

Many credit card companies reserve the right to change the terms of their credit card contract at any time and for any, *or no*, reason. This allows credit card companies to arbitrarily raise interest rates even for cardholders in good standing and with perfect credit histories. Media reports of recent rate hikes by Bank of America demonstrate the unfairness of any-time/any-

[96] 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.
[97] "A Credit Card You Want to Toss," *Business Week,* February 7, 2008.

reason changes: some consumers saw their interest rates triple without explanation.[98] The result of these unfair clauses is that consumers can't depend on the interest rate promised to them.

In the last few months, JP Morgan Chase has begun charging approximately 400,000 cardholders a $10 a month fee. It is also increasing the minimum payment amount for these consumers from 2 to 5 percent, a substantial amount. Many of these cardholders appear to have been promised a fixed interest rate for the life of the balance.[99]

Pricing Tricks: Double Cycle Billing and Manipulation of Payment Allocation

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.[100] Since then, one of these issuers, JP Morgan Chase, has announced that it will no longer use double-cycle billing. 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.

[98] Ibid.
[99] Chu, Kathy, "Chase Adds Fee for Low-Rate Credit Cards," *USA Today*, February 9, 2009.
[100] "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.

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.[101] The actual proportion of large issuers who in effect use this policy is likely closer to 100 percent since the remaining five issuers applied payments "subject to their discretion". 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. Furthermore, a recent study has shown this payment allocation policy and its impact to be very poorly understood by consumers.[102] The study also showed this issuer policy causes pricing to be less related to risk, the opposite of what issuers claim they wish to achieve.

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.[103] In 2002, penalty fees and interest made up 76.8 percent of the industry's $97.1 billion in revenues. For the

[101] *Ibid*.
[102] Frank, Joshua M., *What's Draining Your Wallet? The Real Cost of Credit Card Cash Advances*, Center for Responsible Lending (December 16, 2008), available at http://www.responsiblelending.org/pdfs/whats-draining-your-wallet.pdf.
[103] Daly, James J., "Smooth Sailing," *Credit Card Management*, May 2004 at 31.

approximately 88 million credit cardholding households, penalty fees and interest on their credit card debt cost an average of $830 in 2003.[104]

Unsavory Credit Limit Practices

In its 2008 survey of credit card terms and conditions, Consumer Action identified some unsavory credit limit practices used by major credit card issuers. While reducing credit availability can be a responsible way for credit card issuers to manage growing financial risk during difficult economic times, these aggressive credit line policies can harm consumers. Each in its own way puts consumers at greater risk of being charged higher interest rates, falling deeper in debt, and causing a ripple effect among issuers. Consumers reported some credit limit practices to Consumer Action that are patently unfair.

- Following you down. As consumers pay off large balances, the credit limit is reduced so that the balance is always close to the credit limit.
- Sorry, you're over limit. Credit limits are reduced to levels lower than the current balance, triggering over limit fees and requiring a large "balloon" payment of the over-due amount. This practice also puts the consumer at risk of being hit with a penalty interest rate.
- Where's my credit limit? Cards are declined at the point of purchase, and only then do cardholders find out that their limits have been reduced with no warning.

[104] CFA calculation from Daly, James J. 2004 and Census Bureau figures.

- Ganging up on consumers. One credit card issuer lowers your credit limit, which lowers your credit score, which causes another of your cards to lower your credit limit.

The Combined Effect of Abusive Practices during the Recession

Although credit card issuers have curbed aggressive marketing and cut back on credit extension in the last year, they appear to be accelerating the use of many of the irresponsible and harmful practices detailed above to cut or mitigate their losses. For example, card issuers have used their ability to unilaterally change the terms of credit card contracts by raising interest rates even as the Federal Reserve has sharply reduced the federal funds rate.[105] They have also added new fees,[106] increased the amount of fees,[107] and, as detailed above, used harmful rather than responsible methods to lower credit lines. Citigroup back-peddled last fall on its promises not to increase interest rates "at any time for any reason."[108] As mentioned above, Chase has suddenly started charging hundreds of thousands of cardholders fees of $120 a year, while sharply increasing the monthly amount that these cardholders owe each month. Bank of America and Capital One have used vague clauses in cardholder agreements to raise interest rates on cardholders because of "market conditions."[109] Issuers have every right to try and limit their losses during the current economic crisis if they act responsibly, but the use of these harmful,

