H.R. 5244, THE CREDIT CARDHOLDERS' BILL OF RIGHTS: PROVIDING NEW PROTECTIONS FOR CONSUMERS

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

APRIL 17, 2008

Printed for the use of the Committee on Financial Services

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THURSDAY, APRIL 17, 2008

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H.R. 5244, THE CREDIT CARDHOLDERS' BILL OF RIGHTS: PROVIDING NEW PROTECTIONS FOR CONSUMERS

Thursday, April 17, 2008

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

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Carolyn B. Maloney [chairwoman of the subcommittee] presiding.

Members present: Representatives Maloney, Watt, Ackerman, Moore of Kansas, Waters, Green, Clay, Miller of North Carolina, Scott, Cleaver, Bean, Davis of Tennessee, Hodes, Ellison, Foster; Biggert, Castle, Feeney, Hensarling, Garrett, Neugebauer, Davis of Kentucky, Campbell, McCarthy of California, and Heller.

Ex officio present: Representatives Frank and Bachus.

Also present: Representative Udall.

Chairwoman MALONEY. I would like to call this hearing to order. Before we begin this legislative hearing on H.R. 5244, the Credit Cardholders' Bill of Rights, I would like to thank my colleagues on the Republican side, Ranking Member Bachus and Congresswoman Biggert, and their staffs for working with us to make this hearing possible. There have been a number of issues that we have had to work through, but I am pleased that we have been able to do this in a constructive and bipartisan manner. I also would like to thank the staff of the full committee and my own staff for all of their hard work in putting this together.

I would also like to state that this morning we will have consumer witnesses testifying before the committee. To ensure an open debate, we have asked them to sign an authorization that allows us to work within the relevant privacy laws, allows the committee to receive information about their accounts from their issuers, and allows the issuers to respond publicly regarding their testimony.

At this time, I would like to ask unanimous consent that we keep the hearing record open for 30 days to allow our witnesses and their respective issuers to submit any information relevant to their accounts and to this hearing.

[No response]

Chairwoman MALONEY. Hearing no objection, it is so ordered. I would also like to ask unanimous consent that Congressman Mark Udall of Colorado be allowed to fully participate in today's hearing.

[No response]

Chairwoman MALONEY. Hearing no objection, it is so ordered. I yield myself as much time as I may consume.

I am delighted to welcome the witnesses to the second of two legislative hearings on H.R. 5244, the Credit Cardholders' Bill of Rights. I introduced this bill with Chairman Frank about 2 months ago, and it now has over 101 co-sponsors to date and has received 10 editorials in support from national and regional papers.

The core principle of our bill is notice and choice. Cardholders or consumers should not be trapped by high interest rate increases to which they did not agree and that are applied retroactively to their existing debt, causing it to balloon. As you will hear from our witnesses on the second panel, even cardholders who are financially responsible and do their very best to meet their obligations fall victim to rate hikes that are unexplained, totally out of proportion, and which have driven them deeper into debt.

For example, Steve Autrey—you will be hearing from him later—had a fixed rate of 9.9 percent and he paid his bill on time every month for 8 years. He never went over his limit, except once when interest charges on the account put him over his limit. And he was never late in payment, except once, by one day. Nevertheless, his issuer raised his credit card interest rate from 9.9 percent to 15.9 percent, and when he complained, they told him that they reserved the right to raise fixed interest rates, even for good customers.

Under our bill, card companies would have to spell out in advance all the specific reasons they could raise the rate, not just say that they could do it anytime, for any reason. And, they could not call a rate fixed unless it was really fixed. Cardholders faced with any rate increase would have the right to cancel the card and pay off the balance at the old rate.

Banks argue that interest rates are based on the risk presented by the customer, but as Senator Levin's hearing this winter showed, and I congratulate the Senator on his work and for being with us today, a single customer can end up with different rates from the same issuer, which on its face is inconsistent with the idea that the rate is based on the risk.

Our second cardholder who is testifying today, Susan Wones, has three credit cards from the same issuer, each with a different interest rate. On one of her cards, she has paid on time each month and never went over her limit. However, her rate went up from 14 percent to 25 percent. The reason she was given was that she was getting too close to her credit limit and that this made her a riskier customer. However, she has another credit card with the same issuer at 7.9 percent that they never changed the interest rate on, and she was able to get a third from the same issuer with an introductory offer of 0 percent. Mrs. Wones' card company raised her rate even though she did not pay late or even go over her limit at the end of the month. Our bill would ensure that a customer like Mrs. Wones never has an interest rate increase on her existing balance.

our third consumer witness today, Steve Strachan, is from York, Pennsylvania, where he runs a small business. He has a credit card score in the high 700s, close to perfect, which is critical to managing his company. But over the years, the interest rates on several of his cards have been raised for no other reason than the fact that he has used the credit limit he has been given. Again, our bill would ensure that a customer like Steve Strachan could never get an interest rate increase on his existing balance and could opt out of any future rate increases.

We need to be very clear about the real world consequences of interest rate increases. They cause minimum payments to shoot up and make it very hard for people to ever get out of debt.

I would like to show this one example that is on the easel down there, and it shows the example of a borrower who borrowed $1,000 at 15 percent. You can pay that off in just under 9 years with minimum payments, and end up paying about $600 in interest. If your rate goes up to 30 percent, it will take you over 24 years to pay off the loan making minimum payments, even though those payments would be much larger, and you would pay almost $4,000 in interest for that same loan of only $1,000. We all have constituents who have written us with stories like these.

This bill attempts to put some of the responsibility for fair dealing back on the card companies and to give cardholders the tools they need to control their finances and make sure they can pay back their debts responsibly by requiring card companies to give cardholders advance notice of any interest rate hike and the right to say no to borrowing more money at a higher rate than they originally agreed to.

The bill also stops tricks and traps that make cardholders incur rate hikes and pricey fees and empowers cardholders to set limits on their credit. It shields cardholders from misleading terms like so-called "fixed rates" that are not really fixed, and protects the most vulnerable consumers from fee-heavy subprime cards.

Finally, it gives Congress the tools to provide better oversight of the credit card industry. The bill sets no price controls, no rate caps, and no fees. It does not dictate any business model to credit card companies.

I believe that it is a much needed correction to a market that has gotten wildly out of balance. A credit card agreement is a contract between a card company and a cardholder, but what good is a contract when only one party has any power to make any decisions? Cardholders deserve information and the right to make decisions about their own credit.

That is what our bill does. It simply gives cardholders notice and choice.

I would like to say that obviously credit cards are a very important part of our economy, and we just want them to be fair to consumers. If a consumer does not like the deal their card companies are giving them, they can go elsewhere without getting hit with a big rate increase on their existing debt. That is the free market at work.

The principles in this bill are not radical. In fact, several leading card companies, including Citibank, JPMorgan Chase, and Capital One, for example, have voluntarily said that they will no longer practice universal default or double-cycle billing or continue with the practice of increasing interest rates anytime for any reason. I applaud such moves. This bill just raises everyone to the best standards that these companies have already incorporated. These are three of the most important parts of the bill that we have before us.

The principle that a deal is a deal is as American as apple pie. This bill makes that principle apply to credit cards just as it does elsewhere.

I look forward to the testimony, and I now recognize my colleague and good friend Judy Biggert for as much time as she may consume.

Mrs. BIGGERT. Thank you, Madam Chairwoman, and I would also like to thank the witnesses for coming today, especially those on the third and fourth panels, whose testimony is likely to be heard well after Congress adjourns and Members head to the airport unless we move forward at a rapid rate. But I just want these witnesses to know that their testimony coming later in the day is no less important to me and my colleagues and we thank you for your patience.

First I think it is good for all of us to remember just how credit cards have evolved over their relatively short history. They used to be products for a few wealthy individuals who could afford sizable annual fees and 20 percent interest rates. Now, credit cards are for all borrowers, from the lowest income individual, and they can offer interest rates starting at 0 percent.

Part of this success story is due to technology, innovation, and competition, which have allowed card issuers to assess a borrowers' creditworthiness and set a risk-appropriate card rate and limit. Americans have thousands of cards to choose from. They have greater access to credit, access to cheaper credit, and access to financial education and counseling on financial matters.

The success story of credit cards is often overlooked, and today, instead of taking out other loans using a store layaway plan or cash, millions of Americans, three quarters of Americans each day, choose to use plastic to pay the electric bill, take a family vacation, buy books for school, start a business, or even buy a cup of coffee.

There is no question that until recently, regulations have not kept up with this rapid credit card evolution. Not long ago, the Federal Reserve recognized that consumers needed better information to shop for a credit card and understand their responsibilities and obligations when it comes to their credit card contract. Hence, was born Regulation Z, and I look forward to our conversations about Reg Z, as well as updates to the Unfair and Deceptive Practices Act today to learn how these two regulations will inform and protect consumers. Borrowers need transparency. They need to know what the terms of their contract are simply, clearly, and reliably. On this, I agree with Chairwoman Maloney.

My goal is to make sure that the many are not punished for the transgressions of the few. In our weakened economy, or any economy for that matter, it is critical that we address the problems of a few customers or the abuses of a few issuers. We don't force the majority of credit card borrowers from low income to high income to pay for it with increased costs, fewer credit options, or worst-case scenario, no credit at all. We must first do no harm.

As I said last month, I am inclined to reserve judgment on this bill, H.R. 5244. I want to hear the results. We in Congress authorize the Fed to undertake a revision of Reg Z, the Fed's 4-year intensive expert review utilizing consumer focus groups and other sound methodology, would seem to be just as worthy of our consideration as is the anecdotal, if not dramatic evidence as presented by today's witnesses. In addition, I look forward to the Fed's promulgation of updated rules regarding the Unfair and Deceptive Practices Act.

Do consumers need improved and more helpful disclosures? Do they need information so they can have the tools to make more informed decisions about choosing a credit card, about their card, or about borrowing, in general?

Finally, what is the best way to address these matters? Is it through education, legislation, regulation, self-regulation, in other words, letting the marketplace and competition work for the consumer? Or is updating disclosures and cracking down on unfair and deceptive practices the answer?

I must say that once again, after reviewing data, studies, and testimony, at this time it appears that regulation and education should at least be among the first steps. Should the Congress step in on the basis of a few cases and testimony and preempt the Fed? I am not sure that is the answer.

With that, I look forward to hearing from today's witnesses, and I yield back.

Chairwoman MALONEY. Thank you. The Chair recognizes the distinguished chairman of the full committee, Chairman Frank, for as much time as he may consume, and thanks him for his hard work on this bill.

The CHAIRMAN. Madam Chairwoman, you deserve the credit for formulating and bringing this bill forward, and it is my hope that we will actually be acting on it this year.

I am very pleased to see our Senate colleagues, including my classmate, the Senator from Oregon, as well as the Senator from Michigan who has taken such an important lead on this. For someone who grew up in the era of Senator Joseph McCarthy as I did, seeing under Senator Levin's leadership the subcommittee that was the McCarthy subcommittee put to different uses is a sign that sometimes things do get better, as he chairs that subcommittee.

I first want to say that there has been some discussion of the glitch involving waivers and the inability of people to testify last time. I know we are not supposed to lapse into languages other English, it gets some people all jittery, but I hope in the spirit of the Pope being here, I will be allowed to say, "mea culpa." I was not supervising that process as well as I should have been. There were other things going on; I don't think anyone was ill-intentioned. I made the final decision to postpone the testimony of those witnesses because we had not done it in a way that met my own internal standard of fairness, so I apologize. I don't want to carry it too far, it is not "mea maxima culpa," but it is "mea culpa."

The next point I want to make is, to my friends in the banking industry, to the extent that we are doing anything binding here, it is saying that you can't retroactively raise people's interest rates. I know it is nice to be able to do that. We would all like to have the freedom to make as much money as we can in reasonable ways, but I do want to caution you. The argument that we should not act retroactively, the argument that we should not interfere with existing arrangements, has been a very powerful protection for people in the financial industry when people get angry. I think you would be ill-advised to erode that.

And I understand you can say, "But we had that right in the contract." No one believes that those contractual rights really meet our normal view of contract, and for the banking industry to resist our saying that whatever you do, you can't apply it retroactively, would be to set a precedent with regard to a number of other issues that I do not think you will want to see followed, but you do understand we are now going to be talking about whether or not we help people who made unwise decisions with mortgages. Resistance to that is less than it was before the Federal Reserve stepped in to help the counter parties of Bear Stearns.

Logically there is not a connection, but as people understand, one of the important principles of legislation is that the ankle bone is connected to the neck bone, and once you do something in one place, you may see it again. So I advise you not to resist this notion that you do not undo things retroactively.

Finally, I did want to comment on the last remarks of my good friend from Illinois, and she will have a right obviously to respond later on, but I think she gets it backward when she says that the Congress should not preempt the Fed. I am a supporter of the Federal Reserve system, but I do not find it in the Constitution. I do find Congress there.

When you say we shouldn't do this legislatively, we should do it by regulation, remember that regulation does not spring from the earth. Regulation is only in pursuant of statutory authority granted by this Congress, and the notion that the legislative body should defer to the regulators gets it backward. The regulators get their instructions from the Congress, and I would think that the notion that we should not preempt the Fed; I would disagree with that. I think it is appropriate for us to take some action. To be honest, as I look back at the subprime crisis, and the decision of Mr. Greenspan not to do anything for a long time, I wish we had been able more vigorously to preempt him.

So I thank the Chair again for convening this hearing. I think she has a very reasonable approach, and I hope we will be able to move forward.

Chairwoman MALONEY. The Chair recognizes Congressman Bachus for as much time as he may consume.

Mr. BACHUS. Thank you, Chairwoman Maloney, and I also commend you for holding this second hearing on the credit card bill of rights. Senators Levin and Wyden, I welcome you to our committee. We very much look forward to your testimony. By your presence, I acknowledge that this is an important hearing. It is important to all of our constituents.

Credit cards are a valuable financial resource and convenience for those we represent. Americans rely on them every day. They are convenient, and they make life a lot simpler for many American consumers.

There is, however, a widespread perception that credit card consumers are sometimes treated unfairly in their relations with credit card companies. We have heard that from our constituents. We have had many conversations on this committee and with constituents about complaints regarding the credit card industry and practices. I think it is a given that these agreements are complex and they are confusing to most Americans. Many of these conversations involve anecdotal accounts of problems faced by credit card customers.

Today, we have those customers before us in a panel, and we will listen to them. They will present to us the problems that they encountered and the credit card companies are here to respond and discuss the actions and practices that they took with regard to these specific customers, and I think this will be enlightening.

This hearing will be a valuable contribution toward us understanding this critical part of our credit system, and hopefully will inform our future deliberations on credit card reform, which I believe this committee believes is necessary. In fact the industry has acknowledged that reform is necessary. In closing, and this is probably the most important thing I will say, and the chairman referred to this, we have waited a long time for the Federal Reserve to issue final regulations regarding industry practices and consumer protection. They are long past due and I, for one, look forward to receiving them in the very near future. They should have already been here.

Thank you again, Chairwoman Maloney, for holding this hearing, and thanks to our witnesses for being with us today.

Chairwoman MALONEY. Congressman Moore is recognized for 3 minutes.

Mr. MOORE. Thank you, Madam Chairwoman, and thank you for convening this important hearing today.

Prior to the introduction of H.R. 5244, Mr. Castle and I and several other bipartisan members of this committee sent a letter to the Office of the Comptroller of the Currency asking for their advice and expertise concerning various proposals to increase regulation of the credit card industry. Yesterday, we received a response from Comptroller Dugan at the OCC, and I would ask unanimous consent that both our letter and the response we received from the Comptroller's office be submitted into the record.

Chairwoman MALONEY. Without objection, it is so ordered.

Mr. MOORE. Thank you. I would like to highlight just a couple of points of the OCC's response. Mr. Dugan knows that the regulation of credit cards presents unique challenges because credit cards are fundamentally different from other common consumer credit products such as home mortgage loans. One example he gives is that, unlike a mortgage loan, each credit card transaction is a new extension of unsecured credit that is not separately underwritten at the time of the transaction. Additionally, the consumer, not the lender, generally determines the amount of credit that is involved, the amount of payment above the minimum required payment, and the length of repayment.

While I believe most people agree that these unique features of credit cards have provided a new level of convenience and access to credit enjoyed by many consumers, I am also concerned that unsophisticated borrowers may have difficult navigating the terms of their contracts, which can result in consumers being caught with unexpected fees or rate increases.

Comptroller Dugan goes on to say in his response that there are some issues or practices that may be "so adverse to consumers or generally difficult to understand that they may require an alternative disclosure approach that would warn consumers about the result of the practice rather than simply describe its mechanics." An example he gives is double-cycle billing. Because of the unique features associated with credit cards, I believe regulators are positioned well with their expertise to act to protect consumers.

As our chairman noted, Congress needs to continue pushing the regulators to take strong actions not only to improve disclosures for consumers, but to adjust those practices that may be unfair or deceptive, and I appreciate the chairwoman's leadership in drawing attention to these very important issues. For this reason, I am pleased that the Federal Reserve is working to finalize new rules under Reg Z this year, in addition to new rules regarding unfair and deceptive practices by issuers of credit cards. I look forward to reviewing these new rules, and I hope they will deal with many of the issues that will protect consumers.

I thank the chairwoman, and I yield back my time.

Chairwoman MALONEY. The Chair recognizes Congressman Castle and thanks him for participating in the discussions and forums that we had on this bill and the principles.

Mr. CASTLE. Thank you, Chairwoman Maloney, and thank you for what I consider to be a fair hearing. It is unfortunate that our schedules are such that we are probably not going to be able to participate in all of it, but the panels, I think, are comprehensive, and we should be able to get some answers to questions today, and I appreciate that, and I welcome the Senators here.

As the subcommittee continues its examination of credit cards, I believe it is very important for members to be mindful of the very broad and comprehensive efforts that are drawing to a close at the Federal Reserve with practices controlled by Regulation Z. Obviously I disagree with the chairman of the full committee on where we are supposed to go, or who is supposed to go first with respect to what we are doing.

A few years ago, the Board initiated a comprehensive review of Regulation Z, and in an effort to be fair, reasonable, and sensitive to the needs of consumers, the Fed hired an outside firm to conduct consumer testing and design for improved credit card disclosures. This firm has over 40 years of experience with this sort of thing, a firm with a diverse client base and experience doing similar work for government agencies and nonprofit organization clients.

Testing with everyday consumers was conducted in the States of Maryland, Missouri, Colorado, Massachusetts, Alabama, and Texas. Each focus group consisted of between 8 and 13 people. In addition, four rounds of individual cognitive one-on-one interviews were conducted in each of these locations. Consumers were asked their opinion of six different types of disclosures related to credit cards: solicitation and application disclosures; initial or account opening disclosures; periodic statements; change in terms notices; convenience checks; and solicitation letters. This was done, I might add, with plenty of urging and prodding from my colleagues on this committee. I commend to your attention this report of over 200 pages and ask that you give it your full consideration.

Subsequent to all of this, the Fed released for comment a draft of Regulation Z many months ago. Finally, after carefully reviewing over 2,500 comments from businesses, consumer groups, law firms, and the like, the Fed is about to complete this lengthy, and I might add costly, but important rewrite. I am as frustrated and anxious as anyone on this committee to have the final version of Regulation Z released.

I do hope my colleagues will dedicate their time and that of their staffs to carefully review all that has gone into that effort and give it the consideration it deserves before we legislate. I come to a different conclusion than Mr. Frank on this. I truly believe that the effort they have made is sincere. I believe a number of financial institutions have started to make changes already, and that is the order in which we should go. We should look at Regulation Z and then go back to potentially legislating.

But having said that, I congratulate the chairwoman on the hearing and the fact that we are considering a very important topic, and I yield back the balance of my time.

Chairwoman MALONEY. Chairwoman Waters is recognized for 3 minutes.

Ms. WATERS. Thank you very much, Madam Chairwoman. I appreciate so very much that you have taken up this issue and your providing leadership to get Congress involved in the kind of oversight that we really have the responsibility for, but we don't often do.

We are all credit card users, so many of us are very familiar with the abuses of the industry. Many of us have complained from time to time about abuses that we have witnessed or we have been involved in, but none of us took up a comprehensive effort to try and deal with the problems as we see them.

This is so important because we cannot negotiate our lives without the use of credit cards. We must have credit cards in order to reserve a hotel room, to get on a plane, and to purchase goods and items, so it is a very necessary part of our life, and being that it is such a very necessary part of our life, we must understand what our responsibility and our role is, not only to protect our own personal interests, but the interest of our constituents.

The Credit Cardholders' Bill of Rights certainly does go straight to the heart of some of these issues, and I am very pleased that the number one item listed in the bill of rights is an item that deals with arbitrary interest rate increases. I think that is such an abuse. As a matter of fact, I am reminded of some of the problems that we are experiencing and learning about as we look at the foreclosure problem and the subprime meltdown. What we are finding is the financial services community came up with all kinds of exotic products. None of us understood those products here in Congress, and our regulatory agencies did not take a look at no-documentation loans, they did not explore some of these ARMs that were being created or how they were being originated and initiated and by whom.

I see some of the same kinds of abuses as we look at these credit cards. As a matter of fact, I just learned that if you have a credit card, if you decide that you are going to open up a credit account at a department store when they have these special offers and you make purchases on that same day they extend the credit to you, that your other credit card issuers can then increase your interest rate because they consider that if you open up an account at a department store on some kind of special offer where you take out the goods on that day, that somehow you have created another risk. Most people don't know that, and sometimes when folks go into a department store—

Chairwoman MALONEY. The gentlewoman's time has expired.

Ms. WATERS. Thank you very much. I appreciate the opportunity.

Chairwoman MALONEY. In interest of the Senators' time, we are going to have 4 more minutes of opening statements: 2 minutes for Mr. Hensarling; 1 minute for Mr. Ackerman; and 1 minute for Mr. Ellison. We will then get to the very important testimony of our Senators. We are so thrilled to have you here and we are really sensitive to your time constraints.

The Chair recognizes Mr. Hensarling for 2 minutes.

Mr. HENSARLING. Thank you, Madam Chairwoman. Senator Levin, Senator Wyden, welcome. I am sorry you have to listen to so much talk, but we are led to believe that you do a whole lot more talking on your end of the Capitol than we do over here.

As we sit here and examine today the Credit Cardholders' Bill of Rights, I fear for perhaps 95 percent of America, it may prove to be a credit cardholders' bill of wrongs. I fear that the legislation will help turn back the clock to an era where a third fewer Americans had credit cards, and those that did had little choice and paid the same high universal rate. I fear the bill represents another assault on personal economic freedom. It chips away at risk-based pricing, and I fear it is also fraught with unintended consequences.

According to the ABA's delinquency bulletin for the 4th quarter of 2007, you had roughly 4.38 percent credit card loan delinquencies, which is in line with the 5 year average. That means that for every 22 people paying off their charges on time, there is one who is not. And unfortunately when you press in on one end of the balloon, it presses out somewhere else.

What begins to happen when you chip away at risk-based pricing? A recent survey of banks shows that if legislation like this is passed, we know what will happen. Number one, some will opt to raise rates. Number two, some will tighten underwriting standards. Some will eliminate low-cost products. And some may actually drop their cards, particularly some of our small community banks who continue to suffer under a large regulatory burden.

And we see similar legislation, this isn't just theory, I think there is a very practical model. If you look to the experience in Great Britain in 2006 when credit card issuers were ordered to cut default fees or face legal action, here is what happened: Two of the three biggest issuers promptly imposed annual fees on their cardholders, again harkening back to a previous era; 19 card issuers raised their interest rates; and by one estimate, credit standards were tightened so that 60 percent of new applicants were being rejected.

For all of the Americans who rely upon their credit cards to start and run their small businesses, perhaps to pay their utility bills at the end of the month, to stretch out that paycheck, this legislation, I fear, is a threat to them. Clearly there are legitimate issues of effective disclosure, and I think there is lots of blame to go around and that is worthy of this committee's attention. I do not believe there is an issue of effective competition, which again is the consumer's best friend. And with respect to distasteful practices, the disinfectant of sunshine and competition goes a long way.

I yield back the balance of my time.

Chairwoman MALONEY. The Chair recognizes Congressman Ackerman for 1 minute.

Mr. ACKERMAN. The balance between credit card issuers and consumers has gotten out of balance, and Congress needs to step in to restore fairness. The bill makes a great start to that goal, and a number of provisions that I thought critical have been integrated into the text, and I am grateful for the cooperation of Chairman Frank and Chairwoman Maloney.

I do believe, however, that the legislation and our constituents would be better served if we could find a way to include provisions dealing with the so-called pay-to-pay fees. Pay-to-pay fees, for those who haven't personally experienced this devious practice, are fees that credit card issuers charge their customers simply to pay their bill by phone or online on time, but shortly before payment is due. When used in conjunction with changes in billing cycles, consumers can very quickly find themselves entrapped, handing over a lot of extra money just to avoid late fees caused by slow mail.

This kind of greedy manipulation has to stop. It can be easily addressed during the mark-up for the legislation, and I look forward to working with the chairwoman to make this happen. If amended to include this provision—

Chairwoman MALONEY. Thank you so much, Congressman, for your hard work. Your time has expired. Mr. Ellison, for 1 minute.

Mr. ELLISON. Thank you, Chairwoman Maloney. I cannot even begin to explain how important this hearing is to our consumers and working families. Higher gas prices, soaring food prices, and stagnant wages have made many of our families more and more reliant on borrowing against their homes and through credit cards. But they aren't getting a fair deal from many players in the credit card industry. They are subject to anytime, any reason re-pricing, and at risk of being subjected to unfair practices like universal default and double-cycle billing, all in the name of increased profits.

The credit card companies say that risk-based pricing is to ensure that good consumers get better rates than more risky customers, but as you can see on—I have a chart that I hope to show soon—that is not the case. The chart was presented at the last hearing on the issue by Professor Levitin of Georgetown Law and shows that good consumers only get minimal savings for risk-based pricing. In fact, it shows that the greatest factor when determining pricing is not a borrower's risk, but the Fed funders' rate, the rate that credit cards borrow for the money they lend to you. I intend to ask the issuers about this when they are before us—

Chairwoman MALONEY. The gentleman's time has expired.

Mr. ELLISON. Thank you, ma'am.

Chairwoman MALONEY. Many of my colleagues have important statements to make. They can put them in the record or make them at the end of the hearing, but our two distinguished Senators have indicated that they are under time constraints, so I am delighted now to introduce, first, Senator Levin. We thank him for being here. He has been a leader on this issue by holding hearings that have shone a light on abusive practices and by introducing the first comprehensive credit card reform bill in this Congress, a mark against which subsequent bills must be measured. I also want to thank my good friend and former colleague Senator Wyden for coming to testify today and for all of his thoughtful and important work and for his important bill too. Senator Levin, you are recognized.

STATEMENT OF THE HONORABLE CARL LEVIN, A UNITED STATES SENATOR FROM THE STATE OF MICHIGAN

Senator LEVIN. Thank you, Madam Chairwoman, and members of the subcommittee.

Thanks for the opportunity to join with you today and share some of the experiences that we have had at the Permanent Subcommittee on Investigations at the Senate.

We have been investigating this issue for a couple of years now. We have had a number of hearings. We have an extensive, lengthy record that demonstrates the abuses and the excesses that many members of the credit card industry have engaged in. We would ask that you take into account that record, and I will just quickly sum it up, given all your time constraints.

We commend you on the work that you are doing. This subcommittee, particularly, is tackling credit card reform. It is a complex issue, but these excesses are causing huge financial pain to people who are already undergoing severe economic stress. Congressman Ellison made reference to the kind of challenges which middle-income families face, and I won't reiterate them other than to say that the credit card excesses, the high interest rates and the other abuses that take place, which I will quickly enumerate, just add insult to injury, add additional pain to the pain that is already being suffered by our middle-income families.

The abuses that we have focused on, essentially, are as follows, not necessarily in any order of priority. A number of you have identified abuses that are either in the bill that is pending before you or you feel should be added.

What I am going to list for you are just some of the abuses, excesses, that are in a bill that has been introduced in the Senate and that Congressman Davis has introduced here on the House side: Charging interest on debt that is paid on time; hiking the interest rates of cardholders who have faithfully paid their bills every month; applying higher interest rates, retroactively, to existing debt; imposing fees, late fees and over-the-limit fees, repeatedly. We have an example we will share with you in a moment where somebody went over the limit once and was charged 45 over-the-limit fees.

Interest being charged on late fees—it is one thing to charge interest on money which is borrowed or on purchases which are being charged. It is a totally different thing to charge interest on penalties that are imposed. We think it is improper.

As Congressman Ackerman mentioned a minute ago, charging people a fee to make a payment. If you make your payment over the phone, many companies charge you a $10 or $15 fee to make your payment. That is for an on-time payment, by the way.

Let me just give you a couple of examples from some of the people we have heard from. Bonnie Rushing, a woman from Florida—suddenly her Bank of America credit card interest rate was tripled from 8 percent to 23 percent. She said she was never notified. The credit card company says there should have been a notice sent to her. They gave us an example of the type of notice which they think should have been sent to her—it was totally incomprehensible, even if it was sent to her.

Now, that is a disclosure issue, but it goes much deeper than just disclosure. These bills that have been introduced, including yours, Madam Chairwoman, which we commend highly, address some of the abuses and go to what is needed here, which is change, not just disclosure of abuses, but correcting abuses.

Bonnie Rushing could not figure out, even after she found out about the rate increase, as to why. She was totally unable to figure out why; she made phone calls but couldn't get a reason why. Finally, we tried to figure out why on the subcommittee, and the reason that we finally identified was the reason that Congresswoman Waters identified, which is we think this is the reason: that she took out a credit card at some retailer in response to a solicitation that she do so, because that would give her discounts on her purchases.

She made the purchases she wanted, got the discounts, and then paid those bills on time; and that is the key thing here. Her own relationship with her own credit card company was timely. She was never, never behind on her payments; she always made at least a minimum payment. She took out another credit card at a retailer in response to a solicitation and then made those payments on time. And the only explanation that can be found for why her credit card jumped from 8 percent to 23 percent is because she took out the credit card from the retailer.

That triggered a computer, apparently at the credit rating company, that because she now took out another credit card, that made her a greater credit risk, even though she paid the other credit card on time. That is sometimes called universal default, and it has to end.

Now, to add insult to that injury, the debt that she owed the credit card company was then retroactively treated to the higher interest rate. So that is the retroactivity interest element of your bill.

I will share one other case with you, and then I will close. And that is the case of a man named Wes Wannemacher, a man from Ohio. He had a limit of $3,000 on his credit card. He charged $3,200. He was $200 over his limit. He was getting married. His expenses were $3,200. He charged them all to the credit card. That began a 6-year saga.

That was the only thing he charged—$200 over the limit of $3,000. He went over once and was subsequently charged 47 over-the-limit fees. After 6 years of paying on his credit card, he had paid $6,300 on his $3,200 debt, still owed $4,000, and he was charged these 47 over-the-limit fees. He was also charged interest on those fees, which totaled about $1,500 in interest on fees for going over the limit once.

Madam Chairwoman and other members of the subcommittee, if it is going to be resolved, I am afraid that it has to be resolved here in Congress. The Federal Reserve has been looking at disclosure issues. It is endless. There are 5 billion solicitations a year to people to take out credit cards; that is how profitable this is. It is the most profitable part of the consumer lending world. Year after year, it is the most profitable part.

Profit is perfectly fine. We all believe in profit. Abusing this system, which is what has happened in too many cases, is not fine. If it is going to be changed, it is going to be changed here. I commend you on your efforts to do just that.

[The prepared statement of Senator Levin can be found on page 149 of the appendix.]

Chairwoman MALONEY. Thank you so much, Senator Levin, for your extraordinary work on this issue. I want to underscore one of the things that you said about how confusing the whole process is. We had Richard Syron, the head of Freddie Mac, testify before this committee that he and his wife went over their credit card application for hours and did not understand the terms. This is a leader in the finance industry saying that he agrees completely, certainly on the notification aspect of your testimony.

Thank you again for what you are trying to do for our financial system.

I now recognize my former colleague and good friend, Senator Wyden.

STATEMENT OF THE HONORABLE RON WYDEN, A UNITED STATES SENATOR FROM THE STATE OF OREGON

Senator WYDEN. Thank you, Madam Chairwoman, very much, and I want to commend you, and also my friend of more than 25 years, Chairman Barney Frank, as well as Congressman Bachus and others whom I had a chance to serve with, and it is great to have a chance to be with you.

I am going to spare you the filibustering this morning and I would ask that my prepared remarks could be made a part of the record, Madam Chairwoman, and I could just highlight some of my principal concerns.

Chairwoman MALONEY. It is so ordered.

Senator WYDEN. Madam Chairwoman, first of all, I strongly support the work that you and Senator Levin are doing. It is very much in the interest of our consumers and is urgently needed for the very reason Senator Levin has mentioned; this is going to have to be resolved in the Congress.

What I want to do is take just a few minutes and outline the approach that Senator Obama and I have offered up. It is Senate bill 2411. As you can guess, he is a little tied up today, so he can't be at the witness table, but here is what our concern has been.

We think that the heart of the problem here is that the marketplace is failing the millions and millions of Americans who want to manage their money responsibly and that the marketplace is stacked against the consumer. And here is what it starts with, Madam Chairwoman. This is a credit card agreement, friends. It is 42 pages long, 42 pages larded up with every conceivable kind of legal mumbo jumbo: qualifiers; exemptions; disclaimers.

I will tell you friends that unless you spend your free time reading the Uniform Commercial Code, nobody can sort their way through this. So this is the heart of the problem right here, this document, and as Senator Levin has mentioned, there are millions of these documents floating around the United States.

Now, when you bring this up with the industry, they say, "Oh, valid point, but if people don't like them, they can change their card whenever they want." That is the argument of the industry. The fact of the matter is that it is not that simple. Credit scores are a very large factor in determining which credit card a consumer applies for and the number of times that you have applied for credit recently and the length of time that you have held a card count towards your creditworthiness. So while the issuers say that the market is a perfect laboratory of competition, the reality is that people who want to change their credit cards, as the industry suggests is the answer, cannot do that, because they have to be concerned about protecting their credit scores.

So that makes the choice of which card to choose an important and long-lasting decision. But for the reasons I have outlined, the marketplace is stacked against them. So what Senator Obama and I are seeking to do is level the playing field and make the marketplace more fair. And so we are directing the Federal Reserve, people who know a lot about this business, to set up a system that goes to fairness and safety, not the issues that ought to be left for the marketplace.

The issues that ought to be left for the marketplace are clearly fees and interest rates and rewards, these kinds of things. Our legislation doesn't touch that. That's something that the marketplace ought to resolve, but we do, in our legislation, get at the safety question. So, for example, I'm just going to use one particular term.

A credit card agreement that gave a consumer 90 days notice before the issuer tends to change their terms would do well under the legislation I have written with Senator Obama. They would get points for doing something that was fundamentally fair and relevant to the safety issue. A credit card company that in effect said, "No, we're not going to do it that way; we're going to change the agreement without any notice," would get just the opposite rating on the safety question.

So we say that the Federal Reserve should evaluate these companies on the basis of these safety practices. The credit card companies would have to display the ratings on the marketing materials, billing statements, and agreement materials on the back of the card itself, and in doing so, once again, we go back to free enterprise marketplace principles.

Because if you approach it that way, a credit company that does well with a Federal Reserve safety analysis will say, "Here is an opportunity for us to highlight that in our marketing and promotional material," and a credit card company that is scored down by the Federal Reserve, not on issues for the marketplace, but on safety issues, will have a reason to go out and improve.

One last point that I would make, Madam Chairwoman, is that what you and Senator Levin seek to do—which I am supportive of—is to find these incredibly egregious practices that the credit card industry is engaged in and then you would ban those efforts. I think what you are doing is very much in the public interest, but the reality is, I think all of us who studied this came to this conclusion; this is an incredibly sophisticated industry.

There is a reason, Madam Chairwoman, that credit card companies have consistently done well, year in and year out, no matter what the vagaries are of the American economy generally. They're very savvy, very sophisticated; and, my concern is if all we do is ban these egregious practices, these incredibly outlandish anti-consumer practices, what will happen is this industry, which has always been one step ahead of the oversight process, will just go out and figure out how to come up with a bunch of other egregious practices. And you, Madam Chairwoman, and Senator Levin and all of us, will be back here in a few years looking at another piece of legislation to try to finally drain the slump.

So I hope that what Senator Obama and I are proposing can complement the good work that you, Madam Chairwoman, and Senator Levin are doing. I have worked it out with my good friend Senator Levin that softball questions can now be directed at me. Anything difficult ought to be directed at Senator Levin, but we very much look forward to working with you and hope that this can be a bipartisan effort.

[The prepared statement of Senator Wyden can be found on page 348 of the appendix.]

Chairwoman MALONEY. I thank the witnesses and congratulate them on their extraordinary leadership and very hard work. I have consulted the committee members and there are no questions. We respect your time, we applaud your work, and we thank you deeply for finding time to give us your testimony today and your wisdom.

Thank you very much for being here.

Senator LEVIN. Madam Chairwoman, thank you, and I ask that my full testimony also be made a part of the record.

Chairwoman MALONEY. Absolutely. Thank you so much.

Senator LEVIN. Thank you all.

Chairwoman MALONEY. I now would like to call the second panel of witnesses, and I would like to extend a very special welcome to the three witnesses, Steven Autrey, Susan Wones, and Stephen Strachan. They have come to offer the perspective of real people, real consumers, on credit card practices; and they have a very important point of view.

We welcome you to the witness table, and I am very glad that we have worked in a bipartisan way to create a process for these witnesses to testify today, and I would like to thank the chairman and the ranking member for their efforts in that regard.

Mrs. BIGGERT. Madam Chairwoman, I ask unanimous consent that a statement from the small community bankers be put into the record at this time. I think they play an important role in meeting the credit needs of consumers and small businesses; however, they are disproportionately affected by any new regulation burden Congress decides to impose on the credit card industry. So as such, I would like to submit for the record a statement by the Independent Bankers of America.

Chairwoman MALONEY. Without objection, it is so ordered. The Chair now recognizes Congressman Udall, who has requested an opportunity to introduce an important constituent of his who is testifying today.

Mr. UDALL. Thank you, Madam Chairwoman, and I am really pleased to be here with my fellow Coloradan, Susan Wones. I have a formal statement that I would like to submit for the hearing record, but I want to be brief so that we can hear from our witnesses.

Like many of us here, I strongly support action to require more fair play for people with credit cards. For many Americans, consumer credit is more than a convenience, because they rely on it for everyday needs. So for them it is a necessity. But more and more, they aren't always treated fairly by the companies that issue credit cards, and that is the reason I have been working to make some commonsense changes in the rules for credit card companies.

I first introduced a bill to do so back in 2006, and reintroduced it last year again with my colleague, Mr. Cleaver. I am very proud that they won the support of array of consumer groups as well as 39 co-sponsors from congressional districts across the country. I am very pleased that many of those provisions were included in H.R. 5244, the Credit Cardholders' Bill of Rights Act, and I am proud to join you, Madam Chairwoman, as an original co-sponsor of that bill. It is an excellent bill and I want to do all I can to help get it enacted.

With that as a prelude, I now want to introduce Susan Wones, who is back with us to testify today and share some of her experiences with credit card companies.

Susan, thank you for traveling a second time to be back here with us. The last time Susan was here, she didn't get the chance to testify. None of the consumer witnesses before us did, and I thought it was really too bad that the regular people who come to Washington, the ones who are struggling everyday with these issues, were not heard from last month. And, Madam Chairwoman, I am very pleased that you brought them back. We do need to hear their stories.

I got to know Susan at the suggestion of some people in Colorado who knew of my interest in this subject. What she told me was similar to things I had heard from people all over Colorado. Like Susan, they were responsible in their use of credit cards, following the rules, and paying on time, but did not think they were treated fairly by the card companies. So while she will be testifying for herself, she will be speaking for many others who have had similar experiences.

Her testimony will show why our bill is needed and how it can help people like her who just want to be treated fairly. So, again, I want to thank you for including her on the witness list, Madam Chairwoman, and for your courtesy in allowing me to introduce her this morning.

Chairwoman MALONEY. Thank you, and the Chair recognizes Mr. Steven Autrey for 5 minutes to summarize his testimony, and then we will go to Ms. Wones and then Mr. Strachan.

STATEMENT OF STEVEN AUTREY, FREDERICKSBURG, VIRGINIA

Mr. AUTREY. Chairwoman Maloney, Ranking Member Biggert, and ladies and gentlemen of the subcommittee, good morning and thank you for allowing me to speak before you again.

I would like to give you a brief recap of some negative experiences I have had with one particular credit card issuer. Chase, Citibank, GE Moneybank, have engaged in much more egregious and unethical behavior. I would like to make you aware of some actions of Capital One with regards to a Visa card account.

When a consumer applies for credit with a card issuer, or as we did responds to a pre-approved offer, upon establishment of an account, a bona fide financial contract exists between the consumer and the financial institution. It is because of consumer protection laws at the Federal level that the rates, rules, and terms of the contract are spelled out in advance of the first use of the card. Both the consumer and financial institution trust that the other will live up to the terms of the agreement.

Unfortunately, an increasing number of credit card issuers are engaging in subethical practices at an alarming rate. Unilateral or one-sided changes in the terms of the contract most always in favor of the credit card company are becoming routine practice. These one-sided changes are bad for consumers, bad for our national retail credit health, and essentially violate the spirit and letter of Title 15 consumer credit protection law.

My relationship with Capital One goes back to the year 2000 when I was solicited with an offer for a Visa card with a fixed 9.9 percent rate. I applied over the phone and was approved. The card was used for both purchases and balance transfers, and I had a positive relationship with Capital One for over 7 years, until July of 2007.

That is when Capital One advised me in a small, loose, billing insert that my fixed rate of 9.9 percent was being raised to 15.9 percent, a 60 percent increase. No reason or explanation was given. This was a unilateral change in the terms of the cardholder agreement. Until then, I had been late by one day, one time, and months earlier, my finance charges alone when added to the billing cycle's closing balance, pushed the account $13 over the credit limit. I wanted to find out if these were the reasons why my rate was going up.

In August of 2007, I wrote a letter to Mr. Richard D. Fairbank, chairman, president, and CEO of Capital One, at their McLean, Virginia, home office. My written statement will contain a copy of Capital One's response, which includes this line: "Unfortunately, changes in the interest rate environment or other business circumstances may require us to increase, even for fixed-rate accounts in good standing."

Capital One did offer me the opportunity to maintain my 9.9 percent rate on my balance and pay it off, but in order to do so, there was a cost; I had to close my account. The credit industry, in collusion with the Fair, Isaac and Company of Minneapolis, Minnesota, have carefully constructed an unchallenged scheme where consumers are penalized with a declination in their FICO score when they choose to close accounts.

Lower FICO scores yield less than favorable terms on existing and future loans, mortgages, even insurance rates. Although some of the credit card companies represented here today, and some of those who were allowed to bring testimony before this committee on March 13th, are now voluntarily taking baby steps towards the broader goals of H.R. 5244, random acts of change by some are no bellwether of comprehensive compliance by all card issuers.

The playing field must be leveled between consumer and creditor. In football, the NFL does not allow one team, in the midst of the 4th quarter, to unilaterally move their end zone 20 yards just because they don't like the point spread. The rules are laid out before the kick-off, and the officials enforce the same rules for both the home and visiting teams for the whole contest.

It's time for legislation at the Federal level that tells the credit card industry game over to unilateral, one-sided contract changes. As a registered Republican, it has typically been my philosophy that business and commerce flourish and perform better with minimal government interference. However, when an industry sector proves time and again that it is unable to police itself and behave and engage in fair and ethical trade practices, legislative intervention is required.

With some progress in our consumer credit laws and reform of the monopolistic credit scoring cartel controlled by the Fair Isaac and Company, perhaps once again consumers can have a level playing field in doing business with their credit card issuers.

[The prepared statement of Mr. Autrey can be found on page 90 of the appendix.]

Chairwoman MALONEY. Thank you for your thoughtful testimony.

Ms. Wones?

STATEMENT OF SUSAN WONES, DENVER, COLORADO

Ms. WONES. First, I would like to say that I am extremely nervous, so please bear with me. Good morning, Madam Chairwoman, and members of the subcommittee.

I am Susan Wones from Denver, Colorado, and I want to express my appreciation to the subcommittee for inviting me to come to Washington again to share my experience, which I think will show a need for this legislation you are considering. I am pleased I am able to testify this time.

Since 2003, I have had three Chase credit cards. First, I had a Chase Disney Rewards card. When I signed up, I knew it would be going from an introductory rate of 0 percent to 7.9 percent, but later I discovered it had gone to 14.9 percent. And although I tried, I could not get it lowered. It had a $6,000 limit.

Once I got up to around $6,000, though, the rate jumped from 14.9 to 25 percent, even though I had never gone over the limit and I had always paid on time. So I decided to cancel it and pay off the balance. But after I closed the account, the credit card company still tried to increase my rate to 25 percent again. I don't think this is fair, and I think this bill would prevent that from happening. After this, I decided to open up a new account with Chase, an ASPCA card. The new card had an introductory rate offer of 0 percent and had an initial credit limit of $2,000.

During the middle of the month billing cycle, I was $15 over my limit, and then they raised my interest rate to 23.24 percent, and charged me a $39 over-the-limit fee, even though my beginning and ending balance for that billing cycle were under the limit. I knew that I was close to my limit, but I figured that once I hit my limit, the charges would not be approved. But, in fact, the charges that took me over-the-limit were approved, and I think that was because the company wanted to be able to charge the fee and raise my interest rate.

After that, a few months later, the bank told me they were raising my interest rate to 32.9 percent, so I closed the account. I understand that under H.R. 5244, people would be able to set a limit and that they would not be allowed to go over.

I have a third credit card with Chase that is a non-rewards credit card. It has a $2,000 limit, and has a 7.9 interest rate, which has never been increased. I also have a credit card with my union that is at 10 percent. I understand credit card interest rates are set based on risk, and if a company is charging somebody a higher risk, it is because they think there is a higher risk and the cardholder will not pay the bill.

So it makes no sense to me to have the same bank issue me three different cards with different rates: one at 14.9 percent that they raised to 24.9 percent; another one at 7.9 percent; and a third that had a 0 percent introductory rate and is now at 20.99 percent. If they were truly rating me for risk, shouldn't the cards have either the same or close to the same interest rate? Or, if they think I am over-extended, which they stated in a letter they sent me last week, why would they continue to issue me new credit cards?

There is just one me, and just one risk, if I won't pay or show not to pay. Furthermore, my credit union posted my FICO score of 726 on my account, which I understand to mean my credit is in good standing, and there is low risk that I won't pay my debts. The bank said in its letter of last week that they raised the rate on one of the cards because of the risk level. I showed them my credit report.

Why is the risk for raising my interest rate, if I am, according to my FICO score, such a good credit risk?

H.R. 5244 would end this practice of increasing interest rates based on what is going on with my other accounts and outside the bank accounts. I think this is a fair thing. In a recent letter, the bank offered to discuss payment programs with reduced rates and fees, but I still do not agree that I am a credit risk or over-extended, because I can pay my bills.

All I know is I tried to be a good customer, and I don't think I'm being treated fairly in return. I don't believe that it is fair for me to pay my bills on time and live by the rules they set forth and be penalized for that.

Thank you for letting me speak.

[The prepared statement of Ms. Wones can be found on page 347 of the appendix.]

Chairwoman MALONEY. Thank you. Thank you for traveling here.

Mr. Stephen Strachan. Could you bring the microphone closer to you and make sure that it is on? We can't hear you.

STATEMENT OF STEPHEN M. STRACHAN, YORK, PENNSYLVANIA

Mr. STRACHAN. Madam Chairwoman, and members of the subcommittee, my name is Stephen Strachan and I am a 55-year-old business owner, currently residing in York, Pennsylvania. I want to thank you for this opportunity to testify today. As a small business owner, I have been severely impacted by predatory practices referred to as universal default and credit storing. My testimony is representative of experiences that plague millions of small business operators.

My credit limits were as high as half-a-million dollars and my FICO score is currently 782. I was never informed when I was granted these credit limits, that any such thing as universal default existed. I was never informed that using the lion's share of my credit that I had been granted would result in "violation of a contract, in violation of an agreement."

I had several agreements with several vendors, 140 vendors; 15 of those vendors were banks. I had one bank, one bank only, that decided to violate time after time after time my accounts. I recently received—last night at 9 p.m., to be exact, which is why I am a little bit nervous today, because it kind of threw me for a loop—a 352-page rebuttal. Just a quick cursory glance at that 352-page rebuttal yielded—I stopped writing at the 11th occurrence. Even the physical exhibits apparently don't exist in that rebuttal, if one were to believe that rebuttal.

At any rate, a contract is a contract to me. I experienced instances in which employees were laid off. Other employees could never even be hired because the budget was not available to me anymore. The nature of my business, which is a perishables importing, fresh cut flowers, is that of a perishable receivable. In other words, banks generally do not want week-old flowers as collateral for a loan.

Meanwhile, having already been granted half-a-million dollars in unsecured credit at rates that ranged from 0 percent to approximately 10 percent, it was very attractive for me, so that is why I went tht way. It was post-9/11. In the year following 9/11, there were many instances of mail delays. There were instances of cargo delays. It was a very difficult time for all of us, and money was just not that easy to get.

My integrity and my honor, my professional integrity and professional honor, have always been uppermost and foremost to me. It is for this reason that no matter how difficult things got, and regardless of the fact that other people ran to get underneath the January cut-off for the old bankruptcy laws, I never did that. I had personal debt on credit cards at one point of almost $250,000.

I was a perfect candidate to get into those old bankruptcy laws, but I wasn't raised that way. And I took it as a challenge in my business. My business plan, I was told, "wouldn't succeed because it couldn't succeed."

"You can't run a multi-million dollar business from your house with no start-up capital." Well, they were wrong. They were wrong. Consequently, the same thing exists here. I took this challenge of credit card debt to be, well, it was a challenge to pay off. The fact that my interest rates were doubled, tripled, and quadrupled, up to 400 percent increases, I just went ahead and paid the accounts off. And when I paid the accounts off, time after time with Chase Bank, universal default, universal default, universal default, universal default.

There were several instances in which checks were posted late. Other instances in which checks were either not received by the bank or never posted at all, I don't want to go into a list. I have a whole list of instances here. Some of those were outlined in my written testimony, which I highly recommend that you read. The nature of small business is the backbone of this country, and we employ people.

I am not going to sit here and complain today about a $29 late fee or a $35 over-the-limit fee. What I am going to complain about is having to lay off people and millions of dollars in personal assets that went up in smoke to satisfy universal default.

[The prepared statement of Mr. Strachan can be found on page 285 of the appendix.]

Chairwoman MALONEY. Thank you.

I thank all of the panelists for testifying today.

Your testimony shows that even consumers who do their very best to pay on time and not go over their limit get hit with staggering rate increases. I personally think that consumers deserve the right to know when their rate changes, and to be able to make the decision not to borrow at those rates and not have those increased rates retroactively attached to their balance. That is the core of my bill.

I would like to ask each of you, did you think that if you paid on time, and did not go over your limit, and were good customers that you would be hit with these anytime, any reason, rate increases? I invite anyone to answer.

Mr. AUTREY. No. I did not.

Chairwoman MALONEY. Would you like to elaborate on how this affected you?

Mr. AUTREY. Well, I assumed that fixed meant fixed. I didn't know that there was a caveat somewhere buried in a bunch of paperwork that if market circumstances, or as they put it, business circumstances, require them to change their rates, I mean, what if my business circumstances change. Could I have sent the company a notice cutting my rate in half? There seems to be a one-sidedness. Only the credit card company can call the shots, and that seems to be a little out-of-balance with what is American fairness.

Chairwoman MALONEY. Okay. Ms. Wones?

Ms. WONES. With 30 years of credit history, I have never defaulted. I pay on time. I'm a good customer. So why would I expect a rate to go up to that ridiculous amount when I am following the rules that were set forth by them.

Chairwoman MALONEY. Mr. Strachan?