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[105] Trejos, Nancy, "Less Power to Purchase, Consumers' Credit Card Limits Slashed as Companies Try to Reduce Risk," *Washington Post*, November 16, 2008.
[106] Lieber, Ron, "Credit Card Companies Go to War Against Losses," *New York Times*, January 31, 2008.
[107] Trejos, Nancy, "Less Power to Purchase, Consumers' Credit Card Limits Slashed as Companies Try to Reduce Risk," *Washington Post*, November 16, 2008.
[108] Dash, Eric, "Despite Pledge, Citigroup to Raise Credit Card Rates, Blaming 'Difficult' Environment," *New York Times*, November 15, 2008.
[109] "Card Rates Rise 'Out of the Blue,'" *The Oregonian*, January 25, 2008. Kimes, Mina, "Card Companies Jacking Up Rates," *Cable News Network*, http://money.cnn.com/2008/09/26/news/economy/creditcards_kimes.fortune/.

unjustified and sometimes arbitrary practices is contributing to the economic insecurity of millions of families who thought they were complying with their obligations.

When "Risk-Based" Pricing is 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 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."[110] It is becoming more apparent that many of the most abusive fees and interest rates are assessed simply because it is what the market will bear.

The amount of fees and penalty interest rates do not appear to be proportional to the risk or cost incurred by issuers. For many years, issuers have justified "sticky" interest rates that rise

[110] Testimony of Adam J. Levitin, Associate Professor of Law, Georgetown University Law Center, before the Subcommittee on Financial Institutions and Consumer Credit of the Financial Services Committee of the United States House of Representatives, March 13, 2008.

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 of a short duration – 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 rises when the cost of funds declines. 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.[111]

In response to these "tell-tale" signs of price gouging, it is time for issuers to provide more information to lawmakers and to the public about their real costs to demonstrate that their pricing practices are truly fair.

[111] "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.

## E. AMERICANS ARE HIGHLY CRITICAL OF MANY CURRENT CREDIT CARD PRACTICES

Our organizations regularly conduct public opinion surveys regarding consumer attitudes and behavior. We have rarely encountered the kind of broad, nearly universal condemnation that Americans have for many common practices used by credit card issuers regarding interest rates, fees and the extension of credit.

For example, a nationally representative poll of 1,005 adults conducted by the Opinion Research Corporation for the Consumer Federation of America from September 13 to September 16, 2007 found that:

- 82 percent of Americans think it is unfair to offer several credit cards to a student with little income. (62 percent believe it is very unfair.)
- 91 percent of Americans think it is unfair to raise interest rates or fees at any time for any reason. (76 percent believe it is very unfair.)
- 83 percent of Americans think it is unfair to increase the interest rate on one card because of a person's payment history on another card. (62 percent believe it is very unfair.)
- 84 percent of Americans think it is unfair to apply interest rate increases not only to new balances but also to past balances. (61 percent believe it is very unfair.)
- 85 percent of Americans think it is unfair to increase an interest rate to 30 percent for making two late payments. (64 percent believe it is very unfair.)
- 76 percent of Americans think it is very unfair to charge $30 for making a late payment. (51 percent believe it is very unfair.)

- 82 percent of Americans think it is unfair to charge a $30 fee each month if a balance is over the credit limit when a person is no longer using the card. (64 percent believe it is very unfair.)
- 90 percent of Americans think it is unfair to charge $10 for payment by phone. (72 percent believe it is very unfair.)
- 80 percent of Americans think it is unfair to not allow a person to pay off higher-interest rate debt first, such as on a cash advance, but instead applying payments first to lower-rate debt. (54 believe it is very unfair.)
- 81 percent of Americans think it is unfair to have only one week between the time a person receives a monthly statement and the time he or she must mail the payment. (54 percent believe that it is very unfair.)
- 93 percent of Americans think it is unfair to charge a late fee even though a person has mailed the payment a week or more in advance of the due date. (79 percent believe that it is very unfair.)
- 71 percent of Americans think it is unfair to require that disputes be settled by mandatory arbitration without being allowed to go to court. (45 percent believe that it is very unfair.)