Mr. STRACHAN. Contrary to my delivery of verbal testimony, I am very good at my work. I am very accomplished with the English language, and when I see the word "default," I know what the word "default" means. And I will say that had I known that there was a different definition of "default" for banks than there is for the rest of the world, I would have never, never, allowed somebody to give me floating rates.

I sell flowers, and when I quote somebody $9.99, I can't bill them $14.99. I have to bill them $9.99 or I'm not even going to get paid the $9.99.

Chairwoman MALONEY. Thank you.

A number of you seem to have had your interest rates increased for using too much of your credit and not going over your limit but getting near your limit. Do you think it is fair to penalize you for getting near to the credit limit that was given to you? I again invite Mr. Autrey, Ms. Wones, and Mr. Strachan to reply.

Mr. AUTREY. Sure; your credit limit is a finite amount. It is printed in black and white on the paper, and essentially that is not what is enforced. Your credit limit is a mathematical formula of that number minus some concocted score of your monthly finance charges, which I don't know how the 2-foot slide rule and a calculator determine what those monthly finance charges are. But, you are not really, in essence, allowed to charge up to your credit limit.

You have to leave room and you have to calculate that yourself for the monthly finance charges to be added on. And, why would they give you a credit limit if they don't want you to use it? It seems to be entrapment.

Chairwoman MALONEY. Ms. Wones?

Ms. WONES. Well, to reiterate what he said, why did they give me that credit limit if I'm not allowed to use it? If they feel like that is too much credit, then why did they give me such a high limit? Why didn't they give me a lower limit if they felt that I could not pay it back?

Chairwoman MALONEY. And when you got near to your credit limit, they started imposing higher interest rates? Is that correct?

Ms. WONES. That is true, on the rewards credit cards, they did.

Chairwoman MALONEY. Mr. Strachan?

Mr. STRACHAN. Well, additionally, there was no disclosure ever made that using 80 percent of my credit or 30 percent of my credit would make any difference. You know, I see $90,000, and $90,000 is $90,000. So to vary that rate with usage, because I'm a "higher risk," although my FICO score reflects otherwise, creates only higher risk yet. It is very self defeating and I think we are kidding ourselves to think that somehow that practice was going to get that bill paid off.

Chairwoman MALONEY. Thank you.

I would like to ask Susan Wones, in your testimony, it is my understanding that you had three different credit cards issued by the same bank. Is that correct?

Ms. WONES. Yes, I did. And when I asked them why I had one at 7.9 percent, they told me several times that they had not gotten around to that credit card.

Chairwoman MALONEY. So, the 3 cards had three different interest rates: 14.9 percent; 7.9 percent; and 0 percent?

Ms. WONES. Right.

Chairwoman MALONEY. You had three different interest rates with the same bank?

Ms. WONES. Yes.

Chairwoman MALONEY. And does it make any sense to you that you could have three different accounts with the bank, yet all three had different interest rates?

Ms. WONES. No, and I have yet to get a good explanation for that. I have tried several times and I have not gotten anything that makes common sense to the average person.

Chairwoman MALONEY. I will tell you that I don't understand how you could have three different interest rates at the same bank when the bank says that they are doing risk-based pricing. It does not make any sense to me whatsoever.

My time has expired, and I recognize my colleague and good friend, Representative Biggert.

Mrs. BIGGERT. Thank you, Madam Chairwoman.

I know particularly in my generation, there were a lot of people, when credit cards came into being, who started a business based on a credit card. And it was always tough, particularly for women. I think sometimes that was the only way they could do it, but Mr. Strachan, you were really running your business on a credit card. Is that right?

Mr. STRACHAN. No, I was running my business on my receivables.

Mrs. BIGGERT. Okay, but you had had quite a bit of debt on your credit card.

Mr. STRACHAN. I used my credit cards actively, yes, for personal and for business reasons.

Mrs. BIGGERT. Did you ever consider going to the bank for another type of loan?

Mr. STRACHAN. Oh, absolutely; you know, as I explained, in the period shortly after 9/11, that is when things kind of turned topsy-turvy. Plus, in the flower business, we have cyclical downturns. You know, summertime, people go to the beach; Christmastime, people buy flowers. So during times of seasonal downturn and during times of growth and expansion, cash requirements are different.

Mrs. BIGGERT. Did you ever consider switching to another credit card?

Mr. STRACHAN. Switching to another credit card?

Mrs. BIGGERT. Yes.

Mr. STRACHAN. I have experiences with many credit card banks, actual credit cards.

Mrs. BIGGERT. Well, a credit card is, you know, an unsecured loan. Credit cards are unsecured loans.

Did you ever think if you went to other banks and couldn't get any other type of loan or had equity in your house, or anything?

Mr. STRACHAN. My equity was in my stocks and bonds portfolio and my vintage guitar collection. It was not something the bank wanted.

Mrs. BIGGERT. Did you submit any comments to the Federal Reserve on Regulation Z?

Mr. STRACHAN. No. I did not.

Mrs. BIGGERT. Okay. Do you think that legislation is the way that we should go on this?

Mr. STRACHAN. I have not read enough of Regulation Z to comment today.

Mrs. BIGGERT. Okay. Then, Ms. Wones, you had three cards, but did you ever consider switching to another company?

Ms. WONES. No. Because of the way I was treated with Chase, I was almost afraid to go to a different bank.

Mrs. BIGGERT. Are you still paying off the credit cards?

Ms. WONES. On the two higher ones, I'm paying them off. One of them is almost paid off.

Mrs. BIGGERT. Okay. Then Mr. Autrey, you still owe Capital One?

Mr. AUTREY. Yes, that's correct.

Mrs. BIGGERT. About how much is that?

Mr. AUTREY. The balance, right now, is about $19,000.

Mrs. BIGGERT. Did you consider switching to another credit card?

Mr. AUTREY. I'm a resident of the State of Virginia, and Capital One is a Virginia company; and, I would prefer to keep my business within the State. They actually had a call center in the community where I live.

Mr. STRACHAN. Might I interject? Could I ask a question?

Mrs. BIGGERT. Yes, go ahead.

Mr. STRACHAN. Switching to another credit card, it's not always that easy. You know, to switch to another credit card, are you asking to close?

Mrs. BIGGERT. Well, my question was did you consider doing it, or did you say, well, you weren't going to do it because it wasn't that easy? I mean, that's the answer that you would give.

Mr. STRACHAN. Well, no. Okay, all right.

Mrs. BIGGERT. All right, Mr. Autrey, did you submit your comments to the Federal Reserve?

Mr. AUTREY. I wrote a letter, I believe it was to the Office of the Comptroller of the Currency, and I don't recall ever getting a response,

Mrs. BIGGERT. Okay.

Mr. AUTREY. But to answer your previous question, I had considered switching cards, but you do get penalized just for applying for credit. And I did not want my FICO score to drop anymore at the time; my wife and I were looking at moving to a new home, which we did do.

And we were advised by our mortgage broker not to do anything with our credit. He said, just keep everything where it is, and he explained to me, you know, how the whole FICO thing works. I had at that time no idea just what a quiet secret of a scoring system that is. It has never been made public.

Mrs. BIGGERT. Well, right now, we are considering requiring mortgages to have a one-page disclosure, so that people would understand, and to simplify what they are getting into with the RESPA.

Would you think that would be a good idea for this?

Mr. AUTREY. For mortgages?

Mrs. BIGGERT. No.

Mr. AUTREY. For credit cards?

Mrs. BIGGERT. Credit cards. Do you think that could be boiled down? Do you think people would read it?

Now I am really concerned about financial literacy and work really hard on that. And I think so many times people get into things, and not asking the right questions, or not really delving into it, but it appears that if you get 42 pages on a credit card contract, that might be a little bit difficult.

Mr. AUTREY. Well, you get a slick-gloss envelope in the mail and it says “fixed.” Sometimes it’s “fixed for life.” That language is on there. You know, why would you want to read through 42 pages of literature when they say it is fixed?

I assume fixed means fixed. I didn’t know fixed is until they feel like they can change it.

Mrs. BIGGERT. Thank you.

I yield back.

Chairwoman MALONEY. The gentlewoman’s time has expired. The Chair recognizes Congressman Hodes for 5 minutes.

Mr. HODES. Thank you, Madam Chairwoman.

I appreciate the panel’s testimony at this hearing. We missed you at the last hearing.

Mr. Strachan, I would like to ask you some questions. You have submitted a lengthy, written testimony in great and excruciating detail about your experiences. And one area that I would like to just explore a little bit, because it’s clear to me that you have given great thought to these issues, is the interplay between the credit scores and how you have been treated by the credit card companies and the relations between what you do know, what you don’t know, what you can find out, and what you can’t find out. Directing your attention to the issue of your credit scores and in your written testimony I see at page 7, number 6, scoring products in CBRA is actively engaged partners of lenders.

You talked about the proprietary technology foisted upon cardholders with no regard for veracity supplied by lenders themselves; and, I’m curious to know what you think ought to be done to give you and other consumers access to information about how your credit scores are working that would help solve some of the problems you have been through.

Mr. STRACHAN. A case in point, since the March testimony that was postponed, I have had about another 4 weeks to look through my files, and a number of things have jumped out. A number of payments have also been made in the meantime on pre-existing balances, paying down balances, and I notice that as my balances get lower, my FICO score gets lower.

So, curiously, I go back and I pay money. I monitor my FICO score every month and I see the FICO score dropping. I pull up my credit report to see what happened. Just, was there a bad report? I stay on top of this constantly and the person I see on that credit report is maybe 20 percent me. I see 80 percent other people; or, maybe, some Steve from 12 years ago, or 15 years ago. It wasn’t that long ago that there were still references from the 1980’s on my credit report; and, sometimes, they go away and then they pop back up. Maybe within industry consolidation and data dumping, I don’t know; that is also referred to in my testimony.

I am very curious as to what goes into that FICO report. I can go back as a consumer and I can challenge my written or printed Experian, Equifax, TransUnion. I mean, I can challenge them. I can write letters. I can make phone calls. I may not get anywhere, but at least I have the ability to try.

When it comes to Fair Isaacs or any of the scoring mechanisms, I'll call them, "the black boxes," nobody knows what is in those things. Can anybody in this room tell me what is in those things?

Mr. HODES. Have you made attempts to get behind the paper you are receiving, or the score you are seeing, and beyond the printed page, which shows you whatever they're going to show you?

Mr. STRACHAN. Yes.

Mr. HODES. Have you tried to get behind that to ask, why am I being scored this way? What are the factors? What are you basing it on? What is in your database? What is in your information?

Have you tried?

Mr. STRACHAN. I have tried with people in this room.

Mr. HODES. And what has happened when you have tried to get beyond the printed page to get into whatever proprietary methods they're using, whatever factors they're considering, where their information is coming from.

What have you been able to penetrate, if anything?

Mr. STRACHAN. If I ask three people, I get four answers. Nobody knows. It's possible; maybe I shouldn't say "no one." I'm sure that someone from Fair Isaacs and someone from Equifax knows, with a bunch of degrees on the wall; you know. These are mathematical algorithms. I have no idea how they do what they do. I probably don't want to know how they do what they do, but it affects me.

So just in light of that, throughout my whole course as a borrower, I just find it's easier and it may be fortunate in my case, but it has been possible for me to strive for perfection. Pay off the bills. If it's 3 percent, fine. If it's 30 percent, fine. Just pay it off, because I know once it gets to zero, that is about as close to perfection in credit that one can achieve. At least that's how it occurs to me. Debt free is debt free.

However, over the past several months, I see my actually debt-to-credit ratio standing at approximately 9 percent, but then I look at Equifax and they're telling me it's 20, 26. I don't really care. I don't care what it says. It doesn't reflect on me as a human being, but I honestly don't know how to get behind those numbers.

Transparency is a big issue; and, additionally, the ability to use that number, the fact that lenders use that number or use that credit report of at best dubious accuracy to make these weighty decisions about creditworthiness that affect people's jobs, and they affect people's families; and they affect people's relationships and their homes. I don't mean to give a speech.

Chairwoman MALONEY. The gentleman's time has expired, and he has raised some very relevant and important points that we should follow up at future hearings.

Thank you, Mr. Hodes.

Mr. HODES. Thank you, Madam Chairwoman. Thank you for your indulgence.

Chairwoman MALONEY. The Chair recognizes Ranking Member Bachus.

Mr. BACHUS. Thank you.

Mr. BACHUS. Ms. Wohan?

Ms. WONES. It is pronounced "Wones," like in number one.

Mr. BACHUS. Wones—you can relax—I'm not going to ask you any questions, so—

[Laughter]

Mr. BACHUS. And Mr. Strachan?

Mr. STRACHAN. Strachan, yes.

Mr. BACHUS. We got the response at 8 o'clock last night.

Mr. STRACHAN. You are a more accomplished speaker than I am.

Mr. BACHUS. What I mean is, I just got it at 8 or 9 last night, so I'm saying you had the same situation that I had; I just hadn't had time to look at it.

Mr. STRACHAN. Well, it is a little bit daunting.

Mr. BACHUS. So I'm not going to ask you any questions.

Mr. STRACHAN. You are welcome to ask me anything you like, Congressman Bachus.

Mr. BACHUS. Now, I will say this to you. We amended the Fair Credit Reporting Act about 2 years ago. I was the author of that legislation—"author," you know—I won't go into all that.

But, there is a lot of frustration out there about things getting off the report and popping back up; and, we have made some real changes there. If you will give your Member of Congress your credit report, also after 7 years, that stuff is supposed to be off of there.

So, I don't question what you are saying. I would like to see it, because obviously what's happening, and I take what you're saying is accurate, is that something's not working.

Mr. STRACHAN. In my case, I don't care if it says 782 or if it says 810. It doesn't make that much difference.

Mr. BACHUS. Yes, but I'm saying let us take a look at that, okay? Because it's just not supposed to be on there, and you're not supposed to be able to clear it off and have it pop back up. So let us take a good look at that.

Mr. Autrey, one thing and I did look at, you know, a week or so ago, they sent us your credit report. I'm not going to go into detail about it. You know, there's nothing alarming on there. And you signed a waiver that I could, but I'm not. But I do want to say this, which is, I think you would agree. From 2000 to 2007, you signed up for 9.9 percent interest.

Mr. AUTREY. Right.

Mr. BACHUS. And at a certain point, after 6 or 7 years, they said, we're going to raise your interest rate.

Mr. AUTREY. Sixty percent, yes.

Mr. BACHUS. Well, I understand that, but you said I don't want to do that.

Mr. AUTREY. Right, right.

Mr. BACHUS. And so they kept it at 9.9 percent and you're still paying it off minimum payments, right?

Mr. AUTREY. I'm making more than the minimum payments. Right, you are correct.

Mr. BACHUS. You weren't really harmed by that were you?

Mr. AUTREY. Well, my FICO score—this kind of brings up a good point—Capital One does not report your credit limit, even for an open account, to the credit bureaus and then your balance. They report your balance only and it appears that that is your credit limit. So it appears that you're always at your limit with a Capital One product on your credit report. But by closing my account, that's reducing my available credit; and the more available credit you have, the higher your FICO score is, at least from what I've been able to gather. So this is just less.

Mr. BACHUS. I don't think on a credit report it's just your credit limit. I just think it's the balance. Have you looked at that?

Mr. AUTREY. Yes.

Mr. BACHUS. And it's your balance; it's not your credit limit right now, I mean, on your credit score?

Mr. AUTREY. I believe with Capital One only they report.

Mr. BACHUS. No. I mean, you've seen your credit score. You've seen your credit report.

Mr. AUTREY. Sure.

Mr. BACHUS. And I'm not trying.

Mr. AUTREY. Right.

Mr. BACHUS. Does it have your balance?

Mr. AUTREY. For my American Express, it has the balance that I'm allowed to go up to and then what I'm utilizing.

Mr. BACHUS. Okay.

Mr. AUTREY. Some of them even have a watermark showing the highest I ever went.

Mr. BACHUS. Well, I understand that, and I think that demonstrates you paid it down. But I guess what I'm asking is, are you saying that your credit report shows that you owe a balance higher than you really do or much higher?

Mr. AUTREY. No, it shows that my current balance is my credit limit. So to a computer somewhere, that utilizes.

Mr. BACHUS. Well, that's not bad then, is it?

Mr. AUTREY. That is bad.

Mr. BACHUS. Oh, okay, you're at your credit limit?

Mr. AUTREY. Yes, if this is your credit limit, you want a large buffer between where you are and your credit limit; and, if the company is only reporting this number and never this number into the computer, it looks like you're always at 100 percent.

Mr. BACHUS. But, there were reasons I think you would agree why they repriced your rate.

Mr. AUTREY. They told me it was not because of my behavior, but interest rate in business circumstances.

Mr. BACHUS. Well, I understand that, but it could have been because of some other things that you did.

Mr. AUTREY. Right. I was one day late one time, and another time I believe I was $13.58 over my limit when the interest was added.

Mr. BACHUS. And I know you mentioned those two things in your testimony, but there was something a little more serious than that, wasn't there?

Mr. AUTREY. There was. I made a payment electronically and I selected on my checking account the wrong account. And that wasn't returned like a check. It just wasn't processed, so I had to go back in and select the proper account that had the money in it.

Mr. BACHUS. Yes, but that happened twice.

Mr. AUTREY. But Capital One is saying that they did not reprice or they don't reprice based on those items.

Mr. BACHUS. But, what you're saying is, you had two returned payments.

Chairwoman MALONEY. The gentleman's time has expired.

Mr. AUTREY. Two returned payments?

Mr. BACHUS. Where you made a payment, but they were returned, because, you know, you put the wrong account or something.

Mr. AUTREY. Right. I made two payments at one time in order to pay extra.

Mr. BACHUS. But they still didn't reprice your rate.

Mr. AUTREY. No, they said they don't do that for that activity.

Chairwoman MALONEY. The gentleman's time has expired.

Mr. BACHUS. Okay. Thank you.

Chairwoman MALONEY. Mr. Ellison is recognized for 5 minutes.

Mr. ELLISON. Thank you, Madam Chairwoman.

Mr. Autrey, let's pick up right where we are. Sir, did you ever get a specific answer as to why you were repriced?

Mr. AUTREY. Yes, sir. I actually have the letter right here.

Mr. ELLISON. Is it the letter you attached to your testimony?

Mr. AUTREY. Yes, sir.

Mr. ELLISON. Right, but it sounds to me in the paragraph that I read that there was sort of some possibilities to why you were repriced, but there was never a definitive answer exactly why.

Mr. AUTREY. Correct.

Mr. ELLISON. To this moment in time, did anybody ever say to you, Mr. Autrey, the reason that your interest rate changed is exactly because of a specific reason?

Mr. AUTREY. No, sir.

Mr. ELLISON. And you've asked, because we have the letter that you wrote to the chairman of the company asking.

Mr. AUTREY. Yes, sir.

Mr. ELLISON. How long ago was it for the record that you asked the question?

Mr. AUTREY. I believe I sent the letter in July and I got a response in September.

Mr. ELLISON. Of 2007?

Mr. AUTREY. Yes, sir.

Mr. ELLISON. And until this date, have you received a specific answer as to why your interest rate was changed?

Mr. AUTREY. No, sir.

Mr. ELLISON. Even though you talked to the top guy of the company?

Mr. AUTREY. I'd sent a letter to the top guy and I got a reply from a person in Richmond, Virginia. So, I guess, I don't know.

Mr. ELLISON. Okay, well, when you signed up for your credit card, remember you wrote in here that you called up and said "Give me a credit card." It was easy to get somebody then, wasn't it?

Mr. AUTREY. Absolutely.

Mr. ELLISON. How was it when you tried to work out a problem?

Mr. AUTREY. Well, you have to enter your account number. Then it reads it back to you. Then it wants to make sure they got that right and you wait awhile.

Mr. ELLISON. Is this a person?

Mr. AUTREY. No, sir. This is a computer recording or something, not a human being.

Mr. ELLISON. So when they want to get your business, they have a person, right?

Mr. AUTREY. Yes, sir.

Mr. ELLISON. But when you want to work out a problem, you get some other thing. Am I right about that?

Mr. AUTREY. You have to have patience to get through to a person.

Mr. ELLISON. And if you don't have patience?

Mr. AUTREY. If your time is valuable, you don't get through to a person.

Mr. ELLISON. And if you have to get the kids to school, and if you have to get to work, and if you have to go somewhere, you just can't sit on the phone like that. Am I right or wrong?

Mr. AUTREY. That is correct, unless you want to burn your cell phone minutes.

Mr. ELLISON. Let me ask you this. Someone asked, why don't you just go get a new credit card? What happens when you apply for a new credit card to your FICO score?

Mr. AUTREY. It lowers your FICO score every time you apply for credit.

Mr. ELLISON. Just asking for a new card impacts your FICO score. Is that right?

Mr. AUTREY. Not even asking, responding to a preapproved offer where they tell you, you're a great guy, here's a credit card. Just call us and activate it.

Mr. ELLISON. And it goes down.

Mr. AUTREY. It does. How much, I don't know. That's a well-guarded secret.

Mr. STRACHAN. About 4 points, from what I understand.

Mr. ELLISON. That's interesting. Thank you, sir.

Ms. Wones, you have three cards?

Ms. WONES. Yes.

Mr. ELLISON. Are the three cards in three different addresses?

Ms. WONES. No.

Mr. ELLISON. Three different names? Do you have any aliases in there?

Ms. WONES. No.

Mr. ELLISON. Just you, right?

Ms. WONES. Yes, there is only one of me.

Mr. ELLISON. How did you get three risks? How did you get priced for three different risks if you're just one person?

Ms. WONES. That's what I'd like to know, and if you can find that answer, I'd appreciate it.

Mr. ELLISON. Have you tried to ask anybody about that?

Ms. WONES. Yes, I have.

Mr. ELLISON. And did you get a straight answer?

Ms. WONES. No. I did not.

Mr. ELLISON. Now, when you applied for your cards, did you talk to a person?

Ms. WONES. No, I filled out a form.

Mr. ELLISON. But when you called up to get the problem straightened out, did you get a person?

Ms. WONES. Eventually.

Mr. ELLISON. Eventually; what do you mean by that?

Ms. WONES. Well, like, you have to go through machines.

Mr. ELLISON. Now this is a huge company, right?

Ms. WONES. Right.

Mr. ELLISON. You would think they'd have a person to try to work out a problem with you, right?

Ms. WONES. Exactly.

Mr. ELLISON. Now, did having to go through all those machines diminish your ability to be able to straighten out the problem?

Ms. WONES. No. I kept calling back to get someone.

Mr. ELLISON. I know, but they did put barriers in your way. Isn't that true?

Ms. WONES. Yes.

Mr. ELLISON. And it did make it a little bit more difficult for you to straighten out the problem that you had to wait on the phone and really couldn't get anybody until eventually you got somebody. Am I right?

Ms. WONES. Right.

Mr. ELLISON. I just want to say this. First of all, I believe in financial literacy. I think all three of you are extremely intelligent people and probably understand financial matters better than most people. I think the issue is not financial literacy. It is the Byzantine structure that the company set up, and we need to focus on that. And I just want to say that as a matter of fact, and I also want to say as well that I commend all three of you.

You are tremendously courageous people. You are exposing yourselves and you could just as easily have licked your wounds and gone on about your life. By coming here today, you are doing a public service, and I want you to know that I thank you for it personally. Thank you, one and all.

Chairwoman MALONEY. Thank you. The gentleman's time has expired.

Mr. Hensarling, for 5 minutes.

Mr. HENSARLING. Thank you, Madam Chairwoman.

Let me pick up where my friend from Minnesota left off. I want to thank the panelists for coming here. And I know, Ms. Wones, you said you were a little nervous. I'll let you in on a little secret. Some of the people before you were probably a little nervous as well. But I know it took a lot of time and effort on your part and some courage to come here, and I thank you. And we all benefit from your testimony.

I listened to your testimony. Frankly, I haven't looked at the other side of the argument. I accept what you say. I have no doubt that there are some consumers who didn't understand what they were getting into. Maybe they were misled. Maybe the system hadn't worked well for them. I don't care to delve into your individual cases, but I do have a couple of questions for all of you.

What I thought I heard from each and every one of you is that essentially there was a provision in your agreement with your credit card company that you did not understand, that either wasn't properly disclosed to you or you did not understand the interpretation of the credit card company.

Is that a fair assessment of your testimony? Does anybody disagree with that, or was there something in there you just didn't understand? Is that correct?

Mr. STRACHAN. Apparently, there are multiple definitions for one word, for the word "default," for instance.

Mr. HENSARLING. Okay. If you had understood the provisions of the credit card agreement, would you have accepted the card? Yes or no?

Mr. AUTREY. Yes.

Mr. HENSARLING. You would have gone ahead and accepted the card? Ms. Wones, would you have accepted your card?

Ms. WONES. I would have had to think about the Disney one just because I'm a huge Disney lover. That's the only reason I got it was for the Disney rewards.

Mr. HENSARLING. Okay.

Ms. WONES. But with the interest rates, I probably would not have charged on it.

Mr. HENSARLING. And Mr. Strachan, would you have accepted your card if you understood the provisions?

Mr. STRACHAN. I understood the provisions. Had universal default been explained to me fully, which it was not—and vagaries surrounding FICO and the arbitration clause I was only made aware of after I applied for the card that came in the cardmember agreement later on—had I known those things going in, I would have accepted some of the cards and not accepted other cards.

Mr. HENSARLING. I think you were here for the two Senators who testified before us and one of the Senators held up, I think, he said a 43-page disclosure form; I admit I don't understand those forms either. And I think there are probably a lot of different guilty parties that lead to a forum that none of us can understand. Part of it is probably trial attorney driven. People are trying to reduce their liability exposure, since we assume to live in a country where more often than not we sue our neighbor instead of love our neighbor.

Probably a full amount of it is driven by the Federal Government that seems to have a philosophy for full and voluminous disclosure written in legalese as opposed to simple and effective disclosure written in English. And my guess is the credit card companies may bear some blame, as well, so there's probably a lot of blame to go around.

But my question is, what I think I have heard a couple of you say is that even if you understood it, you might go ahead and take the card. Yet, under this legislation, certain credit cards that are on the market now will be outlawed. Let's assume for the moment you understood. Let's assume for the moment your neighbor understands. Maybe you don't like the card, but he does. Should Congress outlaw a credit card?

Chairwoman MALONEY. For point of information, the legislation does not outlaw any card. It is very heavy on notice so that people understand their cards. It does not have any price controls, nor does it in any way say people cannot have a card, for point of information.

Mr. HENSARLING. Okay, well, with all due respect, Madam Chairwoman, that is not my interpretation of your legislation. And I do not believe it's the interpretation of others. If you're going to essentially outlaw certain credit card practices, I don't frankly know how you come to any other conclusion.

But my question for the panelist is, if you understand the provisions of your card, should Congress outlaw certain credit cards, whether it is in the chairwoman's bill or not?

We'll have that argument at a later time.

Ms. WONES. I didn't get the fact that it would outlaw any credit cards. I agree with her. The way I read the bill, they still have every right to issue any type of card, and it's the consumers.

Mr. HENSARLING. Well, we'll have the debate on that specific legislation, but as a philosophical matter.

Chairwoman MALONEY. The gentleman's time has expired.

Mr. Udall is recognized for 5 minutes.

Mr. UDALL. I thank the chairwoman for yielding to me.

I wanted to come back and visit with the panel on this question of repricing, and I want to start with Ms. Wones, who has done a wonderful job today, I think we would all acknowledge. In some of the information that was sent to us by your issuer, they point out that you were repriced based on a decline in your credit score.

They also point out that they no longer engage in this practice, and I do want to commend them for making the change. However, when they reversed the practice, did they reverse the increased interest rate on your accounts?

I am going to let you respond, and I would like to ask the other two witnesses if they would be interested in responding as well. Ms. Wones.

Ms. WONES. No. My ASPCA card is still at 23 percent.

Mr. UDALL. So they no longer engage in the practice, but your account interest rates did not change one iota.

Ms. WONES. No, it did not.

Mr. UDALL. Mr. Autrey, would you care to comment?

Mr. AUTREY. Yes, my card is closed. I closed it and it stayed at the 9.9 rate until I pay it off. Then it's closed and I won't be able to reopen it or use it anymore.

Mr. UDALL. Mr. Strachan, I saw you nodding. Would you like to respond?

Mr. STRACHAN. I'm bursting at the seams. No. Not only have I not had things rolled back, but I have had APRs increase in leaps and bounds. Additionally, one account was closed. When I paid it off, I paid off $66,000 in about 2 months. My account was closed.

A year later, 16 months later, a card shows up in the mail again for the same account, but the bank still says it was never closed. It's even in my exhibits. At any rate, no one at any time rolled back my interest rates, nor have they offered to refund any of the overcharges.

Mr. UDALL. Madam Chairwoman, I think it probably should go without saying, but I'm going to say it anyway. I would predict that there are many, many thousands more Americans who are in the same situation. That card company has changed its practices, but it is one thing to just say, we have changed the practice, but it's another thing to keep these rates in place that aren't sustainable.

I again thank the chairwoman for holding the hearing, and I yield back any time I have remaining.

Chairwoman MALONEY. The gentleman's time has expired, and we have no further questions for these panelists. We want to thank you very much for coming and testifying before Congress. It is not an easy thing to do, and consumers are very appreciative of your coming forward and giving your stories. You are really speaking for many men and women in this country. I thank you on their behalf. Thank you.

I now call on Ranking Member Biggert, who would like to respond to Chairman Frank's earlier statements.

Mrs. BIGGERT. Thank you very much, Madam Chairwoman. I thought I would put this in the record right now. He was talking about preemption by the Fed, but what I was talking about is that I think we should look at evidence over anecdotes, and that was my point.

I think the point that Chairman Frank misses is that the regulators have the expertise, and Congress directs them to act on an issue, not prescribe what and how they do it. So I was concerned, as I said in my opening statement, that I want to hear the results of what we in Congress authorized the Federal Reserve to undertake, and that was a revision of Regulation Z. And I think that the Fed's 4 years of extensive expert review utilizing consumer focus groups and other sound methodology would seem to be just as worthy of our consideration as is anecdotal evidence presented by today's witnesses.

So I don't think that—when we ask somebody to do something, I think we should not jump in ahead of the time when they have spent 4 years on that. So with that, I thank the chairwoman for her indulgence, and I yield back.

Chairwoman MALONEY. The Chair asks for unanimous consent to place in the record testimony from the American Financial Services Association, and also a statement of John Finneran, who is the general counsel of Capital One Financial Corporation. Without objection, they will be placed in the record.

Our third panel includes: Martin Gruenberg, Vice Chairman of the FDIC; Julie Williams, Chief Counsel and First Senior Deputy Comptroller of the OCC; John Bowman, General Counsel of the OTS; and Sandra Braunstein, Director of the Division of Consumer and Community Affairs of the Federal Reserve.

I want to welcome these regulators who are here to give us their views and an update on their efforts in this area. As Chairman Bernanke recently testified to this committee, the Fed plans to use its unfair and deceptive practices authority to regulate the very same abuses our bill goes after because he said the Fed's authority to regulate disclosure was not enough to deal with the unfair practices the regulators see.

And so I look forward to the testimony of all of the panelists today. We will start first with you, Mr. Gruenberg.

STATEMENT OF MARTIN J. GRUENBERG, VICE CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. GRUENBERG. Thank you very much, Chairwoman Maloney, Ranking Member Biggert, and members of the subcommittee. I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation regarding credit card practices and to provide comments regarding H.R. 5244, the Credit Cardholders' Bill of Rights Act of 2008.

Credit cards have become an important component of everyday life, serving as an accessible form of credit that provides great convenience to consumers. However, as with all credit products, unless provided responsibly and used carefully, they hold the potential to cause significant financial hardship.

By 2004, the most recent year for which aggregate consumer data are available, 75 percent of U.S. households had some type of credit card, and 46 percent carried a credit card balance. Recent growth in credit cards has been especially prevalent in lower income households and among young people.

Credit card lending has proven to be a profitable business line that consistently has been more remunerative than other banking activities. Even though credit card lending is unsecured, the best returns from this activity more than offset their higher level of net chargeoffs.

As you know, credit card lending is generally regulated by the Truth in Lending Act and its implementing regulation, Regulation Z. The Federal Reserve Board has the authority to promulgate regulations to implement TILA, the Truth in Lending Act, which focus primarily on disclosure of the cost in terms of credit.

In May 2007, the Federal Reserve proposed amendments to Regulation Z that are designed to improve credit card disclosures. While improved disclosures are important, it is questionable whether even improved disclosures can mitigate the harmful effect of some of the most problematic practices.

Credit card issuers are also subject to the prohibition against unfair and deceptive acts and practices under Section 5 of the Federal Trade Commission Act. The prohibition against unfair and deceptive practices provides a powerful supervisory tool. However, current law limits FTC rulemaking authority to the Federal Reserve, the Office of Thrift Supervision, and the National Credit Union Administration, and excludes the Office of the Comptroller of the Currency and the FDIC, who are the primary Federal regulators of about 7,000 institutions.

We appreciate this committee's leadership earlier this year in the passage of legislation by the House of Representatives, H.R. 3526, to amend the FTC Act to grant each Federal banking agency the authority to prescribe regulations governing unfair or deceptive acts or practices with respect to the institutions each agency supervises.

With regard to H.R. 5244, the Credit Cardholders' Bill of Rights Act of 2008, the FDIC views this legislation as a balanced and constructive effort to address many of the most problematic credit card practices. These practices include universal default, double-cycle billing, payment allocation to the lowest rate portion of the balance, and inconsistent and often nontransparent billing practices.

For example, in the case of universal default, an issuer increases rates on debt when a cardholder fails to make payments to other creditors or has an overall decline in his or her credit score. The result is that a cardholder who pays on time still may be assessed a higher interest rate because the cardholder made a late payment to another creditor or has incurred a significant amount of additional debt unrelated to the credit card.

Employing this practice may materially worsen a cardholder's financial condition, contributing to the cardholder's overall level of financial distress and reducing incentives to stay current. This has potentially serious implications for ultimate debt repayment, and raises risk management issues.

Under double-cycle billing, when a cardholder fails to pay the entire balance of new purchases by the due date, the issuer, despite the cardholder's having no previous balance, computes interest on the entire original balance that had previously been subject to an interest-free period, including that portion of the balance that the cardholder paid on time.

These practices and others addressed in the bill, such as payment allocation, are so complex that they do not lend themselves to clear and concise disclosure that effectively communicate usable information to consumers.

Among other important provisions, the bill seeks to address practices often found in subprime credit cards, where they can have a particularly harmful impact on consumers already facing financial challenges.

In conclusion, the credit card has been an important innovation in consumer finance, allowing consumers greater flexibility in accessing credit. Yet like all credit, credit cards can create financial hardship if not properly managed or if consumers are confused or misled regarding the terms and conditions of their use.

A proper balance needs to be struck. Legislative and regulatory changes such as H.R. 5244 can help strike that proper balance.

Madam Chairwoman, that concludes my testimony. I would be happy to address any questions the committee might have.

[The prepared statement of Mr. Gruenberg can be found on page 131 of the appendix.]

Chairwoman MALONEY. Thank you very much.

Ms. Williams?

STATEMENT OF JULIE L. WILLIAMS, CHIEF COUNSEL AND FIRST SENIOR DEPUTY COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Ms. WILLIAMS. Chairwoman Maloney, Ranking Member Biggert, and members of the subcommittee, I appreciate the opportunity to appear before you today to provide the OCC's views on H.R. 5244, the Credit Cardholders' Bill of Rights Act of 2008.

In testimony before this subcommittee last year, Comptroller Dugan provided extensive information on the credit card industry and the OCC's concerns and responses regarding current credit card disclosures and marketing practices. He also urged certain key principles that should guide any new credit card legislation or regulation.

First, as a matter of safety and soundness, credit card lenders need to be able to manage their risks effectively.

Second, credit card customers should be given meaningful notice of the terms and conditions of their credit cards and the circumstances under which those terms may change.

Third, credit card customers also should have meaningful choice when faced with certain increases in their credit card interest rates.

My written testimony focuses on these three principles and their application to H.R. 5244. I will briefly summarize some of the key points.

It is important to recognize the type of risk presented by credit card debt. A credit card is an unsecured revolving open-end credit, very different from a mortgage or car loan, and requiring different credit risk management techniques. As the customer pays down the balance of a credit card, the customer can make new charges, and the customer is not required to pay off the entire balance each month.

Thus, changes in a customer's creditworthiness affect the lender's credit risk in two ways: new extensions of credit for new transactions by the customer; and continued extension of credit for the customer's existing unpaid balance.

Because credit card lenders qualify customers for interest rate, credit limit, and other terms based on an assessment of creditworthiness at a time the account is opened, lenders must rely on risk mitigation tools on an ongoing basis to address a customer's changing risk profile. These tools include freezing or reducing credit lines, closing accounts, and repricing, that is, changing the rate of interest charged for outstanding balances on an account.

From a supervisory perspective, we have concerns with certain provisions of H.R. 5244 that would deprive credit card lenders of some options that are important to effectively manage those risks. Specifically, the lender's ability to price for changing risks presented by an unpaid balance would be limited solely to circumstances where the customer has defaulted on the credit card account itself.

The lender could not use information that is highly relevant to its risk exposure, such as defaults on other credit or deterioration of a credit score, to adjust its pricing for the risk of a credit card balance that a customer has not repaid.

Comptroller Dugan has advocated an alternative approach which we believe is consistent with safe and sound credit card lending practices and the principles of meaningful notice and meaningful choice.

Under this alternative, if a creditor seeks to increase the interest rate on an account balance to address increased credit risk due to a deterioration in a customer's credit score or default on other debt, the lender must first provide the customer with: one, a reasonable advance notice; and two, an opportunity to opt out of the changed terms and to pay down the outstanding card balance in accordance with the existing terms.

If the customer opted out of the rate increase, the lender could then mitigate its risk on that account by using other risk management tools, such as reducing the credit line or allowing the customer to wind down the account over a specified time.

An opt-out structured in this manner strikes a fair balance, preserving the lender's ability to monitor and respond to changes in a customer's creditworthiness while recognizing that, from the customer's perspective, certain price adjustments should be preceded by advance notice and an opportunity for the customer to make alternative credit arrangements.

In closing, let me note that the bulk of the bill's provisions do not raise fundamental safety and soundness concerns. They do reflect real customer frustrations with the adequacy of credit card disclosures and with particular credit card practices.

Yet there may well be tradeoffs between the potential benefits and consequences of some of these measures. In this complex and competitive business, for example, if credit card lenders are restricted in their ability to price particular customer segments for the risks and costs they pose, the alternative may be to spread those costs over a broader range of customers, raising costs for customers who do not pose higher levels of risk.

Provisions of the bill dealing with payment allocation and certain billing practices may present similar issues of unintended consequences if lenders react to mandated changes by making other changes that reduce card features that benefit customers.

Thank you, Chairwoman Maloney, for the opportunity to testify on these issues, and I will be happy to respond to any questions you might have.

[The prepared statement of Ms. Williams can be found on page 332 of the appendix.]

Chairwoman MALONEY. Thank you.

Mr. Bowman?

STATEMENT OF JOHN E. BOWMAN, DEPUTY DIRECTOR, GENERAL COUNSEL, OFFICE OF THRIFT SUPERVISION

Mr. BOWMAN. Good afternoon, Chairwoman Maloney, Ranking Member Biggert, and members of the subcommittee. Thank you for inviting me to present the views of the Office of Thrift Supervision on the Credit Cardholders' Bill of Rights Act of 2008, and to discuss credit card lending in the thrift industry. Thank you also for your leadership on this important subject.

We at the OTS share your commitment to protecting consumers from abusive credit card practices, and during my testimony today I will describe some of the ways we at the OTS are honoring that commitment.

The first way is by responding to consumer complaints and following up on trends or patterns that emerge from our analysis of those complaints.

A second way is through the vigilance of our examiners during their inspections of our regulated institutions, assisted by our team of credit card experts known as the core credit card specialty group. This group pays particular attention to the 13 thrift institutions that have significant credit card operations.

A third way we play our watchdog role over credit card practices is through our enforcement powers, either formally or informally. In one recent example, our examiners found evidence of a potentially abusive subprime credit card lending program in one of our institutions. We directed the institution's board of directors to immediately cease new approvals under the program and to phase out existing accounts. This action, while informal, resulted in the termination of the program in a short time frame after the examination.

We have taken similar actions with our institutions in the past. Perhaps the centerpiece of efforts against credit card abuses is an upcoming notice of proposed rulemaking on unfair and deceptive acts or practices. The OTS issued an advanced notice of proposed rulemaking this past August, and after reviewing the comments we received from consumer groups, industry representatives, members of Congress, and individual citizens, we have decided to move forward and will issue the formal notice in the immediate future.

To ensure uniform rules governing such practices across the federally regulated financial services industry, we are working with the other Federal agencies with rulemaking authority under the FTC Act: the Federal Reserve Board; the National Credit Union Administration; and the Federal Trade Commission. We have also consulted with and briefed the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency.

We consider this interagency approach essential for ensuring a level playing field for the industry. We also support the provision already approved by the House, H.R. 3526, to give the OCC and the FDIC the same rulemaking authority as the OTS, the Federal Reserve Board, and the NCUA under the FTC Act.

In our proposal, we are planning to adopt principles-based standards for unfairness and deception. A practice would be considered unfair if it were likely to cause harm, consumers could not avoid the injury, and the injury was not outweighed by countervailing benefits to consumers or competition. A practice would be deemed deceptive if it involved a material representation or omission that was likely to mislead a consumer acting reasonably.

We also expect to address certain specific practices that have raised concerns, such as retroactive rate increases and double cycle billing, in which finance charges are based on account balances that existed in the past.

Although we share some of the same concerns and are addressing some of the same issues as your bill, we believe the OTS currently has adequate authority to combat abuses by credit card lending programs of OTS-regulated thrifts. We prefer an agile regulatory approach for OTS to respond to whatever unfair or deceptive acts or practices it identifies in the industry or on the horizon. We believe the best approach is to continue to work under our existing statutory authority to develop regulations on an interagency basis.

That you again, Madam Chairwoman. I look forward to responding to your questions.

[The prepared statement of Mr. Bowman can be found on page 94 of the appendix.]

Chairwoman MALONEY. Thank you.

And Ms. Braunstein?

STATEMENT OF SANDRA F. BRAUNSTEIN, DIRECTOR, DIVISION OF CONSUMER AND COMMUNITY AFFAIRS, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Ms. BRAUNSTEIN. Thank you. Chairwoman Maloney, Ranking Member Biggert, and members of the subcommittee, I appreciate the opportunity to discuss the Federal Reserve's ongoing efforts to enhance protections for consumers who use credit cards.

In June 2007, the Board proposed substantial revisions to the credit card disclosures required under the Truth in Lending Act or TILA regulations. Those revisions focused on ensuring that consumers have the information they need about credit card costs and terms when they need it and in a form they can use.

Our TILA proposed rules should result in disclosures that are more effective for today's credit plans. Those who have commented on the proposal have generally agreed. At the same time, over 2,000 comments from individual consumers, a growing body of behavioral research, and our own consumer testing provide evidence that it is increasingly difficult to use disclosure alone to help reasonably diligent consumers avoid incurring unnecessary costs on their complex credit card plans.

Careful measures that would restrict credit card terms or practices may in some instances be more effective than disclosure to prevent particular consumer injuries. Such restrictions, however, can have unintended adverse consequences for consumers, such as reducing the availability of credit or increasing its cost.

Mindful of the advantages and limitations of both disclosure and stricter approaches, this spring, the Board plans to utilize its authority under the Federal Trade Commission Act to propose rules prohibiting unfair or deceptive credit card practices.

In developing the proposed rules, we have consulted H.R. 5244, the Credit Cardholders' Bill of Rights Act of 2008. This comprehensive bill has helped us to identify areas of concern where disclosures alone may not be adequate and stricter approaches under the FTC Act may be warranted.

The potential benefits of disclosure are well-known. More effective disclosures make information about terms and pricing easier for consumers to obtain and understand. Informed consumers are prepared to choose products that offer the best combinations of features and pricing to meet their personal financial needs. Better dissemination of information about credit card terms and pricing also enhances competition among credit card issuers, which helps generate products that consumers want.

Along those lines, the Board's June proposal includes elements such as an enhanced Schumer box with a more effective presentation of rates and fees, including clearer disclosure of penalty rates and fees. Penalty cost information is also included in the account opening summary table with a reminder of late penalty payments on every periodic statement.

The proposed TILA rules also include a requirement for a 45-day notice for the imposition of a penalty rate or increase in fees, and restrictions on the use of the word "fixed" with regard to rates in advertisements.

The Board received over 2,500 comments on the June 2007 proposal, about 2,100 of them from individual consumers. Broadly speaking, commenters generally supported the proposed disclosures and the Board's approach to improving disclosure through consumer testing. Some commenters offered specific suggestions to improve the disclosures or reduce unnecessary burden.

In some cases, the commenters were quite divided over whether we had gone far enough, or instead, too far. Industry commenters felt that the 45-day notice requirement for a rate increase would harm consumers overall by raising credit costs or reducing credit availability. Consumers and consumer groups, in contrast, felt the requirement was not sufficient to protect consumers, and urged stricter approaches, such as giving the consumer the right to opt out of a rate increase for existing balances, or prohibiting issuers from applying increased rates to preexisting balances.

Consumers and consumer groups also identified other issues they believe better disclosure will not resolve, such as shortening the time to submit payments, allocating payments first to balances with the lowest interest rate, and computing interest using the so-called double cycle method. They urged stricter approaches for these issues as well, while industry commenters contended that disclosure solutions were best for consumers and warned that stricter approaches could hurt them.

The Federal Reserve remains strongly committed to enhancing consumers' ability to use credit cards to their benefit. Our work is continuing on improving the proposed disclosures through additional consumer testing, and this spring we will issue proposed rules to address targeted and specific practices. We plan to finalize both the TILA disclosure rules and the FTC Act unfair and deceptive rules before the end of the year.

Thank you for the opportunity to appear. I will be happy to answer any questions from the committee.

[The prepared statement of Ms. Braunstein can be found on page 107 of the appendix.]

Chairwoman MALONEY. Thank you. I thank you and everyone, all the panelists, for your testimony before the subcommittee. And I know that it has been a very busy time for all of you.

I would like to commend the Federal Reserve for undertaking the significant step of rewriting and updating many of the disclosures made to credit card companies under Regulation Z. I know that many members of this committee support your efforts, and we eagerly await the final rules that will be coming forward.

Additionally, I would like to note that Chairman Bernanke announced to us in February that the Federal Reserve, in consultation with the other regulators, was starting the process of using your authority to regulate unfair and deceptive acts and practices. And you stated you would be able to release this in the spring or before the end of the year. Could you be more definitive? Which month would this be coming out?

Ms. BRAUNSTEIN. Well, when I was referring to the spring, which—in the next few months, we are going to be releasing our proposed rules under the FTC Act and some additional pieces of TILA. That will be out for public comment. And then after that comment period is over, what we plan to do is roll that in with the final rules for the TILA proposal we released last year and release the final rules for everything all at one time, which will be before the end of the year.

We think that is a better way of doing that, and we have also heard that from the industry. The rules, first of all, intersect with each other. The FTC rules and the TILA rules intersect. And if the industry needs to make a lot of changes to their systems and their operations, it is better to do it all at the same time. So that is why we are rolling it together.

Chairwoman MALONEY. Thank you. An American Banker article written soon after the chairman's announcement of the proposed use of the unfair and deceptive acts and practices authority stated, "The plan would severely curtail double cycle billing, require card companies to let consumers opt out of an interest rate hike, and provide guidance on the allocation of payments."

Each of these proposals is addressed in our legislation. Can you expand on some of the specifics you are looking at and what particular practices you are proposing to rein in?

Ms. BRAUNSTEIN. The practices that are listed—I am not sure where the American Banker got that information. But the practices that are listed in your bill, as well as things we heard about in our comment letters, the comment letters we received on TILA, are all things that we are looking at.

The final decisions have not been made yet, so it would be premature for me to say exactly what we are doing. But we are certainly looking at things like charging increasing rates on existing balances, payment allocation, double cycle billing, the timeliness of statements, and giving people adequate time to pay. We are looking at all those things, and very seriously, in terms of this rulemaking.

Chairwoman MALONEY. Does the Reg Z and Unfair and Deceptive Practices Act and authority provide you with all of the tools necessary to do everything that my legislation presents?

Ms. BRAUNSTEIN. Well, Reg Z doesn't because Reg Z is TILA. That is why we are also utilizing—complementary to Reg Z, we are utilizing the FTC authority, which is a different authority.

Chairwoman MALONEY. Thank you. I would like to return to the testimony of Mr. Gruenberg and Ms. Williams. It appears from your testimony that the FDIC agrees with some of the provisions of our bill which the OCC does not agree with. I would like to explore this a little further.

As I understand it from your testimony, you both agree with the bill's core provision, that a cardholder or consumer should have notice and choice of any rate increase, and have the opportunity to be properly notified, and have the opportunity to opt out of the rate increase and pay off the existing balance at the agreed-upon contract. Is that correct? You both agree with that?

Mr. GRUENBERG. Yes, Madam Chairwoman.

Chairwoman MALONEY. And Ms. Williams?

Ms. WILLIAMS. Yes.

Chairwoman MALONEY. Where you differ is in how to handle universal default under the bill. A card company can raise rates using universal default or off-account behavior, but only going forward. As I understand it, the FDIC agrees with this, but the OCC supports the repricing tool, including allowing card companies to raise the rate on consumers who are never late, never go over their existing balances, and to retroactively raise rates on those balances even though they pay on time, never go over the limit on their card, but because of some outside behavior.

If you would like to elaborate, both of you, if you would explain your positions on this.

Ms. WILLIAMS. Certainly. I would be happy to. As I set out in my testimony, we look to three principles in our evaluation and assessment of the provisions of your bill, and one of them is giving a credit card lender the ability to manage their risk effectively.

There are a variety of circumstances that can be indicative of increased credit risk being presented by a customer that are events that are not the customer's default on the card itself.

This could be relevant risk management information to the credit card lender that the credit card lender should be able to take into account in dealing with the two types of risk that I described, both the risk of the continuation of the extensions of credit on the existing balance, and the rate that the customer is charged on a going-forward basis for new charges. To address risk, the credit card lender should retain the ability to so-called "reprice" the balance, but to do that only after giving the customer the opportunity to opt out of that increase, to keep their existing rate and to pay down the account, and to close out the account over a period of time that would be specified by the lender.

The credit card customer would not be forced to take the higher rate. The credit card customer would have the option and the ability to opt out of the higher rate.

Chairwoman MALONEY. That is what our bill does. It allows them to reprice, but you must notify the customer, the consumer, of your rate increase. And it allows the consumer the opportunity to opt out and pay off the balance at the existing rate.

As I understand it, you are proposing that the increased rate could then revert back to the balance, which would make it incredibly hard for the consumer to pay it off. Is that correct?

Ms. WILLIAMS. Chairwoman Maloney, your bill would allow what we are referring to as repricing, which is raising the rate on an existing balance, only in the circumstance where the customer has defaulted on the card itself. It would not allow the credit card lender to react to other risks that the credit card customer presents and to reprice the existing balance based on those other risks.

Where we differ is that we would want to preserve that option for the lender, but subject to the customer's ability to opt out.

Chairwoman MALONEY. Well, we do differ on that. And I don't see how increasing a cardholder's debt retroactively makes them more able to manage their debt or pay it off. I would ask Mr. Gruenberg to comment on this. As I understand it, you differ with the OCC on this provision.

Mr. GRUENBERG. We basically agree with the point you just made. The issue here is really the prospective or retrospective application in the universal default situation. Under the provisions of your bill, as I understand it, if a customer has been making their payments and the card issuer evaluates the customer based on credit activity unrelated to the card, and makes a judgment that based on that unrelated activity, the card issuer wants to make an adjustment in the terms, under your provision they would be permitted to do that prospectively, on debt incurred by the customer going forward.