## F. FEDERAL RULE ON UNFAIR AND DECEPTIVE CREDIT CARD PRACTICES

On December 18, 2008, the Federal Reserve Board, the Office of Thrift Supervision and the National Credit Union Administration issued a final rule to curb unfair and deceptive practices by credit card issuers. The rules would not take effect until July 1, 2010.[112]

The new rule would prohibit or restrict a number of abusive practices, including:

[112] Federal Reserve System, 12 CFR Part 227 [Regulation AA; Docket No. R-1314]; Department of the Treasury, Office of Thrift Supervision, 12 CFR Part 535 [Docket ID. OTS-2008-0027] RIN 1550-AC17; National Credit Union Administration, 12 CFR Part 706, RIN 3133-AD47; Unfair or Deceptive Acts or Practices.

- **Interest rate increases on existing balances, unless the cardholder is more than 30 days delinquent.** The rule would not prohibit prospective "universal default" rate increases because of a supposed problem that the cardholder has with another creditor. It does eliminate the practice as applied retroactively, which has provided a major financial incentive for issuers to use it. The rule would also prohibit issuers from increasing interest rates on existing balances because a cardholder has made a minor mistake, such as paying late by a few days.

- **Payment allocation methods that cause debts to escalate**. Credit card issuers would be required to more fairly apply the payments that cardholders make to balances with different interest rates. When consumers transfer balances with low, short-term "teaser" rates (that have higher rates for new purchases), or take out high-rate cash advances, issuers would be required to apply payments either to the higher rate debt or to both the higher and lower rate debt proportionately. Currently, credit card issuers apply payments only to the lower rate debt.

- **Interest charges on debts that have already been paid**. The proposal would forbid "double cycle billing," which results in cardholders paying interest on debts paid off the previous month during the grace period.

- **Excessive fees for low-credit cards**. The proposal would forbid credit card companies that target consumers with poor credit histories from requiring consumers to pay fees that amount to more than half of the credit being offered, if those fees are charged to the card that is being issued. If the fees being charged to the card amount to more than one-quarter of the credit line, cardholders would be allowed to pay these fees off over a six-month period.

The rule is an important first step in stopping issuers from using some unfair and deceptive practices to increase the amount of debt consumers owe. However, it is not helpful to consumers struggling to pay off hefty debts in the middle of a recession to allow issuers to continue to use for another year and a half practices that federal regulators have deemed to be abusive. We urge this Committee to provide consumers with more timely relief, and to address abusive practices that are not targeted or completely eliminated by the rule. The Credit CARD Act achieves both of these goals. (See Section H for discussion of this and other legislation introduced in the Senate.)

## G. ENSURING THAT CREDIT CARD ISSUERS RECEIVING GOVERNMENT ASSISTANCE OFFER LOANS THAT ARE FAIR AND SUSTAINABLE

As part of the federal government's efforts to rescue the financial sector, credit card banks are receiving taxpayer assistance in several forms, including through the direct infusion of funds and the Troubled Assets Relief Program (TARP). On February 10th, Treasury Secretary Geithner announced that he would expand an additional program designed to make consumer credit more widely available. The Term Asset Backed Securities Loan Facility (TALF) would use the Federal Reserve Board's credit facility power, be operated by the Federal Reserve Bank of New York, and include a special purpose vehicle capitalized from TARP funds. Initially, the program was to use $20 billion to support a program for up to $200 billion in non-recourse loans to buyers of securities backed by non-mortgage debt, including consumer credit card debt. In other words, buyers of credit card securitizations would be able to borrow funds from the Federal Reserve Bank of New York to purchase these securitizations, with repayment from revenues from the securitized credit card debts. Secretary Geithner said he wants to expand the program to support between $500 billion and $1 trillion in lending.

A diverse coalition of more than twenty organizations led by Consumers Union has called on Secretary Geithner to require that any securitized debt whose purchase is financed through this program meet standards for fairness and truthfulness, including those standards were finalized in December 2008 by the Federal Reserve Board.[113] The groups sought this change to ensure that any consumer credit card debt facilitated through this taxpayer-backed program will promote, rather than damage, household economic stability.

Specifically, the organizations called on Secretary Geithner to impose two minimal eligibility conditions on all financing by the TALF for credit card securitization pools:

1. Immediate compliance with details of the rule against unfair or deceptive acts or practices for all consumer credit card debt in the pool; and

[113] https://mail.consumerfed.org/exchweb/bin/redir.asp?URL=http://www.consumersunion.org/pdf/TALF.pdf.

2. A specific program for cardholders to earn a reduction in penalty interest rates back to a lower standard rate after no more than six months of on-time payments for all consumer credit card debt in the pool.

Any government backed program to make capital available for credit card debt must be limited to that credit card debt which is not associated with practices that federal regulators have determined to be unfair or deceptive. Federal backing of credit card securitizations must also be limited to credit card debt with a clear "road map" to non-penalty rates for households who pay on time while under a penalty rate.

A stated purpose for the Troubled Assets Relief Program (TARP) is to restore stability to the financial system. However, the first installment of TARP money did not even begin to promote financial stability for borrowers, homeowners, and communities in the face of the tide of foreclosures, onerous credit card practices, and the crying need for affordable, sustainable, systematic loan modifications. The new TALF program for non-mortgage debt should limit its offer of liquidity to avoid the type of credit card debt that detracts from sustainable lending and household financial stability.

Providing more capital for credit card lending will not meet the national need for enhanced financial stability for households if the credit card debt that is facilitated under the TALF can continue until July 1, 2010 to contain the harmful terms and practices that the Federal Reserve Board and two other federal regulators have identified as unfair or deceptive. The challenges for the U.S. economy are great. Consumers cannot be the engine of economic recovery if they are burdened with high interest rate credit card debt that federal regulators have determined is not justified. Any further taxpayer assistance to credit card issuers must include conditions that will ensure that the credit provided will promote, or at least not be detrimental to, family economic stability.

## H. SENATE CREDIT CARD LEGISLATION

The Credit CARD Act

For more than a decade, Senator Dodd has often been a lonely voice for credit card reform in Congress. Our organizations commend Senator Dodd and his co-sponsors for introducing a comprehensive proposal that provides a range of protections for consumers well beyond that provided by the federal regulators' rule. The Credit CARD Act of 2008 targets the most abusive practices used by credit card issuers, including:

- **Eliminates unjustified interest rate hikes and unfair "any-time/any-reason" contract clauses.** Card issuers would be required to adhere to the basic principle of fair dealing — a deal is a deal. The Credit CARD Act prevents card issuers from hiking interest rates retroactively on existing balances except for adjustments to variable rates or teaser rates that expire. This will require issuers to be honest about the price of a card up front, rather than using bait and switch tactics and hair trigger penalty rates to double or even triple the rate on debt already incurred. The bill also eliminates the widely-decried practice of "universal default" — raising rates for cardholder behavior unrelated to the card — and card issuer use of "any-time/any-reason" fine-print clauses to impose arbitrary rate hikes.

- **Prohibits retroactive interest rate hikes and requires honest, fair penalty rates.** Under the Act, issuers would not be allowed to increase the interest rate on purchases already made when the rate was lower, though prospective interest rate increases would be allowed. If the issuer does impose a penalty rate, it must tell the consumer exactly why and limit the penalty to six months if the consumer commits no further violations. Issuers must tell consumers in the card agreement the specific actions that will trigger a penalty rate, such as paying late by more than 30 days. Currently, issuers often impose penalty rates for minor transgressions or for no reason the consumer can even discern.

- **Limits excessive and growing penalty fees.** The Government Accountability Office reports that penalty fees have increased sharply in the past ten years, faster than the cost of living (late fees now approach $40). The Credit CARD Act would require that penalty fees be reasonably related to the costs that credit card issuers incur because of a late payment or over-limit transactions and would appropriately prohibit card issuers from charging interest on penalty fees.

- **Prohibits late fees for on time payments**. The Act would prohibit late fees upon proof of mailing seven days prior to the due date and rein in the trend toward ever-shrinking repayment periods that have led to increased imposition of late fees by requiring card issuers to mail cardholders' statements within 21 days of the due date.

- **Gives cardholders greater choice.** First, the Act would allow consumers to instruct the issuer to deny any transaction that would trigger an over limit fee. Today, consumers are charged over-limit fees even when the card issuer approves the transaction that triggers the fee. Second, the Act would require card companies to provide consumers with at least 45 days notice before increasing their interest rate, giving the consumer time to find an alternative credit card provider. Third, it would give consumers the absolute right to cancel the card when the interest rate is increased and prohibit the application of the interest rate hike when the account has been closed. And fourth, consumers' would have the right to reject a card before the account is added to their credit report. Currently, when consumers respond to card solicitations based on a favorable promotional rate but then receive a card with far less favorable terms, the account appears on their credit report before they have the right to reject the modified terms.