On debt that the customer has already incurred that is outstanding and that the customer has been making payment on, they would not be able to do that. That strikes us as reasonable from a standpoint of fair dealing and from a perspective of risk management as well. If a customer has incurred debt based on certain conditions that the customer understood—

Chairwoman MALONEY. Well, thank you for—

Mr. GRUENBERG. —and then that is changed, that in itself can present a problem.

Chairwoman MALONEY. Thank you for your testimony. My time has expired. I would just like to say that 10 editorial boards in our country, regional major editorial boards, agree with the position of the FDIC in support of the legislation we are considering.

I thank everyone for their testimony, and I recognize my colleague and good friend, Ranking Member Biggert.

Mrs. BIGGERT. Thank you, Madam Chairwoman. Before we begin, if I might ask unanimous consent to insert into the record Section 2845 of the U.S. Master Tax Guide, which deals with interest on penalties for the IRS. In one of the panels, it came up that nobody else has charged interest on penalties. And certainly our beloved IRS does.

Then, Ms. Braunstein, I just want to wish you a happy birthday.

Ms. BRAUNSTEIN. Thank you. This is not the way I envisioned spending it.

Mrs. BIGGERT. That is right. Well, we hope that you have a little more time to enjoy the day, and we won't take up too much more of your time.

But could you please describe the studies, comments, and testing that the Fed has conducted and for how long as it works to update Regulation Z? We have heard from a few consumers here today and heard about those who testified at the Senate. So based on your testing and studies and comments received on Regulation Z, do you think that those positions represent the majority of borrowers?

Ms. BRAUNSTEIN. Well, first of all, about the testing, we engaged in extremely extensive consumer testing to develop our proposed credit card disclosures, and that testing process has not concluded yet. We are doing more testing now in preparation for the final rules. There are still things that we are checking out.

Mrs. BIGGERT. And by testing, what do you mean?

Ms. BRAUNSTEIN. We actually have gone out around the country and conducted focus groups with consumers, first of all, to find out what kind of information is important to consumers in shopping for cards, and what kind of information consumers want to know in terms of how to use their cards and the terms of their cards and the cost of their cards.

And then after we hired a professional firm to do this, that has done this for many years, and then working with them, we designed new disclosures and then went back out and conducted more testing, including individual interviews with people, to look at the new forms and see if they worked better than what existed.

One of the things that we learned that was very important to us was the use of language. One example that I have used that is very telling is that most of us in this room probably know what is meant when we talk about default pricing on credit cards. We know that usually means a higher rate, and it means that you did something wrong either on your account or another account, and you are getting charged more.

When we tested that, consumer testing, we found that consumers understood the word default the way you would use it on your computer, as the default setting, which on a computer is the normal or standard setting for that operation, and so that consumers actually, when they looked at the old disclosures and saw default pricing, many of them thought that was the normal price.

Mrs. BIGGERT. You must have had a lot of young people that you tested.

Ms. BRAUNSTEIN. So anyway, but that is just one example where, in the newly designed disclosures that we propose, we have gotten rid of that term altogether. We now use the term penalty pricing, which when we consumer tested was much clearer to people. So that is just an example. And we did that on a number of different things.

We are huge believers in this. We think it definitely takes time. It is time-consuming. But it definitely results in a much better product and clearer information for consumers.

Mrs. BIGGERT. So do you think that when you talk to the consumers that the positions that we heard today was the majority, or were those—

Ms. BRAUNSTEIN. Well, I can tell you this, and I mentioned this in my opening comments. It is hard for me to say. But one thing we did find startling, you know, we do a lot of rulemakings and we get a huge number of comments on some of our rulemakings. We received over 2,000 comments from individual consumers on the credit card rules.

Now, that is not a record at all, by any means, in terms of number of comments. I mean, we have gotten over 5,000 on the HOEPA rules. But what was very unique about this comment database is the fact that normally when we get large numbers of letters, a lot of them, very frankly, are form letters that an organization has issued to its membership, and people just sign it and send it in, and they all say the same thing.

We had over 2,000 letters on the credit card proposal from individuals that were truly personally, individually written about people's personal experiences with their cards. We have never had that on any rulemaking before. So I have to tell you that did kind of—that resonated with us, and it provided a very rich anecdotal database that we have used in working on the rules for the FTC Act.

Mrs. BIGGERT. Now, you already talked about UDAP. I was going to ask you about that, but I won't. Can you just—well, I just have one question for Julie Williams of the OCC.

Can you describe some of the steps that the OCC has taken to address concerns that have been raised over the years about credit card practices, and have you seen any improvement in these practices?

Ms. WILLIAMS. Yes, Congresswoman. We have been very active over the years in taking actions and issuing guidance to address various types of credit card practices that gave us concerns. We took the lead in the development of the interagency credit card account management guidance, which brought about important reforms in overlimit practices, minimum payment requirements, and eliminating negative amortization.

We have issued separate guidance on particular credit card marketing practices, and we have issued separate guidance on secured credit cards. Some of the issues that you heard about this morning, including the individual who had overlimit fees charged 47 times, and clarifying the use of the term "fixed," are issues that have been addressed in the various guidances that I refer to.

That said, we heartily support the Fed's rulemaking effort here. Uniform, consumer-tested disclosures are critically important. This really links very much, Congresswoman Biggert, to your concerns about overall financial literacy. We are not helping people reach the point of financial literacy with respect to credit cards with the types of disclosures that they are getting today, and the approach that the Fed is poised to implement I think will be enormously constructive in that regard.

Mrs. BIGGERT. Thank you. Then back to Ms. Braunstein. Could you describe for us UDAP, what it is, and what could a new UDAP rule mean for consumers and borrowers?

Ms. BRAUNSTEIN. Well, UDAP is Unfair and Deceptive Acts or Practices, and it is an authority that is granted through the Federal Trade Commission Act, and basically allows us to ban or restrict practices that we think would harm consumers in cases where consumers would have a difficult time avoiding those practices, or in some cases would be extremely harmful to consumers, or a reasonable consumer, reasonably intelligent consumer, could not avoid them, could not figure out how to avoid them.

And there are some practices that we are looking at to see whether they are so complicated that even though we are very much advocating our approach under TILA for increased disclosure, there are some practices that we think may be so complex and difficult for consumers to understand that it may be important in order to do some targeted banning of those practices.

Chairwoman MALONEY. Thank you. The gentlewoman's time is over. I now recognize Chairman Watt.

Mr. WATT. Thank you, Madam Chairwoman. And let me congratulate the Chair. I didn't ask the consumer witnesses any questions, but I thought it was a wonderful idea to have them here to express some of the concerns that we hear regularly in our congressional districts about credit cards. That was an important ingredient of today's hearing.

I have a couple of specific questions that I want to try to address here. Mr. Gruenberg, in your testimony on page 9, you say the strength of the unfair and deceptive acts or practices is limited by the need to make case-by-case determinations, and then, depending on the problem being addressed, to decide appropriate corrective action. While this approach results in changes to practices at individual institutions, it does not necessarily result in changes industry-wide.

Ms. Braunstein, is that the way you all are applying this? Or are you applying your authority under unfair and deceptive trade practices to deal with unfair and deceptive trade practices more broadly than his testimony suggests?

Ms. BRAUNSTEIN. Through writing rules, we will be applying it more broadly. We have applied it the way you just described in our supervision process.

Mr. WATT. Okay, there is not a conflict there, so you are going to have a broad set of rules at some point. It sounds like in some respects, your rules may be somewhat at odds with what the Comptroller's Office and the Thrift Supervision Office are talking about.

How are you all going to reconcile those? Weren't there some differences? Because the worst thing we could have at the end of the day is a set of conflicting rules out there, some from the Fed, some from the other regulators.

Mr. GRUENBERG. Congressman Watt, I think it is important to note, as Ms. Braunstein did and I have as well, that what we are talking about is an interagency rule by those agencies—the Fed, the OTS, the NCUA, and the FTC—that have the current authority under the Federal Trade Commission Act to promulgate rules that will be applied as you suggest.

Mr. WATT. I don't understand what you just said. I am sorry. What I want to know is: Is there the prospect that we will have a different set of rules applying to different entities out there that are issuing credit cards? Because I think that would be—

Ms. BRAUNSTEIN. No. Under what we are doing now is that the OTS and the Federal Reserve and the NCUA, which are the three agencies that are going to be issuing the proposal, are all going to issue pretty much the same proposal, so that way, there will be uniformity. And regardless of whether it is a bank or a thrift or a credit union, they will all have the same rules.

Mr. WATT. Now, you are saying something different than that, Mr. Gruenberg?

Mr. GRUENBERG. No, sir. No, sir, I agree.

Ms. WILLIAMS. Congressman, maybe there is a missing piece here, and that is that the Fed has rulemaking authority with respect to all banks, all types of banks today. So when we talk about the Fed's rulemaking—

Mr. WATT. I understand. But if you have authority to do it with respect to credit unions and other folks, and you all come out with two different sets of rules or three different sets—

Ms. WILLIAMS. We don't have rulemaking authority.

Mr. WATT. Just reassure me that there will be one set of rules once you all do—

Mr. GRUENBERG. There will be.

Ms. BRAUNSTEIN. Yes. There will be.

Mr. WATT. Okay. That is all I want to be reassured about.

Now, the other encouraging thing, since my knowledge of the Senate—I am not supposed to say that—my knowledge of the other body suggests that even if we did a bill on this side, you all are going to have your rules out before we ever get it enacted. So that is why I am dwelling on this.

The encouraging thing is that you have said that you are taking Ms. Maloney's legislation into account in drafting your rules. I heard you say that.

Ms. BRAUNSTEIN. Absolutely.

Mr. WATT. Okay. And so a lot of the things that are in Ms. Maloney's bill you expect—in one form or another, given your testing and consumer and stuff—you expect some of that stuff to be in there?

Ms. BRAUNSTEIN. Yes. I would say that is true.

Mr. WATT. All right. That is all the questions I have. I think we are moving in the right direction, and I am—just to reassure the Chair, I am planning to get on her bill. I have been looking at it very carefully, and there are some specific issues that I want to deal with, but they are not so great that I won't be on the bill. So just be reassured that in the next week or so, I will be there.

Chairwoman MALONEY. Thank you so much, Chairman Watt, for your thoughtful comments.

The Chair recognizes Ranking Member Bachus.

Mr. BACHUS. Thank you. And if I could ask the Chair, before my time starts, if I could have a unanimous consent request to introduce—

Chairwoman MALONEY. Absolutely.

Mr. BACHUS. Paul Gillmor, when he was ranking member of the Subcommittee on Financial Institutions, he and I in February of 2007, not 2008, we wrote the Federal Reserve and expressed our opinion that they should accelerate the Regulation Z process. I got a very prompt answer from Chairman Bernanke at that time telling me that they were moving forward. I want to introduce those letters into the record.

One thing we said in our letter to him—and we wrote in February; as you know, Mr. Gillmor passed away September 5th of last year—is that the Board is to review provisions every 5 years to update them in light of industry developments and also consumer issues.

But Regulation Z hasn't been subject to a comprehensive review since 1982. So we are—it has been very late coming, which I think is a shame. I am not saying I am ashamed of it; I am just saying that it is unfortunate.

So I would like to introduce those letters.

And now, I would like to have my 5 minutes, if I may. Thank you.

My first question, Mr. Gruenfield—Gruenberg, I am sorry—you said that disclosures are not enough. Is that correct?

Mr. GRUENBERG. [Nods head affirmatively]

Mr. BACHUS. Would you all all agree to that?

Ms. WILLIAMS. Well, Congressman Bachus, as I think some of the other panelists have said, there may be some situations where a particular practice is very complex. And it is very difficult—

Mr. BACHUS. No. And let me say, I don't think disclosures are enough.

Ms. WILLIAMS. Independent—and independent of that—

Mr. BACHUS. I think there are situations where if there are consumer abuses—

Ms. WILLIAMS. Absolutely. And independent of that—

Mr. BACHUS. —there ought to be more than disclosures.

Ms. WILLIAMS. We have taken enforcement actions in situations when we felt that there were unfair or deceptive practices that banks were conducting.

Mr. BACHUS. Are we hearing from the regulators that you are moving to address those abusive practices? Can I be assured that you are?

Ms. WILLIAMS. Absolutely.

Mr. GRUENBERG. Yes.

Ms. BRAUNSTEIN. Yes.

Mr. BACHUS. Not just on a case-by-case basis?

Mr. GRUENBERG. No.

Ms. BRAUNSTEIN. No. That is the purpose of the rulemaking that the OTS and the Federal Reserve are doing.

Mr. BACHUS. Mr. Autrey, the consumer, mentioned something, and it is not the first time it has been mentioned, and that is reporting credit limit as the—or the current balance as the credit limit. I don't know whether that is, in fact, happening. But that could be a problem, could it not, for the consumer?

Ms. WILLIAMS. Our position is that the credit limit is what should be reported. Regarding the particular institution in question, since that incident, it has become a national bank, so its practices are changing.

Mr. BACHUS. So if he had a credit limit of $5,000, his account was closed because he had the right to close it, then as he paid it down—

Ms. WILLIAMS. What the credit bureau would be showing, or should be showing for the customer, is what the credit limit is, not what the current balance is. His issue was that it was just the current balance being reflected, and so all the information that was available would indicate that was his limit, and that—

Mr. BACHUS. Also, let me ask you this. In the event that a consumer says, "Close my account," or he opted to close his account, are there instances that, as regulators, you have run into where it actually says the institution closed the account as opposed to customer requested? Is that—

Ms. WILLIAMS. Congressman Bachus, to make sure I give you the correct answer on that, I would like to get back to you on that.

Mr. BACHUS. Okay. Let's just suppose that a customer says, "I want my account closed." He calls a 1–800 number and says, "Close my account." Then he writes them, and in the interim, the institution closes that account. There ought to be some accuracy as to—or consumer requested and institution closed, or—because apparently, there is a difference in why that account was closed. And I think it is very important.

Ms. WILLIAMS. I would be happy to get back to you with that.

Mr. BACHUS. Thank you. Mr. Gruenberg says that the FTC finds that there are—under UDAP, that there are a lot of problematic practices. The bill that we passed last year, H.R. 3526, giving you—and it actually would give, as I recall, the Fed and the OCC—and the Fed and the OTS already have the powers. Right?

Ms. BRAUNSTEIN. We already have it. Yes.

Mr. BACHUS. So this would be the OCC and the FDIC. Will this be a help? I mean, the FDIC is saying it will.

Mr. GRUENBERG. We believe it would, Congressman.

Mr. BACHUS. What?

Mr. GRUENBERG. I said, we very much believe it would, and we are strongly supportive and grateful for the legislation that the committee and the House acted on.

Mr. BACHUS. Will this allow you to—now, that bill has not passed the Senate.

Ms. WILLIAMS. That is correct.

Mr. BACHUS. If that bill were to pass the Senate and go to the President and he signed it, would that give you a greater ability to protect consumers against abuses?

Mr. GRUENBERG. We believe it would. Let me try to just clarify this because it has come up, and this is the issue that the bill addresses. Currently, only the Federal Reserve, the Office of Thrift Supervision, and the National Credit Union Administration have the ability to do rulemaking which would apply to all the institutions that they supervise.

The OCC and the FDIC do not have rulemaking authority. We can only enforce on a case-by-case basis, which is a much more limited authority. And what your legislation would do would be to grant to us the same rulemaking authority that the other agencies have. This would expand our ability to address these issues across-the-board for the institutions we supervise, and would also allow us to engage in joint rulemaking with the other agencies to assure we have an across-the-board treatment.

Mr. BACHUS. Thank you.

Chairwoman MALONEY. Thank you. The gentleman's time has expired. The Chair recognizes Chairwoman Waters.

Ms. WATERS. Thank you very much, Madam Chairwoman. I have had to be in and out, but I have tried to spend as much time as I possibly can so I can learn the responsibility of these various regulatory agencies.

It would be very nice if regulation and oversight for credit cards could all be combined in one agency. I suspect, because these agencies are looking at these various institutions in total, it is necessary to look at them not only in relationship to the other services that they provide, but the credit cards also.

But only one of you have rulemaking authority. Is that correct? Two? Which two?

Ms. BRAUNSTEIN. The Federal Reserve and the Office of Thrift Supervision.

Ms. WATERS. Well, in the rulemaking that you describe, where you will be taking a look at some of the chairwoman's proposals in her legislation, who will be responsible for taking those recommendations into consideration?

Ms. BRAUNSTEIN. We are working together on doing that. Because of the way it is structured, there will be two separate rules, but the rules should be identical. One would be the OTS would issue rules for thrifts, and the rules that we issue at the Federal Reserve will cover all banks. And that would include banks that are supervised by the OCC and the FDIC.

Ms. WATERS. Who has the responsibility for the creation of new products?

Ms. BRAUNSTEIN. Creation of new—

Ms. WATERS. New credit card products.

Ms. BRAUNSTEIN. Oh, new products.

Ms. WATERS. Who has that responsibility? For example, when a credit card companies decides that it is going to have retroactive interest rate increases or other practices that we have heard here, who has the responsibility for seeing those new products before they are introduced to the consumer?

Ms. BRAUNSTEIN. The regulatory agencies. That would be normal business practice of the financial institutions. Certainly their array of products would likely be looked at during a supervisory examination. But they don't come to a regulatory agency for approval to introduce new products.

Ms. WATERS. Well, I thought somebody had the responsibility for protecting the consumer against products that would do them harm. Who said that?

Ms. WILLIAMS. Congresswoman Waters, maybe I can jump in here a little bit?

Ms. WATERS. Yes.

Ms. WILLIAMS. As part of our regular supervisory process and the dialogue that we have with the national banks that are credit card issuers, it is fairly customary that we are having discussions with them about new products that they are thinking of offering, and changes in product features and terms. And there is a lot of flexibility under the current law in the terms and conditions that can be provided.

When a product is then offered, if it is offered in a way or if it is structured in a way that is inherently unfair or deceptive, we have enforcement authority and we have the ability, again as part of our regulatory oversight—

Ms. WATERS. May I stop you? May I just stop you at this point?

Ms. WILLIAMS. Sure.

Ms. WATERS. I have a great respect for disclosure. But I really don't want to be told about something that you have seen and you had the ability to determine whether or not it was unfair in your discussions. That brings us to where we are now. Here we are with the chairwoman of this subcommittee having the wisdom and the foresight to take a look at all of these deceptive practices and try and place something in law.

But you have seen all of this before it ever hits the public. You have seen it. You have—I am not sure what your authority is. You discuss it. And it goes—it is instituted. And then maybe we get some disclosure to tell us what it is.

But what I am interested in is consumer protection. And I am not interested in the Congress of the United States having to do this kind of work every few years when we have all of these regulatory agencies running over each other that are supposed to be providing some protection for us.

Now, that is my feeling. Tell me why I am wrong.

Ms. WILLIAMS. Congresswoman, we are interested in consumer protection, too, very much.

Ms. WATERS. Why don't—

Ms. WILLIAMS. And what we do is we take supervisory actions, we take enforcement actions, to deal with these practices.

Ms. WATERS. Did you see the practice of the interest rate increases on unsuspecting customers who had signed a contract or gotten involved with a credit card company based on an interest rate, only to have it increase maybe one, two, or three times after they were into the—did you see that before it happened?

Ms. WILLIAMS. We are very, very strongly in favor of improved disclosures in this area.

Ms. WATERS. Did you see what—did you see that practice before it was introduced to the consumer?

Ms. WILLIAMS. I don't know what particular practice you are referring to. But the practices are—

Ms. WATERS. All right. I am talking about the first practice in the credit card bill of rights. Do you have a copy of that?

Ms. WILLIAMS. I am sorry.

Ms. WATERS. The first practice that is spoken to in the credit card bill of rights. Where is that? Somebody hand me the credit card bill of rights here so we can all get on the same page. Universal default, is that what it is?

Ms. WILLIAMS. Yes.

Ms. WATERS. Did you have an opportunity to discuss universal default?

Ms. WILLIAMS. The term universal default is one term that is sometimes used for what I have described as risk-based pricing.

Ms. WATERS. You don't understand what it is?

Ms. WILLIAMS. And yes, that—

Ms. WATERS. You don't understand what universal default is?

Ms. WILLIAMS. Yes, we do.

Ms. WATERS. Did you see it before it became practice?

Ms. WILLIAMS. That has been a practice for some time, and we do see it as it is implemented.

Ms. WATERS. So you did nothing to deem that was an unfair practice, an abusive practice, and perhaps would be harmful to consumers?

Ms. WILLIAMS. We have taken actions where the nature of that practice has not been adequately disclosed to the consumers in advance.

Ms. WATERS. So as you see your responsibility, it was to disclose it, to let the consumers know that you are going to get ripped off, that your interest rates are going to be increased, and that is the extent of your authority. Is that right?

Ms. WILLIAMS. We don't have rulemaking authority to prohibit it in this area. We have the authority to take case-by-case enforcement action.

Ms. WATERS. All right. Let me ask the whole panel: Who has rulemaking authority in this area? Who saw the practice, the product, before it was introduced to the consumer, and what did you do about it?

Chairwoman MALONEY. After this is answered, the gentlewoman's time has expired. But that is an important question. And if we could start with you, Mr. Gruenberg, and go down the panel. Thank you very much, Congresswoman.

Ms. WATERS. Is it going to be answered?

Mr. GRUENBERG. Yes, ma'am.

Ms. WATERS. All right. Thank you.

Mr. GRUENBERG. Congresswoman, I think the answer is that this is the reason, quite frankly, legislation and/or regulatory rulemaking is needed, to address practices that have not been clear in terms of the application of the Unfair and Deceptive Practices Act in the past.

That is why the proposal, the legislative proposal before the subcommittee to address this practice in law is an important step. And in addition, as has been discussed, the Federal Reserve and the Office of Thrift Supervision have current authority to do rulemaking across-the-board to address these issues as well. This is what needs to be done.

Chairwoman MALONEY. Ms. Williams, would you like to respond?

Ms. WILLIAMS. As I said, we have the ability to take actions on a case-by-case basis against unfair or deceptive practices, but we don't have rulemaking authority in this area. That is something that would be corrected both for the OCC and the FDIC with the legislation that this committee has passed.

Chairwoman MALONEY. Mr. Bowman?

Mr. BOWMAN. Yes. I think, as Ms. Braunstein may have mentioned, there are a number of items in your proposed legislation that we are considering, seriously considering, dealing with in our proposed unfair and deceptive acts and practices regulation.

Ms. BRAUNSTEIN. And yes, I would reiterate that this is one of the practices that we are concerned about and we are looking at very seriously for our rulemaking. But I would also add that even though the other agencies do not have rulemaking authority, everyone has the authority for enforcement through supervision. And had the case been made for unfair and deceptive for any practice, the agencies all have the authority to take enforcement actions on that.

Chairwoman MALONEY. The Chair grants an additional minute to Chairwoman Waters.

Ms. WATERS. Thank you very much. Ms. Braunstein, I would like you to speak directly to the question that I was raising earlier. Did you see the practice, universal default, did you see the practice before it was implemented?

Ms. BRAUNSTEIN. I can't speak for the entire agency.

Ms. WATERS. No. I just—

Ms. BRAUNSTEIN. For myself personally, before it was implemented, no. We became aware of it, obviously, after credit card issuers were doing universal default.

Ms. WATERS. Well, what I am trying to determine is, if I may, Madam Chairwoman, what good is a regulatory agency with the responsibility to see new products, new practices, and see that they are unfair, they may be abusive, and you do nothing about it until the Congress of the United States implements a terribly long procedure in order to correct it? Will this chairwoman or this committee have to do that on every unfair practice that is implemented, or what are you good for? What do you do?

Chairwoman MALONEY. The gentlewoman's time has expired. But Ms. Braunstein, if you could respond to her very pointed question. She has raised a concern that many Members of Congress feel for their constituents.

Ms. BRAUNSTEIN. Well, the first step that we took—we have been concerned about credit card practices, and the first thing that we did was to improve disclosures because we felt that that was an important first step in this process. And then we have moved forward to address unfair and deceptive practices head-on through this UDAP rulemaking, and we are doing that. And we are moving forward.

Chairwoman MALONEY. Thank you very much. The gentlelady's time has expired, and the Chair recognizes, in the spirit of the bipartisan cooperation in this committee, Ms. Biggert, Ranking Member Biggert.

Mrs. BIGGERT. Thank you very much, Madam Chairwoman. I appreciate it.

I just have one last question for Ms. Braunstein, and that is: Could you tell us what are some of the proposals in Reg Z that will help consumers better shop for a credit card and will protect borrowers? What are some of the things that you are looking at?

Ms. BRAUNSTEIN. One of the main things that we did through redesigning disclosures is to greatly improve and enhance the Schumer box, which has been—the Schumer box itself, we found in our consumer testing, has been a very successful innovation. People actually said, when we talked to consumers and asked them, how do you shop for a credit card, many of them said, when I open this piece of mail up, I look for the box.

But what we found is that we thought there could be improvements in terms of really making it much clearer what the costs are of this card and, in particular, the penalty pricing, what conditions would cause that penalty pricing to kick in, so that people would have much better information.

We also have a number of rules around advertising, and one of them is that we did see practices in the past of institutions advertising fixed rates on credit cards when in fact they were not fixed. And so we have added rules along those lines to say that you can't use the term "fixed" unless you are much more specific about for what period of time and under what conditions.

Mrs. BIGGERT. Anything else?

Ms. BRAUNSTEIN. Yes. One of the big ones I want to mention is that we do—we also instituted a 45-day waiting period for changing terms for any increases in rates or fees, that an institution must give a consumer a 45-day notice, which would provide that consumer with an opportunity to either go back and renegotiate with their card institution or to leave that institution and find another product with another institution.

Mrs. BIGGERT. What about advertising? Is there anything that—

Ms. BRAUNSTEIN. Oh, yes. I was mentioning that we put a number of restrictions around the use of the term fixed to make sure that people understood that credit card rates, for the most part, are not fixed, not the way people generally think of it.

Mrs. BIGGERT. Some people might not know what the Schumer box is, but it is a box that is actually—is it in boldface? Is it—

Ms. BRAUNSTEIN. Yes. We have guidelines around the typeface and the array of information. And it is a box that shows up—it has always shown up on solicitations. We now not only use it on solicitations, but we also have moved it and use it on account opening disclosures because we found that people really did pick up information much better through a tabular format than they do through dense prose.

Mrs. BIGGERT. And I don't know if you mentioned this, but the cost of the fees, that is in that box?

Ms. BRAUNSTEIN. Yes. We increased the—we have improved it in terms of highlighting what the fees are, and for penalty rates and things like that, and under what conditions they would kick in.

Mrs. BIGGERT. I yield my remaining time to Ranking Member Bachus.

Mr. BACHUS. Thank you. And actually, you had indicated you wanted to go to the gentleman, Mr. Cleaver?

Chairwoman MALONEY. Would you like me to go to Mr. Cleaver first or to recognize you?

Mr. BACHUS. Well, I just have one question. But I don't want to jump in front of Mr. Cleaver.

Chairwoman MALONEY. She is yielding her remaining time.

Mr. BACHUS. All right. We have seen a problem in the mortgage lending market restricting credit for borrowers. Is there anything in the Maloney bill that causes you concern that it may actually restrict credit to consumers who may want and need a credit card and it may not be available? I mean, is that a concern?

Ms. BRAUNSTEIN. Yes. It is a concern, and it is something that we always look at, unintended consequences of overly restricting credit or even raising the costs of credit. And it is something that we are looking at in terms of doing our UDAP rules. In terms of the specifics of that, I think you would probably have to ask the industry.

Mr. BACHUS. What now?

Ms. BRAUNSTEIN. I say in terms of the specifics, I can't say for sure how much or what the effects are. You would probably have to ask the next panel.

Mr. BACHUS. Yes. And I am not asking you how you ought to say that. I am asking just—that is it.

I have one other question. Of course, earlier, I think I pretty strongly took the position that I don't think disclosures—well, the whole issue. I think there are deceptive practices or abusive practices. And I think what I have heard from you is that you are moving against those.

Everyone agrees that credit cards have become more complex and somewhat more confusing. Has part of that complexity benefitted customers because they can shop for a product that best suits their needs? As you address the complexity, is that something you would factor in?

Ms. BRAUNSTEIN. Well, yes. Certainly a wide array of products offers consumers a lot of choices. But that only works if consumers can comprehend what those choices are.

Mr. BACHUS. I agree.

Ms. WILLIAMS. I would completely agree with the way Sandy has said it. Complexity equates to options. There are a lot of different choices. But if there isn't good disclosure for the consumer to understand the consequences of those options, you don't get to where you want to be.

Mr. BACHUS. No matter how complex, it ought to be able to disclose clearly to a consumer. Thank you.

Chairwoman MALONEY. Thank you. The Chair recognizes Congressman Cleaver, and recognizes his hard work. He has introduced his own credit card reform bill with Mr. Udall. I would also like to note that I have been informed that there will be votes at 1:15 p.m..

Mr. Cleaver.

Mr. CLEAVER. Thank you, Madam Chairwoman. And thank you for your work on this legislation.

I would like to ask four questions. And so, if you would, because time is of the essence, if you would be economical in your answers, the first, and Ms. Williams, maybe you can help. I just need to understand this. The U.S. savings rate is minus one percent compared to almost 20 percent for the Japanese, and, we are having a credit crunch.

Can you explain or help me understand how in a situation like this where we're really having some credit issues that are becoming worldwide, how the credit card industry can make 5.4 billion offers at a time when people don't have money? They're spending money with credit cards that they don't have.

Ms. WILLIAMS. Congressman, very quickly, the credit card companies employ some very sophisticated techniques to try to identify groups of customers that would be likely candidates for their credit cards. And then they make determinations about issuing the cards based on that criteria. I suggest you ask the industry panel to address that in more detail.

Mr. CLEAVER. I will. In the bill Congressman Udall and I have put together, we have a section that deals with underage consumers.

Ms. Braunstein, are you familiar with our legislation?

Ms. BRAUNSTEIN. Actually, I'm sorry, no. I'm not.

Mr. CLEAVER. Okay, I'm not offended, but do you think that more needs to be done to protect underage consumers? For example, our bill would require that no credit cardholder could be under 18 unless he or she received a card on the credit of a sponsor, a parent or a sibling, who would sign for it. Because at 5.3 billion, many of those people are students.

And you go to colleges and they have a table set up in the student union so that kids with no jobs can get credit cards. That just seems to me to be really dumb. And if somebody gave my son a credit card, they deserve not to be paid. I mean, he is in college right now. And when we do the mark-up on this bill, hopefully we can do something along those lines.

But to the regulating agencies, is that something that you would think should be a part of the regulations, Mr. Bowman?

Ms. BRAUNSTEIN. I think.

Mr. CLEAVER. Either one of you.

Mr. BOWMAN. As a parent of a college-age son, I would agree with your analysis. It is of great concern. I'll even point out that in reviewing some mail that came into my house last week, what I thought was a solicitation, actually, ended up being a credit card that he apparently had applied for and had received.

I will tell you that it made for a sleepless night on my part, and I hope that, in fact I feel fairly confident, that my son will make every effort to satisfy whatever obligations he incurs, but it is troubling. He is 22 and, I think, financially literate. But there are temptations that credit cards do provide.

Mr. BACHUS. Can I ask for some clarification just without taking the gentleman's time or extending his time?

Chairwoman MALONEY. Does the gentleman yield for point of clarification?

Mr. CLEAVER. Yes.

Mr. BACHUS. Is this a blanket prohibition under 18 without parents? What if you had a 16- or 17-year-old who didn't have parents?

Mr. CLEAVER. Well, the bill would allow for a person with means to sign for him or her.

Mr. BACHUS. Yes, okay.

Mr. CLEAVER. I mean, you know, my son is financially literate, but he is financially broke. And, so, you know, those two things cancel each other out.

[Laughter]

Mr. CLEAVER. One final question, and any of you can deal with this. Late payments hurt the credit cardholder, and we heard that from some of our panelists. But, as I analyzed this situation, it doesn't hurt the credit card company. And so the credit card company receives late fees, and many of the credit card companies actually build in late fees as apart of that expected revenue. So the consumer gets hurt. The credit card company actually does better. Have I analyzed that wrong?

Chairwoman MALONEY. The gentleman's time has expired, but I invite all the panelists to respond to his very important question.

Ms. WILLIAMS. If I could try a short answer here, the way in which the credit card companies price the package of features that they design is based on their analysis of the likely behavior of the customers that are in that group. The particular issues that you raised and the motives of the companies, again, I'd suggest that the industry people might be better situated to deal with the particulars.

Chairwoman MALONEY. Thank you.

The Chair recognizes Congressman Castle.

Mr. CASTLE. Thank you, Madam Chairwoman.

I apologize for my absence. I had business on the Floor and then I agreed to give a speech off the Hill, which one should never do when one is in Congress, I might add.

I would like to ask Ms. Braunstein a question. You may have been asked this already, but can you help us with the dates of the proposed changes to UDAP and to Regulation Z?

Is there anything new or an update on that? We never seem to get very solid answers on those questions.

Ms. BRAUNSTEIN. Well, I can't give you exact days to circle on your calendar, so to speak, but I can tell you that the UDAP proposal will be coming forward in the spring. And we're in the spring now, so it will be not too long.

That will be out for public comment, and, once that comment period is concluded, then those rules will be finalized in conjunction with the Reg Z rules, the truth-in-lending rules that are already out in proposed form. And they will all be finalized at the same time and that will be done before the end of this year.

Mr. CASTLE. Thank you.

Just a general statement; we talk about Regulation Z and we talk about this legislation. How much they are going to completely overlap, I don't know. But I do know this. Just in reading Regulation Z and hearing what the Federal Reserve has done in terms of going out and doing further investigative type work, plus all the comments they have had, it just seems to me that the public and everybody would be best served if we could get our hands on that particular document when it is issued in final form and make our legislative decisions based on that.

I am not saying we shouldn't do legislation by saying that. I would just sort of like to know; I have a hunch we may get into conflict with each other; and, if we knew exactly what Regulation Z was going to do, it would be easier to base our legislation around that from my point of view.

Chairman Frank obviously argued that he thinks that the legislation takes precedence. I'm not sure in this case that is the best way to proceed, and I would hope that we could work out a methodology of process here that would be in the best interest of dealing with credit cards and dealing with the consumers.

I don't think any of us disagree with many of the points that have been made today and before. I don't disagree with the chairwoman on a lot of those things, but I am very concerned about how we are going about this. And I am always a little suspect of what we in Congress do sometimes. So I would hope that Regulation Z might help straighten that out, and you are welcome to comment on it if you wish. If not, I'll be happy to yield back, because I know time is short.

Ms. BRAUNSTEIN. Well, we do think that Regulation Z is going to be very helpful to consumers, and especially once we have the UDAP rules out too, we think the two are complimentary and together will provide consumers with a lot more information and a lot more protection in regard to these products.

Mr. CASTLE. Thank you.

I yield back, Madam Chairwoman.

Chairwoman MALONEY. The Chair recognizes Melissa Bean.

Congresswoman Bean?

Ms. BEAN. Thank you, Madam Chairwoman, and thank you to our ranking member as well for covering these issues of importance relative to consumer credit in a downward economy. It's very important that we look at access to credit, not just for small businesses, but for our consumers as part of our spending engine.

My question is for Ms. Williams from the OCC. As a regulator for the majority of card issuers, what impact would the risk pricing restrictions in the bill have on the requirements that you place on the banks that you regulate?

Ms. WILLIAMS. I think fundamentally what we would be doing is looking at those credit card lenders to see if they're not going to be allowed to use one particular risk mitigation technique, what other risk mitigation techniques they are going to use, and whether they have thought through the challenges that that presents.

Ms. BEAN. All right, thank you.

And I guess, to the panel, relative to Reg Z moving forward, what is the timing that you see? And, I apologize if I missed some of this earlier, I had another committee mark-up that I had to get to.

What do you see as the real timing and the status overall on that moving forward?

Ms. BRAUNSTEIN. The Reg Z rules will be finalized before the end of this year, along with a proposal we are issuing in the next month or so on unfair and deceptive acts and practices under the FTC Act. That will be out for comment. Once that comment period is over, those rules will be finalized at the same time as the Reg Z rules, because there are overlaps, and it would be easier for everybody if it is all done in one package.

Ms. BEAN. Would anyone else like to comment?

Mr. BOWMAN. I would agree with that. I mean, we have the UDAP rule and our plan, our target, our goal, and it will happen by the end of the year. We will go final with that regulation.

Ms. BEAN. No others?

Thank you. I yield back.

Chairwoman MALONEY. Thank you. We have been called for two votes.

Mr. BACHUS. Madam Chairwoman, I would like to compliment the panel for their testimony and their written testimony which I thought was very informative. I thank you.

Chairwoman MALONEY. Thank you.

[Recess]

Chairwoman MALONEY. I call this meeting back into order.

We just had the last vote of the day. I don't know how many more members will be coming back, and I really thank you for being here all day and for your attention. We have been told by the Republicans to proceed with introductions and testimony.

We will now hear from the witnesses on the fourth panel—three issuers who have participated in the process that led to this bill from the beginning. I am very happy to welcome John Carey from Citibank, Larry Sharnak from American Express, and Carlos Minetti from Discover. I have appreciated very much their companies' input, and in many ways the bill reflects many of their contributions.

We also worked very closely with a group of consumer advocates, and three of them are here today to give us their views and suggestions for further progress: Travis Plunlett from the Consumer Federation, Linda Sherry from Consumer Action, and Ed Mierzwinski from U.S. PIRG.

And we thank you for your dedication and hard work also. And we will begin with Mr. Carey, and your comments will be part of our official record and we thank you so much for being here today and really apologize because it has taken all day to get to you.

Thank you.

STATEMENT OF JOHN P. CAREY, CHIEF ADMINISTRATIVE OFFICER AND EXECUTIVE VICE PRESIDENT, CITI CARDS, CITIGROUP INC.

Mr. CAREY. Thank you.

Chairwoman Maloney, members of the subcommittee, my name is John Carey, and I am the chief administrative officer of Citi Cards. I appreciate the opportunity to appear before you today.

As a leading credit card provider with more than 45 million bank card customers, we understand the concerns motivating legislative action. They are real, and they are the same concerns that underlie the Fed's reform proposals. There is a broad consensus that we need action. The question is, what kind?

Credit cards have become an integral part of the economy. Because they are so familiar, it is easy to forget that using a credit card means taking out a loan. These loans carry a lot of risk for the lender, because they are unsecured and open-ended. So lenders need to protect themselves.

Twenty-five years ago. banks managed that risk by lending only to customers with the strongest credit histories, imposing across-the-board 20 percent interest rates and charging annual fees. In the last 15 years, new technology and more sophisticated risk management practices have allowed issuers to price credit card loans based on a customer's risk profile. This risk-based pricing helps consumers in two ways:

First, by allocating the cost of risk to individual customers, issuers can offer lower costs to customers with solid credit histories, while the customer who poses higher risks appropriately absorbs that higher cost himself.

Second, risk-based pricing actually grows the pie, providing more creditworthy people with access to regulated credit. With more choices, consumers need complete, clear, uniformly presented information to make informed decisions. Unfortunately, Federal disclosure requirements have not kept pace and the industry has not been able to fill the gap. I can tell you about this challenge from our own experience.

Last year, we were one of the first issuers to stop two practices that were the focus of widespread customer concern: Repricing customers during the term of the card on delinquent behavior with other creditors, often referred to as universal default; and so-called, "anytime, any reason repricing."

We hoped and expected that this differentiation would leave customers to vote with their feet, but we have been disappointed in the results so far. So what happened? The problem is that customers could not recognize the differences between us and our competitors; disclosures industry-wide are not providing sufficient, straightforward information to allow a lay person to make an apples to apples comparison on key terms.

That is why we applaud the Fed's efforts to modernize the disclosure regime for the entire industry. The Fed's proposal would require that certain information be provided at each stage of the customer's interaction with her credit card company in a consistent, readable format. In essence, the proposed changes seek to move credit card disclosures to the successful model of food labeling where consumers can get all the information they need in simple, uniform terms that allow them to compare products easily.

In an effective marketplace, consumers will be the judge, and issuers who adopt best practices will enjoy a competitive advantage. We agree that change is necessary, but in our view, the Fed's approach offers a better path to reform than H.R. 5244.

The Fed's thorough, consumer-tested revision of Reg Z is expected to be completed before year-end, and we are confident that given the chance to work, the revision will largely resolve the problems H.R. 5244 is intended to address.

Moreover, the bill could have important unintended consequences that would dramatically affect cardholders. First, the bill would significantly limit our ability to price for risk. Without the ability to do that, higher-risk customers would have fewer ways to get regulated credit, and low-risk consumers would face the higher cost of credit. Second, the bill would rewrite the terms in which issuers offer a grace period, fundamentally altering the way we make credit available to customers, potentially leading to the elimination of a grace period altogether.

I believe this legislation is unnecessary in light of the targeted regulatory efforts underway to address these concerns, and that its unintended consequences would undermine the genuine benefits of a risk-based model for consumers and threaten to further destabilize the credit markets. Thank you, and I look forward to answering your questions.

[The prepared statement of Mr. Carey can be found on page 118 of the appendix.]

STATEMENT OF LARRY SHARNAK, EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER, CONSUMER CARDS, AMERICAN EXPRESS COMPANY

Mr. SHARNAK. Chairwoman Maloney, Congressman Castle, my name is Larry Sharnak, and I am executive vice president and general manager of consumer cards at American Express.

I have submitted my full statement for the record. I want to summarize a few points from that testimony. As Congress considers credit card practices, we believe it is important to focus on three key principles: access; choice; and accountability.

Any legislation should create incentives for transparent pricing and clear disclosures that will help consumers better manage their use of credit. American Express is committed to providing choice in the products we offer and clarity in our terms and conditions. We have recently launched several initiatives to foster even greater transparency, and we believe these initiatives along with the efforts by the Federal Reserve Board to improve disclosures will significantly benefit consumers.

There are a number of practices we simply do not do. We do not increase an individual's interest rate for any reason other than the customer's performance on that particular account. We do not increase a customer's rate if they are late on another account with us, or with another lender. We do not increase a cardmember's rate when we issue a renewal card; and we do not increase a cardmember's rate if our cost of borrowing increases. We do not charge customers a fee to pay their bill. We do not engage in double-cycle billing. In addition, we give cardmembers at least 72 hours after the payment due date before applying any late fees.

I would like to turn now to H.R. 5244. We support the goals of this legislation; however, we are concerned about several specific provisions that could negatively impact consumers. The legislation treats all rate increases uniformly, whether the rate increase was triggered by behavior on the account in question or a mispayment with a third party. This provision would reduce incentives for consumers to make timely payments.

For example, consumers can run up a balance on their account, make no subsequent payments, and still avoid a rate increase by exercising their right to opt out. It would also reduce incentives for issuers to be clear and concise with their terms and pricing, because all rate increases are treated the same. Increases triggered by a customer's performance on their account should not be subject to the 45-day advance notice and opt-out.

We are also concerned about requiring credit card companies to allocate consumer payments on a pro rata basis. This would have a negative impact on consumers, because they will be left with fewer choices should they want to change products.

Many issuers have already curtailed promotional offers in the light of the current economic environment. This legislation would likely accelerate that trend. Our own research clearly demonstrates that consumers significantly reduce their overall effective interest rate by taking advantage of a promotional offer. In closing, I want to emphasize that any legislation focus on preserving consumer's access to credit, enhancing choice in the marketplace, and ensuring accountability for both issuers and consumers.

I can't leave today without sharing a few words from one of our cardmembers: "During the past year we have had an extremely unfortunate experience. Our 40-year-old son was in an accident in Thailand and remains in a coma in a hospital in Bangkok. My wife and I have spent 9 of the past 12 months at his bedside.

"Mrs. Rogers, a customer service representative, went to extraordinary measures to assist us. She arranged for us to use our card for expenses up to $50,000 and arranged systematically for us to make payments by phone from Bangkok. We have encountered numerous challenges, and whenever I contacted Mrs. Rogers, she was there with charm and resolve."

I have been at American Express for 28 years, and stories like these and many, many more is why I am proud of every one of those years.

Thank you for the opportunity to testify today.

[The prepared statement of Mr. Sharnak can be found on page 246 of the appendix.]

Chairwoman MALONEY. Mr. Minetti?

STATEMENT OF CARLOS MINETTI, EXECUTIVE VICE PRESIDENT, CARDMEMBER SERVICES AND CONSUMER BANKING, DISCOVER FINANCIAL SERVICES

Mr. MINETTI. Thank you.

Madam Chairwoman and members of the subcommittee, on behalf of Discover Financial Services, I appreciate the opportunity to appear before you to offer Discover's perspective on H.R. 5244. Like the subcommittee, Discover believes that increased transparency in credit card practices is desirable. I commend you for bringing this topic to the forefront.

When Discover Card was launched, a little over 20 years ago, it was a unique credit card, introducing features that changed the marketplace. Unlike other cards then available, Discover charged no annual fees. Discover pioneered credit card reward programs with the groundbreaking Cashback Bonus award. This feature today returns more than $700 million to Cardmembers annually.

Discover also introduced a level of service that was unknown at the time in the industry: 24/7, toll-free service lines, staffed with knowledgeable representatives, empowered to respond rapidly to Cardmembers. In fact, we answer over 95 percent of all the calls in less than 60 seconds.

We still offer these features and continue to build on them. For example, last year we introduced the Discover Motiva card, which was recently named the best new card product for 2007 by a leading industry publication.

Motiva was another industry first, providing interest rate rebates to consumers who pay their bills on time. This encourages payment behavior that avoids late fees and interest rate increases, while also lowering the balance owed on the account.

We continue to work with our customers to understand what they value, and then strive to create products and services that meet their needs. There are some things we don't do. We don't target subprime borrowers or offer a Discover card to everyone who applies. We don't outsource loan origination or loan servicing. Every Discover card we issue is underwritten by us and serviced by Discover.

We viewed the customer relationship as a long-term commitment, and so do our Cardmembers. In fact, Discover has ranked number one in the industry for customer loyalty for 11 years in a row. We don't outsource customer service. Every service call is made or answered in-house by a Discover employee in one of our service facilities across the United States.

Last year, our Cardmember services representatives spoke with Discover Cardmembers more than 30 million times. We believe that the combination of a competitive market, consumer choice, personal and corporate responsibility, and sensible regulation is the most effective course of action. The majority of the practices in H.R. 5244 are the subject of regulatory changes that the Federal Reserve Board is expected to finalize this year. We believe these developments should be permitted to unfold before statutory changes are made and encourage the Fed to move swiftly towards this objective.

A large number of provisions in the bill address interest rate changes. Let me start by saying that Discover does not engage in the practice of universal default. In fact, we would prefer not to increase the interest rates on any of our customers. This is why we send them online payment reminders, why we call tens of thousands of customers before their bills are due, and why we offer free pay-by-phone and pay-by-Internet features. These efforts contribute to lower delinquencies and prevent unwarranted repricing.

There are instances, however, where we need to reprice, given that the risk profile of the account has worsened. The ability to reprice has allowed the industry to offer lower rates at the outset, and extend credit to a population who had historically been excluded. At Discover, we conduct limited default and risk-based repricing. In all repricing occurrences, we provide a 45-day advance notice, or clearly communicate the default conditions in the Cardmember Agreement.

Furthermore, we provide Cardmembers with the option to cancel their accounts without an increase in the interest rate of their outstanding balances.

The bill also addresses over-the-limit transactions. At Discover we charge an over-the-limit fee only if the account exceeds its credit limit at the end of the billing period. We also provide Cardmembers with online reminders to alert customers when they approach the credit limit, and we reach out to customers who appear to be having difficulties in keeping below their credit limit. Since the inception of this program, we have been able to reduce the number of over-the-limit accounts by half. We also embrace a concept of offering consumer choice with respect to over-the-limit transactions, and will soon allow Cardmembers to opt out of going over the limit.

Given the limited time, I would like to address the provisions regarding payment allocation. H.R. 5244 requires a pro rata allocation of payments on accounts with multiple balances at different APRs. This will result in the elimination or reduced availability of balance transfer offers, hindering competition in the industry, and depriving consumers of features that they value and use frequently.

In closing, we believe that changes being made in the marketplace, and through regulatory actions are advancing the goals of enhanced protection that H.R. 5244 seeks to achieve. We would urge the subcommittee to defer action until these developments play out. Congress should be cautious about some of the potential unintended consequences at a time when consumers are stressed and the need for credit is strong.

Thank you.

[The prepared statement of Mr. Minetti can be found on page 201 of the appendix.]

Chairwoman MALONEY. Thank you.

Mr. Plunkett?

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

Mr. PLUNKETT. Good afternoon, Madam Chairwoman, and Congressman Castle.

I am Travis Plunkett, the legislative director at the Consumer Federation of America. I am testifying today on behalf of CFA and Consumer's Union, the publisher of Consumer Reports. I appreciate the opportunity to speak today in support of H.R. 5244, the Credit Cardholders' Bill of Rights, which would curb some of the most arbitrary, unfair, and abusive credit card lending practices that often trap consumers in a cycle of costly and sharply escalating debt.

It is particularly important that the subcommittee act on this bill now, because the signs of economic distress by credit card consumers are increasing fast. According to the Federal Reserve Board, 30-day credit card delinquencies—a major leading indicator of the coming economic storm—are approaching historically high levels. In fact, they are at their highest peak in 5 years.

It is not just the declining economy and mortgage crisis that are affecting the ability of credit cardholders to pay off their bills. Credit card issuers have caused a good deal of this economic distress all by themselves through reckless lending, especially to financially vulnerable consumers, and by hitting cardholders with costly and unjustified interest rates and fees that can destabilize a family's finances quickly.

Since 1999, the marketing and extension of credit by card issuers has increased about twice as fast as consumers have taken on debt. This means that aggressive marketing and lending by creditors, not consumer demand, has been the driving factor in pushing credit card debt to about $850 billion. Much of this growth has been fueled by loans to new and financially vulnerable borrowers, such as students, lower- and middle-income families, minorities, and older Americans.

The massive amount of credit card debt that exists in this country is not shared equally. Moderate- and lower-income families are more likely to carry a balance from month-to-month and have a much higher proportion of credit card debt relative to their income. The 50 million households that carry credit card debt have an average balance of $17,000.

It is the working families with credit card balances who are starting to show signs of economic distress, and they are just the households who end up coping with balances that shoot up overnight, interest rates and minimum payments that double, and large penalty fees. H.R. 5244 would curb many of these abusive practices. It would stop unjustifiable interest rate increases on existing balances for consumers who are meeting their obligations with their credit card company, because of a supposed problem with another creditor or a drop in their credit score.

It would end bait-and-switch contract clauses where issuers give themselves the right to raise fees or interest rates at anytime for any reason. It would prevent issuers from playing costly games with consumer payments by requiring them to apply payments to both high and low interest rate balances, not just the lower rate debt. It would stop billing methods like double cycle billing, that require consumers to pay interest on debts they have already paid off.

It also takes several steps to stop the assessment of late fees when payments are truly on time. What this bill does not do is as significant as what it does do. It doesn't cap interest rates and it gives issuers several ways to price for risk and protect themselves in the case of higher risk customers. They can set the initial rate based on risk for cardholders.

If a cardholder becomes riskier after they get the card, and it involves a problem not with the credit card itself, they can raise rates on future purchases. If it does involve problems with the card, they can raise rates on future and past purchases.

If issuers become concerned about the increasing risk of a cardholder, they can also deal with the problem the old-fashioned way; they can freeze the credit line or lower the credit line. This protects them better than anything from additional risk, and they can also do a better job of developing a workout with cardholders who get into trouble—a payment plan that will work for the cardholder and still protect the financial risk of the credit card company.

In conclusion, let me say that we have heard from issuers here today and at your last hearing that their "risk-based pricing," as they call it, has lowered rates for consumers and that this proposal would not allow them to offer the kind of risk-based pricing that they have offered in the past. Let me say that two Federal studies have examined the question of risk-based pricing and have not been able to confirm the issuers' contention that what they have been doing since the early to mid-1990's has led to substantially lower interest rates for consumers.

So, we would very much like to talk about why this proposal actually will allow them to price for risk and also protect credit cardholders as well.

Thank you.

[The prepared statement of Mr. Plunkett can be found on page 223 of the appendix.]