- **Eliminates abusive and hidden finance charges.** First, the Credit CARD Act prohibits card issuers from imposing finance charges on balances repaid during the grace period. This so-called practice of "double-cycle" billing is both hidden from consumers and difficult to understand even when consumers are aware of it. Second, when consumers hold balances at different interest rates on the same card, card issuers would be required to allocate any payments made to the highest rate balance first. Currently, card issuers often prohibit consumers from paying off high-interest rate balances until the lowest-rate balance is reduced to zero — a practice that is almost never in the cardholder's best interest because it imposes excessive finance charges and causes higher APR balances to compound without any reduction in the higher rate portion of the balance.

- **Limits aggressive marketing, and irresponsible lending, to young consumers without the ability to repay debt.** Credit card issuers would be unable to provide credit cards to consumers under age 21 unless the consumer has a responsible cosigner, can demonstrate ability to repay, or takes a certified financial literacy or financial education course. In addition, consumers under the age of 21 would be allowed to choose whether to allow credit reporting agencies to sell their name to an issuer sending credit card solicitations. Card issuers could only send credit offers to young consumers prescreened by a credit reporting agency if they receive express, advance consent.

By exceeding the requirements of the recently finalized credit card rule finalized by federal regulators or targeting abuses not addressed by the rule, the Credit CARD Act would offer significantly more protection to consumers. Provisions that exceed the rule's requirements include the complete prohibition of the practices of universal default and the assessment of retroactive interest rates. In contrast, the credit card rule would not prohibit card issuers from increasing interest rates because activity unrelated to the card, if the increase is applied to new purchases. The rule would also continue to allow issuers to assess rate increases on existing balances when the borrower pays late by more than 30 days. At a time of economic crisis, when Congress is considering legislation to assist mortgage borrowers who have fallen behind on loans, it is not good public policy to allow issuers to double or triple interest rates on existing balances for credit cardholders who have missed a payment. In these cases, issuers should be encouraged to take other, less damaging steps to limit their financial risk, including the responsible reduction or freezing of credit lines. The Credit CARD Act also provides more protection to consumers than the federal rule by requiring issuers to allow consumers to pay off their lowest interest rate debt first, rather than providing issuers with the choice of allowing cardholders to pay off both high and lower interest rate debts proportionately.

Provisions of the Credit CARD Act that target serious, abusive practices that are not addressed at all by the credit card rule, include: prohibiting "any-time, any-reason" changes to fees and rates; requiring issuers to ensure that penalty fees are reasonably related to the costs they incur; mandating that penalty interest rates must be lowered after no more than six-months of on-time payment by the cardholder; providing young consumers with a real choice about whether they want to receive credit card solicitations, and prohibiting issuers from offering loans to consumers between the ages of 18 and 21 unless they have the ability to repay the amount offered.

Taken together, the reforms offered in the Credit CARD Act would make the credit card marketplace fairer and more transparent. By prohibiting issuers from using questionable methods to sharply increase "back end" fees and interest charges, this bill would shift pricing in the industry to the "front end," especially the initial interest rate. It would encourage issuers to compete to attract consumers based on those initial charges, and to use responsible risk-management techniques to manage their financial exposure if the risk profile of the borrower declines over time. The bill would not stop issuers from using responsible risk-based pricing methods to establish initial interest rates or to change them prospectively if the borrower's credit worthiness declines.

Other Senate Proposals

We also commend Senators Schumer and Udall, Senator Levin and Senator Menendez for the legislation they have introduced to curb abusive credit card practices. The Schumer/ Udall bill (S. 235) would largely codify the credit card rule finalized by federal regulators, with a few improvements and additions. It is the companion to legislation proposed by Representative Carolyn Maloney in the House of Representatives, which passed that body by a large bipartisan majority in September of 2008. Senators Levin and Menendez have offered sweeping proposals that have common provisions with each other and with the Credit CARD Act. Of particular importance to consumers is a requirement, which both the Levin (S. 1395, 110$^{th}$ Congress) and Menendez bill (S. 392) contain, that is designed to prevent sharp, unaffordable increases in interest rates. The bills would prohibit credit card issuers from increasing interest rates for any reason by more than 7 percentage points.