Chairwoman MALONEY. Thank you very much.

Ms. Sherry?

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

Ms. SHERRY. Chairwoman Maloney, thank you.

Members of the subcommittee, my name is Linda Sherry and I work for Consumer Action, a national nonprofit organization that each year surveys credit card rates, terms, and fees to track industry developments and assist consumers in comparing cards.

The cardholder bill of rights takes aim at many of the unfriendly, even abusive practices. Americans are falling deeper into debt at a particularly troubling time in the economy when consumer use of revolving credit, mostly credit card debt, is growing at rates not seen since 2001. This means credit cardholders are sitting ducks for the retroactive repricing strategies of card issuers, who increase APRs using flimsy excuses like the market conditions loophole already used to hike rates at two top issuers.

The Maloney bill would limit some of the most unfair and deceptive tactics, including universal default, anytime any reason rate changes, and retroactive interest rates for credit-based repricing. The industry continues to abruptly and unexpectedly change the terms of existing cardholder agreements. It won't clean up its act without legislation and UDAP regulation.

It is time for you to enact strong laws to make the credit card industry drop its bait-and-switch business model. Don't sit by as the industry lures people in at unsustainably low interest rates just to jack up rates a couple of months later, all the while exposing cardholders to even more punishing rates if, God forbid, they pay one day late.

We believe the issuers when they say revolving credit is a risky business. It is risky for cardholders as well as for card issuers, yet that business remains immensely profitable. The risk should be to the banks, not to the individuals who attempt to follow rules written in disappearing ink. Anytime, any reason, repricing needs to go. Consumers are taking on more debt, which makes them more vulnerable to repricing tricks.

Change of terms disclosures are just blank checks to hike rates. These disclaimers are so broad they seem comic, but this is not a laughing matter when you consider the damage these policies wreak on struggling families. Universal default or risk-based pricing, based on how customers perform with other financial institutions may be going, but large conglomerate financial institutions assess customer risk across all of their products, a practice that could be called in-house, universal default. A consumer with a checking account, mortgage, and credit card from the same institution is placed in an especially precarious position.

If she bounces a check or pays her mortgage late on other in-house accounts, she could get hit with an interest rate hike on her credit card. In-house, universal default is a clear downside to the often-touted convenience of having all your financial services at one institution. We continually hear three dubious messages from the industry and its hired consultants. These theories have been countered by respected academics whose research has been entered in to the record at previous subcommittee hearings.

Message one: Risk-based pricing benefits credit-worthy consumers through lower prices. Please consider this: One-size-fits-all default rates are opportunistic pricing, which bears no relation to cardholder risk. The application of predatory risk-based rates of 30 percent and higher to existing balances can drive cardholders into default and bankruptcy and drive up costs for all cardholders.

Message two: Regulation and legislation would limit access to credit cards for low-income households. Please consider this: Low-income consumers need and use cards to pay off balances over time, which generates reliable interest income and makes them desirable customers. Anti-predatory lending regulation at the State level has not decimated the market for affordable loan products.

Message three: Risk-based pricing deters irresponsible credit use, the moral hazard argument. Please consider this: Hiking rates based on a drop in a credit score, a late payment or an unrelated account or general economic conditions does nothing to deter irresponsible credit use. You can't game the system if you don't know the rules.

Please look beyond these myths and give reckless lending its day of reckoning. To date in the 110th Congress alone, almost 18,000 individual individuals have visited Consumer Action's Web site to write to you for protection from abusive credit card practices. This is important to the people you represent. Please don't ignore them any longer.

I thank you for holding this hearing. This is a non-partisan issue, despite the way this room looks sometimes.

Please work together to pass the Credit Cardholders' Bill of rights today.

[The prepared statement of Ms. Sherry can be found on page 276 of the appendix.]

Chairwoman MALONEY. Thank you. Our last panelist, Mr. Mierzwinski.

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

Mr. MIERZWINSKI. Thank you, Madam Chairwoman, and members of the subcommittee. I am Ed Mierzwinski with the National Office of the State Public Interest Research Groups. We take on powerful interests on behalf of our members.

It's a privilege to be before the committee again to talk about this important issue. The question is, how did we get to where we are today? Very quickly, I would summarize that we really have three problems. First, we have the problem of preemption by the courts, the Congress, and then the OCC, asserting broad preemption first of State rights to protect their citizens against the credit card industry; second, taking away the rights of State attorneys general to enforce the laws when credit card companies break the law.

Second, as you have heard, these contracts that Senator Levin called incomprehensible all include a clause that says we can change the rules for any reason at anytime, and including no reason. In addition, to that clause, they all include a clause that essentially prevents consumers from being able to go to court. So attorneys general cannot enforce the law, nor can consumers through the binding mandatory arbitration provision. We are left with the regulators.

Contrary to the views expressed by some of the regulators, although I want to except the FDIC, which I was pleased to see supported your legislation, or at least many parts of it, it is not the view of this consumer advocate that the OCC enforces the laws. The OCC is primarily a cheerleader for banks. The more banks that become national banks, the bigger the budget of the OCC under the way the OCC is funded through bank contributions, not the regular appropriations process. That cheerleader role conflicts with the supervisory role, and may be one of the reasons no big bank has been publicly punished for breaking a credit card rule since Providian in the year 2000.

And that is just the way it is. The regulators don't enforce the law. The banks do what they want to do. Consumers are left in the situation that we're in today. But if we don't have the regulators helping us, we have to rely on the Congress.

Oh, and by the way, in terms of regulators, we also have the Fed. I would agree with Senator Levin, who said the Fed's deliberations are endless. And maybe they'll finish this rule by the end of the year, but then will it be enforced? I don't know. It is better to have a law than to wait for the regulators.

And so your bill, as my colleagues, Mr. Plunkett and Ms. Sherry, have articulated, does many important things to enforce the law and improve the situation.

First, it says no retroactive application of universal default. We prefer no universal default at all. But the worst part of it is applying it to the old balances. So that is a very strong provision.

The other provisions of your bill. We strongly support the payment allocation provision, and we believe that is a reasonable provision that will be fairer to consumers who don't understand that if they make a $1,000 payment, it will only applied to their lowest balance.

And the other provisions in your bill are also very important. As Mr. Plunkett pointed out, and as I concur in my written testimony, your bill doesn't go as far as we would like. We would like to put usury ceilings back in place. We would like to impose limits on the fees that banks can charge.

I believe that it is an unfair and deceptive practice of banking lobbyists to assert that your bill imposes price controls or is a form of price-fixing, because you do not do either of these things. Your bill is a moderate approach that does not impose price controls in any way. So for that reason, we would support it.

The provision that I would like to talk about now is—we talked a little bit about earlier that the banking industry makes the most money on credit cards. That's a fact. It's a fact documented by the Federal Reserve Board. It is something that everybody agrees on. Every year, the Federal Reserve Board puts out a report that says credit cards are the most profitable form of banking.

There are three ways the credit card industry makes money. The first one is they're imposing greater fees on their existing good customers, which is the subject of your bill. Second, they try to recruit new customers from existing cardholders of other banks. But that's expensive; it costs a lot of money to kill the trees that they kill to send out the 5.7 billion solicitations each year.

The third thing they do is, they try to recruit new customers. And there are really two major populations. But there is a third one, the subprime customers, who have previously defaulted on cards. They offer them very expensive, unfair cards.

And the two kinds of customers they're going after are either immigrant populations who never had cards or students who never had cards.

And in response to Mr. Cleaver's comments earlier, I would point out that PIRG is running a 40-campus campaign to educate college students about credit card debt; we're handing out at our own credit card tables FEESA—it sounds like VISA but it's not VISA—FEESA. We're handing out our own credit card literature and we're handing out free lollipops that say, "Don't be a sucker."

We also recently issued a report, "The Campus Credit Card Trap," which found that most students—

Chairwoman MALONEY. The gentleman has to wrap up, even though these are important points.

Mr. MIERZWINSKI. Right. It found that most students support strong reforms for the credit card marketing on campus, and we would like to work with the committee on improving the bill by adding some provisions on campus credit card marketing and marketing to youth.

We appreciate your time.

[The prepared statement of Mr. Mierzwinski can be found on page 186 of the appendix.]

Chairwoman MALONEY. Thank you very much.

I first of all would like to thank all of the panelists for all of their hard work and for participating in what has been a very deliberative process, and for participating in the credit cardholders' bill of rights, and also our best set of practices and values that we came forward with.

At the last hearing we heard from the Bank of America, Capital One, and Chase. And after the testimony today from the other issuers, we will have heard from the six largest credit card issuers in our country.

I would like to note that some of the practices that are contained in my bill are practices that some of you have voluntarily abandoned, and I truly applaud you for these efforts.

A number of these practices I would consider some of the best practices in the credit card industry. In my legislation, I seek to adopt a number of them uniformly, so that all consumers have the protections that they provide.

I would like to ask the issuers a question that was raised by Mr. Plunkett in his testimony, and Ms. Sherry in hers. And that is, could you identify which of the practices in my legislation you would consider to be the most difficult to live by, and in doing so, can you explain why it presents a difficulty?

I refer to their testimony on risk-based pricing. And given the studies by the GAO and the Federal Reserve—and I'd like unanimous consent to place these studies in the record—and hearing no objection, they will go in the record—but these studies were not able to confirm that risk-based pricing has led to lower interest rates, which of course we would all like and support for consumers.

In fact, it has been shown that the main reason in these two reports that rates dropped at the beginning of this decade, was because of a lower Federal funds rate. And what evidence can you provide that risk-based pricing, as you define it, has led to lower interest rates for some or all cardholders? Because that has been mentioned in previous testimony.

I will ask all of you to respond, if you would like to, and I will begin with Mr. Carey.

Mr. CAREY. Congresswoman, you had a number of questions there, and I'm wondering whether you could break them down for me? I apologize.

Chairwoman MALONEY. Basically, the main question is risk-based pricing, and some issuers have testified that they believe that risk-based pricing lowers interest rates. There have been two reports—and this was referenced in the testimony of Mr. Plunkett and Ms. Sherry—specifically from the GAO and the Fed, that have said that it does not lower interest rates. And in fact, in those reports said that the lower Federal funds rate was the reason that interest rates were lowered.

So my basic question is, can you provide any facts or figures or statistics or analysis that shows that risk-based pricing as you define it has led to lower interest rates for some or all of your cardholders?

Mr. CAREY. I most certainly can. It was in my testimony, but if you go back to a model where we were a number of years ago, everybody was at a much, much higher rate. We had very low late fees, we had very low over-the-limit fees. And everybody had a $35 or $50 annual fee.

What has happened over time is that banks have been able to—in a very, very competitive business—better calibrate the risk and do risk-based pricing when they acquire an account, and offer very, very competitive rates upfront. And they are able to do that because they know that in Citi's example, if the customer's credit risk profile changes and the customer defaults on their agreement with us, we have the ability to re-examine the customer's risk profile and re-price it accordingly, thus, shifting the cost of the credit risk to those that are the most credit-risky, and leaving those that are not at this very competitive rate.

If you look at our portfolio over a number of years, what you would see is the actual—the pricing for credit cards, for example, this year over last year, is either at the same rate or lower than it was the previous year. That was about 90 percent of the portfolio, and only about 10 percent of the portfolio was actually higher.

So that's the data that I would refer to. I also think the Congressional Research Service, which is cited in my testimony, actually supports the notion about risk-based pricing.

Chairwoman MALONEY. My time is almost up. Later, I would like the consumer groups to respond, but right now, I want to recognize my colleague's time.

Is there any other issue you would like to respond to?

Mr. MINETTI. If I can add one thing to it, which is that I think the overall interest rate has remained the same. But one fact that the study doesn't mention is that credit cards have become much more available to a segment of the population that they were not previously available to. So I think if you look at the same customers that the credit card companies had 10 years ago, for those customers, the rates have come down. For new customers, some of whom are subprime, the rates are higher. The blended rate is the same, but not when you break it down into two constituents.

Chairwoman MALONEY. Okay. My time has expired. The Chair recognizes Congressman Castle.

Mr. CASTLE. Thank you, Congresswoman Maloney. Let me start with this. Let me ask Mr. Plunkett and Ms. Sherry and Mr. Mierzwinski, have you personally read Regulation Z in its draft form that the Federal Reserve has issued? You are nodding your heads "yes." You are sure?

[Chorus of ayes]

Mr. CASTLE. Because I want to ask questions about it if you have. You all have? Do you have any objection to what is included in Regulation Z? And one of you testified—I think it was Mr. Mierzwinski—you'd prefer to this a law. I understand that. But do you have any concerns in Regulation Z, either in terms of omission or in terms of something included with respect to addressing many of the issues that have been raised at these hearings today?

I'm asking any of you.

Ms. SHERRY. I'll take the question, initially. I would say that they have done a very good job with outlining some new and improved disclosures. Disclosures, of, really are not going to protect people. Legislation protects people—substantive regulation.

They have also, I think, left out some key things in their attempt to tell consumers about fees, etc. They have in the fee-inclusive APR idea they have, they have actually left out penalty rates, penalty fees. Excuse me. Like late fees and over-limit fees. And I think these are a major cost, as, Mr. Carey even alluded to, of carrying credit today. So that's one thing.

I also am very glad that they are looking into unfair and deceptive practices act type rules under the Federal Trade Commission authority, because that is one thing that was missing from the Regulation Z to begin with.

Mr. CASTLE. Okay. Any comments from either of the other two?

Mr. PLUNKETT. Congressman, here are three examples to buttress Ms. Sherry's point that disclosure, while helpful, will not solve some of the underlying problems in the marketplace. We have heard criticisms today about the payment allocation methods that issuers use, the use of retroactive interest rates on existing balances, and of universal default. Two of those three practices are used by virtually every issuer that I am aware of, so shopping around the marketplace isn't going to help you there.

On universal default, that is what we often call a back-end process; that is, you get your card, you get your standard interest rate or your teaser rate, and you only deal with it after the fact. There is really no evidence that consumers now in the marketplace shop based on back-end practices by credit card companies. So, shopping doesn't help you much there, either. That is why you need substantive regulation on these three concerns.

Mr. MIERZWINSKI. I would briefly, Mr. Castle, say that along with other consumer groups including the National Consumer Law Center, our group submitted over 90 pages of comments to the Fed. I think I have a footnote linking to them. And one of the things that is missing again is we believe the Fed has existing authority to do some of the things that are in Chairwoman Maloney's bill, such as fixing the due date problem and the postmark problem. They simply don't do it; that's why we need—

Mr. CASTLE. Well, they could do it.

Mr. MIERZWINSKI. They could do it.

Mr. CASTLE. We don't know what they could do in final form.

Mr. MIERZWINSKI. They could do it, but—

Mr. CASTLE. They have not done it.

Mr. MIERZWINSKI. Because they don't do these things, and that is why we're pushing the legislation.

Mr. CASTLE. Okay.

Let me turn to those representing the issuers here. I noted this before of the other large issuers. Many of your practices have changed, so that you're doing a number of the things that have been asked for by the rest of the panel with respect to eliminating universal default and a few other areas, the anytime pricing, or whatever. Aren't we as consumers and as a country best served by having those practices either in a Regulation Z or in legislation so that everybody would be in the same circumstance? Or do you feel it should be a market decision and it should not be regulated or legislated against?

Mr. CAREY. Congressman—no, that's all right, that's fine.

Mr. CASTLE. I gave you the volunteers.

Mr. CAREY. I gave the example of what Citi had done.

Mr. CASTLE. Right.

Mr. CAREY. That we thought these were significant improvements and we thought transformed the business. You actually heard from two other companies today about their best practices. And frankly, a lot of their best practices I am not aware of, because I can't take the time to go through very, very complicated disclosures that don't make a lot of sense and don't help the average consumer.

What the changes in Regulation Z are going to do is actually be able to outline those differences, so that American Express can compete against Citi, and Discover can compete against Citi for what are the best practices. I saw no lift, no change, in the great things we did for consumers.

It is because consumers couldn't see it, and that is why I am supportive of a much more market-based approach where consumers have the power to make decisions and they can vote with their feet and go to the issuer that has those best practices.

So I would look to that first, but I do believe there are certain practices that are so outrageous, so unfair that they should be stopped. And I believe the Fed already currently has that authority, either under UDAP or under Reg Z.

Mr. CASTLE. I yield back.

Chairwoman MALONEY. Thank you. The Chair recognizes Chairwoman Waters.

Ms. WATERS. Thank you very much, Madam Chairwoman.

Let me start with Mr. Carey, I don't know whether or not you have said this already, but do you support Ms. Maloney's bill?

Mr. CAREY. Congresswoman, I think the work that Congresswoman Maloney and her staff and the other people who have worked on it have done is a terrific first step. I actually do, however, support credit card reform through the tools that the Federal Reserve has presented with the amendments to Regulation Z as well as their work in UDAP. I do support the direction in which she is going.

Ms. WATERS. Which of the points in the credit cardholders' bill of rights do you disagree with? Do you have it before you? The nine points of the bill?

Mr. CAREY. I don't have that document before me. I am reasonably familiar with it.

Ms. WATERS. Arbitrary interest rate increase?

Mr. CAREY. Again, I think that is something that needs to be looked at through a rulemaking process because of the consequences that may occur. But I do believe that is something that ought to be looked at, and there out to be robust debate around that, and I think the regulatory process that the Fed is working on will do that.

Ms. WATERS. The second point is that credit cardholders who pay on time should not be penalized. Do you think that is a good idea?

Mr. CAREY. I am not aware of any issuer who penalizes a customer, who—so I support that.

Ms. WATERS. There has been a lot of discussion about due-date gimmicks.

Mr. CAREY. Well, again, I think from the reputable issuers, you wouldn't get a disagreement.

Ms. WATERS. Do you think that the disclosure that is done and that is discussed so much today is enough to protect consumers, and that there is no need for the Congress to produce legislation on all these issues?

Mr. CAREY. I believe that, again, the Federal Reserve has the power to first look at all of those issues that people and consumers are concerned about, and to come up with a solution that makes the most sense for consumers and for consumer lending.

Ms. WATERS. They have been looking all of these practices. Do you think they have done a good job?

Mr. CAREY. Their first work hasn't been done and they're actually in sort of a middle phase; they are, as they announced today they are—

Ms. WATERS. Well, I'm talking about historically. As I understand it, they see your products before they hit the market, and they have an opportunity to discuss them, to talk with you about them, and to do disclosure. Do you think that they could perhaps engage you a little bit more, and discuss why perhaps some of these practices would be harmful to the consumer?

Mr. CAREY. I am absolutely convinced, certainly through the attention of this committee, that, in fact, will occur.

Ms. WATERS. Mr. Sharnak?

Mr. SHARNAK. Yes.

Ms. WATERS. Which of these points of Ms. Maloney's bill do you disagree with?

Mr. SHARNAK. As I said in my testimony, we support the goals of the legislation. We don't do universal default. We don't raise people's rates for any other reason than if they violate their terms and conditions on that specific account.

We don't change due dates. We don't penalize people who pay on time. We don't engage in a lot of those practices, so I'm not going to try to defend them.

Now as I did say, there are a couple of provisions in Ms. Maloney's bill that we think need to be amended. There needs to be a distinction between what we'll call on-account and off-account behavior, because it is very different.

I do think that payment allocation, as I said in my testimony, as written, will make credit less available to certain groups, low-rate interest to certain people. So those are the two provisions, and the one specifically on on-account, off-account, the 45-day notice for on-account behavior where it has been disclosed upfront in the application process in the terms and conditions, we don't think that that should go forward.

Ms. WATERS. Do I have any more time, Ms. Maloney? I don't want to take more than my time.

Chairwoman MALONEY. Your time is expiring, Chairwoman Waters.

Ms. WATERS. Thank you.

Chairwoman MALONEY. But I do want to say that there is a distinction in the bill on on-account and off-account behavior. And I just want to just point that out.

Ms. WATERS. Does the Chair have the liberty to explain that? Because evidently, there is a difference of opinion here.

Chairwoman MALONEY. Well, in the bill on on-account behavior, you cannot retroactively put interest rates on the actions there. On off-account behavior, you can notify and go forward with it. But there is a distinction in the bill.

The Chair recognizes Ms. Biggert.

Mrs. BIGGERT. Thank you, Madam Chairwoman.

For the issuers, given your broader knowledge of the industry as a whole, can you tell me what the consumers this morning told us about in their experiences? Is this typical of the industry as a whole? Mr. Minetti?

Mr. MINETTI. I think it is unfortunate that it happened to those consumers. At Discover, that is fairly atypical. I don't mean to imply that we are perfect, but we do the best we can for our customers. And as I mentioned before, we get over 30 million calls a year, and we actually have very, very few complaints.

Mrs. BIGGERT. Okay.

Mr. Sharnak?

Mr. SHARNAK. Those individuals, those behaviors they described that caused their rates to go up wouldn't happen at American Express.

Mrs. BIGGERT. Okay.

Mr. Carey?

Mr. CAREY. Congresswoman, exactly the same—those practices are not practices that we engage in at all.

Mrs. BIGGERT. Okay.

Then back to Mr. Minetti. You know, we've heard some talk about what happened to Discover in the UK.

Mr. MINETTI. Yes.

Mrs. BIGGERT. And that some of the changes that might be coming in this bill would cause a problem here in the United States?

Mr. MINETTI. Well, what happened in the UK is that the regulators limited the amount of fees that could be assessed on accounts, among other things, and what it created was an environment where the profitability of those businesses no longer met the hurdles that we're required to have. And as a result, we have pulled out of the UK; we no longer do business in the UK.

Mrs. BIGGERT. Yes.

Mr. MINETTI. You know, there are some provisions that could have unforeseen impacts, and I think we need to look at them long and hard before we go forward with them.

Mrs. BIGGERT. Okay. Thank you.

Then, Mr. Carey, has Citi taken any steps to help people avoid fees for late payments, or going over their credit limit?

Mr. CAREY. Generally, I mean as this is a business practice for us, and we have heard a lot about this, but it is becoming increasingly expensive to acquire customers, particularly good customers, who pay their pay their bills on time, and use the product wisely, all of those things. It is very, very expensive to bring customers on because of the intensive competition that's in this industry.

When a customer has trouble, we want our customers to engage with us. And if they feel that they have been treated unfairly because the check came late, or they were traveling away, or there was some explanation to explain why their payment was late or why their card would have gone over the limit, we want to engage with them.

Now some customers because of—and again, we only reprice when a customer defaults on the agreement between Citi and the customer, and then at that point in time we look at the customer's overall credit risk profile, and depending upon that, we may change the pricing to accompany or tied to risk.

What we don't want to do is, we don't want to tip that customer to the point of default. There is no interest in us being able to do that. In most cases when they incur a fee or they are default repriced, customers do exactly what you would want them to do.

They pay off their balances faster, they start paying on time, they incent the customer to do the thing you would hope that they would do.

But there is a small set of customers—and I will grant you that—that because of the repricing or because of the change, we might have—don't know—contributed to that. But, again, it is not in our best interests, and we don't get it right all the time; we have 45 million customers, and from time to time, I hate to say it, but we don't get it right.

But our goal is not to cause that. There is no incentive for me to force a customer to default and not pay on the loan. And so we do engage with our customers, and we have a number of temporary and work-out programs, depending on where the customer is and the problems that they are facing.

Mrs. BIGGERT. Would you say that when a customer tries to call you, there was some talk this morning that it was very difficult to reach a real person. Have credit card companies had to put more people on the job to answer their phones?

Mr. CAREY. Well, again, I think there is a little bit of a misunderstanding of it. We rate our customer service—we take our customer service very seriously—again, we believe it is a competitive differentiator—so we have analytics, which I'm sure my competitors do as well, called "average speed of answer," and we try to drive a performance based on that.

And so when a customer calls—the first thing virtually every issuer does is, you get a recording. Because most customers who are calling just want to know what their balance is. They key in their account number, they find out their balance, they don't talk to a representative. They like that.

But there are other pieces of the phone tree, where if they push "4," they would get a representative, or if they push "0," they would get a representative.

Then there is a hold time. The hold time for us and the goal for us is certainly under 60 seconds. We try and do that the way we manage the business, because we know if it's any longer than that, then customers are dissatisfied.

Again, we want to compete on performance and value and this is how we do it, and I'm convinced that my competitors next to me have the same thing.

Chairwoman MALONEY. Thank you. The gentlelady's time has expired. The Chair recognizes Congressman Cleaver.

Mr. CLEAVER. Thank you, Madam Chairwoman.

I think I'm probably the last questioner, so I'll try to be brief, if you will respond by being brief in your responses. I raised the question earlier when some of you were here about the late payments. It is my view that the late payments hurt the credit cardholder, but they do not hurt the credit card company. It seems to me that the credit card companies have become addicted to the late fees that are paid, and that it is actually a part of the revenue stream that supports the credit card company.

Mr. Carey, am I correct or incorrect? Help the world understand this.

Mr. CAREY. There is certainly revenue that comes from the fees, but again the goal here is to drive customers not to be late. We actually give customers the tools to be able not to be late, by having alerts that can go to their e-mail or on their cell phone to tell them when their statement is, how many days before. We give the customer complete control to avoid any type of fee at any time.

Mr. CLEAVER. I want to get Ms. Sherry's or Mr. Plunkett's response to that. Just to follow up, though, Mr. Carey, are you saying that the revenue from the late fees does not exceed the cost of sending out a notice or whatever you do for a late payment?

Mr. CAREY. I don't know about the cost, but what I can say is that when investors who are in the securitization market look at credit quality, one of the things they look at is whether the account is delinquent or not. And that affects the pricing of how we're able to place those loans. So being late is, first, a terrific indicator of increased credit risk, and it's a terrific indicator for investors who look at the quality of the loan portfolio and say, "What percentage of those customers are delinquent?"

So it is important. You know, we don't run our business that way about the cost of individual—what we want, again, is we want customers not to pay late fees; what we want them to do is pay on time, and we give them the tools to do that.

Mr. CLEAVER. Mr. Plunkett?

Mr. PLUNKETT. Yes. I do think for some issuers that penalty fees have been driven by the need for greater income, rather than by the need to deter bad behavior on the part of borrowers. The GAO reported in 2006 that the size of these fees, over-the-limit fees and late fees in particular, had grown in the last 10 years far faster than the rate of inflation. And you are facing a $35 to $40 late fee now if you are late by a single day, with some issuers. But that is another issue.

There doesn't seem to be differentiation by some issuers as to whether the consumer is late one time by an hour or a day, or late repeatedly. They still get hit with the same one-size-fits-all fee. So I think there is some evidence that for some issuers, the goal has been to drive up revenue, not to deter bad behavior.

Ms. SHERRY. And I think the point needs to be made here, Mr. Cleaver, is that you know being one day late, that is a quite a bit different than a true default, which probably investors would be concerned about of a 30-to-60-day late that is reported on the credit report. Otherwise, they would have no way of knowing about a one-day late that results in a $40 fee.

Mr. CLEAVER. Let me go back. I am having some difficulty. One of you represents my credit card company. I only have one credit card. I'm having difficulty with the fact that a company as successful as those represented at the table are not aware of whether or not the fees they receive exceed the cost of the administration of late payments. I mean those companies, your companies, are some of the top companies on the planet. And I can't believe that a dumb Methodist preacher would come up with this issue, and the credit card companies had never even thought about it.

Chairwoman MALONEY. The gentleman's time has expired, but I invite the issuers to respond to his important question.

Mr. SHARNAK. As I said in my testimony, we give consumers at least 72 hours before we apply a late fee; that is at least 3 days.

We have many products that don't have late fees. We offer choices to our consumers.

So we have a clear card from American Express that has no fees whatsoever, no late fees, no over-limit fees, no bounced check fees. So we do give consumers choice. And as was said earlier, they do have the ability to get alerts from us when their bill is about to go delinquent, so we give consumers many different choices and options, including a card that wouldn't have late fees.

Chairwoman MALONEY. Okay. Thank you very much. The Chair recognizes Ranking Member Bachus.

Mr. BACHUS. I thank the chairwoman. The first thing I would say is to the three issuers, you agreed to come here. You volunteered to testify. I mean we just didn't arbitrarily say to Citi, American Express, and Discover, "You will be here." We asked everybody if they would testify. And there may have been others too, but the three of you said that you would come.

That to me indicates something good, indicates you were willing to come here, you were willing to sit down, and you were willing to say, "These are our practices."

I don't know if the consumer groups would agree, but to me that's at least anecdotal evidence that you probably do a very good job, or at least a better job than some of your peers.

I appreciate that. You know, maybe no good deed goes unpunished. And you know, you may be in tomorrow's newspapers here answering questions, and people won't realize that your three organizations volunteered to come. But I thank you.

Let me just ask this—because I have been in negotiation on something else entirely out of this committee for the last 20 minutes—is there anything you would like to say? I'm just going to give each one of you 30 or 40 seconds to respond to, you know, anything that has been asked here or anything that has been said. You don't have to take that opportunity, but I would just go from left to right, starting with Mr. Carey. I have enjoyed our visits together in the office, and you're certainly knowledgeable. And I know that you are committed as American Express and Discover. You have made changes. You know, American Express kind of has a different model, so you know some of these problems that we talk about have never been a problem for American Express customers. And we don't hear—you know, I don't recall hearing any complaints about Discover.

I appreciate the consumer groups for your concern for the American people and for being advocates for them.

Mr. CAREY. I appreciate the opportunity. I feel like I have been talking a lot already. But I think the one thing that I would say is that we believe that there's a terrific opportunity to transform the way this business is done. And we place a lot of reliance on the work that the Federal Reserve has done in their careful analysis in looking at disclosures. We believe that when that work is completed, for the first time we will see a truly vibrant marketplace where those institutions, those credit card issuers will be able to compete on a level playing field, and those that truly have the best practices will see a competitive advantage against those that will not.

And we think that is the best way to drive change in this business. Because the marketplace is not transparent, people don't have a true ability to understand how their card is different from that of competitors. We don't see those changes. You know, as I was commenting earlier, I'm unaware of my competitors' best practices, because I can't take the time to read through disclosures that simply don't work. And what the Fed is trying to do is create something where literally consumers can line up the disclosures like cereal boxes in a grocery store, and compare the products that give them the most value.

So we look forward to the effort, and we are very much engaged in it, as you know. Thank you.

Mr. BACHUS. Sure.

Mr. SHARNAK. First, thank you for taking note that American Express hasn't been cited by any of these consumers for practices. We haven't had to change any of our practices, and we have not changed one practice, because we do believe our practices are fair.

We do support the goals of the legislation and think they are noble. And I do want to just throw out that we did win the J.D. Power award for customer satisfaction.

That last thing I want to say is the reason—

Mr. BACHUS. I think that's good. I think that speaks well of you.

Mr. SHARNAK. Thank you. The last thing I want to say is that Mr. Carey was not aware of some of our practices because every day we do things for our customers, and we don't brag about it. We just do it in the normal—

Mr. BACHUS. Now I don't think he was talking about you. I never got that idea.

Mr. SHARNAK. Well, I think he was talking about transparency. So we do lots of things for consumers that we don't go around bragging about. We give them extra time to pay their bills, and we do lots of things. And we just think it's the right thing to do, and we go about it every day.

Chairwoman MALONEY. Thank you.

Mr. MINETTI. I want to thank you for giving me the opportunity to speak to the subcommittee. We agree with most of the provisions in the bill. As a matter of fact, our practices already reflect many of those provisions. There are some that we are in the process of changing, for instance, giving customers the opportunity to opt out or being over limit, I think, is a great practice, and we will implement that.

And there are some that we believe might have unforeseen or unintended consequences, or might be unnecessary. But I think I agree with what my competitors have said. The most important thing for us is to do what's best for the customer. We are in business for the customers, and we want to have them for a long time, so we certainly wouldn't do anything to harm them.

Mr. BACHUS. Thank you.

Mr. Plunkett, you don't have to say anything if you don't want to.

[Laughter]

Chairwoman MALONEY. All right, enough grumbling over there. Thank you, Mr. Bachus.

Mr. PLUNKETT. Let me say this. I believe Mr. Carey when he says that there has been no intent to cause default among credit cardholders. And I am talking about the whole industry here; I am not talking about just one issuer. But the truth is, the last 10 years have been like the Wild West in the credit card industry. Underwriting standards were lowered. Loans were made that shouldn't have been made. Interest rates, whether teaser interest rates or balance transfer interest rates were offered, and when they reset at a much higher level, just like mortgage loans, the consumers in some cases couldn't afford them. These were unsustainable loans, and defaults occurred.

And then, as we heard from Professor Ausubel at the last hearing, the issuers have an interest at that point in trying to get as much money from cardholders in trouble as they can, as quickly as they can. He called it a "pooling" problem, which further destabilizes the finances of some cardholders and puts them in a bad situation. So that is where we are now, with delinquencies rising and charge-offs, or the amount of money written off by the credit card companies rising, and a number of people in shaky financial condition.

Thank you.

Mr. BACHUS. Thank you.

Ms. SHERRY. Thank you, Mr. Bachus.

I would like to make a couple of points actually. One is the thing about credit card rates going down. Well, Consumer Action surveys we have done since the mid-1980's don't really show any major lowering of credit card rates for consumers except when the underlying indexes are going down, as the point Mrs. Maloney made. So the variable rate cards do go down when the indexes like the prime go down, but otherwise, we have seen absolutely no kind of direct causality to that over the years as we have done our surveys.

And the other thing is, again Mrs. Maloney mentioned that some of the top issuers are stopping unilateral change of terms and the rest of it. Well, just last Friday, I went onto the Web sites of all five issuers, and I found language about change of terms for any reason on all cards offered by those five issuers. But the thing I want to point out is that even Citi, which does have its very laudable practice of letting people go 2 years or more without any change of terms, then does actually apply a standard of anytime, any reason type of change of terms at that point.

So we are seeing this still.

Mr. MIERZWINSKI. Mr. Bachus, I appreciate the question. And I would simply say, as I said in my testimony, that any marketplace needs rules to be an effective marketplace. To use Mr. Carey's example—

Mr. BACHUS. In fact, I think the free market system depends on structure, rules.

Mr. MIERZWINSKI. Right.

Mr. BACHUS. And—

Mr. MIERZWINSKI. And that's really the summary of what I was just going to say. To use Mr. Carey's comment about the cereal that you choose from, well that's okay, but there's an FDA guaranteeing that the cereal is of a high enough quality. And to use Mr. Plunkett's analogy of the Wild West, which I absolutely agree with, we need a sheriff in this marketplace, and the credit cardholders' bill of rights should be the sheriff setting minimal standards, and then the best practices should go above the minimal standards.

Mr. BACHUS. Thank you.

Chairwoman MALONEY. Thank you very much for your questions and for being here with us, and I thank all of the panelists, all of whom voluntarily came, and all of whom participated in numerous deliberative meetings prior to this hearing.

I would like to go back to the question of my colleague, Congresswoman Biggert, and ask you, Mr. Minetti, you discussed how fees were limited in the UK, which required you to pull out of that market. Can you point out any part of my bill or the bill that we're considering that puts a cap on a fee amount or a price cap or does actually anything else that was done in the UK? I, for one, respect the free-market system, but I also believe very strongly in notice and choice, and purposely did not include any fee caps or price limits as many bills before this Congress do, but relied heavily on giving adequate notice to consumers when there was a fee increase, and letting them pay off their existing balance at the agreed-upon contract, allowing them if they so chose to go to a higher fee. But our bill does not have any fee limits or price controls, as did the UK. Can you clarify that? Did you see any price controls in this bill? They are not in the bill, so I just wanted you to clarify the question for Mrs. Biggert.

Mr. MINETTI. Chairwoman Maloney, I think you have been very thoughtful in your bill, and your bill does not contain any price restrictions or any price limits. I was answering the specific question about the UK and what happened in the UK.

Chairwoman MALONEY. Yes.

Mr. MINETTI. In that case, there were price restrictions that were enforced, and we had to pull out of the market, because it wasn't profitable for us. I am sure that our pulling out of the market was not good for the consumers in the UK.

Chairwoman MALONEY. Okay. I just wanted to say that those who are opposed to my bill continually put out memos and statements that I have price controls in it. And I purposely do not have any price controls or fee limits. Industry is free to make their business model, make their decisions, but whatever your decision is, I think it's only fair that consumers be told what this decision is, and allow them to make their decision if the terms of the contract change.

I would like to ask, going back to the some of the testimony from Mr. Sharnak, what evidence can you offer that requiring consumers to pay off lower interest rate debt before higher interest rate debt, a practice that financial educators say is harmful, is financially beneficial to your cardholders?

I would like to just point out that in my bill or the bill that Congressman Frank and I and many Members, 101 Members of Congress have been working on, requires that all payments be allocated pro-rata when a cardholder has two rates. As you know, in Senator Levin's bill and other bills, they require that the lower interest rate debt be paid off first, and some of our consumer panelists have testified today that they feel that is what should be done. I purposely was very balanced, and said that it should be allocated between the two rates. But you testified earlier that you believe that they have to pay off—your statement that paying off the higher rate first lowered rates. Could you please clarify that for us, or comment further with us?

Mr. SHARNAK. Sure. When consumers take one of our low rates now, on average, their rate decreases by 2.8 percent on their account. So, today it is working for the overwhelming majority of the consumers. The new payment allocation that you're proposing will raise the cost of doing this, because we cannot allocate it to the lowest payments first. All I said is that it will limit our offers to many, many consumers. We will not be able to make it to as many consumers as we do today. And so those who are getting the benefit on average of 2.8 percent, there just won't be as many offers in the marketplace.

Chairwoman MALONEY. I would like to—my time is expiring, but I would like to invite any of the consumer panelists to comment on this provision, and any additional information you could provide to the members of the subcommittee?

Mr. PLUNKETT. Well, I would just like to say that I think it is an important provision. Given the way that this industry works, I think it is very likely that we are still going to see competition between the issuers to lure customers, especially very creditworthy customers, away from each other. And the balance transfer offer is a key way to do that. I would like to see numbers to show that this provision would somehow lead to fewer balance transfer offers.

It seems hard to fathom, given that is the business model for the most significant credit card issuers in this country. And I would like to remind the subcommittee how damaging this practice can be if somebody ultimately ends up paying a higher interest rate, once that balance transfer offer resets, or a higher interest rate because their new purchases on the new card are at a very high rate. That can be financially damaging, so I don't accept Mr. Sharnak's notion that, in all cases, this saves customers money. I don't think there is evidence to show that.

Chairwoman MALONEY. Thank you. Ms. Sherry, do you—

Ms. SHERRY. Mrs. Maloney, I would just like to add that if, in fact, I would even accept what Larry Sharnak has said about the fact that overall this leads to lower rates for consumers. But in accepting that, I would say that if you're truly offering and giving your cardholders a benefit, such as a lower rate on balance transfer, why not make that a legitimate rate that they can rely on? Why use the bait-and-switch tactic of bringing them in at 0 percent, when overall, with payment allocation practices, they actually are not going to pay 0 percent?

So why not really make it clear from the get-go what they really are paying? I think many cardholders would be happy to get a lower interest rate on a balance transfer and give up 0 percent, if they knew that the payment allocations were not actually causing them to get deeper and deeper in debt as time went on.

Mr. MIERZWINSKI. I would just add that in addition to the balance transfer offers that I get from other credit card companies, my own credit card companies, of course, send me more blank checks than I think I have from the credit union downstairs in the form of their convenience checks, and those of course are at the highest rate. And they're trying to encourage me to take on the high-cost debt at the same time as other companies are trying to lure me. So I would concur that we think your provision is a very important change. We don't see any evidence that it will hurt consumers.

Chairwoman MALONEY. Thank you. My time is up. I recognize Ranking Member Bachus.

Mr. BACHUS. I yield back my time.

Chairwoman MALONEY. Thank you.

I would like to ask the consumer panel a question that has come up repeatedly today from many members of the committee, and some of my colleagues have argued against passing the legislation because the regulators will be coming up with updated disclosure under Regulation Z. I would add that we have been waiting for this update for 4 years. And it has also been pointed out repeatedly today that the regulators are about to propose regulations using their unfair and deceptive acts and practices authority, and the current economic uncertainty that we're confronting in our country. Could you please respond to these arguments and provide me what you believe is the best argument? Do you believe we should wait for the regulators to act? Or do you think we should move forward? Could you give me your best judgment, please? I will start with Mr. Plunkett and go down the line.

Mr. PLUNKETT. I would urge the subcommittee and the full committee to act as quickly as possible to send guidance to the Federal regulators as to exactly how they should proceed on these crucial questions. I think that too much is at stake to wait. Now, if you did decide to wait, I wouldn't hold your breath, because your hearing today has enlightened us as to what we might see. It is hard to predict what the Federal Reserve might write in the way of rules, but I think you saw today what the situation is with the regulators. The Fed writes the rules, technically.

But it is a collaborative decision, as the regulators said. And the Office of the Comptroller of the Currency, which regulates virtually all of the biggest national credit card issuers, does not want to address many of the substantive problems that your legislation addresses, such as retroactive interest charges, unfair universal default rate hikes, and payment allocation problems.

So, with a very significant regulator opposed to those approaches, I think it's very likely that we're not going to see strong substantive regulation from the Federal Reserve.

Ms. SHERRY. Mrs. Maloney, I think it's a great question. I have been with Consumer Action for 13 years, and I have to tell you that for 13 years, ever escalating we have been hearing from consumers, cardholders, people who have credit cards, that there are abusive practices out there in the industry. I think you need to act now quickly, because we can't just let this go on forever. There are certain things about the industry that they have gotten very entrenched with, certain practices that they're not going to let go of easily without Federal legislation.

And as Travis really very well notes, we could wait forever for some of the regulations to come down.

Mr. MIERZWINSKI. Thank you, Madam Chairwoman. I would concur. The regulators have ignored or encouraged many of these practices for many years, and again regulation should sit on top of strong law. Strong law should form the basis for regulation. We shouldn't wait for them. You should act first.

Chairwoman MALONEY. Well, thank you. And I really want to thank all of the panelists. It has been a long day, and I thank you for being involved in the development of this legislation and in our many conferences and meetings, and I congratulate the issuers who have come forward with best practices and standards that I believe others should follow.

I would like to note that the hearing record will remain open for 30 days so that members may submit written questions to these witnesses and place their responses in the record. And I would just like to conclude by thanking all of you and inviting you as panelists to submit additions that you think should be part of this legislation, or if you could inform the committee of what you consider the most important aspect of the legislation, and what ideas you feel should be added or deleted in writing, we will certainly consider it.

Again I thank you very much for your commitment and your time and for being here today. This meeting is adjourned. Thank you.

[Whereupon, at 3:30 p.m., the hearing was adjourned.]

A P P E N D I X

April 17, 2008

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Financial Services Committee
Financial Institutions Subcommittee Hearing: "HR 5244 the Credit Card Holders' Bill of Rights: New Protections for Consumers"
Opening Statement for Congressman André Carson
April 17, 2008

Thank you Chairwoman Maloney and Ranking Member Biggert for holding this hearing today on the issue of credit card practices and in particular, H.R. 5244, the Credit Card Holders' Bill of Rights. For many individuals, credit cards offer necessary sources of liquidity and allow individuals to establish good credit by making on time payments and not carrying a balance.

Recent trends; however, have shown that consumers rely more heavily on this source of credit and the average household now carries $8,000 in credit card debt. While balances have increased, so have the incidence in which those consumers have fallen victims to deceptive and, in some cases, predatory credit card company practices.

As we have discussed in numerous hearings in the Financial Services Committee this week, hard-working Americans loosing their homes at a devastating rate. Job cuts, increased energy and health costs all severely limit their disposable income.

In light of these growing financial burdens, more and more consumers have come to rely on credit cards to make basic payments such as utility costs. During this fragile time in our economy, consumers need enhanced disclosure from their credit card companies, not to fall victim to ill-advised loan agreements and hidden rate hikes.

The egregious practice of universal default and "any time any reason rate" hikes are particularly troubling. These practices are not instigated by a consumer's irresponsibility in paying their loans; rather they reflect a company's effort to achieve higher profits as they provide no corrective course of action after universal default is triggered.

I am please that companies like Citi Cards have ceased these practices and I am pleased they are forbidden in H.R. 5244.

Beyond these practices, I have concerns regarding excessive fees and the populations who are aggressively targeted for credit cards. I am particularly worried about the number of young adults taking on credit card debt while they are in school and have limited means to pay their bills. The average college student now holds an average of

$2,169 in credit card debt. Further, 76% of undergraduates have credit cards and 47% have four or more.

Clearly, we need stronger oversight and regulations of this industry in addition to enhanced financial literacy programs for consumers. I thank Chairwoman Maloney for bringing forth this responsible bill. I look forward to hearing testimony in regards to the bill from our witnesses.

Thursday, April 17th, 2008
Testimony of Steven Autrey

Ladies and Gentlemen of the subcommittee, Ranking member, and Madame chair: Good morning, and thank you for inviting us to speak before you. Again.

I would like to give you a brief recap of some negative experiences I have had with one particular credit card issuer. Though Chase, Citibank, and GE Money Bank have engaged in much more egregious and unethical behavior, I would like to make you aware of some actions of Capital One with regards to a Visa card account.

When a consumer applies for credit with a card issuer, or as we did – respond to a "pre-approved" offer, upon establishment of an account, a bona-fide financial contract exists between the consumer and financial institution. It is because of consumer protection laws at the federal level, that the rates, rules, and terms of the contract are spelled-out in advance of the first use of the card. Both the customer and financial institution trust that the other will live up to the terms of the agreement.

Unfortunately, an increasing number of credit card issuers are engaging in sub-ethical practices at an alarming rate. Unilateral, or one-sided changes in the terms of the contract – most always in favor of the credit card company - are becoming routine practice. These one-sided changes are bad for consumers, bad for our national retail credit health, and essentially violate the spirit and letter of Title 15 Consumer Credit Protection Law.

My relationship with Capital One goes back to 2000, when I was solicited with an offer for a Visa card with a "fixed" 9.9% rate card. I applied over the phone, and was approved. The card was used for both purchases and balance transfers in a positive relationship with Capital One for over seven years until July, 2007. That's when Capital One advised me in a small, loose, billing insert that my "fixed" rate of 9.9% was being raised to 15.9% - nearly a 60% increase. No reason or explanation was given. This was a unilateral change to the terms of the Cardholder Agreement.

Until then, I had been late by one day one time, and months later, my finance charges alone – when added to billing cycle's closing balance – pushed the account $13.58 over the limit. I wanted to find out if these were the reasons why my rate was going up.

In August, of 2007, I wrote a letter to Mr. Richard D. Fairbank, Chairman, President, and CEO of Capital One, at their McLean, Virginia home office. My written statement will contain a copy of Capital One's response which includes the line, "Unfortunately, changes in the interest-rate environment or other business circumstances may require us to increase rates, even for fixed-rate accounts in good standing."

Capital One did offer me the opportunity to keep my fixed 9.9% rate on the balance and pay it off, but in order to do so, there was a cost: I had to close my account. The credit industry, in collusion with the Fair Isaac and Company of Minneapolis, has carefully constructed an unchallenged scheme where consumers are penalized with a declination to their FICO credit score when they choose to close accounts. Lower "FICO" scores yield less-than-favorable terms on existing and future loans, mortgages, even insurance rates.

Although some of the credit card companies represented here today, and some of those who were allowed to bring testimony before this committee on March 13th *are* now voluntarily taking baby steps toward the broader goals of H.R. 5244, random acts of chosen change by some are no bellwether of comprehensive compliance by all card issuers. The playing field must be leveled between consumer and creditor.

The NFL does not allow one team, in the midst of the fourth quarter, to unilaterally move their end zone 20 yards just because they don't like the point spread. The rules are laid out before the kickoff, and the umpires enforce the same rules for both home and visiting teams for the whole contest. It's time for legislation at the federal level that tells the credit card industry, "Game Over" to unilateral, one-sided, contract changes.

As a registered Republican, it has typically been my philosophy that business and commerce flourish and perform better with minimal government interference. However, when an industry sector proves time and again that it is unable to police itself and behave and engage in fair and ethical trade practices, legislative intervention is required.

With some progress in our consumer credit laws, and reform of the monopolistic credit scoring cartel controlled by the Fair, Isaac, and Company ("FICO"), perhaps once again consumers can have a level playing field in doing business with credit card issuers.

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Capital One

Capital One Services, Inc.
PO Box 85870
Richmond, Virginia 23285-5870

September 12, 2007

Steven G. Autrey
2714 McKenzie Lane
Fredericksburg, VA 22408

Re: Account ending in 8743
Case No: 10000307331710

Dear Mr. Autrey:

Your letter has been forwarded to my attention for response. You express concern with our recent change in terms to your account.

First and foremost, we want you to know we value your business and appreciate the opportunity to be your credit card provider. As described in your original solicitation, the fixed Annual Percentage Rate (APR) on your account was 9.9%, which was not a promotional rate. Unfortunately, changes in the interest-rate environment or other business circumstances may require us to increase rates, even for fixed-rate accounts in good standing.

As stated in your *Customer Agreement* (copy enclosed), provided to you at account opening, we reserve the right to make changes to your account as long as we provide you written notification prior to such changes taking effect. Due to rising interest rates, we notified you of a pending APR increase on your account, in a separate change in terms notice. The change in terms notice explained that your APR for purchases and cash advances would increase from a 9.9% APR to 12.9% APR beginning with your first billing cycle after September 16, 2007.

We offered you the option to decline these changes by contacting our automated system at 800-211-3315, by midnight EST on September 11, 2007. If you decline the changes, you will be able to pay down your account at your existing terms, but, will not be able to use your card. Additionally, if you decline the changes, we will close your account after your balance reaches zero and we confirm no new charges have posted to your account.

Keep in mind, if you have accumulated rewards and would like to redeem them, you will need to do so before September 16, 2007.

We appreciate this opportunity to address your concerns. If you have any additional questions or concerns, please feel free to call me at 1-800-955-1455, Ext. 4353.

Sincerely,
T Brown
Tanesha Brown
Capital One Services, Inc.

Steven Autrey
2714 McKenzie Lane
Fredericksburg, VA 22408

Richard D. Fairbank,
Chairman, President and CEO
Capital One Financial Corporation
1680 Capital One Dr.
McLean, VA 22102-3407

Capital One
Attn: Disputes
PO Box 85520
Richmond, VA 23285-5520

RE: Capital One Visa Card Account #xxxx-xxxx-xxxx-8743

August 27th, 2007

Dear Mr. Fairbank:

Our banking relationship has grown since the above-referenced card was first issued back in 1999. Over the last eight years, Capital One has raised my credit limit numerous times – most without solicitation - and has honored the contents in the cardholder agreement.

Recently, I received a notification from Capital One that due to the "increased costs of doing business" (sic), my fixed rate of 9.9% is being raised to 16.9% effective after the September, 2007 billing cycle.

As a longstanding customer of Capital One's, and a good customer who generates a lot of finance charge revenue and purchase revenue for your company, and in light of our heretofore good relationship since 1999, I am asking you to maintain my 9.9% fixed rate.

My personal financial situation has changed for the positive, and a new payrate will go into effect next month here at my job.

Thank you for your kind consideration.

Best regards,

Steven Autrey

Embargoed until
April 17, 2008, at 10:00 am

Statement of

John E. Bowman, Deputy Director, Chief Counsel
Office of Thrift Supervision

concerning

The Credit Cardholders' Bill of Rights Act of 2008

before the

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

April 17, 2008

Office of Thrift Supervision
Department of the Treasury

1700 G Street, N.W.
Washington, DC 20552
202-906-6288

Testimony on the Credit Cardholders'
Bill of Rights Act of 2008
before the
Subcommittee on Financial Institutions and Consumer Credit
of the Committee on Financial Services
United States House of Representatives

April 17, 2008

John E. Bowman, Deputy Director, Chief Counsel
Office of Thrift Supervision

I. Introduction

Good morning, Madame Chair, Ranking Member Biggert, and Members of the Subcommittee. Thank you for the opportunity to present the views of the Office of Thrift Supervision (OTS) on H.R. 5244, the Credit Cardholders' Bill of Rights Act of 2008 and issues related to credit card lending in the thrift industry. Thank you also for your interest and leadership on this important aspect of the financial services market. We share your commitment to protecting consumers from abusive credit card practices.

In my testimony today, I will discuss the thrift charter, authority for savings associations to issue credit cards, OTS authority to supervise the credit card activities of thrift institutions and credit card holdings of the industry. Next, I will explain how the OTS monitors and oversees the credit card activities of the industry. Then, I will address the adequacy of our authority to oversee credit card lending, regulatory alternatives to legislation and our comments on H.R. 5244.

I would also like to take this opportunity to update the Subcommittee on OTS efforts to curb abusive practices with regard to credit cards and other lending activities. On August 6, 2007 the OTS issued an Advance Notice of Proposed Rulemaking (ANPR) requesting comment on the issuance of additional OTS regulations implementing section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive acts or practices (UDAPs). The ANPR solicited comment on a wide range of potential UDAPs in addition to those already covered by the existing OTS Credit Practices Rule.

Based on our review of comments from consumer advocates, industry representatives, members of Congress, and the general public, we are working to issue a Notice of Proposed Rulemaking (NPR) in the immediate future. We expect the UDAP rule to address certain practices that have raised concern, including retroactive rate increases and double cycle billing. In response to commenters' requests for consistent interagency standards and a level playing field, we have invited the other federal agencies with FTC Act rulemaking authority – the Federal Reserve Board, Federal Trade Commission, and National Credit Union Administration – to participate in the rulemaking. I will discuss our UDAP proposal in more detail later in this testimony.

In this regard, before proceeding it is important to note that we are providing comments on H.R. 5244 while our existing UDAP rulemaking is pending. As you are aware, there are clear standards and requirements under the Administrative Procedure Act (APA) that all federal agencies must follow in the context of any rulemaking. Therefore, we are providing comments on H.R. 5244 today mindful of preserving the integrity of our existing rulemaking under the APA. That is, our comments on H.R. 5244 are offered as observations only on that legislation. While policy observations have informed our rulemaking efforts, the public comment process will ultimately guide our rulemaking on our pending UDAP proposal.

II. Overview of the Thrift Charter and Thrift Credit Card Lending Authority

By statute, thrift institutions must maintain 65 percent of their assets in mortgages and mortgage-related assets; however, this requirement makes accommodation for certain retail lending activities of thrifts, including credit card lending. The purpose of this statute and accommodation is to encourage a mortgage lending focus by thrifts, but also permit activities that are complementary to mortgage lending, such as consumer-based retail lending operations. This benefits consumers by increasing competition for these types of lending services. It also promotes asset diversification and balance in thrift operations by avoiding overexposure to a limited and narrowly focused lending strategy.

The authority for thrifts to engage in credit card lending depends on whether the institution is state or federally chartered. The authority for state-chartered thrifts comes from state law, and the extent and scope of this authority varies depending on the jurisdiction. Generally, state chartered thrifts may engage in credit card lending, although there may be differing limits and/or other restrictions depending on the state.

The authority for federal thrifts to engage in credit card lending derives from the Home Owners' Loan Act (HOLA). Pursuant to the HOLA,[1] a federal savings association may invest in, sell, or otherwise deal in loans made through "credit cards or credit card accounts" without limitation as a percentage of assets to the extent specified by OTS regulations. OTS regulations permit thrifts to issue credit cards and maintain credit card accounts,[2] but impose no general limitation on the extent of credit card lending by federal

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1. 12 USC § 1464(c)(1)(T).

2. 12 CFR § 560.30. A credit card is "any card, plate, coupon book, or other single credit device that may be used from time to time to obtain credit." 12 CFR § 560.30. A credit card account is defined as "a credit account established in conjunction with the issuance of, or the extension of

thrifts. By regulation, however, the OTS may establish an individual limit on such loans if the agency determines that an institution's concentration in such loans presents a safety and soundness concern.[3]

III. OTS Authority to Supervise Thrift Credit Card Lending Activities

Federal thrifts are subject to the authority of the OTS to supervise thrift credit card lending activities. OTS authority includes the ability to examine, regulate and, as noted above, limit for safety and soundness reasons the credit card operations of federal thrifts.[4] Pursuant to its authority to oversee the activities and operations of a federal thrift, the OTS is authorized to regulate, oversee and limit the credit card operations of a federal thrift that are in violation of consumer protection laws and/or that the agency determines pose a reputation risk – and thus a potential safety and soundness risk – to an institution.

IV. Thrift Industry Credit Card Holdings

As of December 31, 2007, OTS-regulated thrifts had total credit card holdings of $44.59 billion, or 2.9 percent of aggregate thrift industry assets. This amount represents approximately 10.6 percent of the aggregate $422.5 billion of credit card holdings of all FDIC-insured depository institutions. Thrift holdings of credit card balances were highly concentrated in just a few thrifts. Eight OTS-regulated thrifts reported over $1 billion in credit card balances as of December 31, 2007. These institutions reported $43.54 billion outstanding, representing the vast majority (97.6 percent) of thrift industry holdings. By contrast, the remaining 116 thrift institutions that reported some level of credit card balances accounted for only $1.05 billion, or 2.4 percent of thrift industry credit card holdings.

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credit through, a credit card." 12 CFR § 560.30. A credit card account includes loans made to consolidate credit card debt, including credit card debt held by other lenders, and participation certificates, securities and similar instruments secured by credit card receivables. 12 CFR § 560.3

3. 12 CFR § 560.30, Endnote 6.

4. Section 4(a) of the HOLA, 12 USC § 1463(a), provides that the OTS Director shall provide for the examination, safe and sound operation, and regulation of state- or federally-chartered savings associations. It further provides that the OTS may issue such regulations as the Director determines to be appropriate to carry out its responsibilities. In addition, HOLA section 5(a), 12 USC § 1464(a), provides that the OTS Director may prescribe the organization, incorporation, examination, operation, and regulation of federal savings associations. Finally, as previously noted, the OTS has specific authority to regulate the credit card activities of federal thrifts pursuant to HOLA section 5(c), 12 USC § 1464(c)(1)(T), which provides that a federal thrift may engage in credit card lending to the extent specified by OTS regulations.

On an aggregate basis, unused consumer credit card lines at OTS institutions totaled $686.5 billion in December 2007, up from $597.1 billion one-year earlier. This represented 14.7 percent of the unused balance of $4.68 trillion of consumer credit card lines reported by FDIC-insured institutions as of December 31, 2007.

Nineteen thrift institutions had credit card loan balances in excess of 10 percent of their risk-based capital. Nine of these institutions had credit card concentrations exceeding 100 percent of risk-based capital. Notwithstanding these levels, issuers continue to have strong capital positions supporting their credit card lending programs.

Credit card delinquencies have trended up in the past two years. Credit card balances with payments between 30 and 89 days delinquent were 1.88 percent at the end of 2007, up from 1.68 percent at the end of 2005. Similarly, credit card balances 90 days past due plus those in non-accrual status were 1.58 percent at the end of 2007, up from 1.08 percent two years ago. Net charge-offs by OTS-regulated credit card lenders have also been trending higher. On an aggregate basis, adjusted net charge-offs were 5.04 percent of the credit card portfolio during 2007, compared to 3.84 percent and 4.26 percent during 2006 and 2005, respectively. We continue to monitor these trends closely, especially given weakness in the labor markets and the strains on consumer budgets caused by higher energy and food costs.

V. OTS Monitoring and Oversight

In addition to quarterly monitoring of the loan levels, performance and capital adequacy of thrifts engaged in credit card lending programs, the OTS monitors the marketing, pricing, fee and servicing practices of these programs. An important component of our oversight is examining for compliance with consumer protection laws, and particularly the account management and collection activities and practices of these institutions.

The OTS has a dedicated team of credit card specialists known as the Core Credit Card Specialty Group that works on continually improving our examination staff's knowledge base, effectiveness, and inter-regional training program with respect to credit card oversight. Our Core Group staff assists our regional examiners review institutions with the most complex credit card operations and they enhance cross-training efforts and the consistency of these examinations. Staff at the national office prepares specific quarterly monitoring reports and assigns core teams to assist in key selected institutions. For the thrifts that have significant credit card operations, we currently have examiners assigned to this core group. The group focuses on the major functional areas involved in credit card lending: marketing, underwriting, account management, and collections activity.

The OTS is required to ensure that thrifts conduct their credit card lending activities and programs in compliance with applicable consumer protection laws and subject to rigorous scrutiny of all aspects of an institution's program. In conducting its oversight of thrift credit card lenders, the OTS is particularly mindful of reputation risks that could undermine the safety and soundness of an institution and/or the thrift charter under which an institution conducts its credit card operations.

We regularly examine thrifts for compliance with federal consumer protection statutes including the Truth in Lending Act (TILA) and fair lending laws such as the Equal Credit Opportunity Act (ECOA). We examine for compliance with our advertising regulation, which prohibits thrifts from making any representation that is inaccurate or that misrepresents its services, contracts, investments or financial condition.[5] We also examine thrifts for compliance with our nondiscrimination regulation, which prohibits thrifts from discriminating in lending and other services, appraisals, marketing practices and related areas.[6] Finally, long-standing OTS guidance provides that a thrift's collection activities must comply with the following:

- state laws that pertain to collection and foreclosure actions; and
- bankruptcy law – an institution's collection activity is affected by any bankruptcy plan into which a debtor has entered.

An area of particular scrutiny with respect to credit card management practices in recent years is the application of minimum amortization standards by credit card lenders. Pursuant to guidelines issued by the federal banking agencies, credit card lenders are expected "to require minimum payments that will amortize a current loan balance over a reasonable period of time, consistent with the unsecured, consumer-oriented nature of the underlying debt and the borrower's documented creditworthiness."[7] The banking agencies understand that safety and soundness concerns are raised by prolonged negative amortization, inappropriate fees, and other practices that inordinately compound or protract consumer debt and disguise portfolio performance and quality.

OTS examiner guidance provides interpretation of the interagency amortization guidelines that are even stricter than those of the other agencies, stating that "monthly payments should cover at least a one percent principal balance reduction, as well as all assessed monthly interest and finance charges."[8] While the interagency credit card

5. 12 C.F.R. § 563.27.

6. 12 C.F.R. Part 528.

7. Interagency Credit Card Lending, Account Management and Loss Allowance Guidance, January 8, 2003.

8. Section 218, OTS *Examination Handbook*.

guidance and OTS examiner guidance allow for exceptions within well-managed credit card programs, consistent with prudent underwriting, we significantly limit the issuance of exceptions.

A. Consumer Complaint Activity

The OTS continually tracks, investigates and responds to consumer complaints involving thrift institutions with respect to product offerings and services, including credit cards. Consumer complaint staff and managers also prepare summaries of consumer complaints for OTS examiners to utilize in their reviews during on-site examinations.

Institution consumer complaint records are an integral part of the OTS individualized Pre-Examination Response Packages (PERK), which is our request to thrifts for data that will be used during the examination. This data plays a significant role in identifying areas for examiners to focus on during on-site examinations. These records also play a critical role in assessing the adequacy of an institution's overall compliance management program and in pursuing corrective action that may be appropriate to address programmatic weaknesses or deficiencies.

Specific complaint activity for particular institutions engaged in credit card lending varied considerably over the past year. Not unexpectedly, the largest issuers generally received larger numbers of consumer complaints. In contrast, the remaining institutions generated relatively few complaints in this area. The most frequent complaints related to billing errors and credit card underwriting. Other common complaint areas involved penalty charges, credit bureau reporting, fair debt collection practices, and customer service and consumer relations issues.

It is important to note that our consumer complaint policy provides that even when evidence does not reveal regulatory violations, OTS complaint analysts and management have the flexibility and authority to encourage thrifts to take voluntary action to satisfy a consumer, where circumstances warrant such action. This happens fairly frequently in the interest of preserving strong customer relationships and further enhancing the reputation of thrifts as essential providers of financial services.

B. OTS Enforcement Activities

It is important to note that OTS jurisdiction and oversight of an institution's lending programs also extends to its holding companies and related entities, service providers, and other contractual relationships that an institution may utilize to conduct its credit card activities and related operations.

When an institution's lending programs are found to be potentially predatory or lacking adequate controls to support responsible lending, there are numerous options that the OTS can take. These include informal agreements, supervisory directives, board resolutions, and various other approaches.

For example, we previously addressed an issue with an institution that we believe was engaging in a potentially abusive subprime credit card lending program. The nature of the program was uncovered in the normal course of an examination. To resolve the matter, we directed the institution's board of directors to establish a systematic process to withdraw from the subprime credit card program and immediately cease new approvals under the program. Although this was an informal action pursued in the course of an examination, it resulted in termination of the program in a reasonably short timeframe following the examination. We have taken similar actions with other institutions in the past.

We have also used a combination of formal and informal enforcement actions to force the discontinuation of lending operations by federal thrifts that were attempting to exploit the charter to engage in lending programs lacking adequate consumer protections and management controls. Some cases referred to as "charter rental" strategies involve situations where an institution is attempting to avoid state oversight of out-of-state lending activities by the institution. In addition to raising significant consumer protection issues, these situations not only expose the institution to potential risks, but undermine the integrity of the federal thrift charter. The OTS is particularly vigilant in intervening and expeditiously shutting down these types of operations.

There are numerous other such examples of actions taken by the OTS in the course of examinations of the institutions we regulate. While we find informal actions to be an effective mechanism to address many supervisory concerns, we do not hesitate to use our formal enforcement authority when appropriate. Fundamental to our continuing oversight of the industry we regulate is ensuring that institutions conduct their activities in a manner consistent with sound consumer protection.

VI. Adequacy of Existing OTS Authority

For the reasons described above, I believe that OTS's existing authority is adequate to address the types of issues and potential abuses that may arise with the credit card lending programs of OTS-regulated thrifts. While we believe many of the provisions of Chair Maloney's bill may be beneficial, OTS favors an alternative to new legislation prohibiting specific credit card practices. We support a more agile regulatory approach that allows OTS to respond to whatever unfair or deceptive acts or practices it finds exist in the industry or are on the horizon.

Accordingly, OTS believes the best approach at this time is to continue to work on regulations on an interagency basis addressing unfair or deceptive acts or practices under its existing statutory authority under the FTC Act. We do note, however, that using the FTC Act in a way that creates a level playing field among all financial institutions is complicated because of some restrictions on the Federal Trade Commission's rulemaking authority to prohibit unfair or deceptive acts or practices that appear to have outlived their usefulness.

Specifically, the FTC must use special rulemaking procedures applicable only to the FTC, while the other agencies with FTC Act rulemaking authority can use standard Administrative Procedure Act rulemaking procedures. The FTC has testified on a previous occasion before the House Subcommittee on Commerce, Trade, and Consumer Protection of the Committee on Energy and Commerce (October 23, 2007) that its rulemaking procedures "are much more cumbersome and time-consuming than the APA rulemaking procedures."

This disparate rulemaking authority creates a potential regulatory gap because the FTC is responsible for issuing rules on unfair or deceptive acts or practices that apply to financial institutions that are independent of a depository institution as well as state chartered credit unions. Those entities would not be covered by a joint rule issued by OTS and the other agencies with FTC Act rulemaking authority.

To close that gap, the House of Representatives passed H.R. 3526 on December 5, 2007. One provision in that bill would allow the FTC to use the same APA rulemaking procedures that the other agencies use when promulgating an FTC Act rulemaking jointly with the other agencies to address unfair or deceptive acts or practices. We note that H.R. 3526 also would provide the OCC and FDIC with the same rulemaking authority under the FTC Act as is currently provided to the OTS. We believe these provisions are a good idea and would be helpful.

VII. Consumer Protection Issues

Now I would like to describe two regulatory agencies' proposals to provide proper disclosure and to curb abusive practices with regard to credit cards, as well as to address Chair Maloney's bill.

A. Proposed Amendments to Truth in Lending Act (TILA) Regulations

I believe that clear, comprehensible disclosure of all significant loan terms is essential to every consumer credit transaction. One of the primary purposes of TILA is to provide meaningful disclosure of credit terms so that consumers are able to compare financial products and avoid the uninformed use of credit.

While the Federal Reserve Board (FRB) has sole authority to promulgate substantive rules to implement TILA,[9] a number of regulatory agencies have authority to enforce them. Known collectively as Regulation Z, these rules are enforceable against thrifts, thrift holding companies, and thrift subsidiaries by the OTS under TILA, HOLA, and the Federal Deposit Insurance Act.[10]

In September 2006, the Government Accountability Office issued a report which concluded that the credit card disclosures used by the largest issuers had weaknesses which reduced consumers' ability to understand them.[11] In June 2007, the FRB proposed changes to the provisions of Regulation Z that apply to open-end credit.[12] According to the FRB, the goal of the proposed amendments is to improve the effectiveness of the disclosures that creditors provide to consumers at application and throughout the life of an open-end account that is not secured by a home.[13] Consistent with this narrow goal, the amendments do not attempt to directly address practices that may cause harm to consumers.

B. Proposed Rulemaking to Address Unfair or Deceptive Practices

As noted above, TILA and Regulation Z are primarily intended to provide consumers with information to help them comparison shop among competing products. While improving the quality of this information is a positive step, there are a number of harmful practices that cannot be addressed through improved disclosure alone.

Recognizing this, the OTS has initiated a rulemaking intended to address unfair or deceptive practices (UDAPs) prohibited by the Federal Trade Commission (FTC) Act. On August 6, 2007, we issued an advance notice of proposed rulemaking (ANPR) requesting comment on the adequacy of our current UDAP rules.[14] Based on our review of comments from consumer advocates, industry representatives, members of Congress, and the general public, we are working to issue a Notice of Proposed Rulemaking (NPR) in the very near future.

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[9] 15 U.S.C. 1604.

[10] 15 U.S.C. 1607(a)(2), 12 U.S.C. 1464(d), 1467a, 1813(q)(4), and 1818.

[11] See, "Credit Cards: Increased Complexity in Rates and Fees Heightens Need For More Effective Disclosures to Consumers", GAO-06-929, issued September 2006.

[12] 72 FR 32948 (June 14, 2007).

[13] Id.

[14] Unfair or Deceptive Acts or Practices: Advance Notice of Proposed Rulemaking, 72 FR 43570 (August 6, 2007).

In response to commenter requests for consistent interagency standards and a level playing field, we invited the other federal agencies with FTC Act rulemaking authority – the Federal Reserve Board, Federal Trade Commission, and National Credit Union Administration – to participate in the rulemaking. The Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency currently do not have rulemaking authority under the FTC Act; however, we have consulted with them regarding our UDAP proposal. We envision promulgating a rule that adopts principles-based standards for unfairness and deception. Under these standards, a practice is viewed as unfair if: it is likely to cause harm; consumers cannot avoid the injury; and the injury is not outweighed by countervailing benefits to consumers or competition.[15] A practice is viewed as deceptive if it involves a material representation or omission that is likely to mislead a consumer acting reasonably.[16]

Our ANPR examined a broad array of issues and practices, including practices relating to the marketing, origination and servicing of credit cards.

C. Comments on H.R. 5244

We have reviewed your bill, the Credit Cardholders Bill of Rights (H.R. 5244), which seeks to end certain credit card industry practices and provide important consumer protections to credit cardholders.

We share many of your concerns. For example, some issuers have engaged in pricing practices that are potentially harmful to consumers. These include increasing the annual percentage rate on an outstanding balance for reasons other than cardholder behavior that is directly related to the account. In our UDAP proposal we expect to place restrictions on some of these types of practices.

Also troubling is "double cycle billing," the practice of computing finance charges based on account balances in billing cycles preceding the most recent billing cycle. It is very difficult for consumers to avoid the increased costs associated with double cycle billing because most consumers simply can't understand it. This is another area that we address in our proposal.

Like you, we believe that payment allocation practices also require attention. Where an account has balances with different rates (e.g., for balance transfers, cash

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[15] See 15 U.S.C. 45(n) (unfairness standard codified for FTC use).

[16] See FTC Policy Statement on Deception, Letter from the FTC to the Hon. John H. Dingell, H. Comm. on Energy & Commerce (Oct. 14, 1983) ("FTC Policy Statement on Deception") (available at http://www.ftc.gov/bcp/policystmt/ad-decept.htm)

advances, and charged purchases), most issuers now allocate payments in ascending order from the balance with the lowest interest rate to the highest. This maximizes issuer returns, but is costly for consumers. Moreover, because cardholders have difficulty understanding how issuers allocate payments, it is hard for them to use their cards in a manner that minimizes the cost attributable to these strategies. Your bill would respond to these issues by requiring that issuers allocate payments on a pro-rata basis. We agree that payment allocation needs to be addressed, but would offer additional options that could reduce cost for consumers. These might include allocating payments from the highest interest rate balance to the lowest or allocating payments equal dollar amounts to each balance.

Overlimit fees have also generated negative public attention. It can seem counterintuitive that an issuer would permit a cardholder to exceed his or her credit limit - which ostensibly represents the amount of credit for which the cardholder is qualified - and then charge a fee for the transaction that the issuer permitted. The possibility that an issuer would take this approach multiple times during a billing cycle is disturbing. Your bill would respond to these concerns by restricting overlimit fees to one per cycle if the cardholder's credit limit was exceeded on the last day of the cycle. Our research indicates that most issuers are already handling overlimit fees in this manner. We are continuing to gather information in this area.

Finally, your bill responds to serious concerns that have been raised about cards typically offered in the subprime market. All too often, fees imposed when such cards are issued erode most of the credit promised. Your bill would prohibit issuers from imposing fees during the first year an account is open from exceeding 25% of the credit financed. We certainly support efforts to ensure that consumers who are promised credit actually get it.

We appreciate your intentions in introducing H.R. 5244 and would be pleased to work with you and your staff to address these important issues. In crafting our UDAP rule, one of our primary objectives has been to deal with practices that have raised concern about the fairness and transparency of the credit card market.

X. Conclusion

While credit card lending programs are not prevalent throughout the OTS-regulated thrift industry, there are a number of institutions that engage in significant amounts of credit card lending. For our part, we will continue to work with our institutions to ensure safe and sound underwriting standards and strong consumer protections that benefit both the institutions that we regulate and their customers. We will continue to support efforts to strengthen the ability of consumers to make informed decisions with respect to their credit card accounts.

As I said earlier in my testimony, I favor a regulatory solution to protect consumers from any abuses in the credit card lending activities and practices of the thrift industry. I do not believe that additional statutory authority is necessary at this time, with the exception of enhancing the FTC's rulemaking authority and providing the OCC and FDIC the authority to issue joint rules on unfair or deceptive acts or practices as previously indicated. However, at such time as a need should arise, I assure you that we will advise the Chair and Members of the Subcommittee of the need for legislative assistance to address any deficiency in our ability to supervise and/or respond to thrift credit card lending practices that pose consumer protection, safety and soundness, or other risks to the federal thrift charter.

Thank you, Madame Chairman and Ranking Member Biggert, for holding this important hearing. We appreciate the opportunity to present the OTS's views on these issues.

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Statement of

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Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions and Consumer Credit

Committee on Financial Services

U.S. House of Representatives

April 17, 2008

Madam Chair Maloney, Ranking Member Biggert, members of the Subcommittee, I appreciate the opportunity to discuss the Federal Reserve Board's ongoing efforts to enhance protections for consumers who use credit cards. In June 2007, the Board proposed substantial revisions to the credit card disclosures required under the Truth in Lending Act (TILA) regulations. Those revisions are focused on ensuring that consumers have the information they need about credit card costs and terms, when they need it, in a form they can use. In addition, as Chairman Bernanke indicated in testimony before the full Committee in February, the Board plans to use authority under the Federal Trade Commission Act (FTC Act) to propose rules prohibiting unfair or deceptive credit card practices. The proposal will be issued this spring. We are working on these rules with the Office of Thrift Supervision (OTS) and the National Credit Union Association (NCUA) so that consumers would have the same level of protection whether their card issuer was a bank, savings association, or federal credit union.

Implications for Consumers of Increased Credit Card Complexity

In the early 1980s, less than half of American families had a general purpose credit card (43 percent in 1983). Currently close to three-quarters have at least one card (71 percent in 2004). The increase in credit card holdings was sharpest among lower-income families: from 1983 to 2004, the share of families in the lowest income quintile that hold such cards jumped from 11 percent to 37 percent.[1] In addition, consumers are using their cards more both as a payment device and as a source of credit. Total charges on bank credit cards increased by about five times and total debt outstanding as of year-end by almost four times from 1991 to 2006.[2] This growth is explained by several factors, including substitution of cards for cash and

[1] Board of Governors of the Federal Reserve System (2006), Report to the Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and their Effects on Consumer Debt and Insolvency (Washington: Board of Governors of the Federal Reserve System), table 6.
[2] Board staff calculations from Thomson Financial Media, Cards and Payments: Card Industry Directory, various editions (New York: Thomson Financial Media, pp. 14-16 in each edition).

installment credit and the development of credit scoring and risk-based pricing, which have made credit cards available to more people.

As consumers have relied more on credit cards, card plans have become more complex. Once, a card may have allowed the user to make purchases or obtain cash advances and applied a single, unchanging annual percentage rate, or APR, to each feature. Fees were typically limited to an annual fee, a charge for cash advances, and perhaps fees for paying late or exceeding the credit limit. Today's more complex products offer balance transfers and treat different classes of purchases and cash advances as different features, each with its own APR (for example, an APR for purchases generally and a lower APR for certain purchases made during a "promotional" period). In addition, APRs adjust much more frequently to changes in the market, in a borrower's credit risk profile, or in other factors the creditor considers important. The typical card no longer has an annual fee, but it can have many other fees tied to a variety of features, requirements, or services.

These more complex plans hold significant potential benefits for consumers. Pricing that is sensitive to consumers' preferences for services likely increases the availability of the services that consumers find most valuable. Pricing that is sensitive to consumers' credit risk profiles can increase the availability of credit and lower its cost for many consumers. Growing complexity, however, has increased the risk that consumers will not understand or notice key terms that affect a plan's cost. With so many rates, fees, and features, it has become more likely that even reasonably diligent consumers make costly mistakes. Moreover, when complexity reaches the point of reducing transparency, it impedes competition and creates inefficiencies.

Even when credit card plans were simpler, ensuring that consumers understood the cost of using the plan or of using it for a particular purpose was a challenge. Key variables that affect a consumer's costs, such as the amount of credit the consumer will use or the timing and amount of the consumer's payments, are not known in advance to the card issuer. TILA, therefore, does not require advance disclosure of a single, effective rate. It requires the issuer to disclose a nominal rate and other terms that determine the cost of the plan, such as fees, any grace period, and the balance calculation method. Clear disclosure of these terms and how they determine what the consumer will pay has always been a challenge. The disclosure challenge has grown substantially with the increase in the complexity of credit card plans.

The Board has sought to meet this challenge with a systematic and comprehensive review of TILA disclosures based on extensive consumer testing. We believe that our June 2007 proposal will lead to disclosures that are more effective for today's more complex credit plans. Those who have commented on the proposal have generally agreed. At the same time, over two thousand comments from individual consumers, a growing body of behavioral research, and our own consumer testing provide evidence that it is increasingly difficult to use disclosure alone to help reasonably diligent consumers avoid incurring unnecessary costs on their increasingly complex credit card plans. Careful measures that would restrict credit card terms or practices may in some instances be more effective than disclosure to prevent particular consumer injuries. At the same time, such restrictions can have unintended adverse consequences for consumers, such as reducing the availability of credit or increasing its cost.

Mindful of the advantages and limitations of both disclosure and stricter approaches, the Board is developing a second set of rules to supplement the June 2007 disclosure proposal with new targeted requirements and restrictions on credit card terms. As Chairman Bernanke recently testified, these rules will be issued later this spring under the FTC Act, in coordination with the OTS and NCUA. In developing proposed rules, we have consulted H.R. 5244, the "Credit

Cardholders' Bill of Rights Act of 2008" introduced by Madam Chair Maloney. This comprehensive bill has helped us to identify consumer protection concerns that we should consider addressing by regulation.

In the remainder of my testimony, I will review the Board's pending proposal to improve credit card disclosures and discuss the concerns raised and suggestions made about certain credit card practices during the comment period. I will also summarize our ongoing efforts working with the OTS and NCUA to develop joint rules under the FTC Act.

The Board's 2007 Proposal to Improve Disclosures

The potential benefits of disclosure are well-known. More effective disclosures make information about terms and pricing easier for consumers to obtain and understand. Informed consumers are less likely to fall into "traps for the unwary" and more able to choose products that offer the best combination of features and pricing to meet their personal financial needs. Better dissemination of information about credit card terms and pricing also enhances competition among credit card issuers, which, in turn, helps generate products that consumers want.

The Board's proposal to improve disclosures seeks to ensure that consumers receive key information about the costs of credit card transactions in ways they can understand, in formats they can use, and at times when it is most helpful. To help us craft a proposal to meet these specific objectives, we considered comment letters, available sources of data and information, and our own long experience implementing TILA. We also considered what consumers themselves had to say by interviewing consumers individually about their use and understanding of different disclosures. Consumers told us what information they find useful when making credit decisions and what information they ignore. We learned which words and formats for presenting information promote understanding and which do not.

Lessons from our extensive consumer testing are reflected in a myriad of preliminary judgments made in the proposal about appropriate disclosure content, format, and timing. The proposal includes the following specific elements:

- Advertisements of introductory rates would more clearly disclose the eventual higher rates and how soon they would be imposed;
- Advertisements of "fixed" rates would be restricted to rates that are truly not subject to change, either for a clearly disclosed period or for the life of the plan;
- The "Schumer box" required with credit card solicitations and applications would be updated to more effectively present information about rates and fees. The most critical rate and fee information would be presented in the box; rates and fees would be separated into two sections; and graphic techniques such as minimum font size, judicious bolding, and vertical alignment of key numbers would make it easier to read and use;
- A summary table similar to the Schumer box would accompany the lengthy, complex credit agreements that consumers receive when they first open an account and would also be provided, later, when account terms are amended;
- The penalty rate and penalty fees would be highlighted in the Schumer box and the account-opening summary table; and a reminder of late payment penalties would appear on every periodic statement;
- A consumer would be sent notice 45 days before a penalty rate was imposed or the rate or a critical fee was increased for other reasons;

- The cumulative cost of fees would be highlighted every month. Fees charged in the previous month would be grouped together on the statement in a prominent location and totaled for the month and year-to-date;
- The periodic statement's "effective APR," another way of disclosing the total cost of credit, is the subject of two alternative proposals. Under one proposal, the effective APR could be revised to make it simpler for creditors to compute and potentially easier for consumers to understand. Alternatively, if continued consumer testing, public comments, and the Board's analysis indicate that the effective APR does not offer a meaningful consumer benefit, then it could be eliminated, as the statute authorizes;
- Consumers would be warned on the periodic statement about the higher cost of making only minimum payments, and creditors would be provided incentives to give consumers a more precise estimate of the time it would take to repay the balance and to place that estimate on the periodic statement rather than make it available by telephone;
- Creditors would receive clearer guidance regarding what charges must be disclosed, when, and how. They would be given increased flexibility to disclose charges at times and by methods more useful to the consumer and more convenient to the creditor.

Comments on the 2007 Proposal

The Board received over 2,500 comments on the June 2007 proposal, about 2,100 of them from individual consumers. Many consumers wrote us about their personal experiences with credit cards, providing information that we have found invaluable in our continuing efforts to improve disclosures and in our development of proposed regulations under the FTC Act.

Consumer advocacy groups also wrote to us, as did financial institutions or their trade associations. We also heard from members of Congress and other government agencies.

Broadly speaking, commenters generally supported the proposed disclosures and the Board's approach to improving disclosure through consumer testing. Some commenters offered specific suggestions to improve the disclosures or reduce unnecessary burden, and we are taking those suggestions into account. As we expected, a few elements of the proposal elicited significantly divided reactions. For example, industry representatives contended that the format requirements we proposed for periodic statements, which are favored by consumer groups, would be overly prescriptive. Consumer groups opposed the proposal to eliminate the effective APR from the periodic statement, a proposal supported by industry representatives. We are carefully evaluating these matters, including through more testing with consumers.

Consumers and consumer groups also contended that better disclosures were not sufficient to address certain issuer practices and they urged the Board to regulate these practices more strictly. Among the concerns frequently cited were shortening of the time to submit payments, applying interest rate increases to pre-existing balances, allocating payments first to balances with the lowest interest rate, and computing interest using the so-called double-cycle method.

Individual consumers and consumer advocates indicated that consumers are allowed too little time after receiving their bills to submit their payments, thus leading to late fees and interest charges and other adverse consequences such as rate increases. They urged the Board to require that consumers be given more time to pay and to require creditors to show that the consumer, rather than the mail service, was to blame for a late payment. Comments from creditors, however, generally asserted that consumers have ample time to make payments, particularly in light of the increasing number of consumers who receive periodic statements and make payments electronically. These comments also stated that providing longer grace periods to consumers would reduce interest revenue and lead creditors to increase other consumer costs.

The Board's proposal to require 45 days' notice before a rate or critical fee is increased was criticized by some commenters for going too far, and by others for not going far enough. This proposed notice was intended primarily to give consumers time to pay off the balance before the rate increase, through then-existing resources or alternative credit sources. Industry representatives contended, however, that the requirement would harm consumers overall. They say it would delay issuers from increasing rates when there is an increase in the consumer's risk of default or the issuer's cost of funds, and that issuers would likely need to respond by raising credit costs or reducing credit availability. On the other side, individual consumers, consumer groups, and members of Congress contended that the proposed 45-day notice did not go far enough to protect consumers from unfair surprise. They argued that many consumers would not be able to avoid the increase by transferring their balances to lower-rate accounts and recommended stricter approaches, such as giving the consumer the right to "opt out" of a rate increase for existing balances, prohibiting issuers from applying increased rates to pre-existing balances, or prohibiting issuers from increasing rates until the card expires.

The issue of payment allocation also elicited divided responses. If a card holder's account has two or more balances with different interest rates (for example, a purchase rate and a cash advance rate), issuers typically apply payments to the lowest-rate balance first, so the consumer accumulates interest at the higher rates applicable to other balances. The Board proposed a new disclosure of this practice when issuers advertise promotional rates. Industry representatives generally favored the proposed disclosure and urged that it be applied more broadly, not just to promotional terms. Consumers, consumer groups, and members of Congress, however, commented that a disclosure would not protect consumers sufficiently. These commenters urged the Board to prohibit the practice of allocating payments to the lowest-rate balance first. Industry representatives countered that regulating payment allocation methods could reduce consumers' choice of features and increase their credit costs.

Consumer groups urged the Board to prohibit the use of a method sometimes referred to as "two-cycle" or "double-cycle" to compute the balance on which the consumer's interest obligation is determined. The finance charge is computed by most issuers on the balance from the most recent billing cycle. Under the less typical two-cycle method, the finance charge is computed beginning on the date of the transaction, even if that date falls in the prior billing cycle. This method yields higher finance charges whenever a consumer shifts from paying the balance in full each month to carrying a balance on the account. Consumers and consumer groups contended this method is unfair to consumers. Industry representatives generally did not comment on the issue, perhaps because few card issuers currently use the two-cycle method.

Regulatory Proposal under the FTC Act

The FTC Act gives the Board authority to prohibit unfair or deceptive practices by banks. The OTS and NCUA have identical authority over savings associations and federal credit unions, respectively. We are working closely with these agencies with the expectation of developing uniform rules to prohibit unfair or deceptive practices with respect to credit cards. In addition, we plan to use our authority under TILA, which applies to all card issuers regardless of regulator, to adopt stronger substantive protections where appropriate.

Our work is ongoing. Just last week we received useful information in a forum on credit cards hosted by Governor Kroszner in which card issuers and processors, consumer advocates, counseling agencies, and other regulatory agencies came together at the Board to discuss relevant industry trends and identify areas that may warrant action or further study. Among the topics discussed were the Board's previously announced plan to issue a proposal under the FTC Act and the Board's June 2007 disclosure proposal. Participants provided key insights for us to consider as we develop the FTC Act proposal and work to finalize new disclosures.

Our efforts to develop new disclosures continue apace. The public comments identified potential areas for improvement that we are testing through additional in-depth, one-on-one interviews with consumers. Quantitative testing on a statistically valid basis will follow, and we expect to issue a final rule under TILA before year-end.

Conclusion

Madam Chair, in closing let me emphasize the Federal Reserve's commitment to enhancing consumers' ability to use credit cards to their benefit. Disclosure requirements can help ensure that consumers receive information about credit card terms in ways they can understand, in formats they can use, and at times when it is most helpful. More complex pricing and continuous change in the marketplace, however, make the task of writing rules for effective disclosure increasingly challenging. Consumer testing has proven to be very useful in improving disclosure, but we have also concluded that stricter approaches in some areas may be needed. To that end, we will be proposing regulations under the FTC Act later this spring that would impose new restrictions and requirements on credit card issuers to prevent unfair or deceptive practices.

Testimony of John P. Carey

Before the House Financial Services

Subcommittee on Financial Institutions and Consumer Credit

April 17, 2008

Introduction

Good morning Chairwoman Maloney, Ranking Member Biggert, and Members of the Subcommittee. My name is John Carey, and I am the Chief Administrative Officer of Citi Cards. I appreciate the opportunity to appear before you today to discuss our views on H.R. 5244 and its implications for credit card customers and issuers.

Citi Cards is one of the leading providers of credit cards, with roughly 45 million active bank card customer accounts in the United States, served by 33,000 employees in 20 states. This is a complex business—managing literally billions of individual financial transactions for our customers each month—and we strive to get it right. This is a highly competitive business, so we are continually analyzing our business practices and looking for ways to do a better job of meeting our customers' needs.

That's why last year we were one of the first issuers to stop two practices that were the focus of widespread customer concerns: repricing customers during the term of the card based on delinquent behavior with other creditors, often referred to as universal default, and so-called "any time any reason" repricing.

More broadly, we know customers are not satisfied with the status quo across the industry and, frankly, we are not satisfied either. We understand the concerns motivating legislative action. They are real. They are the same concerns that underlie the Federal Reserve Board's (Fed) proposed modification to the regulatory regime that governs credit cards. There is, in fact, a broad consensus—across the credit card industry and among consumers, advocacy groups, and academics—about the need for action. The question for robust discussion is what kind of action.

We have studied H.R. 5244 closely, and we welcome the opportunity to share our views. My testimony today will: (1) examine how the evolution of the credit card industry created the challenges we face today; (2) identify what we think are the best solutions to those challenges; and (3) offer our views about why H.R. 5244 is not the right approach.

Evolution of the Credit Card Industry: Roots of Today's Challenges

Background. To understand the roots of today's challenges in the credit card industry, it is important to appreciate how credit cards have evolved over the past half-century: they have transformed from an accommodation by local merchants for a few trusted customers to an integral part of the national economy and the principal form of credit for millions of Americans.

The industry's roots are found in small retail stores where customers charged purchases and paid the merchant back monthly; these arrangements were based on face-to-face relationships and the credit issuer's knowledge of the borrower's financial situation and ability to repay the loan. Even as recently as 25 years ago, credit cards were available only to a relatively small group of high-income individuals who had strong credit histories. But even those reliable customers had little choice and more onerous terms than what is available to most Americans today. Before 1990, nearly all credit cards carried an annual fee, ranging from $20 to $50, and most cards charged fixed interest rates of roughly 20%. Today, the situation is nearly reversed. By 2005, 75% of cards had no annual fee, and 80% of cardholders had interest rates lower than 20%.

Risk-Based Pricing. Before the late 1980s, two factors combined to create a one-size-fits-all credit card market, with fewer cards available and more restrictive terms: first, for lenders, credit card transactions are not secured by a lien on a tangible asset, which makes them a risky form of loan; and second, lenders at that time had no good way to evaluate and calibrate that credit risk for individual customers.

Because credit cards are now so familiar and ubiquitous, it is easy to lose sight of what they are. While most people may not think of it this way, the fact is that every time a person uses a credit card, that consumer is taking out an unsecured loan through a revolving line of credit. Although credit cards are treated interchangeably with cash, checks, or debit cards during a transaction, they operate quite differently. When a customer pays with cash, check, or debit card, she is simply choosing among different methods of transferring *her own funds* to a merchant. But a credit card is more than a method of payment; when a customer uses a credit card, she borrows funds from the issuer of the credit card and directs the issuer to transfer that *borrowed money* to the merchant at the same time.

And because the loan a customer takes out when using a credit card is an unsecured revolving loan, it carries a lot of risk from a lender's perspective. Unlike other common consumer loans, such as car loans and mortgages, which are backed up by tangible security, a credit card loan is secured only by a customer's promise to repay. Moreover, it is an open line of credit, which the customer can access at any time from almost anywhere in the world. Finally, these loans typically are made not through personal interaction, but through the mail, by telephone, or over the Internet, to someone the lender in all likelihood has never met.

The unsecured, open-ended nature of credit card loans means that lenders need to take steps to protect themselves against unanticipated changes in credit risk. Twenty-five years ago, issuers did that by lending only to customers with the strongest credit histories and by imposing across-the-board 20% interest rates and charging annual fees. At that point, credit card companies simply did not have sufficiently developed technology or the analytical tools to permit the pricing of credit card loans based on a customer's risk profile.

In the last 15 years, new technology and more sophisticated risk management analytics and practices have made it possible for issuers to evaluate an individual customer's risk profile more effectively at account opening and throughout the relationship, and to base credit card loan pricing on those evaluations. Thus, while issuers still have to contend with the inherently riskier nature of an unsecured, revolving loan, these technological and analytical advances have given issuers more precise and effective tools to mitigate that risk. This is risk-based pricing, and it has revolutionized the credit card market, with many benefits for consumers.

Benefits to Consumers. Issuers now can set prices and credit limits at the time a credit card application is approved that will better correspond to an individual customer's credit risk profile, and they also can react in "real-time" to changes in risk over the life of a customer's account.

This risk-based pricing is good for consumers in two ways. First, by allocating the cost of risk to individual customers, issuers can reward customers who have solid credit histories with more competitive pricing, while the customer who poses a higher risk appropriately absorbs the cost of that risk himself.

Second, risk-based pricing actually grows the pie, providing more people with access to regulated credit, including consumers who were previously underserved or had no access to unsecured, revolving credit. With the ability to adjust pricing so that it has a nexus to risk, issuers can expand access to credit, giving a broader range of consumers across the economic spectrum the opportunity to establish a credit history, better manage their cash flow, and deal with costs associated with unexpected life events such as job loss or health emergencies. These benefits are particularly important for Americans who may not have been able to build up a cash nest egg and otherwise would have to dip into retirement savings or seek credit from payday lenders or others in the unregulated market.

These improvements derived from risk-based pricing also have led to increased competition in the industry, which, in turn, has created both more choices for consumers and overall lower prices. Issuers offer affinity, co-branded, and special feature credit cards, including cards with rewards programs tied to airlines or retail stores, with special pricing for higher payments, or that provide contributions to an associated 529 college savings plan. In addition, credit card interest rates have declined since mid-1991, largely through greater competition and reduced cost of funds. As a result, in 1991 only 11% of cardholders reported interest rates below 16%, while 71% did so in January 2007. According to the 2006 report by the Government Accountability Office (GAO), the average interest rate on cards declined by almost six percentage points as compared to 1990.[1]

Taking Action: Solving the Challenges

There is widespread agreement on the need for comprehensive changes—beyond individual companies' actions—to improve the credit card marketplace. As the credit card market has evolved and the products have become more numerous and complex, it is all the more important for consumers to have complete, clear, consistently-presented information to make informed choices. Unfortunately, federal disclosure requirements have not kept pace with market innovation. Nor has the industry been able on its own to develop a uniform set of rules that would effectively inform consumers about the credit card products they choose and use every day. This lack of transparency prevents consumers from being able to make fully informed decisions and distorts the marketplace.

Citi's Experience as an Innovator. I can tell you from our own experience that the lack of complete, understandable information about credit card practices undermines the incentive to make consumer-friendly changes. Last year, we led the industry in responding to consumers and policymakers who criticized two practices that, while rational from a purely credit risk-pricing perspective, were viewed as heavy-handed. First, we eliminated the practice—known as universal default—of adjusting our customers' interest rates during the term of their card based on their delinquent behavior with other creditors, even though a customer's credit behavior with another creditor has proven to be predictive of that customer's behavior with us. Some issuers continue to

[1] *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*, GAO at 15, Sept. 2006.

assert that they have eliminated universal default simply because they give customers *notice* before they reprice on the basis of behavior with another issuer. But we mean more than that: we have eliminated not just "automatic" repricing (*i.e.,* without notice) based on such behavior, but *any* repricing.

Second, we also gave up the ability—commonly known as "any time any reason repricing"—to increase rates or fees during the term of the card (typically two years) for reasons such as changes in economic conditions, including our own cost of funds, which obviously affect our business.

We hoped and expected that these two points of differentiation would lead customers to vote with their feet. These changes were widely applauded, both by consumer advocates and by many of you. But we have been disappointed with the results we have seen so far. So, what happened? The problem is that customers cannot recognize the differences between us and our competitors; disclosures across the industry are not providing sufficient, straightforward information that allow a layperson to use a side-by-side comparison to select the best value.

Simple, clear disclosures stimulate innovations that benefit consumers, encourage firms to adopt policies and practices that are distinctive and attractive to consumers, and help to prevent potentially unfair practices by shining a light on them. If properly designed, disclosures provide a clear understanding of credit card policies and practices; help consumers in selecting the card best suited to their needs; help consumers avoid being surprised by unexpected fees; provide sufficient notice of potential changes in practices; and promote greater competition within the industry.

We have invested significant time and effort in making sure our own disclosures communicate effectively. While we are, of course, always looking for ways to improve, our disclosures were the only ones singled out by the GAO in its September 2006 industry-wide report on credit cards as effective and simpler to read. We also have introduced an enhanced "*Facts About Rates and Fees*" table in our cardmember agreements, summarizing all rates and fees in clear, easier to read language; adopted a more consumer-friendly notice to better inform each customer of a change in terms and the right each customer may have to opt out of that change; and enhanced our "responsible lender" disclosures by adding a simple paragraph to the front page of all solicitation letters making clear, among other things, any balance transfer fee, the circumstances under which a customer may lose a promotional rate, and the balances to which the promotional rate does and does not apply.

We recognize, however, that our own efforts, and those of a number of other issuers, are not enough. The industry cannot solve this problem itself because there is no incentive for companies with poor practices to have clear disclosures. In fact, quite the opposite is true. That is why we applaud the Fed's efforts to modernize and improve the disclosure regime for the entire industry for the first time in 30 years.

Regulatory Action by the Fed. When we last appeared before this Subcommittee in June 2007, the Fed had just announced its proposed changes to Regulation (Reg) Z, which implements the Truth in Lending Act (TILA). Our initial reaction was quite positive, and now, having had the opportunity to study the Fed's detailed proposal carefully, we fully support this approach to reform.

The nuanced and extensively reviewed proposal aims to improve the clarity and consistency of disclosures at every important point in the customer's relationship with her bank, and to enhance the customer's understanding of key credit card terms and conditions. The proposal is rooted in the belief, as expressed by Congress in TILA, that economic stability and competition among consumer credit providers are strengthened when consumers make informed judgments about the cost of credit. The Fed would, for example, require a standardized presentation of information in easy-to-read tables that show key rate and fee information, including penalty fees.

In essence, the proposed Reg Z changes seek to move credit card disclosures toward the successful model of food labeling, where consumers can get all the information they need in simple, uniform terms that allow them to readily compare one product to another. Consumers should be able to do the same thing in the world of credit cards, relying on the consistent, easily-understandable presentation of important information in table-form when applying for credit, when opening an account, when receiving their statement, or when the terms of the account change. We also want consumers to have ample opportunity to exercise their leverage and negotiate with the issuer or seek out a new credit card provider if they are not satisfied with a change in terms proposed by their current issuer. And because meaningful disclosure and financial literacy go hand-in-hand, we also support a broader, sustained investment in financial literacy on a national basis, in conjunction with improved disclosures.

While all of these changes certainly would benefit consumers, they also would ensure that financial services providers compete on a level playing field. At Citi, we want consumers to be able to compare us to our competitors on an apples-to-apples basis.

In fact, we relish that comparison. We want disclosures that will highlight our best practices and enable us to compete effectively in the marketplace against issuers whose practices may be less consumer-friendly.

We agree that industry-wide change is necessary to address the real challenges in the system, but, in our view, the regulatory changes underway at the Fed offer a better path to reform than H.R. 5244.

H.R. 5244: Not the Right Approach

We understand the impetus for this bill. We have heard the dissatisfaction of consumers and policymakers loud and clear. But we urge Congress to tread cautiously here in order to avoid unintended consequences—particularly at a fragile time for the economy.

Premature. First, passing legislation—which itself would result in months of rulemaking to develop implementing regulations—would slow down the regulatory train, which is already nearing its destination. The Fed's thorough revision of Reg Z—which reflects extensive consumer testing and review—will be finalized before the end of the year. We are confident that, if given the chance to work, the Fed's revamped disclosure requirements will largely address the problems H.R. 5244 is intended to address. Uniform disclosure that enables customer understanding is the best way to address practices that are not consumer friendly; in a fully effective marketplace, consumers will be the judge, and issuers who adopt the best practices will enjoy a competitive advantage. We think that the Fed's approach should be given an opportunity to take effect before Congress makes a determination as to whether legislative action is necessary.

Regulatory Expertise and Flexibility. There are other practical reasons—in addition to timing—to favor the Fed's regulatory approach. As the regulator responsible for addressing consumer concerns with the credit card industry, the Fed has an unparalleled understanding of this complex and evolving business, so it makes sense to take advantage of this expertise in designing solutions to the challenges facing the industry. Regulations are also more flexible than legislation and can be modified more easily than statutes to take into account changes in market conditions or consumer demands.

Unintended Consequences. We have significant concerns that H.R. 5244 would fundamentally alter the credit card business in ways that would dramatically affect consumers and the broader economy. I will highlight a few of our key concerns below, and we would be happy to discuss our concerns in greater detail with the Committee.

<u>First</u>, H.R. 5244 would seriously impair issuers' ability to reflect consumer risk in credit card pricing. At bottom, the bill's restrictions amount to price controls—not because they impose specific numerical caps, but because they limit the amount of risk an issuer can incorporate into the price of the loan. For example, by prohibiting issuers from using credit bureau information to evaluate a customer's risk when her card is up for renewal, the bill (as we understand it) would have the perverse result of forcing the issuer to make a pricing decision based on anything *except* the customer's own risk profile.

The capacity to consider relevant information about risk when making credit available is a fundamental foundation of safe and sound lending practices. Without that ability to differentiate risk, less creditworthy consumers would have fewer means of accessing regulated credit, relatively risk-free consumers would face a higher cost of credit, and banks would have to re-think their lending models. The Congressional Research Service (CRS), for example, reports that legislation that limits the ability of issuers to reprice for risk could lead to increased minimum payments, reduced credit limits, and less access to credit cards.[2]

In short, if this bill is enacted, the financial burdens associated with the higher-risk customers will be spread across all customers, instead of being borne by the higher-risk customers themselves.

<u>Second</u>, the bill effectively bars a lender from charging interest on an outstanding loan. That result would fundamentally alter the credit card economic model. Under current industry practice, a cardholder qualifies for a grace period and can avoid paying interest on her loan when she pays the entire balance on time and in full. This is an extraordinary feature in the world of lending. It is good for issuers because it encourages customers to pay on time, and it is good for customers because it gives them an interest-free loan. In fact, 55% of our customers use it. But because it is so unusual, and so contrary to the basic business model of lending money for interest, this deal has set terms: a cardholder must pay off the *entire* balance by the due date. The bill would completely rewrite the terms of the deal to make the lender give an interest free loan for *any* amount paid by the due date, greatly expanding the grace period concept. If such a provision were enacted into law, card issuers would be forced to change their pricing models, and to consider eliminating the grace period altogether.

<u>Third</u>, by prohibiting any changes to the terms of the card agreement except for reasons that are specifically set out in the agreement at the time the account was opened,

[2] Darryl E. Getter, *The Credit Card Market: Recent Trends, Funding Cost Issues, and Repricing Practices*, CRS REPORT TO CONGRESS at 11, Feb. 27, 2008.

H.R. 5244 undermines the push to simplify disclosures, as issuers will be forced to set forth every potential eventuality in the original agreement.

Fourth, by barring issuers from notifying credit reporting agencies about the existence of a new card until it is actually used, this bill will distort customers' credit risk profiles and could adversely affect their credit scores. Moreover, this bill will make it more difficult to prevent fraud and identity theft. Prohibiting this flow of information means that no one will be able to flag unusual and inappropriate patterns of card activity, which are key triggers to stopping fraud and identity theft before it happens.

Conclusion

I believe that this legislation is unnecessary in light of the targeted regulatory efforts underway to address these concerns, and that its unintended consequences would undermine the genuine benefits the risk-based model has brought to consumers and threaten to destabilize the credit markets.

Thank you for the opportunity to discuss these important issues with the Subcommittee. I look forward to answering any questions you may have.

EMBARGOED UNTIL DELIVERY

STATEMENT OF

MARTIN J. GRUENBERG
VICE CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

THE CREDIT CARDHOLDERS' BILL OF RIGHTS: PROVIDING NEW PROTECTIONS FOR CONSUMERS

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

of the

FINANCIAL SERVICES COMMITTEE
U.S. HOUSE OF REPRESENTATIVES

April 17, 2008
2128 Rayburn House Office Building

Chair Maloney, Ranking Member Biggert and members of the Subcommittee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding credit card practices and to provide comments regarding H.R. 5244, the Credit Cardholders' Bill of Rights Act of 2008.

Credit cards have become a vital component of everyday life, serving as an accessible form of credit that provides great convenience to consumers. However, as with all credit products, unless provided responsibly and used carefully, they hold the potential to cause significant harm.

At the Subcommittee's June 2007 hearing, FDIC Chairman Bair outlined credit card practices that have raised concerns at the FDIC. In my testimony today, I will discuss recent trends in credit card lending and borrowing, the current legal and regulatory context, and how H.R. 5244 addresses a number of abusive practices.

Trends in Credit Card Lending and Borrowing

Credit Card Usage and Growth

Credit card lending today is an integral part of the consumer finance marketplace, widely accessible to households spanning all demographic and socio-economic groups. By 2004, the most recent year for which aggregate consumer data are available, 75 percent of U.S. households had some type of credit card, and 46 percent carried a credit card balance.[1] A 2007 study found that U.S. consumers individually had an average of 4 credit cards, with approximately 51 percent holding at least 2 cards and approximately 14 percent having more than 10 cards.[2]

The Federal Reserve 2004 Survey of Consumer Finances documents that the median level of indebtedness for families with credit card debt was $2,200 in 2004, up from $1,300 in 1989 (in 2004 dollars). A significant number of families have much higher amounts of credit card debt, however. Thirty six percent of credit card users who carry balances owe more than $10,000, and 13 percent carry balances larger than $25,000.[3]

The use of credit card debt by lower income households has grown particularly quickly in recent decades. Nearly 30 percent of households in the lowest income quintile held credit card debt in 2004, up from 15 percent in 1989.[4] The increase in credit card usage has often been cited as a factor in the growing incidence of financial distress, especially for lower income households. Over one quarter of households in the lowest income quintile have debt to income ratios greater than 40 percent, and 16 percent report having had a debt payment 60 days or more past due.[5] Almost one-third of these lower income families report that they hardly ever pay their total balance in full.[6]

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[1] Federal Reserve 2004 Survey of Consumer Finances.
[2] Experian's National Score Index Study (2007).
[3] CardTrak.com, "Credit Card Debt – What Do Americans Really Owe?" May 31, 2007. www.cardtrak.com/press/2007.05.31
[4] Federal Reserve 2004 Survey of Consumer Finances.
[5] Federal Reserve 2004 Survey of Consumer Finances.
[6] Federal Reserve 2004 Survey of Consumer Finances.

Use of credit cards by young adults also has increased. The average credit card debt held by young adults ages 18 to 24 and 25 to 34 grew by 22 percent and 47 percent, respectively, between 1989 and 2004.[7] In 2004, more than three quarters of undergraduate students started the school year with a credit card, but only 21 percent of college students pay off their entire balance each month.[8]

As of fourth quarter 2007, consumer credit outstanding totaled $2.5 trillion; $941 billion of this was revolving credit, which is made up primarily of credit card debt.[9] Since 2006, increases in consumer credit outstanding have been largely driven by revolving credit growth. Revolving credit grew by $66 billion, or 7.5 percent, between fourth quarter 2006 and fourth quarter 2007. This was the fastest rate of credit card growth seen since second quarter 2001. At the same time, mortgage liabilities, while up 6.6 percent on a year over year basis in fourth quarter 2007, experienced the slowest growth since 1998[10] and unused commitments on home equity lines grew only 0.2 percent, the slowest growth since first quarter 2002.

It is expected that revolving credit demand will remain strong in the coming quarters, particularly if consumers are less able to obtain other sources of funding to finance consumption, such as drawing upon their mortgage equity. In contrast to other types of credit, credit card loans are still relatively easy to obtain. The January 2008 survey of financial institution Senior Loan Officers conducted by the Federal Reserve

[7] "Generation Debt: Student Loans, Credit Cards, and Their Consequences," Demos, Winter 2007, at 3.
[8] "Undergraduate Students and Credit Cards in 2004: An Analysis of Usage Rates and Trends," Nellie Mae, May 2005, at 8.
[9] Federal Reserve Statistical Release G.19 Consumer Credit.
[10] Federal Reserve Flow of Funds.

Board showed that lending standards for credit cards have not become more stringent. Specifically, 90 percent of banks reported that lending standards for approving credit card loan applications remained basically unchanged over the prior three months, while standards on mortgage loans and consumer loans other than credit cards tightened considerably.[11]

Although credit card lending standards might not be changing, overall solicitations are slowing. In 2007 there were 5.2 billion credit card solicitations sent to U.S. households, down nearly 10 percent from 5.8 in 2006.[12] Yet, as recently as third quarter 2007, offers sent to households using more than 30 percent of their available credit, who represent greater credit risks than those who use less credit, grew 5 percent from the previous quarter. This indicates that issuers have not stopped pursuing higher-risk borrowers.[13]

Credit Card Performance

In recent months, some analysts have expressed concerns that losses and disruptions of the type being experienced in the mortgage market will extend to credit card markets and other areas of consumer credit. However, to the extent that credit card lines at FDIC-insured institutions have shown signs of weakness, losses are much less

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[11] January 2008 Senior Loan Officer Opinion Survey on Bank Lending Practices, Board of Governors of the Federal Reserve System, February 4, 2008.
[12] "US credit card mail volume declined in 4th quarter 2007 as troubled issuers push back," Synovate Mail Monitor, February 6, 2008,www.synovate.com/current/news/article/2008/02/us-credit-card-mail-volume-declined-in-4-sup-th-sup-quarter.
[13] "Mailed Card Offers Gain As Lack of Liquidity Bites," *American Banker*, December 5, 2007.

severe than those in the mortgage sector. Thus far, credit card credit quality has remained relatively strong. The net charge-off rate for credit card loans was 4.06 percent in fourth quarter 2007, and 2.22 percent of credit card loans were noncurrent. Credit card charge-offs grew 33 percent from fourth quarter 2006, compared to mortgage loan charge-offs and home equity line of credit charge-offs, which climbed by 144 percent and 378 percent, respectively. Nevertheless, the FDIC will continue to monitor credit card performance, especially given the current turmoil in mortgage markets.

Similarly, despite the financial market turmoil of the past months, credit card lending remains a generally profitable business. In fact, credit card lending has been the most profitable business line for some time. The 27 institutions the FDIC has identified as credit card specialty banks reported a return on assets (ROA) of 2.61 percent in fourth quarter 2007, while the banking industry overall had a ROA of 0.18 percent; these figures were down from 3.43 percent and 1.20 percent, respectively, in fourth quarter 2006. These 27 institutions account for more than three-quarters of all credit card loans (on-balance sheet plus receivables securitized and sold) extended by insured institutions at the end of 2007. During the past 10 years, the average ROA of insured credit card specialists has ranged from a low of 2.86 percent in 1998 to a high of 4.19 percent in 2006. For all insured institutions during this period, the average ROA ranged from a low of 0.86 percent in 2007 to a high of 1.38 percent in 2003.

The higher profitability of credit card lenders stems from high average yields on their asset portfolios, combined with high levels of noninterest revenue. In 2007, the average yield on credit card specialists' interest-earning assets was 13.2 percent, almost double the industry average of 6.8 percent. Also, noninterest income accounted for 61 percent of total net operating revenue at the 27 credit card specialists.[14] For the industry as a whole, noninterest income represented 40 percent of net operating revenue. Notably, 54 percent of the noninterest income reported by credit card specialists was income from securitization and servicing of securitized receivables. These robust revenues help offset the higher net charge-offs associated with unsecured consumer lending. At 4.23 percent, fourth quarter charge-offs at credit card lenders were notably higher than for the banking industry as a whole.

Whether or not credit card performance will weaken in the coming quarters in the wake of the ongoing challenges faced by the mortgage industry is unknown. Historically, consumers have chosen to protect their most valuable asset, their homes, by paying mortgage debt before credit card debt. However, a study conducted by the consumer credit bureau Experian found that subprime borrowers were delinquent on mortgage debt more often than bankcard debt.[15]

Given current economic and credit conditions, bankers and analysts are not expecting marked improvements in credit card performance in the near future. In fact, about 70 percent of senior loan officers reported in January that they expected

[14] Net operating revenue is the sum of net interest income and total noninterest income.
[15] "Experian analysis of subprime lending market uncovers surprising trends," Experian Media Alert, April 10, 2007.

deterioration in the quality of credit card loans.[16] Despite the possibility that some borrowers may choose to keep paying credit card bills even after becoming delinquent on home loans, the available evidence is mixed so it is not clear that new bill payment behaviors will favor credit cards. A recent survey found that credit cards were the most likely bill not to be repaid if the borrower did not have enough money. Nearly 35 percent said they would leave their credit card bill unpaid, versus less than 5 percent who said they would leave their mortgage unpaid.[17]

Legal Context and Developments

Truth in Lending Act/Regulation Z

The Truth in Lending Act (TILA), enacted in 1968, along with its implementing regulation (Regulation Z), are still the primary federal law applicable to credit card lending. TILA and Regulation Z focus primarily on disclosure of the cost and terms of credit. Included in the law, however, are some important consumer protections related to crediting of payments, treatment of credit balances, various protections to cardholders (such as limits on consumer liability for unauthorized or unlawful credit card use and the right of a cardholder to assert claims or defenses against a credit card issuer), and billing resolution procedures.

[16] January 2008 Senior Loan Officer Opinion Survey on Bank Lending Practices, Board of Governors of the Federal Reserve System, February 4, 2008.
[17] "Payment Delinquencies Spanning All Industries: A Survey of US Consumers and the Companies They Pay," Online Resources, December 2007.

The Federal Reserve Board (FRB), which has exclusive authority to promulgate regulations to implement TILA,[18] proposed amendments[19] to Regulation Z in late May 2007 which would significantly improve credit card disclosures. The proposed amendments include changes to format, timing, and content requirements in solicitations, applications, account opening documents, change-in-term notices, and periodic billing statements. The proposal also incorporates an increase, from 15 to 45 days, in the required advance notice before a changed term could be imposed on consumers. While improved disclosures are important, it is doubtful whether even improved disclosures can mitigate the harmful effect of some of the most questionable practices. Action by Congress may expedite solutions to some of the most troubling practices.

Unfair and Deceptive Acts and Practices

Credit card issuers also are subject to the Federal Trade Commission (FTC) Act Section 5 prohibition against unfair and deceptive acts and practices (UDAP). The UDAP prohibition applies to all types of consumer lending, such as mortgages and credit cards, and to every stage and activity, including the development of products. The prohibition also applies to the marketing, servicing, collections, and the termination of the customer relationship.

[18] While they lack rulemaking authority, other Federal banking agencies enforce compliance with TILA and Regulation Z by their supervised institutions and use their enforcement authority pursuant to section 8 of the Federal Deposit Insurance Act (FDI Act) to address violations. *See* section 108 of the Truth in Lending Act, 15 U.S.C. § 1607.
[19] *See* May 23, 2007 press release announcing issuance of proposed amendments to Regulation Z (Truth in Lending), http://www.federalreserve.gov/boarddocs/press/bcreg/2007/20070523/default.htm. The proposed amendments may be found at 72 Fed. Reg. 32948 (June 14, 2007).

The UDAP prohibition provides a powerful supervisory tool. However, its strength is limited by the need to make case-by-case determinations and then, depending on the problem being addressed, to decide appropriate corrective action. While this approach results in changes to practices at individual institutions, it does not necessarily result in changes industry-wide. Having rulemaking authority enables an agency to significantly limit, or even prohibit, practices deemed to be unfair or deceptive.

Current law limits FTC rulemaking authority with respect to banks, thrifts and credit unions to the FRB, Office of Thrift Supervision and National Credit Union Administration, and excludes the Office of the Comptroller of the Currency and the FDIC, who are the primary federal regulators of about 7,000 institutions.[20] Last year, the House of Representatives passed legislation, H.R. 3526, to amend the FTC Act to grant each federal banking agency the authority to prescribe regulations governing unfair or deceptive acts or practices with respect to the institutions each such agency supervises. The authority in H.R. 3526 would be a helpful addition to our present enforcement authority, and would enable us to improve our ability to address egregious and pervasive practices on an industry-wide hasis. Including the perspectives of the supervisor of some of the nation's largest banks and the perspectives of the supervisor of the largest number of banks as well as the deposit insurer would provide valuable input and expertise to the rulemaking process.

[20] While it lacks rulemaking authority, the FDIC will take appropriate action pursuant to its authority under Section 8 of the FDI Act when unfair or deceptive trade practices are discovered at state-chartered banks under its supervision.

Comments on H.R. 5244

The FDIC views H.R. 5244, the Credit Cardholders Bill of Rights Act of 2008, as a balanced and constructive effort to address many of the most problematic credit card practices in an effective way.

Competition and innovation in the credit card market has sometimes outstripped the ability of the regulatory process to expeditiously address practices that may be unfair to consumers. Further, the disclosures required by TILA, while useful, are not necessarily sufficient to fully inform consumers about the prices and terms of credit products or to protect them from abusive practices. H.R. 5244 addresses many of the concerns the FDIC and others have identified as questionable credit card practices. As we have seen repeatedly, loan products that trap consumers in debt they cannot repay raise significant concerns for safety and soundness, as well as consumer protection.

Key Provisions

H.R. 5244 addresses a number of the most troubling credit card practices, several of which raise supervisory and consumer protection concerns no matter how clearly they are disclosed. These practices include: universal default; double-cycle billing; payment allocation to the lowest rate portion of the balance; and inconsistent and punitive billing practices.

Universal Default: In utilizing universal default, an issuer increases rates when a cardholder fails to make payments to other creditors or has an overall decline in his or her credit score. The result is that a cardholder who repays on time still may be assessed a higher interest rate because the cardholder made a late payment to another creditor, or has incurred a significant amount of additional debt. Employing this practice may materially worsen a cardholder's financial condition, contributing to the cardholder's overall level of financial distress and reducing incentives to stay current. This has potentially serious implications for ultimate debt repayment, and raises risk management concerns.

H.R. 5244 would address universal default by prohibiting a creditor from increasing the annual percentage rate (APR) applicable to an outstanding account balance due to adverse information about a borrower in a credit report or as a result of a change in their credit score, other than borrower actions or omissions directly connected to the account in question. This provision is a reasonable approach that both reduces the likelihood that increasing payment amounts will undercut the ability of the borrower to repay, as well as preserving for the lender the flexibility to use risk-based pricing for amounts borrowed in the future.

Double-Cycle Billing: Under double cycle billing, when a cardholder fails to pay the entire balance of new purchases by the due date, the issuer, despite the cardholder's having no previous balance, computes interest on the original balance that had previously been subject to an interest-free period.[21] H.R. 5244 prohibits double-cycle billing, providing that creditors may not impose or collect an interest charge on the portion of credit that was repaid on time. The complex nature of double-cycle billing practices and calculations do not lend themselves to clear and concise disclosure that effectively communicates usable information to consumers.

Payment Allocations: In this practice, varying interest rates are tied to account usage, but the issuer applies payments first to the portion of the account with the lowest rate. As a result, balances on different tiers may shrink or grow disproportionately as payments are made by a customer. Allocating payments to the balance with the lowest interest rate effectively increases the overall interest payments for the customer. H.R. 5244 would end that practice by providing that if a credit card account accrues interest at two or more different APRs, each periodic payment must at least be allocated among the outstanding balances at each APR at the proportion each balance bears to the total balance.

Billing Practices: A variety of billing practices that have been used by the credit card industry generate confusion and complaints by consumers. H.R. 5244 addresses a number of these practices.

For example, the bill would address the so-called "any-time any-reason" clauses regarding changes in terms. Credit card agreements that reserve the right of issuers to

[21] *See* GAO-06-929, Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers (GAO Report), "How the Double Cycle Billing Method Works," p. 28, Figure 6.

change their terms at any time or for any reason render illusory the value of those agreements as contracts or as a means for consumers to understand the potential cost of credit. While there are legitimate reasons for lenders to change the terms of a credit agreement over time, those reasons should be clearly described so that consumers understand the terms they are accepting and can set their expectations accordingly. Issuers should specify in their agreements the reasons they will change the terms of the agreement, at least for interest rates, fees, and the borrower's line of credit.

Under the terms of H.R. 5244, creditors would be prohibited from changing the terms of an agreement until renewal, except for specific material reasons articulated in the agreement at the time of account opening. This approach allows creditors to adjust the terms of accounts for changing risks while at the same time providing borrowers with important account information in a manner that allows them to appropriately manage their use of the credit.

Another difficulty cardholders face is that "any-time any-reason" changes to their credit agreement may be coupled with very short advance notices. The combined impact of these two practices force cardholders to either accept the change or immediately pay off any balance – which many cardholders cannot do. TILA/Regulation Z currently requires only that creditors mail or deliver a notice of change in terms 15 days prior to the effective date.[22] There is no requirement that borrowers be given the opportunity to pay off the account on its existing terms.

[22] 12 C.F.R. §226.9(c).

H.R 5244 would increase the notice period for changes to the APR[23] to at least 45 days and consumers would be permitted to cancel the account without penalty and repay any balance due under the current terms. The consumer could exercise the right to cancel at any time during the period between when they receive the notice and when they receive the third periodic statement after the effective date of the increase. This provision of the bill allows creditors to adjust their terms while providing consumers a genuine opportunity to opt out. The Committee may wish to consider whether these same provisions also should apply to other fees, especially penalty fees. This is a particular issue with respect to subprime credit cards (as well other types of subprime credit), where the fees are often more onerous than the interest rate and the cards are structured in a way that makes it difficult to avoid incurring fees.

Subprime Cards: Practices in the subprime credit card area are often particularly egregious. These include inadequate or deceptive marketing and account disclosures, as well as credit products that have little or no credit availability left following the assessment of opening and other fees -- so-called "fee harvester" cards. Fees associated with the product, which in the case of subprime cards can be very sizable, may result in depletion of the available credit.[24] Practices also include card programs with features and requirements that produce frequent and excessive fees and penalties that result in a debt spiral, along with abusive collection practices.

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[23] Except for introductory rates or changes to another interest rate to which the APR is indexed.
[24] *See* "Fee Harvesters: Low-Credit, High-Cost Cards Bleed Consumers," National Consumer Law Center, November 2007, www.consumerlaw.org.

H.R 5244 would prohibit creditors from issuing a credit card or reporting the account opening to a consumer reporting agency if the account requires the consumer to pay fees in an amount exceeding 25 percent of the authorized credit in the first year, until payment of such fees is made in full and the payment is not made from the available credit on the card. Based on our experience, the FDIC would also suggest consideration of other approaches, such as restricting use of such fees to reduce available credit, or capping the fees. We would be happy to work with the Subcommittee on a comprehensive restriction of these practices.

The agencies have, on occasion, taken action under Section 5 of the FTC Act against card issuers who effectively provide no credit as a result of the initial fees and the structure of certain subprime credit cards. However, rather than having to make a case-by-case determination of unfairness, it would be more effective to have a bright-line test such as the one embodied in the bill to apply to all offered cards. The Subcommittee also might consider whether, in addition to fees that are charged in conjunction with the account, the 25 percent test should include auxiliary products and services (such as travel programs, insurance, etc.) sold by the card issuer in conjunction with the account. These products often have limited utility and may consume all of the credit not used by the initial fees.[25]

[25] Ibid.

Additional Provisions in H.R. 5244

H.R. 5244 contains a number of other provisions to improve credit card practices. For example, the bill would require creditors to allow consumers to choose whether to prohibit the creditor from completing a transaction that would put the consumer over their credit limit ("over-limit transactions") if the credit plan has an over-limit fee provision for extensions over the limit. In addition, for consumers who opted to allow over-limit transactions, the bill would restrict over-limit fees to one per billing cycle, and would limit their imposition in later cycles.

These provisions would allow consumers to avoid unexpected "over-limit" fees or penalty interest rates, which often significantly increase the cost of credit, particularly for consumers with subprime credit cards that have very low credit limits. Very often such consumers have balances that reflect little use of credit for actual purchases, but instead consist of over-limit fees piling on each month, coupled with rapidly increasing interest charges. Even if consumers opt to allow over-limit transactions, the bill's provisions would reduce the disproportionate cost that some currently pay.

Other provisions also address questionable fee increases, such as the bill's prohibition on charging fees in connection with balances that consist only of accrued interest on previously repaid credit, and its prohibition on finding the failure to pay those amounts in a timely manner to be an event of default. These practices substantially increase the cost of credit for consumers.

Finally, the bill addresses consumer concerns about abbreviated due dates that make it difficult for consumers to make timely payments and avoid fees. The bill would require that periodic statements be sent to consumers at least 25 days before the due date. The bill also would require that periodic statements disclose a payment due date, and treat any payment received by 5:00 p.m. EST on that due date as timely. Further, if the borrower has proof of mailing at least seven days prior to the due date, the payment must be presumed timely. This is an improvement over current law. Consumers deserve a fair opportunity to pay their bills on time and avoid additional fees.

Conclusion

The credit card has been an important innovation in consumer finance, allowing consumers greater flexibility to access credit. This flexibility, in turn, has fueled economic growth by making it more convenient for consumers to purchase goods and services. Yet, like all credit, credit cards can create economic hardship if not properly managed or if consumers are confused or misled regarding the terms and conditions of their use. A proper balance needs to be struck. Legislative and regulatory changes, such as H.R. 5244, can help strike that appropriate balance.

Prepared Testimony of Senator Carl Levin
Chairman, Senate Permanent Subcommittee on Investigations
on
Unfair Credit Card Practices and the Need for a Legislative Remedy

Before the House Financial Services
Subcommittee on Financial Institutions and Consumer Credit

April 17, 2008

Chairwoman Maloney, Ranking Member Biggert, and Members of the Subcommittee, I thank you for the opportunity to testify today and add to your legislative record a description of some of the work on unfair credit card practices that has been conducted in the other body, by the Senate Permanent Subcommittee on Investigations, which I chair. I would also like to commend this Subcommittee and the full Financial Services Committee for the important work you have been doing to expose credit card abuses. The Maloney-Frank bill you are considering today, H.R. 5244, includes valuable provisions which would alleviate many of the credit card abuses hurting American families. It's impressive that the bill already has 95 cosponsors.

I also commend my colleague Senator Wyden for his work on this topic.

Credit card companies have gone too far when they hike the interest rates of cardholders who pay on time and comply with their credit card agreements, impose interest rates as high as 32%, charge interest for debt that was paid on time, apply higher interest rates retroactively to existing credit card debt, pile on excessive fees, charge interest on those fees, apply consumer payments first to the debt with the least expensive interest rate, and engage in other outrageous practices that are burying American consumers in a mountain of debt. Working families are already under pressure from skyrocketing gasoline and food costs, the mortgage crisis, and mounting debt; now more than ever, credit card abuses are compounding their misery.

Because these unfair practices have gone on for so many years and often represent the industry norm, it is unlikely industry will give them up unless credit card reform legislation creates a new level playing field that applies equally to all credit card issuers. Otherwise, I am afraid that these practices are too entrenched, too profitable, and too immune to consumer pressure for the companies to change them on their own. Legislation is critical not only to protect consumers but also to ensure that credit card companies willing to do the right thing are not put at a competitive disadvantage by companies continuing unfair practices.

Some argue that Congress doesn't need to ban unfair credit card practices; they contend that improved disclosure alone will empower consumers to seek out better deals. Sunlight can be a powerful disinfectant, but credit cards have become such complex financial products that even improved disclosure will frequently not be enough to curb the abuses -- first because some practices are so confusing that consumers can't easily understand them, and second because better disclosure does not always lead to greater market competition, especially when virtually an entire industry is using and benefiting from practices that hurt consumers.

PSI Credit Card Investigation

Before I discuss the credit card investigation conducted by the Senate Permanent Subcommittee on Investigations – or PSI – I'd like to briefly explain a bit about PSI. PSI is a unique subcommittee charged with conducting bipartisan investigations into a specified range of issues. The Subcommittee traditionally takes the time to delve deeply into a subject and conducts hearings using detailed case histories to illustrate the issues being examined. The Subcommittee has no legislative jurisdiction, and so takes pride in sharing its work with the committees of legislative jurisdiction to add to their legislative records. It is also common for Subcommittee Members to introduce legislation addressing the problems examined in a PSI investigation. That legislation is then referred to the committees of legislative jurisdiction for their further consideration.

Our work on credit cards started in 2005, when I requested a U.S. Government Accountability Office (GAO) report to compile a description of the fees, interest rates and disclosure practices of popular credit cards from the largest credit card issuers. Following the release of that GAO report in 2006, we began to investigate some of the highlighted practices. The Subcommittee staff met with each of the major card issuers, visited a credit card bill processing facility, spoke with credit card regulators, and took other steps to be sure we fully understood the industry's practices and standards. The staff also met with consumer groups, businesses, and experts familiar with credit card practices. The Subcommittee also poured through numerous case histories of individuals describing abusive practices that had mired them and their families in debt.

PSI held two hearings examining a range of unfair credit card practices. The first hearing, in March 2007, examined practices involving fees, interest rates and grace periods at the major credit card companies. A second hearing in December 2007 looked at how even cardholders who play by the rules, pay their bills on time, and stay under their credit limits, have had their interest rates hiked, sometimes to the extent that their interest rates were doubled or even tripled. Together, these hearings provide a detailed legislative record documenting a host of unfair credit card practices and the need for legislative reform.

I'd like to describe here some of the case histories that the Subcommittee examined at its hearings.

Excessive Fees

The first case history we examined illustrates the fact that major credit card issuers today impose a host of fees on their cardholders, including late fees and over-the-limit fees that are not only substantial in themselves but can contribute to years of debt for families unable to immediately pay them.

Wesley Wannemacher of Lima, Ohio, testified at our March 2007 hearing. In 2001 and 2002, Mr. Wannemacher used a new credit card to pay for expenses mostly related to his wedding. He charged a total of about $3,200, which exceeded the card's credit limit by $200. He spent the next six years trying to pay off the debt, averaging payments of about $1,000 per year. As of February 2007, he'd paid about $6,300 on his $3,200 debt, but his billing statement showed he still owed $4,400.

How is it possible that a man pays $6,300 on a $3,200 credit card debt, but still owes $4,400? Here's how. Take a look at Exhibit 1. On top of the $3,200 debt, Mr. Wannemacher was charged by the credit card issuer about $4,900 in interest, $1,100 in late fees, and $1,500 in over-the-limit fees. He was hit 47 times with over-limit fees, even though he went over the limit only 3 times and exceeded the limit by only $200. Altogether, these fees and the interest charges added up to $7,500, which, on top of the original $3,200 credit card debt, produced total charges to him of $10,700.

In other words, the interest charges and fees more than tripled the original $3,200 credit card debt, despite payments by the cardholder averaging $1,000 per year. Unfair? Clearly, I think, but our investigation has shown that sky-high interest charges and fees are not uncommon in the credit card industry. While the Wannemacher account happened to be at Chase, penalty interest rates and fees are also employed by other major credit card issuers.

The week before the March hearing, Chase decided to forgive the remaining debt on the Wannemacher account, and while that was great news for the Wannemacher family, that decision doesn't begin to resolve the problem of excessive credit card fees and sky-high interest rates that trap too many hard-working families in a downward spiral of debt.

These high fees are made worse by the industry-wide practice of including all fees in a consumer's outstanding balance so that they incur interest charges. It is one thing for a bank to charge interest on funds lent to a consumer; charging interest on penalty fees goes too far.

<u>Charging Interest for Debt Paid on Time</u>

Another galling practice featured in our March hearing involves the fact that credit card debt that is paid on time routinely accrues interest charges, and credit card bills that are paid on time and in full are routinely inflated with what I call "trailing interest." Every single issuer contacted by the Subcommittee engaged in both of these unfair practices which squeeze additional interest charges from responsible cardholders.

Here's how it works. Take a look at Exhibit 2. Suppose a consumer who usually pays his account in full, and owes no money on December 1st, makes a lot of purchases in December, and gets a January 1 credit card bill for $5,020. That bill is due January 15. Suppose the consumer pays that bill on time, but pays $5,000 instead of the full amount owed. What do you think the consumer owes on the next bill?

If you thought the bill would be the $20 past due plus interest on the $20, you would be wrong. In fact, under industry practice today, the bill would likely be twice as much. That's because the consumer would have to pay interest, not just on the $20 that wasn't paid on time, but also on the $5,000 that was paid on time. In other words, the consumer would have to pay interest on the entire $5,020 from the first day of the new billing month, January 1, until the day the bill was paid on January 15, compounded daily. So much for a grace period. In addition, the consumer would have to pay the $20 past due, plus interest on the $20 from January 15 to January 31, again compounded daily. In our example, using an interest rate of 17.99% (which is the interest rate charged to Mr. Wannamacher), the $20 debt would, in one month, rack up $35 in interest charges and balloon into a debt of $55.21.

You might ask – hold on – why does the consumer have to pay any interest at all on the $5,000 that was paid on time? Why does anyone have to pay interest on the portion of a debt that was paid by the date specified in the bill – in other words, on time? The answer is, because that's how the credit card industry has operated for years, and they have gotten away with it.

There's more. You might think that once the consumer gets gouged in February, paying $55.21 on a $20 debt, and pays that bill on time and in full, without making any new purchases, that would be the end of it. But you would be wrong again. It's not over. Look again at Exhibit 2. Even though, on February 15, the consumer paid the February bill in full and on time – all $55.21 – the next bill has an additional interest charge on it, for what we call "trailing interest." In this case, the trailing interest is the interest that accumulated on the $55.21 from February 1 to 15, which is time period from the day when the bill was sent to the day when it was paid. The total is 38 cents. While some issuers will waive trailing interest if the next month's bill is less than $1, if a consumer makes a new purchase, a common industry practice is to fold the 38 cents into the end-of-month bill reflecting the new purchase.

Now 38 cents isn't much in the big scheme of things. That may be why many consumers don't notice these types of extra interest charges or try to fight them. Even if someone had questions about the amount of interest on a bill, most consumers would be hard pressed to understand how the amount was calculated, much less whether it was incorrect. But by nickel and diming tens of millions of consumer accounts, credit card issuers reap large profits.

I think it is indefensible to make consumers pay interest on debt which they pay on time. It is also just plain wrong to charge trailing interest when a bill is paid on time and in full.

Unfair Interest Rate Hikes

My Subcommittee's second hearing focused on another set of unfair credit card practices involving unfair interest rate increases. Cardholders who had years-long records of paying their credit card bills on time, staying below their credit limits, and paying at least the minimum amount due, were nevertheless socked with substantial interest rate increases. Some saw their credit card interest rates double or even triple. At the hearing, three consumers described this experience.

Janet Hard of Freeland, Michigan, had her Discover credit card interest rate increased from 18% to 24% in 2006, even though she had made payments to Discover on time and paid at least the minimum amount due for over two years. Discover applied the 24% rate retroactively to her existing credit card debt of $8,300, increasing her minimum payments and increasing the amount that went to finance charges instead of the principal debt. The result, as shown on Exhibit 3, was that, despite making steady payments totaling $2,400 in twelve months and keeping her purchases to less than $100 during that same year, skyhigh interest charges ate up most of her payments and Ms. Hard's credit card debt went down by only $350.

Millard Glasshof of Milwaukee, Wisconsin, a retired senior citizen on a fixed income, incurred a debt of about $5,000 on his Chase credit card, closed the account, and faithfully paid down his debt with a regular monthly payment of $119 for years. In December 2006, Chase increased his interest rate from 15% to 17%, and in February 2007, hiked it again to 27%. Retroactive application of the 27% rate to Mr. Glasshof's existing debt meant that, out of his $119 payment, about $114 went to pay finance charges and only $5 went to reducing his principal debt. As shown in Exhibit 4, despite his making payments totaling $1,300 over twelve months, Mr. Glasshof found that, due to high interest rates and excessive fees, his credit card debt did not go down at all. Later, after the Subcommittee asked about his account, Chase suddenly lowered the interest rate to 6%. That meant, over a one year period, Chase had applied four different interest rates to his closed credit card account: 15%, 17%, 27%, and 6%, which shows how arbitrary those rates are.

Then there is Bonnie Rushing of Naples, Florida. For years, she had paid her Bank of America credit card on time, providing at least the minimum amount specified on her bills. Despite her record of on-time payments, in 2007, Bank of America nearly tripled her interest rate from 8 to 23%. The Bank said that it took this sudden action, because Ms. Rushing's FICO credit score had dropped. When we looked into why it had dropped, it was apparently because she had opened Macy's and J.Jill credit cards to get discounts on purchases. Despite paying both bills on time, the automated FICO system had lowered her credit rating, and Bank of America had followed suit by raising her interest rate by a factor of three. Ms. Rushing closed her account and complained to the Florida Attorney General, my Subcommittee, and her card sponsor, the American Automobile Association. Bank of America eventually restored the 8% rate on her closed account.

In addition to these three consumers who testified at the hearing, the Subcommittee presented case histories for five other consumers who experienced substantial interest rate increases despite complying with their credit card agreements. The facts of these cases, as well as details related to the Hard, Glasshof and Rushing case histories, are set forth in Exhibit 5.

I'd also like to note that, in each of these cases, the credit card issuer told our Subcommittee that the cardholder had been given a chance to opt out of the increased interest rate by closing their account and paying off their debt at the prior rate. But each of these cardholders denied receiving an opt-out notice, and when several tried to close their account and pay their debt at the prior rate, they were told they had missed the opt-out deadline and had no choice but to pay the higher rate. Our Subcommittee examined copies of the opt-out notices and found that some were filled with legal jargon, were hard to understand, and contained procedures that were hard to follow. One example, a full four pages long, is shown in Exhibit 6. When we asked the major credit card issuers what percentage of persons offered an opt-out actually took it, they told the Subcommittee that 90% did not opt out of the higher interest rate – a percentage that is contrary to all logic and strong evidence that current opt-out procedures don't work.

The case histories presented at our hearings illustrate only a small portion of the abusive credit card practices going on today. Since early 2007, the Subcommittee has received letters and emails from thousands of credit card cardholders describing unfair credit card practices and asking for help to stop them, more complaints than I have received in any investigation I've conducted in more than 25 years in Congress. The complaints stretch across all income levels, all ages, and all areas of the country.

The Need for Legislation

In 2006, Americans used 700 million credit cards to buy $1.8 trillion in goods and services. The average family now has 5 credit cards. Credit cards are being used to pay for groceries, mortgage payments, even taxes. And they are saddling U.S. consumers, from college students to seniors, with a mountain of debt. The latest figures show that U.S. credit card debt is now approaching $1 trillion. These consumers are routinely being subjected to unfair practices that squeeze them for ever more money, sinking them further into debt. It's long past time to enact legislation to protect them.

That's why I introduced the Stop Unfair Practices in Credit Cards Act, S. 1395, a summary of which is contained in Exhibit 7. Senator Claire McCaskill joined me in that introduction, and so far the bill has ten cosponsors. It has also been introduced in the House as H.R. 5280 by Representative Lincoln Davis, a member of this Subcommittee. Our bill has also been strongly endorsed by consumer groups, labor unions, and the National Small Business Association. In the Senate, it has been referred to the Senate Banking Committee, which is chaired by Senator Chris Dodd, a longtime champion of credit card issues. Senator Dodd has introduced credit card legislation in the past and is working on the issue again this Congress.

There is significant overlap between my bill and the Maloney-Frank bill being considered today, including provisions which would:

- prohibit the charging of interest on debt that is paid on time;
- prohibit the charging of so-called "trailing interest" -- that is, interest charged between the time that a bill is sent out requesting payment and the date on which the bill is paid; and
- prohibit interest rate increases on cardholders who pay their bills on time, a practice that is sometimes referred to as universal default.

There are also some provisions in the Maloney-Frank bill that are not in my bill, but which are important and should be enacted into law, including the following:

- provisions to end the credit card billing games that go on today, by requiring bills to be sent out at least 25 days before payment is due, requiring the acceptance of payments up until 5:00 p.m. on the due date, and creating a presumption that payments mailed 7 days before a due date are on time;
- provisions requiring a 45-day notice period before a higher interest rate can take effect; and
- provisions to limit the ability of subprime credit cards to surprise consumers with high fees.

There are also some unfair practices addressed in my bill that are not addressed in the Maloney-Frank bill, and that I encourage this Subcommittee to consider adding to its legislation.

- **No Interest on Fees.** The Levin-McCaskill bill would stop credit card issuers from charging interest on their fees. It's one thing for a credit card issuer to collect interest on money that was lent to the cardholder at his or her request, but it is totally different to assess interest on penalty and transaction fees that the credit card issuer has imposed on cardholders and is requiring them to pay out of pocket.

- **No Retroactive Interest Rates.** The Levin-McCaskill bill would also prohibit credit card issuers from hiking an interest rate and then applying it to pre-existing credit card debt. No other type of consumer lending allows the lender to re-write the terms of an earlier lending agreement, especially by increasing a previously agreed-to interest rate on an existing debt. Credit card companies should not be allowed to engage in this practice either.

- **7 Percentage Point Cap on Penalty Interest Rates.** The Levin-McCaskill bill would also put a cap on how much an interest rate can be increased if a cardholder misses a payment or exceeds a credit limit. Under the bill, penalty interest rates could not increase more than seven percentage points over the prior rate. I believe seven percentage points is a more than a fair increase. The concept of an interest rate cap is taken from the practice now followed in some adjustable rate mortgages that place a ceiling on how much the interest rate can increase. A seven percentage point cap would allow issuers to impose a substantial penalty, while protecting cardholders from outrageous increases for what are often minor infractions.

- **Applying Consumer Payments.** Another provision involves consumer payments. Right now, all credit card issuers apply consumer payments first to the debt with the least expensive interest rate. The Levin-McCaskill bill would flip that practice, and require payments to be applied first to the debts with the most expensive interest rates. The Maloney-Frank bill would split the difference by requiring a pro rata allocation of payments to balances with different interest rates. While that approach is an improvement over the status quo, it is more complicated than our approach and less favorable to consumers who are often saddled with debts carrying extremely high interest rates of 20, 25 and even 32% and ought to be allowed to pay those debts off first.

- **No Pay-to-Pay Fees.** Still another provision in the Levin-McCaskill bill would stop credit card issuers from charging cardholders a fee to pay their bills, such as a fee to pay a bill by the Internet or telephone. Charging folks a fee to pay their bills on time is a travesty, it provides an unjustified windfall to credit card companies, and it shouldn't be allowed. I hope this Subcommittee will see fit to ban that practice in your bill.

Credit card issuers like to say that they are engaged in a risky business, lending unsecured debt to millions of consumers, but it is clear that they have learned to price credit card products in ways that produce enormous profit. For the last decade, credit card issuers have reported year after year of solid profits, maintained their position as the most profitable sector in the consumer lending field, and reported consistently higher rates of return than commercial banks. Credit card issuers make such a hefty profit that they sent out 5 billion pieces of mail last year soliciting people to sign up. With profits like those, credit card issuers can afford to give up abusive practices that treat consumers unfairly.

In closing, while the remaining legislative days in this Congress are dwindling, there is still time to enact tough credit card reform legislation. U.S. families have incurred credit card debt that now reaches a total of nearly $1 trillion. Too many of these families are being hurt by too many unfair credit card practices to delay action any longer. Credit card companies are piling on excessive fees, charging interest on debt that is paid on time, hiking interest rates even for consumers who faithfully pay their bills every month, applying higher rates retroactively to pre-existing credit card debt, and engaging in other unfair practices that attempt to squeeze more money out of even the most responsible cardholders. I commend this Subcommittee for tackling credit card reform and taking the steps needed to ban unfair practices that are causing so much pain and financial damage to American families today.

I ask unanimous consent to include in the hearing record the seven exhibits referred to in my statement.

Exhibits to accompany the Prepared Testimony of
Senator Carl Levin
Chairman, Senate Permanent Subcommittee on Investigations

Before the
House Financial Services Subcommittee on Financial Institutions and Consumer Credit

April 17, 2008

1. *Summary of Wes Wannamacher Account (March 2001 to February 2007)*, prepared by the Permanent Subcommittee on Investigations and used in a March 2007 Subcommittee hearing.

2. *Example of Interest Charges on Credit Card Debt that has Already Been Paid,* prepared by the Permanent Subcommittee on Investigations and used in a March 2007 Subcommittee hearing.

3. *Summary of Janet Hard Account (November 2006 to October 2007)*, prepared by the Permanent Subcommittee on Investigations and used in a December 2007 Subcommittee hearing.

4. *Summary of Milard Glasshof Account (November 2006 to October 2007)*, prepared by the Permanent Subcommittee on Investigations and used in a December 2007 Subcommittee hearing.

5. *Credit Card Case Histories: Eight Examples of Unfair Interest Rate Increases*, prepared by the Permanent Subcommittee on Investigations and used in a December 2007 Subcommittee hearing.

6. *Bank of America Change in Terms Notice for Bonnie Rushing account,* submitted to the Permanent Subcommittee on Investigations and used in a December 2007 Subcommittee hearing.

7. *Summary of S. 1395, The Stop Unfair Practices in Credit Cards Act.*

Summary of Wannemacher Account

(March 2001 to February 2007)

Total purchases:	$3,200
Total interest charges:	$4,900
Total over-limit charges:	$1,500
Total late fees:	$1,100
Total charges as of February 2007:	$10,700
Total payments:	$6,300
Owed as of February 2007:	$4,400

Prepared by the Permanent Subcommittee on Investigations Staff, March 2007

Testimony of Senator Carl Levin

EXHIBIT #1

EXAMPLE OF INTEREST CHARGES ON CREDIT CARD DEBT THAT HAS ALREADY BEEN PAID

January

Jan. 15	Amount owed from prior month:	$0
Jan. 31	New Jan. purchases:	$0
	Bill sent for Dec. purchases:	$5,020
	Bill due date is Feb. 15	

February

Feb. 15	Payment made on due date:	$5,000
Feb. 28	New Feb. purchases:	$0
	Bill sent for Jan. purchases:	$55.13
	Charges include: –$20 past due; –17.99% interest on $5,020, Feb. 1-14, compounded daily ($34.75) –17.99% interest on $20, Feb. 15-28, compounded daily ($0.38)	
	Bill due date is March 15	

March

March 15	Payment made on due date:	$55.13
March 31	New March purchases:	$100
	Bill sent for Feb. purchases:	$100.38
	Charges include: –$100 in new purchases; –17.99% interest rate on $55.13, March 1-15, compounded daily ($0.38)	

Prepared by U.S. Senate Permanent Subcommittee on Investigations, March 2007

Testimony of Senator Carl Levin
EXHIBIT #2

Summary of Janet Hard Account

(November 2006 to October 2007)

Owed as of October 2006:	$8,330
Total interest charges:	$1,900
Total purchases:	$100
	$10,330
Total payments:	$2,400
Owed as of October 2007:	$7,980
Total reduction in debt after one year:	$350

Source: Discover credit card statements. Figures have been rounded.
Prepared by U.S. Senate Permanent Subcommittee on Investigations, December 2007

Testimony of Senator Carl Levin

EXHIBIT #3

Summary of Millard Glasshof Account

(November 2006 to October 2007)

Owed as of October 2006:	$4,800
Total interest charges:	$1,100
Total fees:	$200
Total purchases:	$0
	$6,100
Total payments:	$1,300
Owed as of October 2007:	$4,800
Total reduction in debt after one year:	$0

Source: Chase credit card statements. Figures have been rounded.
Prepared by U.S. Senate Permanent Subcommittee on Investigations, December 2007

Testimony of Senator Carl Levin

EXHIBIT #4

Credit Card Case Histories:
Eight Examples of Unfair Interest Rate Increases

The following eight case histories are the result of a bipartisan investigation of the U.S. Senate Permanent Subcommittee on Investigations into unfair credit card practices. These histories detail the experiences of individual consumers who paid their credit card bills in compliance with the terms set by their credit card issuers, but whose interest rates were nevertheless increased. Each case history includes a brief description of the cardholder and circumstances surrounding the interest rate increase, as well as a chart with specific data related to their credit card account.

The data contained in these charts is taken from the credit card billing statements sent to the cardholders. Because purchases made in one month typically appear on the billing statement sent out in the next month, the charts synthesize data from two consecutive billing statements. The first three columns of the chart identify the month in which the closing date occurs for purchases that were or could have been made on the credit card, the interest rate applicable to such purchases, and the total amount of purchases actually made during the billing month. The next three columns identify the total amount of funds paid by the cardholder each month, and show how much of that payment went to pay for fees or interest charges and how much to reduce the cardholder's actual debt. The final column of the chart shows the cardholder's overall balance – the entire debt owed on the credit card – after the payment was made.

Here is a sample chart for illustration:

ABC Credit Card **Credit Limit: $4,500, increased to $5,500 in 2/07**

				Amount Paid Toward:		
Transaction Period	**Interest Rate**	**Purchases**	**Applicable Payment**	**Interest and Fees**	**Reduction in Principal**	**Balance after Payment**
Jan. '07	10.00%	$100.00	$300.00	$135.00*	$165.00	$5,000.00
Feb. '07	15.00%	$0.00	$300.00	$179.00**	$121.00	$4,879.00

*Includes $39 over-the-limit fee.
**Includes $39 late fee.

Explanation: In January 2007, the cardholder purchased $100 worth of goods. The interest rate applicable at that time was 10% and the credit limit was $4,500. After receiving a credit card bill in the subsequent month, the cardholder made a payment of $300, of which $135 was used to pay a $39 over-the-limit fee and $96 in interest charges on pre-existing credit card debt, leaving $165 to reduce the overall debt. The resulting balance owed by the consumer after making the $300 payment was $5,000. In February 2007, the cardholder made no new purchases. That same month, the interest rate was increased to 15%, and the credit limit was raised to $5,500. The cardholder received the billing statement in the subsequent month and paid $300 after the due date. Of that $300, $179 was used to pay a $39 late fee and $140 in interest charges, leaving $121 to reduce the principal debt. Subtracting $121 from $5,000 leaves a total balance owing of $4,879. (Note: If purchases had been made during February, the cost would have been added to the new balance total shown for the month.)

Prepared by the U.S. Senate Permanent Subcommittee on Investigations, December 2007

Testimony of Senator Carl Levin
EXHIBIT #5

Case History No. 1: Janet Hard
Freeland, Michigan

Janet Hard is a 42 year old registered nurse. She is married, with two children, and her husband works as a steamfitter. She has a credit card with Discover, which she has not used to make purchases in over a year other than to make an $8 monthly payment for high speed Internet access. She makes regular monthly payments of $200 to pay off an existing debt on the card of about $8,500. Ms. Hard has never made a late payment or exceeded her credit limit on the Discover card, and always paid at least the minimum amount due.

In May 2006, Discover increased Ms. Hard's interest rate from about 18% to 24%. Ms. Hard did not realize her interest rate had been increased until later when she saw that her debt was not decreasing and went back to look at her billing statements a second time. After she complained, Discover lowered the interest rate to about 21%.

When she called Discover, Ms. Hard was told that her interest rate had been increased, because her credit card debt was too near her credit limit, she had too many credit cards, and she had delinquencies on credit cards at other companies. Ms. Hard is unable to explain these concerns, since she and her husband have always been careful to meet their credit obligations. When questioned by the Subcommittee, Discover explained that a credit bureau had reduced Ms. Hard's FICO credit score which, in turn, had caused the bank's automated system to impose a higher interest rate on her card. The bank did not know what specific events had triggered the lower credit score, other than the general reasons cited above which were supplied by the credit bureau. Discover also admitted that, despite increasing Ms. Hard's interest rate because she supposedly posed a greater credit risk, it raised her credit limit, in August 2007, from $10,000 to $11,000.

Discover applied the increased interest rate to Ms. Hard's existing credit card debt. In February 2006, under the 18% interest rate, out of her $200 monthly payment, about $148 went to pay for finance charges and $52 went to pay down her principal debt. In February 2007, under the 24% interest rate, $176 went to finance charges and only about $24, less than half the amount previously, went to pay down the principal debt.

Over the last year, Ms. Hard has charged less than $100 on her Discover card, incurred interest rates of 21% to 24%, and paid Discover a total of $2,400. Despite this year of steady payments, her November 2006 debt of about $8,300 fell by just $350 and, as of October 2007, she still owed Discover nearly $8,000.

Janet Hard
Freeland, Michigan

Discover Card **Credit Limit: $10,000, increased to $11,000 in 8/07**

Transaction Period	Interest Rate	Purchases	Applicable Payment	Amount Paid Toward: Interest and Fees*	Amount Paid Toward: Reduction in Principal	Balance after Payment
Feb. '06	17.99%	$273.34	$200.00	$148.31	$51.69	$9,428.64
March '06	18.24%	$159.52	$225.00	$136.91	$88.09	$9,500.07
April '06	23.74%	$7.95	$1,500.00	$197.88	$1,302.12	$8,205.90
May '06	23.74%	$7.95	$300.00	$188.40	$111.60	$8,102.25
June '06	23.99%	$15.11	$200.00	$172.48	$27.52	$8,089.84
July '06	24.24%	$7.95	$200.00	$166.11	$33.89	$8,063.90
Aug. '06	24.24%	$324.96	$200.00	$178.19	$21.81	$8,367.05
Sept. '06	24.24%	$7.95	$193.00	$177.50	$15.50	$8,359.50
Oct. '06	24.24%	$7.95	$200.00	$171.81	$28.19	$8,339.26
Nov. '06	24.24%	$7.95	$200.00	$177.19	$22.81	$8,324.40
Dec '06	24.24%	$7.95	$200.00	$171.23	$28.77	$8,303.58
Jan. '07	24.24%	$7.95	$200.00	$176.45	$23.55	$8,287.98
Feb. '07	24.24%	$7.95	$200.00	$176.13	$23.87	$8,272.06
March '07	24.24%	$7.95	$200.00	$158.70	$41.30	$8,238.71
April '07	24.24%	$7.95	$200.00	$175.23	$24.77	$8,221.89
May '07	24.24%	$7.95	$200.00	$169.17	$30.83	$8,199.01
June '07	20.99%	$7.95	$200.00	$150.95	$49.05	$8,157.91
July '07	20.99%	$8.91	$200.00	$145.10	$54.90	$8,111.92
Aug. '07	20.99%	$7.95	$200.00	$149.27	$50.73	$8,069.14
Sept. '07	20.99%	$7.95	$200.00	$148.50	$51.50	$8,025.59
Oct. '07	20.99%	$7.95	$200.00	$142.88	$57.12	$7,976.42

*No late or over-the-limit fees were charged.

Case History No. 2: Millard Glasshof
Milwaukee, WI

Millard Glasshof is an 81-year-old retired engineer living on a fixed income. He has had one credit card for many years, administered first by Wachovia, then Bank One, and, since 2005, by Chase after it purchased Bank One. Mr. Glasshof has not used this card to make purchases since 2001, instead making monthly payments to reduce a debt which at its height was about $6,400.

From 2001-2003, Mr. Glasshof participated in several Bank One payment programs that, after closing his account, allowed him to pay down his debt using a low interest rate. He did not always complete these programs successfully, but continued to reduce his debt. In 2003, after he missed one or more payments, Bank One increased his interest rate to 15%. For the next four years, until recently, Mr. Glasshof made regular payments of $119 per month to reduce his debt. His bank statements show, for example, that he has not missed a single payment in over two years. Although $119 is less than the minimum specified on his billing statements, Chase did not charge him a late fee. Chase did, however, charge him multiple over-the-limit fees, since his debt exceeded the card's $4,500 credit limit. In March 2007, Chase stopped these fees after discontinuing its policy of charging unlimited over-the-limit fees in response to a single overage.

In December 2006, Chase increased his interest rate to 17%. In February 2007, Chase increased it again to 27%. When Mr. Glasshof called Chase to ask why, he told the Subcommittee he was not given a satisfactory explanation, especially since his circumstances were unchanged. When questioned by the Subcommittee, Chase explained that a special automated initiative to "clean up" closed accounts had flagged his account due to a low credit score and caused the December interest rate increase. Chase said the February increase occurred, because Mr. Glasshof "had failed to bring his balance below his credit limit," even though that had been true for more than six years, it was Chase's interest charges and fees that were keeping him above the limit, and he was in excess of the limit by only $300.

Chase applied the 27% rate to Mr. Glasshof's existing credit card debt. Prior to the increase, out of his monthly $119 payment, about $92 went to pay for finance charges and $27 to pay down the principal debt. After the increase, about $114 went to finance charges and only $5 went to pay down the principal debt.

Over the last twelve months, Mr. Glasshof made payments to Chase totaling roughly $1,300. Despite this year of steady payments, due to high interest rates and fees, his October 2006 debt of about $4,800 did not decline at all.

In August 2007, Mr. Glasshof received a letter telling him his minimum payment would change. Because the letter was confusing and difficult to read, he called Chase and was advised to change his minimum payment to $111. After making this payment, Mr. Glasshof was assessed a late fee of $39 on top of his interest charges, apparently because he should have made a larger payment. In response, he took out a personal loan and completely paid off his Chase credit card. What he did not know is that, the same month he took out the loan, Chase had lowered his credit card interest rate to 6%.

Millard Glasshof
Milwaukee, WI

Chase **Credit Limit: $4,500**

Transaction Period	Interest Rate	Purchases	Applicable Payment	Amount Paid Toward: Interest and Fees	Amount Paid Toward: Reduction in Principal	Balance after Payment
Jan. '06	14.99%	$0.00	$119.00	$96.89*	$22.11	$5,187.73
Feb. '06	14.99%	$0.00	$119.00	$96.67*	$22.33	$5,165.40
March '06	14.99%	$0.00	$119.00	$89.96*	$29.04	$5,136.36
April '06	14.99%	$0.00	$119.00	$96.07*	$22.93	$5,113.43
May '06	14.99%	$0.00	$119.00	$93.78*	$25.22	$5,088.21
June '06	14.99%	$0.00	$119.00	$95.35*	$23.65	$5,064.56
July '06	14.99%	$0.00	$119.00	$63.37	$55.63	$5,008.93
August '06	14.99%	$0.00	$119.00	$64.77	$54.23	$4,954.70
Sept. '06	14.99%	$0.00	$119.00	$64.41	$54.59	$4,900.11
Oct. '06	14.99%	$0.00	$119.00	$61.68	$57.32	$4,842.79
Nov. '06	14.99%	$0.00	$119.00	$91.82*	$27.18	$4,815.61
Dec. '06	17.24%	$0.00	$119.00	$115.76*	$3.24	$4,812.37
Jan. '07	17.24%	$0.00	$119.00	$118.51*	$0.49	$4,811.88
Feb. '07	27.24%	$0.00	$119.00	$153.13*	-$34.13	$4,846.01
March '07	27.24%	$0.00	$119.00	$104.10	$14.90	$4,831.11
April '07	27.24%	$0.00	$119.00	$114.57	$4.43	$4,826.68
May '07	27.24%	$0.00	$119.00	$110.06	$8.94	$4,817.74
June '07	27.24%	$0.00	$119.00	$114.08	$4.92	$4,812.82
July '07	27.24%	$0.00	$119.00	$110.38	$8.62	$4,804.20
August '07	27.24%	$0.00	$111.00	$113.67	-$2.67	$4,806.87
Sept. '07	26.74%	$0.00	$111.00	$151.12**	-$40.12	$4,846.99
Oct. '07	6.00%	$0.00	Loan taken			$0.00

*Includes over-the-limit fee of $29 or $39.

**Includes late fee of $39.

Case History No. 3: Bonnie Rushing
Naples, Florida

Bonnie Rushing has been employed as a corporate paralegal for many years. Her husband is a retired engineer. She has two Bank of America credit cards, one of which is affiliated with the Automobile Association of American ("AAA"). For years, both cards carried an interest rate of about 8%. Ms. Rushing has never made a late payment or exceeded the credit limit on either card, and always paid at least the minimum amount due. In April 2007, Bank of America nearly tripled the interest rate on the AAA card, increasing it from 8% to 23%.

Ms. Rushing first noticed the increase on her April billing statement. She called the bank, which said that she had failed to take advantage of a change-in-term notice mailed earlier that would have allowed her to reject the increase, close her account, and pay the debt at the old rate. Ms. Rushing explained that she never received the notice and noted that when a similar notice had been sent to her in 2004, she had responded in a timely manner and kept her prior rate. Ms. Rushing told the Subcommittee that, in two conversations, bank personnel pressed her to agree to a rate lower than 23% but higher than her 8% rate. When she refused and Bank of America declined to restore her prior rate, Ms. Rushing sent a letter of complaint to the Florida Attorney General who forwarded it to Bank of America's primary federal regulator. Ms. Rushing also asked AAA to close her account. AAA intervened on her behalf, and Bank of America agreed to apply the prior 8% rate to her closed account. The bank informed its regulator that it had resolved Ms. Rushing's complaint about its conduct.

Ms. Rushing asked the bank why her interest rate had been increased, and was told that her debt was too high compared to her credit limit, even though her debt level had not substantially changed in months and had been higher in the past when the bank allowed her to cash a $2,500 credit card check. When questioned by the Subcommittee, Bank of America explained that a credit bureau had reduced Ms. Rushing's credit score which, in turn, had caused the bank's automated system to impose a higher interest rate on the card in question, though not the second card which retained its 8% rate. The bank did not know what specific events triggered the lower credit score. Ms. Rushing speculated that her credit score may have been affected when, in January and March 2007, she opened Macy's and J. Jill credit cards to obtain discounts on purchases of cosmetics and clothes. She has since closed both accounts.

Bank of America applied the 23% interest rate to Ms. Rushing's existing debt on her AAA card, increasing her finance charges substantially. Under the prior interest rate, her finance charges were in the range of $150 each month. Under the 23% rate, her finance charges were in the range of $450, three times greater. When the bank closed her account and restored her prior rate, it also refunded about $600 in interest charges from just the two months the higher rate had been in effect.

Bonnie Rushing
Naples, Florida

Bank of America (AAA) **Credit Limit: $ 24,100**

Transaction Period	Interest Rate	Purchases	Applicable Payment	Amount Paid Toward: Interest and Fees	Amount Paid Toward: Reduction in Principal	Balance after Payment
Oct. '06	7.90%	$0.00	$400.00	$141.54	$258.46	$21,219.29
Nov. '06	7.90%	$2,500.00*	$400.00	$202.26**	$197.74	$23,521.55
Dec. '06	7.90%	$0.00	$390.00	$149.83	$240.17	$23,281.38
Jan. '07	7.90%	$0.00	$400.00	$163.66	$236.34	$23,045.04
Feb. '07	7.90%	$550.00 (medical)	$400.00	$155.42	$244.58	$23,350.46
March '07	7.90%	$0.00	$395.00	$153.83	$241.17	$23,109.29
April '07	22.90%	$0.00	$680.00	$443.71	$236.29	$22,873.00
May '07	22.90%	$0.00	$700.00	$459.00	$851.68***	$22,021.32
June '07	7.99%	$0.00	$400.00	$156.39	$243.61	$21,777.71
July '07	7.99%	$0.00	$400.00	$145.23	$254.77	$21,522.94
August '07	7.99%	$0.00	$400.00	$148.20	$251.80	$21,271.14

* Used credit card check to obtain this amount from Bank of America.
**Includes $50 fee for using the credit card check.
No late or over-the-limit fees were charged.
***Includes $610.68 refunded by bank for past interest charges under 23% rate.

Case History No. 4: Gayle Corbett
Seattle, Washington

Gayle Corbett works full time at the Seattle courthouse. She has multiple credit cards, keeps careful track of the amounts she owes, and pays her bills on time, providing more than the minimum due each month. In 2007, despite her regular payments, the interest rates were increased on her credit cards with Bank of America, Citi Card, and Capital One.

Bank of America increased her interest rate in August 2007, from 15% to 24%, because a credit bureau had lowered her credit score. After the Subcommittee inquired about the account, the bank reduced her rate to 10%, and she agreed to suspend new purchases until she reduced her debt on the card. In January 2007, Citi Card more than doubled her interest rate, from 11% to 23%. This increase was also due to a lower credit score. Citi announced the next month, in March 2007, that it would no longer increase cardholder interest rates due to lower credit scores unrelated to Citi Card activity, but still declined to restore Ms. Corbett's prior rate. In September, in response to Ms. Corbett's request and an improved credit score, Citi reduced her rate to 19%, still 8% above her original rate. At the same time, Citi increased her credit limit by nearly $2,500.

In September 2007, Capital One increased Ms. Corbett's interest rate from 15% to 19%. Capital One's increase was not due to a lower credit score, but because the bank had decided to pass on its borrowing costs to its cardholders. Ms. Corbett's account was selected by Capital One's automated system, because it had not had an interest rate increase in three years and carried what the bank characterized as a "below market" interest rate. After she complained, Capital One agreed to close her account, restore her prior 15% rate, and credit her account with the excess finance charges imposed earlier.

In twelve months, Ms. Corbett was subjected to interest rate increases on three credit cards, even though she was meeting her credit card obligations. As she contested each increase, her cards were assigned a wide range of interest rates, from 10% to 23%. Her interest rates have settled for the moment at 10%, 19% and 15%, but are subject to further increases by the credit card issuers.

Each of the higher interest rates was applied to Ms. Corbett's credit card debt, increasing her finance charges. In December 2006, for example, prior to the increases, she made monthly payments on all three cards totaling $530, of which $193 went to pay for finance charges. By August 2007, out of monthly payments totaling $580, about $350 went to pay for finance charges, substantially more than previously.

Ms. Corbett told the Subcommittee, "I owe this money. I'm willing to pay my debts – just don't make it harder for me." She said that contesting the three interest rate increases in 2007, none of which were her fault and all of which threatened her ability to repay her debts, had left her exhausted and worried about what would happen next.

Gayle Corbett
Seattle, Washington

Bank of America **Credit Limit: $9,000**

Transaction Period	Interest Rate	Purchases	Applicable Payment	Amount Paid Toward: Interest and Fees*	Amount Paid Toward: Reduction in Principal	Balance after Payment
Oct. '06	15.24%	$23.99	$206.00	$122.25	$83.75	$8,368.13
Nov. '06	15.24%	$0.00	$190.00	$102.52	$87.48	$8,280.65
Dec. '06	15.24%	$0.00	$185.00	$98.95	$86.05	$8,194.60
Jan. '07	15.24%	$326.54	$205.00	$120.25	$84.75	$8,436.39
Feb. '07	15.24%	$26.75	$186.00	$100.90	$85.10	$8,378.04
March '07	15.24%	$157.15	$200.00	$114.87	$85.13	$8,450.06
April '07	15.24%	$26.75	$190.00	$104.62	$85.38	$8,391.43
May '07	15.24%	$54.96	$195.00	$107.62	$87.38	$8,359.01
June '07	15.24%	$200.31	$201.00	$115.77	$85.23	$8,474.09
July '07	15.24%	$26.77	$193.00	$108.93	$84.07	$8,416.79
August '07	23.99%	$200.32	$270.00	$177.39	$92.61	$8,524.50
Sept. '07	9.99%	$0.00	$160.00	$71.61	$88.39	$8,436.11

AT&T
Universal/Citi **Credit Limit: $7,100 increased to $9,590 in Sept. 2007**

Transaction Period	Interest Rate	Purchases	Applicable Payment	Amount Paid Toward: Interest and Fees*	Amount Paid Toward: Reduction in Principal	Balance after Payment
Oct. '06	10.81%	$174.30	$130.00	$58.69	$71.31	$6,746.80
Nov. '06	10.81%	$64.99	$140.00	$65.60	$74.40	$6,737.39
Dec. '06	10.84%	$74.87	$260.00	$61.10	$198.90	$6,613.36
Jan. '07	23.31%	$174.54	$201.28	$132.28	$69.00	$6,718.90
Feb. '07	23.31%	$134.31	$208.00	$138.42	$69.58	$6,783.63
March '07	23.31%	$0.00	$200.00	$129.05	$70.95	$6,712.68
April '07	23.31%	$0.00	$201.00	$132.26	$68.74	$6,643.94
May '07	23.31%	$0.00	$212.00	$144.19	$67.81	$6,576.13
June '07	23.31%	$0.00	$190.00	$120.80	$69.20	$6,506.93
July '07	23.31%	$0.00	$200.00	$132.39	$67.61	$6,439.32
August '07	23.52%	$0.00	$220.00	$136.60	$83.40	$6,355.92
Sept. '07	19.10%	$0.00	$165.00	$99.03	$65.97	$6,289.95
Oct. '07	18.52%	$0.00	**	$98.06	**	**

*No late or over-the-limit fees were charged.
** The November billing statement was not available at the time of this analysis.

Gayle Corbett
Seattle, Washington

Capital One **Credit Limit: $3,000**

Transaction Period	Interest Rate	Purchases**	Applicable Payment	Amount Paid Toward: Interest and Fees*	Amount Paid Toward: Reduction in Principal	Balance after Payment
Oct. '06	14.90%	$37.63	$85.00	$35.41	$49.59	$2,779.09
Nov. '06	14.90%	$5.00	$90.00	$37.41	$52.59	$2,731.50
Dec. '06	14.90%	$5.00	$85.00	$33.41	$51.59	$2,684.91
Jan. '07	14.90%	$5.00	$81.00	$35.09	$45.91	$2,644.00
Feb. '07	14.90%	$104.03	$85.00	$35.49	$49.51	$2,698.52
March '07	14.90%	$134.11	$90.00	$32.88	$57.12	$2,775.51
April '07	14.90%	$5.00	$90.00	$36.34	$53.66	$2,726.85
May '07	14.90%	$5.00	$85.00	$34.48	$50.52	$2,681.33
June '07	14.90%	$101.74	$90.00	$44.62	$45.38	$2,737.69
July '07	14.90%	$84.68	$85.00	$36.09	$48.91	$2,773.46
August '07	14.90%	$5.00	$90.00	$35.98	$54.02	$2,724.44
Sept. '07	19.40%	$34.18	$85.00	$44.81	$40.19	$2,718.43
Oct. '07	14.90%	$0.00	***	$36.37	***	***

*No late or over-the-limit fees were charged.
**Includes monthly $5 payment toward $60 Capital One annual credit card fee.
***Capital One will refund past interest charges on the November billing statement. This statement was not available at the time of this analysis.

Case History No. 5: Agnes Holmes
Montgomery, Alabama

Agnes Holmes considers herself a loyal Chase customer; she has two Chase credit cards, one with MasterCard and the other with Visa. Ms. Holmes takes care to stay below the credit limit, always pays the requested amount due, and takes pride in paying her credit card bills on the same day she receives them. Despite her history of on-time payments, in May 2007, Chase increased the interest rate on her Visa card from 19% to 30%.

Ms. Holmes called Chase and asked for her prior rate to be restored but was told that the 30% rate could not be reduced. When questioned by the Subcommittee, Chase explained that Ms. Holmes' credit score had been lowered by a credit bureau which, in turn, had caused the bank's automated system to impose a higher interest rate on her card. The bank did not know what specific events triggered the lower score, other than the general reason provided by the credit bureau that the cardholder had engaged in excessive utilization of her available credit, even though none of her accounts exceeded her credit limits. Ms. Holmes told the Subcommittee that she had not been informed that her credit score was a factor in raising her interest rate, and she had paid all her bills on time for years. In addition, because Ms. Holmes employs a service that tracks her credit reports to prevent identity theft and indicates her credit score each quarter, she provided materials showing that, for the quarters before, during and after the month her interest rate was increased, her credit score had not fallen but remained at or above 700.

Chase applied the 30% interest rate to Ms. Holmes' existing credit card debt, increasing her monthly finance charges. Under the 19% rate, in March 2007, out of a monthly payment of $125, about $75 went to pay for finance charges. After the increase, under the 29% rate, out of a payment of $165 in May 2007, about $118 went to finance charges.

In September, Ms. Holmes informed Chase that she had contacted the Subcommittee about her account. In October, the bank informed her that it would lower the interest rate on her credit card to a 13% fixed rate and credit her account with the full amount of the finance charges imposed earlier.

Agnes Holmes
Montgomery, Alabama

Chase **Credit Limit: $5,000**

Transaction Period	Interest Rate	Purchases	Applicable Payment	Amount Paid Toward: Interest and Fees*	Amount Paid Toward: Reduction in Principal	Balance after Payment
Sept. '06	18.99%	$0.00	$0.00	$0.00	$0.00	$0.00
Oct. '06	18.99%	$2,946.47	$100.00	$0.00	$100.00	$2,846.47
Nov '06	18.99%	$1,253.95	$125.00	$79.86	$45.14	$4,055.28
Dec '06	18.99%	$715.64	$125.00	$76.77	$48.23	$4,722.69
Jan '07	18.99%	$0.00	$125.00	$77.37	$47.63	$4,675.06
Feb '07	18.99%	$0.00	$125.00	$69.19	$55.81	$4,619.25
March '07	18.99%	$0.00	$125.00	$75.75	$49.25	$4,570.00
April '07	18.99%	$0.00	$120.00	$72.47	$47.53	$4,522.47
May '07	29.99%	$0.00	$165.00	$117.74	$47.26	$4,475.21
June '07	29.99%	$0.00	$160.00	$112.75	$47.25	$4,427.96
July '07	29.99%	$0.00	$160.00	$115.54	$44.46	$4,383.50
August '07	29.99%	$0.00	$160.00	$114.38	$45.62	$4,337.88
Sept. '07	29.99%	$0.00	$155.00	$109.55	$45.45	$4,292.43
Oct. '07	12.99%**	$0.00	***	$45.83	***	***

* No late or over-the-limit fees were charged.

** Statement lists the 12.99% as a "promotional" rate and 29.99% as interest rate applicable to purchases.

*** Chase will refund past interest charges on the November billing statement. This statement was not available at the time of this analysis.

Case History No. 6: Linda Fox
Circleville, Ohio

Linda Fox is a working grandmother who has been employed by the same large company for 25 years. She has had a Capital One credit card for over ten years, has never made a late payment or exceeded her credit limit, and always paid at least the minimum amount due. In April 2007, Capital One increased her interest rate from 8% to 13%.

Ms. Fox first noticed the increase when she saw her May billing statement. She called the bank, which said she had failed to take advantage of a change-in-term notice mailed earlier that would have allowed her to reject the increase, close her account, and pay her debt at the old rate. Ms. Fox explained that she had never received the notice. Capital One declined to reduce the rate and told her that her account could be placed in a "closing status" but would still be subject to the new 13% interest rate.

When questioned by the Subcommittee, Capital One explained that it had increased Ms. Fox's interest rate, not because she was at fault, but because the bank had decided to pass on its borrowing costs to its cardholders. Capital One's automated system had selected Ms. Fox's account, because it had not had an interest rate increase in three years and had what the bank characterized as a "below market" interest rate. She was one of many Capital One accounts selected for an interest rate increase.

Capital One applied the increased interest rate to Ms. Fox's existing credit card debt. In January 2007, before the increase, out of her $600 payment, about $130 went to pay for finance charges. In June 2007, after the increase, out of her $600 payment, about $247 went to pay for finance charges, almost double the previous amount.

In November 2007, after Ms. Fox complained, Capital One agreed to allow her, beginning in her December billing statement, to close her account and repay her debt at the prior rate of 8%. Capital One also credited her account with the excess finance charges imposed earlier.

Linda Fox
Circleville, Ohio

Capital One **Credit Limit: $20,000**

Transaction Period	Interest Rate	Purchases	Applicable Payment	Amount Paid Toward: Interest and Fees*	Amount Paid Toward: Reduction in Principal	Balance after Payment
Oct. '06	7.90%	$163.08	$600.00	$123.38	$476.62	$17,846.54
Nov. '06	7.90%	$381.23	$852.06	$125.53	$726.53	$17,501.24
Dec. '06	7.90%	$1,131.57	$859.96	$122.68	$737.28	$17,895.53
Jan. '07	7.90%	$879.81	$600.00	$129.87	$470.13	$18,305.21
Feb. '07	7.90%	$612.24	$1,021.24	$129.52	$891.72	$18,025.73
March '07	7.90%	$965.91	$825.50	$117.77	$707.73	$18,283.91
April '07	12.90%	$837.11	$837.17	$214.60	$622.57	$18,498.45
May '07	12.90%	$377.19	$800.00	$207.09	$592.91	$18,282.73
June '07	12.90%	$0.00	$600.00	$246.86	$353.14	$17,929.59
July '07	12.90%	$0.00	$2,000.00	$201.53	$1,798.47	$16,131.12
August '07	12.90%	$0.00	$600.00	$186.14	$413.86	$15,717.26
Sept. '07	12.90%	$0.00	$500.00	$176.95	$323.05	$15,394.21
Oct. '07	12.90%	$0.00	$500.00	$167.25	$744.70**	$14,649.51
Nov. '07	7.90%	$0.00	***	$104.94	***	***

*No late or over-the-limit fees were charged.
**Includes $411.95 refunded by bank for past interest charges under 12.90% rate.
***Ms. Fox will pay her bill in December. The December billing statement was not available at the time of this analysis.

Case History No. 7: Marjorie Hancock
Arlington, Massachusetts

Marjorie Hancock is a retired financial director from an engineering firm and the mother of three grown children. She has four credit cards with Bank of America, one which she stopped using in May in order to pay down the debt; a second card she stopped using years ago and on which she has made steady payments to reduce the debt; a third which she uses occasionally; and a fourth which her son, a student enrolled in graduate school, uses for his school expenses as an authorized signer. In August, Bank of America increased the interest rate on the first credit card from 19% to 27%.

Ms. Hancock has never made a late payment or exceeded the limit on the card, and always paid more than the minimum amount due. She owed about $8,200 on that card, well below its credit limit of $15,000. She owed sums on the other three cards as well, but all were below their credit limit and all were being paid off in compliance with the terms of each card.

When Ms. Hancock called Bank of America to ask why her interest rate had increased, she was told that her credit card "utilization" was too high, even though her balances had not substantially changed in over a year. She was also told that she had "serious delinquencies" on cards with other companies, even though she is current on all her credit card obligations. When questioned by the Subcommittee, Bank of America explained that Ms. Hancock's credit score had been reduced by a credit bureau which, in turn, had caused the bank's automated system to impose a higher interest rate on the card in question. The bank did not know what specific events had triggered the lower score, other than the general reasons provided by the credit bureau and given to Ms. Hancock.

Ms. Hancock's four Bank of America credit cards now carry interest rates of 8%, 14%, 19%, and 27%, even though she poses the same credit risk on all four. Bank of America has declined to restore her prior rate on the credit card bearing the highest rate. At the same time, Bank of America regularly sends Ms. Hancock credit card checks which would allow her to incur additional debt.

Bank of America applied the 27% interest rate to Ms. Hancock's existing debt on her credit card, which substantially increased her finance charges. In July 2007, for example, when her interest rate was 19%, out of a $230 payment on the card, about $128 went to pay for finance charges. In August, after the increase to 27%, out of a payment of $300, about $200 went to finance charges, an increase of more than 50%.

Ms. Hancock noted that, in a telephone call, Bank of America personnel claimed the bank was "helping" her by increasing her interest rate. She wrote to the bank that it would help her more if the bank had lowered rather than increased her interest rate.

Marjorie Hancock
Arlington, Massachusetts

Bank of America **Credit Limit: $15,000**

Transaction Period	Interest Rate	Purchases	Applicable Payment	Amount Paid Toward: Interest and Fees*	Amount Paid Toward: Reduction in Principal	Balance after Payment
Nov. '06	18.24%	$140.10	$231.00	$132.13	$98.87	$8,857.17
Dec. '06	18.24%	$336.83	$250.00	$143.84	$106.16	$9,087.84
Jan. '07	18.24%	$176.38	$250.00	$147.11	$102.89	$9,161.33
Feb. '07	18.24%	$0.00	$300.00	$131.08	$168.92	$8,992.41
March '07	18.24%	$0.00	$270.00	$147.95	$122.05	$8,870.36
April '07	18.24%	$4.95	$235.00	$132.07	$102.93	$8,772.38
May '07	18.24%	$0.00	$500.00	$134.84	$365.16	$8,407.22
June '07	18.24%	$0.00	$225.00	$140.29	$84.71	$8,322.51
July '07	18.24%	$0.00	$230.00	$128.06	$101.94	$8,220.57
August '07	26.99%	$0.00	$300.00	$200.22	$99.78	$8,120.79
Sept. '07	26.99%	$0.00	$1,000.00	$181.12	$818.88	$7,301.91
Oct. '07	26.99%	$0.00	**	$173.03	**	**

*No late or over-the-limit fees were charged.
**The November billing statement was not available at the time of this analysis.

Case History No. 8: Donna Bernard
Dallas, Texas

Donna Bernard is an administrative assistant at a large corporation. She has multiple credit cards with substantial balances, keeps careful track of the amounts she owes, and pays her bills on time. She has not used one of her credit cards, from Chase, to make purchases since 2001, instead making steady monthly payments to reduce a debt of about $7,900. She has never made a late payment or exceeded her credit limit on the card, and always paid at least the minimum amount due. In December 2006, Chase nearly doubled her interest rate on the card, from about 15% to 29%.

When Ms. Bernard contacted Chase to find out why, she was told that the increase was because her "total bankcard balances have grown too fast," she had too many credit cards with high balances, and her credit card balances "are too high compared to total credit limits." Chase had apparently determined that these factors outweighed her history of making regular, on-time payments for years to reduce her Chase debt. When questioned by the Subcommittee, Chase explained further that a special automated initiative at the bank to "clean up" closed credit card accounts had flagged Ms. Bernard's account due to a low credit score provided by a credit bureau and imposed the December rate increase. Chase did not know what specific events triggered the lower score, other than the general reasons provided by the credit bureau which were given to Ms. Bernard.

Ms. Bernard was also told that she had missed the deadline to reject the increase, close her account, and pay the debt at the old rate. In discussing the matter, Ms. Bernard learned from bank personnel that the bank had closed her account to new purchases years earlier. Despite having closed her account in 2001, Chase declined to restore her prior interest rate, informing Ms. Bernard that closed accounts are not protected from interest rate increases.

Chase applied the 29% interest rate to the existing debt in her closed account, substantially increasing her monthly finance charges. In October 2006, for example, under the 15% rate, out of a $165 payment, about $100 went to pay for finance charges and $65 to pay down the principal debt. In January 2007, after the increase, out of a larger payment of $200, $199.75 went to pay finance charges, and just 25 cents went to pay down the principal debt.

Chase applied the new interest rate to Ms. Bernard's account for seven months. After she contacted the Subcommittee, Chase restored her 15% interest rate and credited her account with nearly $600 in interest charges imposed earlier. Chase set up the 15% as a "promotional rate" that would be replaced with a 29% rate if Ms. Bernard were to be late making a single payment.

Over the last twelve months, Ms. Bernard made payments on her Chase credit card totaling about $2,300. Despite this year of steady payments, her October 2006 debt of about $7,900 fell by only about $900 to just under $7,000.

Donna Bernard
Dallas, Texas

Chase **Credit Limit: $12,150**

Transaction Period	Interest Rate	Purchases	Applicable Payment	Amount Paid Toward: Interest and Fees*	Amount Paid Toward: Reduction in Principal	Balance after Payment
Oct. '06	14.99%	$0.00	$165.00	$100.03	$64.97	$7,896.58
Nov. '06	14.99%	$0.00	$159.00	$102.39	$56.61	$7,839.97
Dec. '06	29.24%	$0.00	$194.00	$193.73	$0.27	$7,839.70
Jan. '07	29.24%	$0.00	$200.00	$199.75	$0.25	$7,839.45
Feb. '07	29.24%	$0.00	$200.00	$199.34	$0.66	$7,838.79
March '07	29.24%	$0.00	$180.00	$179.55	$0.45	$7,838.34
April '07	29.24%	$0.00	$199.00	$198.79	$0.21	$7,838.13
May '07	29.24%	$0.00	$193.00	$192.54	$0.46	$7,837.67
June '07	29.24%	$0.00	$201.00	$200.31	$0.69	$7,836.98
July '07	14.99%**	$0.00	$146.00	$87.27***	$650.37****	$7,186.61
August '07	14.99%**	$0.00	$166.00	$93.24***	$72.76	$7,113.85
Sept. '07	14.99%**	$0.00	$164.00	$92.33***	$71.67	$7,042.18
Oct. '07	14.99%**	$0.00	$159.00	$88.33***	$70.67	$6,971.51

*No late or over-the-limit fees were charged.
**Statement lists the 14.99% as a "promotional" rate and 29.24% as the interest rate applicable to purchases.
***For July, figure includes $1.97 at 29.24% rate and $85.30 at 14.99% rate; for August through October, figures include $0.05 at 29.24% rate and remainder at 14.99%.
****Includes $591.64 refunded by bank for past interest charges under 29.24% rate.

Dear Customer:

The following information pertains to your account ending in Redacted by Permanent Subcommittee on Investigations

IMPORTANT AMENDMENTS TO YOUR CREDIT CARD AGREEMENT, NOTICE OF BENEFITS CHANGE AND ANNUAL PRIVACY NOTICE

At Bank of America, providing timely and relevant information about the terms of your Credit Card Agreement is one of our most important responsibilities. The enclosed documents **contain important changes to the terms of your Credit Card Agreement with Bank of America, information describing changes to the benefits associated with your account and your 2007 Annual Privacy Policy for Consumers.** If you have more than one account with us, you may receive more than one copy of the privacy policy. This may include closed accounts with balances or inactive accounts. Please remember that if you previously opted out of sharing information with third parties or among Bank of America companies in accordance with the privacy policy you do not need to opt out again. Please read this notice carefully and keep it with your Credit Card Agreement.

IMPORTANT AMENDMENTS TO YOUR CREDIT CARD AGREEMENT

Please read this document carefully and keep it with your **Credit Card Agreement.** Except as amended below, the terms of your **Credit Card Agreement** remain in effect. If there is a conflict, the terms in this Amendment(s) will prevail.

<u>Annual Percentage Rates</u>
Summary: We are increasing your Annual Percentage Rates (APRs) and changing your APRs to variable rates. Your APRs will vary each month with changes in the prime rate. The prime rate will be selected at the end of each month. The variable APR calculated using the new prime rate will apply to all balances in the same billing cycle as this selection date. The balances include transactions made before the new prime rate is selected. **You may reject these changes as described below.** These changes will not affect any promotional rates that may currently be applied to your account.

Amendment: Effective on the **first day following your statement Closing Date in March 2007:**

Your account will have variable APRs which are higher than your current APRs. All variable rates are calculated using the variable rate formula below.

- The variable **ANNUAL PERCENTAGE RATE** for Category A is currently **22.90%** (corresponding Daily Periodic Rate of 0.062739%). The margin is 14.65 percentage points. This is the category for Balance Transfers and Check Cash Advances.
- The variable **ANNUAL PERCENTAGE RATE** for Category B is currently **22.90%** (corresponding Daily Periodic Rate of 0.062739%). The margin is 14.65 percentage points. This is the category for Bank and ATM Cash Advances.
- The variable **ANNUAL PERCENTAGE RATE** for Category C is currently **22.90%** (corresponding Daily Periodic Rate of 0.062739%). The margin is 14.65 percentage points. This is the category for Purchases.
- The variable **ANNUAL PERCENTAGE RATE** for Category D is currently **22.90%** (corresponding Daily Periodic Rate of 0.062739%). The margin is 14.65 percentage points. This is the category for Other Balances.

<u>Variable Rate Information</u>
The variable APR formula is calculated by adding together an index and a margin. The index is the highest U.S. Prime Rate as published in the "Money Rates" section of <u>The Wall Street Journal</u> on the last

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publication day of each month. As of December 31, 2006, the index was 8.25 percentage points. The margin for each balance category is described above.

An increase or decrease in the index will cause a corresponding increase or decrease in your APRs on the first day of your billing cycle that begins in the same month in which the index is published. An increase in the index means that you will pay higher periodic rate finance charges and have a higher Total Minimum Payment Due. If The Wall Street Journal does not publish the U.S. Prime Rate, or if it changes the definition of the U.S. Prime Rate, we may, at our sole discretion, substitute another index.

As part of the Annual Percentage Rate Amendment decision, we obtained consumer report information, such as your accounts with other creditors, from Equifax Credit Information Services. Equifax did not make the decision and is unable to provide the specific reasons why the interest rate was increased. You have the right to obtain a free copy of your consumer report from Equifax within 60 days by calling 1-800-685-1111 and choosing option 1 from the voice response unit, or by writing to Equifax Credit Information Services, P.O. Box 740241, Atlanta, GA 30374-0241. You also have the right to dispute the accuracy or the completeness of any information in your consumer report.

To learn about your specific credit reasons for the Annual Percentage Rate Amendment, you may contact Bank of America at P.O. Box 15718, Wilmington, DE 19850 or call us at 1-800-421-2110 within 60 days of our providing this notice to you. Bank of America will provide a written response within 30 days after receiving your request.

Rejection Instructions for APR Increase:
If you do not wish to accept the above changes, you must meet all of the following requirements:

1. Write to us at Bank of America, P.O. Box 15718, Wilmington, DE 19850. Clearly print or type your name and full credit card account number and state that you reject this change. You must give notice in writing; it is not sufficient to telephone us. Send this notice only to the address in this paragraph; do not send it with a payment or any other type of customer service request. This mailbox is ONLY for rejection of change in terms.
2. Write to us immediately. We must receive your letter at the above address by **March 1, 2007** or your rejection will not be effective.
3. If you reject this change, it will not apply to your account. However, you must not use your account after March 1, 2007. If your account is used at any time after March 1, 2007, the above change will apply to your account even if you sent us timely notice rejecting the change. Remember, use of your account includes credit card access checks and any charges that are billed to your account on a regular basis such as online services and subscriptions.

Monthly Minimum Payment
Summary: As a result of federal guidance, we are changing the minimum payment calculation on your account. The Current Payment portion of your minimum payment will no longer have a cap. This change may increase your monthly payment requirement. This change will be effective with the minimum payment that is calculated based on your balance for the billing cycle that closes in July 2007. If you use a bill payment service, you should contact them about the new minimum payment.

Amendment: This change will be effective with the minimum payment that is calculated based on your balance for the billing cycle that closes in **July 2007:**

We are replacing the *Total Minimum Payment Due* section of your Agreement with the following:

TOTAL MINIMUM PAYMENT DUE
You may pay your total outstanding balance at any time. Each billing cycle, you must pay at least the Total Minimum Payment Due shown on your monthly statement by its Payment Due Date. The Total Minimum Payment Due is the sum of all past due amounts plus the Current Payment. The Current Payment for each billing cycle includes three amounts: (1) 1% of your balance (your New Balance

Total except for any new Periodic Rate Finance Charges, and Late Fee), and (2) new Periodic Rate Finance Charges, and (3) new Late Fee. Generally, the lowest it will be is $15. We round the payment amount down to the nearest dollar. If a payment is credited to your account but is returned unpaid in a later billing cycle, we will recalculate the Total Minimum Payment Due for the billing cycle in which the payment was originally credited.

Overdraft Protection

Summary: Your Agreement now permits overdraft protection transfers to a properly linked Bank of America checking account. Overdraft protection transfers are Bank Cash Advances. There is a fee for each overdraft protection transfer.

Amendment: Effective on May 1, 2007:

We are adding the following section to your Agreement:

Overdraft Protection

If your checking account with Bank of America is linked to this account, this overdraft protection feature will allow funds to be transferred ("overdraft protection transfers") from this account into your designated checking account with Bank of America ("checking account") when transactions occur on your checking account, such as checks or other debits, that if paid would cause the checking account to be overdrawn ("overdraft transactions"). Overdraft protection transfers include automatic transfers to cover checking account fees. Overdraft protection transfers are processed after close of business Monday through Friday and are treated as Category B Bank Cash Advances. Each day's overdraft transactions will be totaled and rounded to the next $100 ($25 if you opened your checking account in Washington or Idaho) increment up to your available credit limit, regardless of who initiated the overdraft transactions. For example, if your checking account has a balance of $1.00 and a check or other debit item for $125 is presented for payment, which if paid would cause your checking account to be overdrawn, an overdraft protection transfer of $200 will be made to your checking account and a Bank Cash Advance of $200 will post to this account. The amount of available credit on this account must be sufficient to cover the total amount of overdraft transactions (received by Bank of America that day) rounded to the next $100 increment (but excluding any overdraft protection fee); otherwise one or more of the overdraft transactions for that day will be rejected. However, if the available credit on this account is greater than the overdraft transaction amount, but the available credit is insufficient for the overdraft transaction amount to be rounded to the next $100 increment, then the amount of the overdraft transaction will be rounded to the highest whole dollar amount of your available credit. (And in such an event, the accrued finance charges may result in an Overlimit Fee.) We may permit or refuse to permit any overdraft protection transfer that would cause you to exceed the credit limit on this account, but if we permit it, you may be assessed an Overlimit Fee during the billing cycle in which the transfer occurs. This overdraft protection feature will automatically be cancelled if this account is closed by either you or us, or at any time upon your request. Your overdraft transactions remain subject to the terms of your checking account with Bank of America, any related enrollment agreement, and this Agreement.

We are adding the following to your Agreement section titled *Transaction Fee Finance Charge:*

Transaction Fee for Overdraft Protection: If you have enrolled this account to provide overdraft protection, we will assess a transaction fee (**FINANCE CHARGE**) equal to 3% of the U.S. dollar amount of each such overdraft transaction that posts to this account (Fee: Min. $10.00). The transaction fee for these overdraft protection transfers will be assessed in lieu of the Bank Cash Advance fee.

The definition of Bank Cash Advance is:

"Bank Cash Advance" means use of your account to obtain a loan at any financial institution (*e.g.*, to obtain cash, money orders, or travelers checks), including overdraft transactions if this account is eligible for and properly enrolled in an overdraft protection program, at any non-financial institution (to obtain cash), or for any payment you make to us that is returned to us unpaid for any reason, including the related finance charges.

IMPORTANT - CHANGES TO THE BENEFIT COVERAGE ON YOUR ACCOUNT - PLEASE READ

Effective June 1, 2007, some benefits associated with your account will change. To download a new benefit guide, which details the changes summarized below, please visit www.fiacardservices.com/visaaaa or to request a paper copy of the benefit guide, please call 1-866-783-8663.

Change To The Benefit Provider And Claims Process

The benefit administrator for all of the benefits associated with your credit card except Visa Auto Rental Collision Damage Waiver is changing to the Cardwell Agency. The change will result in modifications to the claims process and provider contact information.

Change To Common Carrier Travel Accident Insurance Coverage And Benefit Provider

There are changes to your Common Carrier Travel Accident Insurance Coverage. No change in the coverage levels will occur, except changes to the types of covered losses including elimination of Permanent Total Disability coverage and elimination of Exposure and Disappearance coverage. In addition, the benefit administrator is changing to the Cardwell Agency. The change will result in modifications to the claims process and provider contact information for this benefit. The current travel accident coverage will still apply to covered trips commencing before June 1, 2007 and will be processed through the current benefit provider as outlined in your current benefits guide.

EQUAL CREDIT OPPORTUNITY NOTICE

The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this bank is the Office of the Comptroller of the Currency, Customer Assistance Group, 1301 McKinney Street, Suite 3450, Houston, TX 77010-9050.

FIA Card Services, N.A., P.O. Box 15718, Wilmington, DE 19850. Please note that if you choose to correspond with us in writing, please provide your full account number and print your name.

SUMMARY OF S. 1395, STOP UNFAIR PRACTICES IN CREDIT CARDS ACT

The Stop Unfair Practices in Credit Cards Act, which is sponsored by Senators Levin, McCaskill, Leahy, Durbin, Bingaman, Cantwell, Whitehouse, Kohl, Brown, Kennedy, and Sanders and endorsed by consumer, labor, and small business groups, would do the following:

(1) **No Interest on Debt Paid on Time.** Prohibit interest charges on any portion of a credit card debt which the card holder paid on time during a grace period.

(2) **No Trailing Interest.** Prohibit added interest charges on credit card debt which the card holder paid on time and in full.

(3) **Limits on Penalty Interest.** Prohibit interest rate hikes on a credit card account unless the card holder agrees to them at the time, and, in any event, limit penalty interest rate hikes to no more than a 7 percentage point increase.

(4) **Apply Interest Rate Increases Only to Future Debt.** Require increased interest rates to apply only to future credit card debt, and not to debt incurred prior to the increase.

(5) **No Interest on Fees.** Prohibit the charging of interest on credit card transaction fees, such as late fees and over-the-limit fees.

(6) **Restrictions on Over-Limit Fees.** Prohibit the charging of repeated over-limit fees for a single instance of exceeding a credit card limit, and allow such fees to be charged only when a card holder's action, rather than a penalty, causes the limit to be exceeded.

(7) **Fixed Credit Limits.** Require that card issuers must offer consumers the option of operating under a fixed credit limit that cannot be exceeded.

(8) **No Pay-to-Pay Fees.** Prohibit charging a fee to allow a credit card holder to make a payment on a credit card debt, whether payment is by mail, telephone, electronic transfer, or otherwise.

(9) **Reasonable Currency Exchange Fees.** Require currency exchange fees to reasonably reflect the credit card issuer's actual costs.

(10) **Prompt and Fair Crediting of Card Holder Payments.** Require payments to be applied first to the credit card balance with the highest rate of interest, and to minimize finance charges. Prohibit late fees if the card issuer's actions caused the delay in crediting the payments.

(11) **Prime Rate Reference.** Require interest rates linked to a "prime rate" to use the prime rate published by the Federal Reserve Board.

(12) **Annual Audit.** Require the credit card issuer's primary regulator to perform annual audits to ensure compliance with credit card requirements and prohibitions.

(13) **Improved Data Collection.** Improve existing data collection efforts related to credit card interest rates, fees, and profits.

(14) **Transition Period.** Allow credit card issuers six months to implement the bill's provisions.

Testimony of Senator Carl Levin
EXHIBIT #7

Testimony of the

U.S. Public Interest Research Group

Edmund Mierzwinski
Consumer Program Director

Legislative Hearing On
HR 5244, the Credit Cardholders Bill of Rights

Before the Subcommittee
On Financial Institutions and Consumer Credit
Of the Financial Services Committee,
U.S. House of Representatives
Honorable Carolyn Maloney, Chair

17 April 2007

Chair Maloney, ranking member Biggert, members of the committee:

Thank you for the opportunity to offer U.S. PIRG's views in support of HR 5244, the Credit Cardholders Bill of Rights, sponsored by Chairwoman Maloney and by at least 94 other members. We commend you for having this timely hearing. I am Edmund Mierzwinski, Consumer Program Director of U.S. PIRG. As you know, U.S. PIRG serves as the federation of and national lobbying office for state Public Interest Research Groups. PIRGs are non-profit, non-partisan public interest advocacy organizations with offices around the country. We take on powerful interests on behalf of our members and other consumers.

(1) SUMMARY:

U.S. PIRG supports HR 5244, the Credit Cardholders Bill of Rights, as a good, measured first step and strong step forward to reforming the out-of-control, virtually lawless, credit card industry.

Owning a credit card company is truly a license to steal. The credit card industry, for years easily the most profitable form of banking according to Federal Reserve Board annual reports to Congress, has seen its profits grow to new heights on the wings of revenue derived from punitive APRs of 36% or more, imposition of late and over-the-limit fees of up to $39 issued on a repeat basis for purported violations that may not have been violations and from the cumulative effects of deceptive disclosures of the true cost of credit, especially in the case of minimum monthly payments. The failure to adequately disclose the cost of credit encourages the most at-risk members of the customer base to carry large unpaid balances at unaffordable interest rates and leaves them in a cycle of perpetual debt. Concentration of the industry has resulted in a tight oligopoly where the largest and most powerful players act with impunity. Once vigilant state enforcers have been de-fanged; private enforcement is hampered by unfair binding mandatory arbitration and federal agencies merely aid and abet bank practices, instead of regulating them. The credit card industry operates without fear of either market or regulatory action to temper its excesses, at the expense of the public's welfare.

HR 5244, the Credit Cardholders Bill of Rights, reins in the industry's most egregious practices.

- It bans retroactive imposition of punitive interest rate increases based on the notorious universal default or risk-based re-pricing schemes, where the increases are made despite a cardholder's perfect "paid as agreed" relationship with the company;
- It says "a deal is truly a deal, by prohibiting "any time for any reason, including no reason" contract term changes;
- It requires proportional allocation of consumer payments when their balance reflects different interest rates;
- It prohibits late fee due date "gotchas;"
- It imposes a variety of other "tell me first, don't trick me" disclosures, and bans arcane and unfair methods used to collect interest on already-paid balances.

While PIRG itself is not opposed to a reinstatement of usury ceilings, nor to limits on punitive fees, we note that the Credit Cardholder Holders Bill of Rights takes numerous steps to protect consumers without resorting to these reforms, so we are hope that when the bill is brought to markup, it garners widespread support, even from members who may philosophically oppose what some call price controls, although we disagree with that pejorative term. The bill reins in unfair practices, through tough disclosures and simple, but significant requirements to treat consumers fairly. All markets function better with rules, and the Credit Cardholders Bill of Rights simply imposes some reasonable rules.

We would expect that the industry witnesses will still oppose the bill and urge the committee to wait another year or more for the Federal Reserve's nearly final disclosure rules[1] that have been delayed even further by its laudable, but not worth waiting for, proposals to improve regulation of unfair and deceptive practices. Perhaps the industry will also engage in "don't hit us while we're down" rhetoric, either on the record or, more likely, in behind-the-scenes lobbying meetings. Losing money on bad hedge and derivative bets and, in some cases, predatory or even illegal practices in the mortgage business is no defense to treating credit card consumers unfairly.

Other major reforms that U.S. PIRG would urge to be included in the Credit Cardholders Bill of Rights and discussed below include the following:

- A ban on pre-dispute binding mandatory arbitration in consumer credit card contracts to allow consumers private enforcement rights to police the marketplace;
- Limits on granting credit cards to young people, based on their ability to repay, and limits on even making offers to young people, unless they first opt-in.

(2) PROFITS OF THE CREDIT CARD INDUSTRY

Credit card lending is the most profitable form of lending, according to the Federal Reserve's most recent report to Congress in 2007:

> Although profitability for the large credit card banks has risen and fallen over the years, credit card earnings have been consistently higher than returns on all commercial bank activities. For example, for all commercial banks, the average return on all assets, before taxes and extraordinary items, was 2.01 percent in 2006, well below the returns on credit card activities in that year.[2]

In recent years, those profits have been augmented by rapid increases in fee income.

There may be, as the industry witnesses will trumpet, some 6,000 credit card issuers. But there are only ten that matter. The actual marketplace is higbly concentrated.

Since 1980, revolving debt, which is largely credit card debt, increased from just $56 billion to well over $800 billion, according to recent Federal Reserve data.[3] Approximately 55% of consumers carry balances (the rest are convenience users) meaning consumers with credit card balances average $10-12,000 each in total credit card and revolving debt.[4]

Credit card companies have increased profit by increasing the amount of credit outstanding. The firms do this by decreasing cardholders' minimum monthly payments, increasing interest rates, and piling on enormous fees. Until very recently, credit card companies engaged in a practice of decreasing the minimum percentage of the balance that cardholders must pay in order to remain in good standing. Today, despite recent changes mandated by the OCC to require that minimum payments reduce principal by at least 1%, most companies still require a minimum monthly payment of only 2% or 3% of the outstanding balance. As a result, cardholders who choose to pay only the minimum each month take longer to pay off their balances, paying more interest in the process. In its recent guidance, the OCC admonished banks to raise these minimum payment levels only modestly. "The required minimum payment should be sufficient to cover finance charges and recurring fees and to amortize the principal balance over a reasonable period of time"[5] but OCC allows banks to reduce principal by as little as 1% per month. According to a U.S. PIRG analysis, a consumer carrying just $5,000 of debt at 16% APR would take 26 years to pay off the balance if she only made a 2% requested minimum payment, even if she cut the card up and never used it again.

And, according to the Fed, industry aggressively seeks new customers: "An industry source indicates that in 2004, 71 percent of US households received an average of 5.7 offers per month, or 58 offers/year.[6] During 2004, US households received an estimated 5.23 billion credit card offers, up 22% compared to 2003 and exceeding the previous record of 5.01 billion offers set in 2001.[7]" While some recent reports indicate these offers may be down due to the economic slump, it is likely that this is temporary and banks will restructure the offers and start making them again. Remember that offers are made both to people with positive credit attributes and to people with negative attributes. The offers are simply different.

(3) UNFAIR CREDIT CARD COMPANY PRACTICES

The most common unfair or deceptive credit card company practices include the following:

- Unfair and deceptive telephone and direct mail solicitation to existing credit card customers – ranging from misleading teaser rates to add-ons such as debt cancellation and debt suspension products, sometimes called "freeze protection," which are merely the old predatory product credit life, health, disability insurance products wrapped in a new weak regulatory structure to avoid pesky state insurance regulators[8];
- Increasingly, the use of unfair penalty interest rates ranging as high as 30-35% APR or more, including, under the widespread practice of "universal default," imposing such rates on consumers who allegedly miss even one payment to <u>any</u> other creditor, despite a perfect payment history to that credit card company;
- Card companies now impose multiple APRs – one for balance transfers, one for purchases and one for cash advances, for example – but apply monthly payments first to the balance with the lowest APR, ensuring that it will take the longest to pay off the card.
- Card companies take advantage of Truth In Lending Act loopholes that allow a variety of unfair methods of balance calculation (the so-called two-cycle and the "residual" (or "trailing") interest methods) that allow companies to reach back into previous cycles to collect interest on balances already paid off.
- Imposing those punitive penalty interest rates retroactively, that is on prior balances, further exacerbating the worsening levels of high-cost credit card debt;
- Imposing higher late payment fees, which are often levied in dubious circumstances, even when consumers mail payments 10-14 days in advance;
- Using a variety of mail trickery, such as changing the due dates of monthly bills, making the due date a Sunday but not posting on the weekend; shortening the period between when a bill is mailed out and when that bill is due, etc.;

- Increasing the use of aggressive and deceptive marketing to new customer segments, such as college students with neither a credit history nor an ability to repay and to persons with previous poor credit history;
- Making partnerships with telemarketers making deceptive pitches for over-priced freeze protection and credit life insurance, roadside assistance, book or travel clubs and other unnecessary card add-ons;
- Imposing unfair, pre-dispute mandatory arbitration[9] as a term in credit card contracts to prevent consumers from exercising their full rights in court; and the concomitant growing use of these arbitration clauses in unfair debt collection schemes;
- The failure of the industry to pass along the benefits of what, until recently, were several years of unprecedented the Federal Reserve Board interest rate cuts intended to provide economic stimulus, through the use of unfair floors in credit card contracts.
- Using the clause "Any term can be changed at any time for any reason, including no reason" in credit card contracts as allowed by Delaware and other safe harbor state laws.

The practices described above can be illustrated with the following examples:

- Banks entice consumers to open or continue credit card accounts with promises of a fixed interest rate on unpaid balances on purchases. Thereafter, they unilaterally increase the so-called fixed rate, and may change it to a variable rate.[10]
- Banks bait and switch credit card consumers with teaser offers promising a low introductory interest rate on additional credit card debt and the consumer's pre-existing (regular) interest rate thereafter. But after individual consumers accept the offer and increase their unpaid balance, banks unilaterally and without notice raise the consumer's regular interest rates because now, the individual consumer's debt is allegedly "too high."
- Banks ignore consumers' disputes to charges, which, according to banks themselves, need not be paid pending resolution. Instead, banks unilaterally use such non-payment to charge late fees and raise interest rates.
- Banks reduce credit limits of consumers on their credit card accounts unilaterally and without advance notice, and do so in such manner and to such an extent as to intimidate consumers into abandoning their legitimate objection to charges.
- Banks fail to adequately inform consumers in advance of a proposed increase in interest rate based on the individual consumer's purportedly high debt or other information in such consumer's credit report. Thereby, consumers have no opportunity to avoid the increased interest rate, and are saddled with significant additional interest payments without advance notice.
- Credit card companies use low, short-term "teaser rate" introductory APRs to mask higher regular APRs. The introductory APR is one of the primary tools used to market a card, and it usually appears in large print on the offer and envelope. In a PIRG study, of the 100 card offers surveyed, 57 advertised a low average introductory APR of 4.13%. Within an average of 6.8 months, the regular APR shot up 264% to an average regular APR of 15.04%. The post-introductory APR, as well as the length of the introductory period, were not prominently disclosed.
- Important information is disclosed only in the fine print of the offer. For example, the fine print of most offers states that if an applicant does not qualify for the offered card, s/he will receive a lower-grade card, which usually has a higher APR and punitive fees (a practice

called "bait and switch"). The fine print is easy to overlook, and as a result, a consumer may receive a card that s/he did not want.

- Free does not mean free. The "free" offers that are advertised with many cards are not usually as impressive as they appear. Most have significant restrictions or hidden costs, such as enrollment fees or expiration dates.
- Fine print fees for cash advances, balance transfers, and quasi–cash transactions such as the purchase of lottery tickets significantly raise the cost of these transactions. But the terms governing these transactions are buried in the fine print, where consumers can easily miss them. Minimum fees, also stated only in the fine print, allow credit card companies to guarantee themselves high fee income regardless of the transaction amount.

(4) DISCUSSION OF KEY ELEMENTS OF THE CREDIT CARDHOLDERS BILL OF RIGHTS, HR 5244

A. IT ELIMINATES THE MOST ONEROUS CREDIT CARD TERMS SO CONSUMERS CAN REPAY

1. No Retroactive Interest Increases After Universal Default

Consumer advocates remain unconvinced that universal default or "risk-based re-pricing" schemes – based on factors external to a cardholder's "paid-as-agreed" relationship – are truly based on risk modeling. We have also seen no data to prove that the practice is implemented fairly. As one example, picture this: when consumers apply for credit cards, their applications and credit scores are reviewed and they are placed in one of numerous pricing "buckets" based on their risk. You may get a 10% APR "gold" card with a $10,000 available credit limit. I may get an 18% APR "classic" card with a $500 limit. Our neighbors and friends and colleagues may get any of 7 or 8 different combinations in between, depending on their risk.

Yet, some banks will use either one alleged late payment to another creditor or a minor drop in a credit score, to raise any or all of us – whether we are paying a preferred rate of 0% APR or 10% APR, or a not-so-good rate of 18% APR – immediately to a punitive rate of 31-36% APR or more. This increase is applied not only to our prospective purchases, but retroactively to our current balance.

This is not a proportional response:

- Why isn't a first offense subject only to a penalty fee?
- Why doesn't a second offense result in an incremental increase (for example, of 5%), so the person at 10% APR goes to 15% APR, and the person at 18% APR goes to 23% APR?
- Why does everyone's risk go immediately to the same punitive level (31% - 39% APR or more) even though they were each previously at different risk levels, solely on the basis of one (or two) dings, or even on the basis of a decline in credit score, which could occur with no dings?

Simply, universal default in our view is not based on risk. No data have been provided to the Congress to justify it on the basis of risk modeling. It is more likely that banks use universal default to increase revenue because they can, rather than because it is a justifiable, proportional risk-based response.

Worse, by applying universal default retroactively to an existing balance, it actually increases a consumer's risk of non-payment.

To illustrate: a consumer who has a $10,000 credit card balance at 12% APR owes a monthly minimum payment (if he/she owes no penalty fees) of $200, but would owe $400 each month at 36% APR (under the OCC minimum payment requirements) with the additional $200 going to increased interest penalty, not reduction of principal.[11] Paying twice as much each month (in this case) makes it harder to pay off a balance, not easier. Of course, paying as much as you can afford (twice the minimum payment or more) does result in a more rapid reduction of your balance.

Finally, by imposing punitive interest rate changes retroactively, the credit card industry is allowed to change the prices of products consumers have already bought.

For these reasons, we would support a total ban on universal default or risk-based re-pricing. But again, your moderate bill does not go this far. While your bill would not prohibit this wrong-headed result in all circumstances, it prohibits it only in the most unfair circumstance. We support your moderate approach—allowing the new interest rate for future purchases, but banning imposition of punitive rates retroactively, whenever that new punitive rate is based on alleged conduct not related to the card's use.

2. It Eliminates Any-Time Any-Reason Changes in Terms

The outrageous rule that credit card companies have operated under for too long is that they can impose a "take it or leave it" contract of adhesion on consumers that allows one side, their side, to change the rules at any time, for any reason, including no reason. While Citibank has "voluntarily" reversed this policy, and even run ads in Capitol Hill tabloids saying that "a deal is a deal," we do not believe that the credit card marketplace operates in a free and open fashion, so the Congress should adopt this rule as statute, in case Citi changes its mind, and to force other banks to be fair.

3. It Provides Advance Notice of Credit Card Account Rate Increases and Right To Cancel Account

Consumers deserve better notice, as even the Fed's proposals when implemented presumably will provide, but they also need rights. Your bill gives 45 days notice of interest rate increases, as the Fed would provide, but also grants the right to cancel the card and pay it off under the old terms.

B. IT REQUIRES PRO RATA PAYMENT ALLOCATIONS

Importantly, the bill requires that when consumers have a balance subject to multiple interest rates, that his or her payments be allocated proportionately. Currently, on all but a few proprietary label cards, it is standard industry practice to allocate partial payments of an unpaid balance to the portion of the balance with the lowest available interest, often a 0% APR balance transfer. Meanwhile, interest on high-cost cash advances (when you use a "convenience" check provided by the card company, you are taking out a cash advance) piles up.

At a hearing last summer, full committee ranking member Spencer Bachus explained the problem best:

> [In an opening statement] … "I have constituents who come to me, like a young man … [who] was paying his credit card on time. He realized it was the last day to pay his mortgage payment, so he called his mortgage company up, and they said, ''Well, you can use your credit card,'' so he said, ''Great.'' He used his credit card. When his credit card bill came in, he noticed that not 8.5 percent interest was charged on that, but 24.9 percent interest on the mortgage payment. So, he said, ''Oh, my gosh,'' you know, so he called his credit card company, and he said, ''I want to pay that off today, I am going to send you a check,'' so they said, ''Okay.'' He sent that check in, plus his minimum payment for the month, and they applied it to his lowest balance. Now, here is a young man who would have never come into my office; he probably didn't have time. He saw me in a restaurant, and he came up to me and he basically said, ''Congressman, I don't think that's right.'' And, quite frankly, I don't, either. .." [And responding to Federal Reserve Governor Mishkin] "Now, it would obviously be always unfavorable to the consumer to target that to the balance where there is either no interest rate, or where there is a low interest rate instead of the high interest rate. That is never going to be anything but unfavorable to the consumer, or unfair."[12]

The bill also commendably restricts certain other unfair interest practices, such as taking advantage of archaic Truth In Lending Act loopholes to charge interest on balances already paid through either the "double-cycle-billing method" or the "trailing" (or residual") interest method. Both these methods inappropriately allow companies to reach back to previous periods in calculation of average balances for the purpose of determining interest owed.

C. <u>IT SAYS: NO MORE LATE FEE "GOTCHAS" THROUGH DUE DATE CHICANERY</u>

The Credit Cardholders Bill of Rights takes several steps to make sure that payments sent on time are recorded on time, so consumers can avoid unfair late fees and concomitant, double-whammy increases to a punitive penalty interest rate. Most importantly, the bill establishes a presumption that payments mailed 7 days in advance are timely. It also eliminates the practice of claiming that bills that arrive after "1pm" or "noon" can be considered late by making payments received before 5PM Eastern Standard Time timely. It extends the current minimum period for mailing bills to consumers from the current 14 days to 25 days before the due date. Finally, it requires that phone or Internet payments be considered timely if made on the due date before 5PM Eastern Standard Time.

We would support additional amendments to these laudable provisions. First, there should be no "pay to pay" fees for paying over the phone or on the Internet. Second, we would support changing the 5PM EST time to midnight Pacific Time.

Finally, we support additional prohibitions on "jumping due dates" and making bills payable on weekends or holidays. According to a recent news story "Floating Due Date Snags Chase, Citibank Customers:" [13]

Consumers complain that Chase and Citibank are routinely changing the due dates on their statements from month to month, often making customers with automatic payments late, thereby saddling them with late fees and higher interest rates. "(Citibank) moved my due date to cause me to be late and give them the ability to charge a late fee and move my rate from 3.99% (for the life of the balance) to 24.44%," wrote Jeff of Noblesville, Ind. "I have always paid electronically on the 24th. ... It sent my monthly bill for Citibank from $211 to $495."

D. OTHER POSITIVE PROVISIONS OF THE CREDIT CARDHOLDERS BILL OF RIGHTS

The bill also includes other provisions we have long supported.

- It limits over-the-limit fees.
- It bans misleading use of the terms "fixed" or "prime."
- It gives consumers the right to reject cards without having their credit record damaged.
- It allows cardholders to set limits on available credit.
- It requires greater oversight of the industry by improving data collection.

In addition to these provisions, the bill includes a provision which attempts to rein in sub-prime "fee-harvester" credit cards, which have a business model that relies only on squeezing vulnerable consumers for fees and never allowing them access to the promised credit. We support the intent of the provision but would like to work with the committee to ensure that the provision achieves its intent without unintended consequences.

(5) LACKING STATE OR FEDERAL ENFORCERS, OR CONSUMER RIGHTS, THE CHANGES IN THE CREDIT CARDHOLDERS BILL OF RIGHTS ARE CRUCIAL TO POLICING THE MARKETPLACE

In previous testimony before the committee, I have pointed out in detail that the wrong-headed state preemption doctrine accepted by the Congress, the courts and the federal regulators has eliminated the ability of states to enact better laws and state attorneys general to enforce the law. Without states coming up with new legislative ideas, and without state attorneys general – the best consumer cops on the beat – we are left to the permissive, lax supervision of the federal regulators. Leaving consumer protection to the chief national bank regulator, the OCC, or Office of the Comptroller of the Currency, is as if we have no consumer protection at all. Waiting for the Federal Reserve Board to issue modest rules largely based on disclosure is unacceptable.

Worse, the OCC, the other regulators and the Congress have allowed banks to impose pre-dispute binding mandatory arbitration as a condition of credit card contracts, which has virtually eliminated private enforcement against unfair credit card company practices.

Absent legislation to eliminate state preemption and mandatory arbitration, two reforms which we would enthusiastically support, the need for the Credit Cardholders Bill of Rights is even more apparent. Here is why we need these two additional reforms.

A. THE FAILURES OF THE OCC CALL FOR REINSTATEMENT OF STATE ATTORNEY GENERAL AUTHORITY, AT A MINIMUM

The failures of the OCC to protect consumers have been well-documented before this committee. OCC has not taken a public enforcement action against a large credit card issuer since 2000, and in that case, it was shamed into acting against an albeit large, but relatively upstart mono-line[14] credit card bank, Providian (now part of Washington Mutual (WAMU)) only after the tiny San Francisco District Attorney and the California Attorney General initiated earlier and widely-praised enforcement actions. A number of states aggressively took action against credit card companies in this time frame as well. Yet, most if not all of these state and local actions would generally be prohibited now, after promulgation of the 2004 OCC preemption rules.

In 2006, as in previous years, 39% of OCC's complaints were against credit card banks, according to the GAO.[15] Yet, while even the GAO explains that the large number of credit card complaints to OCC versus to other regulators is because it supervises so many large banks, to our knowledge, the OCC has not imposed public penalties or sanctions on any of the "Top Ten" banks under its regulation even though most advocates believe the sharp practices are endemic to the industry, including its largest players. Further, Professor Art Wilmarth has testified before this subcommittee in concordance with these views: "The OCC's record is similarly undistinguished with respect to consumer enforcement actions taken against national banks for violations of consumer protection laws." [16]

We would urge the committee to rescind OCC-passed rules eliminating state Attorney General authority over national banks and preempting state laws. Further, we urge the committee to reverse the Marquette and Smiley decisions that enable the exportation of interest rates and fees from bank "safe harbor" states.

Although states had until recently aggressively sought to enforce unfair and deceptive practices laws against credit card companies, the states have been limited in their enforcement by the growing use of preemption theory to restrict their regulation of the industry. In 1978, in Marquette,[17] the Supreme Court held that states could export nationally the interest rates of the bank's home state, prompting a concentration of the industry in a few bank-friendly states, including Delaware and South Dakota. In 1996, the court in Smiley[18] extended the Marquette holding by defining late fees as "interest," for the purpose of allowing a bank's home state late fees rules to similarly be exported nationally.

These onerous decisions applied to the regulation of interest. In 2002, a U.S. District Court used National Bank Act preemption theory, backed by the OCC, to overturn an important new California law requiring a monthly minimum payment warning, further restricting the states.[19] Then, of course, in 2004, the OCC imposed two onerous administrative rules restricting states from enactment or enforcement against national banks and their state-licensed operating subsidiaries[20] which has resulted in further court decisions upholding the rules.

These decisions and actions have aided and abetted the anti-consumer practices of this industry and deserve careful scrutiny by the committee. We remain disappointed that, at a minimum, the committee has not reined in the over-reaching OCC rules, although it did in 2004 condemn the OCC[21] when it passed a bipartisan budget resolution[22] on a vote of 34-28, stating that the OCC action "may represent an unprecedented expansion of Federal preemption authority" and "comes without congressional authorization, and without a corresponding increase in budget resources for the agency." The committee also pointed out that without a budget increase, the OCC cannot really expect its modest staff of forty consumer-complaint specialists to both continue their own work and also take over much of the work of an estimated 700 state consumer enforcers and examiners. "In the area of abusive mortgage lending practices alone, State bank supervisory agencies initiated 20,332 investigations in 2003 in response to consumer complaints, which resulted in 4,035 enforcement actions."

B. **MANDATORY PRE-DISPUTE ARBITRATION CLAUSES IN CREDIT CARD CONTRACTS DETER PRIVATE ENFORCEMENT AGAINST SHARP PRACTICES.**

The Congress has enacted legislation protecting car dealers from unfair arbitration clauses in their contracts with car manufacturers. The Senate has in the past passed (and is now considering again) legislation similarly protecting farmers from arbitration in their contracts with powerful agri-business concerns. Legislation protecting consumers in nursing homes is under consideration, It is time to enact similar legislation to protect consumers in credit card contracts, as well as other contracts.

Studies have shown that arbitration programs essentially run as collection mills on behalf of credit card companies and hospitals, among others, not the vaunted low-cost alternatives to court proceedings their marketing purports them to be. Further, imposing the arbitration requirement as a condition of obtaining a card is simply unfair. Finally, companies are allowed to persist in unfair practices because they have achieved an enforcement trifecta—no consumer enforcement of the law allowed, no state attorney general enforcement of the law allowed, and a cozy relationship with their so-called federal regulators means no enforcement happens at all.

Congress Should Ban Mandatory Arbitration In Consumer Contracts: Rep. Gutierrez has introduced HR 1443, the Consumer Fairness Act, to ban mandatory pre-dispute arbitration in consumer contracts. Rep. Hank Johnson has introduced HR 3010, the Arbitration Fairness Act, which bans arbitration in consumer and other contracts (small farmers, franchisors). These bill deserve support and consideration as amendments to HR 5244.

Congress Should Ban The Use of Arbitration in Debt Collection Schemes: Arbitration agreements are not only being used in attempts to prevent consumers victimized by deceptive advertising and interest rate practices to have their day in court. Increasingly, according to a recent report by the National Consumer Law Center, major credit card companies are partnering with arbitration firms to establish debt collection mills that force consumers into paying debts, including debts they may not even owe:

> Now, at least two giant credit-card issuers and one of the nation's largest firms arbitrating their consumer disputes have combined these practices in a disturbing new way: They're using binding, mandatory arbitration primarily as an offensive weapon, by fast-tracking disputes over credit-card debt into rapid arbitration. A number of consumers charge that the banks often do this with little notice, after long periods of dormancy for the alleged debt or over consumers' specific objections -- then force those who don't respond swiftly or adequately into default. The arbitrator often forces the consumer to also pay for the hefty arbitration costs and the card issuer's attorney, making the total tab for consumers several times the original amount owed and many times what it would have been in more

> traditional debt settlements. So it's a neat pathway to turbo-charged profits for both the card issuer and the arbitrator.[23]

A more recent study by Public Citizen[24] found that MBNA (now known as FIA Card Services and part of Bank of America) allegedly used the National Arbitration Forum to collect disputed debts from consumers, including debts not even owed-- from identity theft victims who never had accounts with the bank. As the Wall Street Journal reported last week, the City of San Francisco has sued NAF and FIA Card Services:

> The suit alleges that in specific cases NAF approved an inflated award, improperly imposed attorneys fees and didn't respond to a consumer's request to appear at an arbitration, among other things...From 2003 through March 31, 2007, 18,075 consumers' arbitrations in California were resolved through hearings conducted by the NAF, according to the suit, citing data reported by the NAF. Thirty of the matters, or fewer than 0.2%, were won by consumers.[25]

(6) ABUSIVE CREDIT CARD INDUSTRY PRACTICES EXTENDING ONTO CAMPUS AND TO NEW CUSTOMER POPULATIONS

How do banks increase their already massive credit card profits? As has been widely reported and is the subject of these Congressional inquiries, first, banks can squeeze their existing customers for greater profits in several ways, including the following:

(1) using a variety of rewards and tricks such as encouraging extremely low minimum payments to maintain highly-profitable high revolving card balances;
(2) raising interest rates on those balances through a variety of traps including imposition of penalty interest rates for late payments and changing due dates to encourage more of those late payments;
(3) using misleading teaser rates and,
(4) raising the rates of otherwise good customers by claiming that their credit score had declined or that they were late to another lender (called "universal default")

Further, banks can market to customers of other credit card companies, urging them to switch by offering low teaser rates on balance transfers and other incentives. But this marketing is expensive both because of the cost of the zero-interest offers and the cost of sending out the billions of solicitations.

Finally, having saturated the working adult population with credit card offers, credit card companies are now banking on new markets: college students and others who have never had, or had only limited access to, credit cards, including recent immigrant populations.[26]

According to a March, 2008 PIRG Report, the Campus Credit Card Trap[27], college students are among the most prominent targets for this marketing. They are young and understand that they need credit to get ahead in the world. Some need credit because of the rising cost of a college education. Finally, most of them are clumped together on campuses that they either commute to or live at. This makes them easy to target. Companies use a variety of techniques, from buying lists from schools and entering into exclusive marketing arrangements with schools to marketing directly to students through the mail, over the phone, on bulletin boards and through aggressive on-campus and "near-campus" tabling-- facilitated by "free gifts."[28]

College students, under regular credit criteria, would not be able to get a card because they have no credit history and little or no income. But the market for young people is valuable, as industry research shows that young consumers remain loyal to their first cards as they grow older. Credit card marketing, coupled with students' lack of financial experience or education, leads many students into serious debt. According to another recent PIRG study, the Burden of Borrowing, credit card debt exacerbates skyrocketing student loan debts. That 2002 study found that thirty-nine percent (39%) of student borrowers now graduate with unmanageable levels of debt, meaning that their monthly payments are more than 8% of their monthly incomes. The study also found that student borrowers were student borrowers were even more likely to carry credit card debt, with 48% of borrowers carrying an average credit card balance of \$3,176.[29]

The 2008 PIRG study of campus credit card marketing found that students support a variety of reforms: We asked students their views on whether colleges and universities should regulate the practices of credit card companies on campus. The results show that students overwhelmingly support stricter regulation of campus credit card marketing. Four out of five (80%) students supported adoption of strong campus credit card marketing principles. Only 1 in 5 students replied yes to the proposition that students could handle credit card marketing without regulation. Some of these also supported some of the reform principles anyway. Of those who supported one or more strong principles, nearly three-in-four students (74%) asserted that only cards with fair terms and conditions should be marketed on campus. Students also overwhelmingly (67%) opposed the sale or sharing of student lists (which can include home and dorm addresses, email addresses and land line and cell phone numbers) with credit card companies.

While some of these reforms may more appropriately be considered on campus, this committee should consider amendments to restrict marketing to youth in the following ways:

Ban giving credit cards to young people who cannot demonstrate an ability to re-pay. Bank witnesses and spokespeople have largely admitted that even though young applicants do not have adequate credit reports to qualify for cards, their mere "status as students" is an adequate criterion for approving a card. This is unacceptable. Banks should underwrite credit cards for students and young people, just as they do for all other applicants. It may be appropriate to substitute completion of an approved, legitimate financial literacy class as an alternate criterion. It may also be appropriate to restrict the credit card limits and maximum number of cards available to young people. A variety of bills make proposals in this area and we would be happy to work with the committee and student groups on the best amendment.

Ban Marketing Cards To Young Consumers Unless They Opt-In To Receive Solicitations. A broad credit card reform proposal, S 2753, the Credit Card Reform Act, by Senator Robert Menendez includes this laudable provision. In the 2008 PIRG study, 8 of 10 students reported receiving mailed offers from credit card companies.

(7) CONCLUSION

We thank you for holding this important oversight hearing. We have attempted to describe a failed enforcement climate that has led to a pattern of sharp industry practices. We hope that we have provided you with adequate information to support the need for action by the Congress to rein in the credit card industry's most unfair and abusive practices. We believe that your bill, HR 5244, the Credit Cardholders Bill of Rights, is a careful, measured response to the problem. It could be strengthened with the additional amendments we suggest, but, as is, it is deserving of widespread support and not deserving of untoward and shrill industry opposition. We look forward to working with the Committee to advance this bill.

ENDNOTES

[1] See Comments of National Consumer Law Center, U.S. PIRG, Consumer Federation of America et al "Regarding Advance Notice of Proposed Rulemaking: Review of the Open-End (Revolving) Credit Rules of Regulation Z," Federal Reserve System, 12 CFR Part 226, Docket No. R-1217 available at http://www.consumerlaw.org/initiatives/test_and_comm/content/open_end_final.pdf The consumer group comments provide a window on the way that the industry exploits loopholes and inconsistencies in the act to hurt and exploit consumers. The TILA was supposed to be a remedial act, a law written to prevent unfair practices, and has often been correctly interpreted that way in the courts, yet the regulators have insisted on allowing the industry to carve out nooks and crannies that allow it avoid the spirit of the law. The proposals augment and update the disclosures in the important 1988 disclosure legislation that established what is known as the "Schumer" box, which requires credit card company solicitations to clearly and prominently disclose all fee and interest related "trigger terms." The proposed rules have been delayed, following recent testimony by Board Chairman Ben Bernanke that additional proposals on unfair and deceptive practices would augment the disclosure proposal.

[2] Report to the Congress on the Profitability of Credit Card Operations of Depository Institutions
Submitted to the Congress pursuant to section 8 of the Fair Credit and Charge Card Disclosure Act of 1988
July 2007, available at http://www.federalreserve.gov/boarddocs/rptcongress/creditcard/2007/default.htm, last visited 16 April 2007.

[3] The February 2008 Fed data estimate consumers have $952 billion in revolving debt. This figure must be deflated to account for non-credit card debt and for a share of debt that is paid off on a timely, monthly basis, so we use "over $800 billion." See G19 Consumer Credit release 7 April 2008 available at http://www.federalreserve.gov/releases/g19/current/default.htm

[4] The banks frequently cite a Federal Reserve analysis of University of Michigan Survey of Consumer Finances polling data to allege that only 45% of consumers carry a balance. Consumer group contacts with industry sources indicate that these numbers are low. If true, of course, average balances would be even higher. Consumer groups use a conservative figure of 55% carrying balances, with some sources putting the number as high as high as 60% or more. For a discussion of our analysis of credit card debt, see the state PIRG report "Deflate Your Rate," March 2002, available at http://www.truthaboutcredit.org

[5] OCC Advisory Letter AL 2004-4, April 28, 2004, available at http://www.occ.treas.gov/ftp/advisory/2004-4.txt

[6] Report to the Congress on the Profitability of Credit Card Operations of Depository Institutions
Submitted to the Congress pursuant to section 8 of the Fair Credit and Charge Card Disclosure Act of 1988
July 2007, available at http://www.federalreserve.gov/boarddocs/rptcongress/creditcard/2007/default.htm, last visited 16 April 2007.

[7] According to Mail Monitor, the direct mail tracking service from Synovate.

[8] See an Office of the Comptroller of the Currency (OCC) regulatory interpretative letter endorsing debt cancellation and debts suspension products at http://www.occ.treas.gov/interp/jan01/int903.doc

[9] The consumer organizations testifying today, U.S. PIRG and the Center for Responsible Lending, and many others, including the Consumer Federation of America and Consumer Action, are all members of a broad new campaign to educate the public and the Congress about the need to eliminate one-sided binding mandatory arbitration (BMA) clauses in consumer contracts. See http://www.givemebackmyrights.org/

[10] It is the bank position that the Truth In Lending Act allows them to change fixed rates with as little as fifteen days notice and that a fixed rate is merely a rate that is not variable. A variable rate is defined as one tied to an index, such as the Wall Street Journal prime rate as disclosed on a certain date.

[11] The OCC requires that minimum payments reduce principal by 1% (1% of $10,000 is $100) and pay current interest (and fees). For an annual interest rate (APR) of 12%, the monthly or periodic rate is 1% (12% X 1/12) or $100, resulting in a minimum payment of $200 ($100 + $100). At 36% APR, the monthly periodic rate is 3% (36% x 1/12) or $300, resulting in a minimum payment of $400 ($100 + $300).

[12] Remarks of Rep. Spencer Bachus (AL), transcript of hearing of the Subcommittee on Financial Institutions and Consumer Credit, 7 June 2007.

[13] "Floating Due Date Snags Chase, Citibank Customers," by Joseph Enoch, ConsumerAffairs.Com, 14 March 2008, available at http://www.consumeraffairs.com/news04/2008/03/floating_due_dates.html, last visited 15 April 2008.

[14] Primarily a credit card bank, as opposed to a multi-faceted bank with a variety of products.

[15] See OCC Consumer Assistance: Process Is Similar To That of Other Regulators But Could Be Improved by Enhanced Outreach, at page 23, U.S. Government Accountability Office, February 2006, available at http://www.gao.gov/new.items/d06293.pdf

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[16] See testimony of Professor Art Wilmarth, 26 April 2007, before Financial Institutions and Consumer Credit Subcommittee, available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/htwilmarth042607.pdf

[17] In 1978, the Supreme Court in Marquette vs. First Omaha Service Corp invalidated state usury laws as they apply to national banks. Marquette held that under Section 85 of the National Bank Act (NBA) of 1863 national banks could export to any of their customers, no matter where they lived, the highest interest rate allowed in the bank's home state, now usually Delaware, Virginia, Nevada or South Dakota. See Marquette Nat. Bank. V. First of Omaha Services, 439 US 299 (1978).

[18] In Smiley, the Supreme Court extended Marquette to allow exportation of a home state's fees. The court paid deference to a new OCC rule that added a wide range of fees to the definition of interest under Section 85 of the National Bank Act, including late fees, over limit fees, annual fees, and cash advance fees. See Smiley v. Citibank (South Dakota). 517 US 735 (1996)

[19] Since the federal Truth In Lending was non-preemptive with respect to certain account statement disclosures, California enacted legislation (Civil Code Section 1748.13) requiring that monthly credit card statements disclose information about how long it would take to pay off a card if you only made the minimum requested monthly payment. Federal law did not then require this, although a similar, weaker provision is included in the Bankruptcy law recently signed (Public Law 109-8). The law was overturned on summary judgment in American Bankers Association v. Lockyer, 239 F. Supp. 2d 1000, 1009 (E.D. Cal. 2002).

[20] See the PIRG OCCWatch website for detailed information on the OCC's anti-consumer actions, including links to its rules, http://www.pirg.org/occwatch Also see "Preemption Of State Consumer Laws: Federal Interference Is A Market Failure," by U.S. PIRG's Edmund Mierzwinski, which appeared in the Spring 2004 (Vol. 6, No. 1, pgs. 6-12) issue of the Government, Law and Policy Journal of the New York State Bar Association. The article includes a major section on the OCC rules, available at http://www.pirg.org/consumer/pdfs/mierzwinskiarticlefinalnysba.pdf

[21] News story on committee vote available here: http://www.housingchoice.org/news%20stories/2004/02272004.htm

[22] See Comm. On Fin. Serv., 108th Cong., Views And Estimates Of The Committee On Financial Services On Matters To Be Set Forth In The Concurrent Resolution On The Budget For Fiscal Year 2005, At 15–16 (Comm. Print 2004).

[23] See 17 February 2005, "New Trap Door for Consumers: Card Issuers Use Rubber-Stamp Arbitration to Rush Debts Into Default Judgments," National Consumer Law Center, available at http://www.consumerlaw.org/issues/model/content/ArbitrationNAF.pdf

[24] The Arbitration Trap: How Credit Cards Companies Ensnare Consumers, 27 September 2007, Public Citizen, available at http://www.citizen.org/publications/release.cfm?ID=7545 last visited 16 April 2007.

[25] San Francisco Sues Provider of Arbitrators, by Nathan Koppel, the Wall Street Journal, 7 April 2008, page A3.

[26] See, for example, "Eliminating Barriers to Credit and the Challenges of Credit Card Use for Latino Consumers," testimony to the Senate Banking Committee summarizing a recent report by the National Council of La Raza, by Beatriz Ibarra, 1 February 2007, available at http://www.nclr.org/content/publications/detail/44284/ The report details a variety of challenges Latino credit card consumers face, including greater vulnerability to scams, reliance on higher-priced cards and difficulty working with the OCC's "obscure consumer complaint system."

[27] See "The Campus Credit Card Trap, March 2008, by Edmund Mierzwinski and Christine Lindstrom, U.S. PIRG, available at http://www.truthaboutcrdit.org .

[28] Recently, Ohio Attorney General Marc Dann sued Citibank and Potbelly Sandwich Works because a "free" sandwich was conditioned on first filling out a credit card application. General Dann has settled with the sandwich store, but not with Citubank. News release, 10 March, 2008, "Attorney General Announces Agreement with Potbelly," Office of Ohio Attorney General Marc Dann.

[29] See "The Burden of Borrowing," the State PIRGs' Higher Education Project, March 2002, available at http://www.pirg.org/highered/highered.asp?id2=7972

Statement of

Carlos Minetti

Executive Vice President,

Cardmember Services and Consumer Banking

of

Discover Financial Services

before the

Subcommittee on Financial Institutions and Consumer Credit

Committee on Financial Services

United States House of Representatives

April 17, 2007

Discover Financial Services[1] appreciates the opportunity to comment on H.R. 5244.

When Discover® Card was launched a little over 20 years ago, it was a unique credit card, introducing features that changed the marketplace. Unlike other cards then available, Discover charged no annual fee. Discover pioneered credit card reward programs with the groundbreaking Cashback Bonus® award that allows customers to receive up to 1% of their purchases back as a cash reward. (This feature today returns

1. Discover Financial Services is a leading credit card issuer and electronic payment services company with one of the most recognized brands in U.S. financial services. The company operates the Discover® Card, America's cash rewards pioneer, with more than 50 million Cardmembers, and is one of the largest card issuers in the U.S. Its Third-Party Payments business consists of the Discover Network, with millions of merchant and cash access locations, and PULSE, one of the nation's leading ATM/debit networks. Discover recently announced an agreement to acquire Diner's Club, International.

more than $700 million to Cardmembers annually - more than $7 billion since 1986). Discover also introduced a level of service that was unknown at the time in the industry: "24/7" toll-free service lines, staffed with knowledgeable representatives empowered to respond rapidly to Cardmembers' needs.

We still offer these features, and continue to build on them. For example, last year we introduced the Discover Motiva Card, which was recently named the "Best New Card Product" of 2007 by a leading industry publication. Motiva was another industry first, providing interest rebates to consumers who pay their bills on time. Cardmembers who make six consecutive on-time payments earn a Cashback Bonus award equal to the amount of the finance charges shown on their next monthly statement. This encourages payment behavior that avoids late fees and interest rate increases while also lowering the balance owed on the account.

We continue to work with our customers to understand what they value, and then strive to create products and services that meet their needs. There are some things we don't do:

- We don't target subprime borrowers or offer a Discover® Card to everyone who applies. We turn down more applicants than we approve.

- We don't outsource loan origination or loan servicing: every Discover® Card we issue is underwritten by us and serviced by Discover.

- We view the customer relationship as a long-term arrangement - and so do our Cardmembers. Less than 5% of Discover customers close their accounts each year, a very low attrition rate in the credit card industry. In fact, Discover has ranked number one in the industry for customer loyalty for 11 years in a row. [2]

- We don't outsource customer service: every service call is made or answered in-house by a Discover employee in one of our service facilities across the United States. Last year our Cardmember Services representatives spoke with Discover Cardmembers more than 30 million times. These interactions allow us to understand what's on our Cardmembers' minds and how they expect to be treated, and to adjust our products and services accordingly.

Discover helps our Cardmembers manage their accounts with user-friendly features (like free online and telephone payments and balance paydown calculators), clear disclosures and statements and understandable information. We reach out proactively to Cardmembers who appear to be having difficulties. Each month we contact tens of thousands customers whose accounts are not past due or over limit, but appear to show signs of financial stress, to offer assistance through customized account management programs.

[2] Brand Keys Customer Loyalty Engagement Index, 1997-2008. Discover also was ranked "Best in Class" for customer loyalty in Gallup's 2006 and 2007 surveys.

This is working:

- The percentage of Discover Cardmembers whose payments are delinquent has declined by 40% over the past five years. Even in the current economic climate, payment defaults are near historic lows.

- Our Cardmembers' late fees and over limit fees have declined very substantially over the last five years.

- We allow Cardmembers to pick a payment date that is most convenient for them, and we do not move that date.

- We provide an additional day, after the stated payment due date, to ensure that payments we receive are promptly credited and late fees are not charged.

- A very small percentage of Discover Cardmembers pay interest rates at the maximum interest rate. Three out of four Discover accounts received a *reduction* in interest rates over the past year.

With millions of Cardmembers, it is not possible to please everyone, but we think we do a good job responding to Cardmembers' expectations. In last year's JDPower & Associates customer satisfaction survey, Discover was the only credit card that ranked first or second in every category studied. Survey respondents said that Discover had the lowest incidence of problems among the 10 largest issuers, ranked us highly for problem resolution, and second for "fees and rates."

Impact of H.R. 5244

We welcome this Subcommittee's focus on credit card practices, and support the goal of improving credit card services and practices. We appreciate the opportunity that we have been afforded to provide input to the Subcommittee in the development of this legislation, and are pleased that the bill as introduced included changes that reflect some of our comments.

As Subcommittee members appreciate, credit cards have become a vital tool for American consumers, many of whom use them to pay for needs until the next paycheck arrives, often without paying interest. Credit cards are being used for an ever-increasing number of services, and help consumers manage their household budgets and avoid extra expenses. For example, a growing number of consumers pay recurring bills, like utility bills and Internet service fees, via credit card to avoid mailing costs, service disruptions and late fees imposed by the service companies. The growing reliance on credit cards by consumers makes it all the more important that legislation changing the regulation of cards be carefully crafted to avoid unintended consequences such as reducing competition, increasing consumer costs or curtailing credit availability

A number of the requirements of H.R. 5244 are consistent with our current practices, or could be implemented without significant change. Still, we think some of the bill's key provisions are unnecessary or counterproductive. Most of the industry practices covered by the bill are being addressed by changes made by Discover and others in the marketplace. Other practices are the subject of current regulatory changes that are expected to be finalized later this year, after a thorough rulemaking proceeding that we are pleased is winding down. We believe that these developments should be permitted to unfold before statutory changes are made.

The Federal Reserve Board has proposed changing the Regulation Z requirements pertaining to changes in credit card interest rates, payment allocation practices, late and over limit fees and other practices that are the focus of H.R. 5244. For example, the Board has proposed a 45-day advance notice before account terms (such as interest rates) can be changed to give borrowers a chance to look for credit elsewhere if they want to avoid the new terms. The Board will soon propose new rules under its authority to address unfair and deceptive practices that we expect will include a nationwide requirement, similar to the one that currently pertains to Discover Bank under Delaware law, to allow consumers to opt out of "risk based" APR changes and pay off the outstanding balance at the "old" APR. Although the rulemaking process has been lengthy, both of these Federal Reserve rules are expected to become final later this year. Other regulators also are focusing on credit card industry practices, and the House of Representatives has approved a bill that would expand the authority of these bank regulators to address unfair and deceptive practices by issuing regulations.

The regulatory process allows changes to be made by those with years of experience regulating credit card lenders, and the ability to examine banks for compliance with the rules they write or enforce. Regulators also have the ability to examine the impact of proposed requirements on consumers before they are implemented through consumer focus groups, interviews and other techniques that allow proposals to be fine tuned to ensure they achieve their desired intent. In addition, requirements developed through the regulatory process can be adjusted over time through rule changes and the examination process to keep abreast of changes in industry practices, information technology and consumer needs.

In short, pending regulatory actions, as well as changes in the marketplace, make the enactment of H.R. 5244 unnecessary. More important, the bill would prohibit a number of longstanding practices that do far more good than harm. These practices encourage the responsible use of credit and reward responsible credit users with lower interest rates, larger credit lines, longer-term account agreements, rewards programs, and other benefits. They also provide borrowers who have less than perfect credit histories with access to credit that they would not otherwise find – from mainstream lenders.

Risk-Based Pricing

The principal impact of HR 5244 is its prohibition on risk-based changes in the interest rate on a credit card balance. This provision purports to address "universal default," a term that formerly referred to the practice of changing interest rates on an account when the borrower "defaults" - misses payments or stops making payments altogether - on an account with another lender. We do not use a missed payment with another lender as the basis for increasing interest rates.

What the bill actually does is to prohibit interest rate changes on the basis of *any* information (not just payment defaults) that reflects deterioration in the creditworthiness of the borrower and the ability or willingness to repay debts. For example, it prohibits APR adjustments based on information about how a customer uses his or her account in combination with the borrower's FICO score, or other information (e.g., changes in outstanding borrowing, loss of income, or the filing of a wage garnishment) that make it less likely that the current loan balance will be repaid. This prohibition is based on a misunderstanding of how lenders actually utilize so-called "off us" information, and appears to disregard the negative consequences that would be felt by large numbers of borrowers and applicants if lenders are prohibited from making risk-based price changes.

Information about how an individual uses credit extended by others is a demonstrably reliable predictor of a borrower's likelihood of continuing to repay existing and future loans. Historic data on millions of borrowers has been incorporated into risk scores that predict the likelihood that an individual with a specific risk score will default on his or her loans in a specified number or months or years. The use of this information in underwriting and pricing consumer credit cards has brought about the "democratization of credit" that has lowered interest rates for more creditworthy borrowers and allowed lenders to extend credit to greater numbers of individuals. As former Federal Reserve Chairman Alan Greenspan observed:

> "Experience indicates that access to the information assembled by [credit reporting agencies] and credit evaluation systems based on that information have improved the overall quality and reduced the cost of credit decisions while expanding the availability of credit." [3]

Risk-based pricing is one of the developments that has allowed the credit card to evolve from a product offered to affluent borrowers likely to have assets and other resources to pay their bills into a widely available (and popular) borrowing tool that is based on assessments of a borrower's ability and willingness to repay loans out of future income.[4] In addition, the models used to identify risk have improved with use over the past two decades, and changes have been made in the data that is used in these models. For example, the Fair and Accurate Credit Transactions Act (2003) amended the Fair Credit

[3] Letter of Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, to the Hon. Michael N. Castle (July 22, 2003).

[4] An ancillary benefit of credit risk-scoring models is that they ensure that credit decisions are based on objective information about an individual's use of credit. These systems, required under the by the Equal Credit Opportunity Act to be "empirically based and statistically sound" replaced so-called "judgmental" systems that predicted default risk based on individual analysts' reviews of information about borrowers and analyst "expertise" in spotting characteristics thought to relate to risk. Judgmental systems were criticized by regulators and lawmakers as subjective, and prone to individual evaluator bias. They were also imprecise: sometimes signs of risk were missed and credit was extended to unqualified borrowers or on unsound terms, while in other cases credit was denied to creditworthy individuals based on unwarranted concerns. As a result of this imprecision, higher across-the-board credit standards, higher interest rates, one-size fits-all APRs, and fees were used to ensure that default risk was spread across the portfolio The risk scoring models we use today are based solely on objective information relevant to an individual's use of credit, and they address both the lack of precision and concerns about objectivity and fairness inherent in judgmental systems.

Reporting Act to enhance the accuracy and completeness of consumer report data through new obligations for both credit bureaus and creditors that furnish information to them.

Although H.R. 5244 prohibits pricing adjustments based on changes in risk, it nevertheless recognizes that information about a borrower's use of credit extended by other lenders is pertinent to credit-granting decisions. The bill allows this information to continue to be used at the time of application in deciding whether to extend credit, the interest rate that will be charged, the amount of credit to be extended and the length of time for which credit will be offered. It allows this information to be used after an account is opened to take actions (other than changing the interest rate) to respond to changes in default risk, such as lowering credit lines or closing accounts. *And the bill recognizes that external information can be used both before and after an account is opened to adjust the interest rates on the outstanding account balance: it permits variable interest rates that change based on movements in the prime rate set by the Federal Reserve.*

There is a misconception that a large percentage of U.S. credit card users are subjected to risk-based interest rate increases. In fact, at Discover, changes in a risk score do not automatically trigger a price change or evaluation, and only a small percentage of accountholders are affected by risk-based interest rate changes. Credit scores for some borrowers change frequently, even monthly, but these changes are not the basis for interest rate adjustments. Risk-based price changes are made periodically, on a targeted basis, and most accounts are not affected. For example, new accounts (those opened less than a year) are not eligible for repricing. Thereafter, the APR on an account will not be considered for a risk-based adjustment more than once a year. Other exclusions include accounts subject to repayment agreements.

The last thing that any lender wants to do is to increase the chance that the borrower will default on a loan because it carries a higher interest rate. There is nothing to be gained by adding additional interest to an account balance if that interest, along with the principal balance, will end up being written off because the loan became unaffordable and payments ceased. Experience shows that risk-based interest rate changes motivate consumers to improve their payment behavior by making larger payments and reducing purchase activity. Some accountholders take advantage of their option to close their account and repay the balance at the old APR, but most choose to keep their accounts open and available for use even with a higher interest rate.

Risk-based pricing of credit cards is like risk-based price increases for auto insurance premiums. Drivers who run up accident claims on other policies, move to high accident locales, or collect tickets for driving violations are charged higher premiums, even if they pay their insurance premiums on time. These increases allow safe drivers to pay less. Legislators have not stepped in to reward these high-risk drivers and protect them from the consequences of their risky behavior by outlawing premium increases that are based on external information predictive of increased insurance claims.

Missing loan payments or running up high balances with other lenders are consumer behaviors that Congress should encourage consumers to *avoid.* Customers who default on loan payments with other lenders, or increase their total indebtedness without a corresponding increase in income, are demonstrably riskier borrowers whose financial management has worsened. Their likelihood of defaulting *on outstanding debts* has increased in a predictable and demonstrable way. Prohibiting lenders from making APR changes when this occurs will inevitably result in higher lender costs and negative consequences for other, more responsible, consumers. The ability to price for risk allows the higher costs of lending to riskier borrowers to be borne by the individuals who cause them. Prohibiting lenders from recovering these costs from those responsible for them will result in higher costs for lenders and their lower-risk borrowers.

A ban on risk-based APR changes will require lenders to use other risk-management techniques when customers show signs of risk, like restricting credit limits and possibly closing accounts to future purchases. However, when credit limits are frozen or reduced, or accounts closed, borrowers experience more than an inconvenience and the need to look elsewhere for credit. Moreover, an account closing is an adverse action that negatively impacts the consumer's credit score. Reducing credit limits has the same effect: the individual's "credit utilization" goes up because the customer's outstanding loan balances now account for a greater percentage of their available credit. Higher credit utilization, in turn, results in lower FICO scores, negatively impacting the individual's ability to obtain credit from other lenders. Thus, a restriction intended to protect consumers from risk-based price changes may result in other risk management responses that might be worse than paying a higher rate of interest, and reduce access to credit for the very borrowers who may need it the most. Some borrowers may prefer to have an open line of credit that costs more to use than a credit line that has been reduced, frozen or closed. H.R. 5244 eliminates this choice.

Default-Based Interest Rate Changes

While H.R. 5244 recognizes the legitimacy of changing the APR on a credit card balance when a borrower defaults on contractual obligations, it imposes significant delays on implementing these changes, and an option to avoid the APR increase altogether, APRs on borrowers who default cannot be changed unless a 45 day billing statement notice of the change and the right to avoid it is provided first – a requirement that may require the pre-default rate to remain in effect for two full billing cycles. In addition, interest collected at the default APR during the following three billing periods would have to be rebated if the consumer elected to opt out of the increase.

These requirements delay the implementation of the contractual penalty for customers' default behavior that was established in advance as part of the borrower's credit card account agreement. This delay rewards consumers who have failed to meet their loan obligations (and represent an increased default risk). The Federal Reserve's proposals provide a more sensible approach, by permitting consumers to opt out of default-based interest rate changes without prolonging their ability to avoid APR increases if they decide not to opt out. Discover intends to offer this option to our Cardmembers.

It is important to remember that the best way to help consumers to avoid interest rate increases for missing payments is to encourage and facilitate on-time payments. Discover has made making on-time payments increasingly simple. The result, as noted previously, has been a very significant decline in the percentage of customers who pay late.

In the first place, we provide Discover Cardmembers ample time from the mailing of statements until the payment due date to assist customers who send payments by mail in getting payments to us on time. Cardmembers can select a statement date so that their Discover statements arrive at a time most suitable for them. We work with the U.S. Postal Service to expedite the delivery of statements. Outgoing mail is presorted by us and delivered by us to postal facilities. In many cases this avoids the need for handling by postal Service facilities and by employees other than the letter carrier who brings the mail to the consumer's home. Incoming statements are picked up by Discover from the Postal Service facilities and processed promptly so that payments are posted as of the day we receive them.

Discover also provides a number of no-cost alternatives to sending payments by mail. Free on-line payments, that Discover regards as timely if received by 3:00 pm on the date payment is due, enable Cardmembers to make payments on time, without charge. This avoids late fees, default-based APR increases, and postage costs. A growing percentage of our customers make their payments online either at Discover's Website or through sites operated by the other financial institutions. Cardmembers also can schedule automatic payments in any amount (from the minimum due to the full balance owed) to be debited from checking or other accounts and credited by the payment date. This free service allows customers to avoid fees and penalties even if they forget the payment date or misplace the account statement. Furthermore, Cardmembers can also make payments over the telephone without charge, even on the due date.

We should mention that the Federal Reserve Board is in the process of implementing a statutory requirement designed to make sure that credit card billing statements prominently disclose the amount of late fees and the date by which the payment must be received to avoid late fees. If there are consumers anywhere who cannot find this information, this new "front of the statement" disclosure will make it easier for them to do so.

In addition to assisting Cardmembers in avoiding late fees, Discover minimizes the long-term impact of default-based price increases by reducing interest rates if the customer resumes on-time payments after a default. Interest rates are automatically lowered if the Cardmember makes nine consecutive on time payments.

"Two-Cycle Billing"

H.R. 5244 purports to ban "double cycle billing" (a method of computing the interest rate on a credit card balance that Regulation Z calls the "two-cycle average daily balance computation.) In fact, the language is broader: the text of this provision actually restricts all balance computation methods, requiring credit card lenders to provide interest free loans on any portion of a credit card balance that is repaid during the billing cycle. This would fundamentally change longstanding industry practice and the rationale for grace periods. Grace periods – which constitute interest free loans - have long been offered as an incentive to consumers who pay the full account balance during the grace period. The proposed change would, instead, provide this benefit to customers who do *not* repay the full balance, but make partial payments and "revolve" the rest of the loan balance. A legislative mandate that establishes the terms for offering grace periods, prohibits the assessment of interest on borrowed funds, and rewards consumers who elect to pay less than the full balance owed is not warranted. We believe this provision should be dropped.

Even if the bill were limited to address only the "two-cycle average daily balance computation method," a prohibition on that practice would be unnecessary. As explained in more detail below, the two-cycle computation affects a relatively small number of credit card users who usually pay their account balance in full. When they do not, the computation imposes what in most cases is a low-dollar increase. This is often a one-time occurrence.

The two-cycle computation is a legitimate practice, expressly recognized in Regulation Z, and used for more than 20 years. Bank regulators are familiar with it and examine banks that use it. They have not questioned this computation method as improper under The Truth in Lending Act, unfair and deceptive practices laws, or otherwise. In examining the required disclosure of the two-cycle and other computation methods in its current rulemaking, the Federal Reserve found that consumers do not necessarily consider balance calculation methods when considering or comparing credit cards.

The two cycle computation does not have a significant impact on consumers. It applies only in limited circumstances that affect "convenience users" who are able to pay the full balance on their credit card accounts each month, collecting credit card "rewards" without paying interest. The two-cycle computation affects these individuals only when they begin a billing cycle with a zero balance, make purchases, but elect to pay less than the full balance. This additional interest paid by this small subset of borrowers is usually small, and is not paid repeatedly.

In commenting on previous legislation that would have required all credit card issuers to use the average daily balance computation so consumers more easily compare different credit card offers, the Federal Reserve cautioned against the proposal:

> *"[R]egulating the balance computation area might result in restricted credit availability, the elimination of grace periods, or higher interest rates, annual fees or merchant discounts. It is uncertain, therefore, whether the benefit of having a uniform balance computation method would exceed the associated costs to consumers after such adjustments have taken place."*[5]

[5] Statement of Emmett J. Rice, Member, Board of Governors of the Federal Reserve System, to Senate Banking Committee, Financial Institutions Subcommittee, May 21, 1986, p.53).

A statutory prohibition of the two cycle computation method is not necessary given its limited impact on consumers, regulators' existing authority to ensure that it is not harming consumers, and changes in the marketplace. With regard to changes in card issuer practices, we should note that while for many years the two cycle computation has been used across the industry, this is changing. In 2006, as part of our ongoing competitive review of industry-wide practices and our own product features, Discover decided that all new card products (such as our Discover Miles Card and the Discover Motiva Card) would use the average daily balance computation method rather than the two-cycle method. At the same time, we made a decision that in the future other new Discover accounts will use the average daily balance computation. Discover Cardmembers now have the ability to choose a Discover card that does not use this computation method.

Over limit Transactions

HR 5422 requires cards that charge over limit fees to allow consumers to block all transactions that would exceed the credit limit.

While some banks may charge an over limit fee whenever a credit card transaction brings the balance above the account's spending limit, Discover does not. We make the over limit computation once - on the last day of the billing cycle - and impose an over limit fee only if charges posted to the account during the month exceed the authorized spending limit *after payments and credits are posted.* Thus, while a purchase, utility bill payment or other transaction might exceed the credit limit, this will not result in an over limit fee if transactions are offset by payments sent to us or through credits from a merchant (e.g. for returning merchandise or checking out of a hotel with a bill lower than the preauthorized "hold" on the account). H.R. 5244 would require all card issuers to use this method.

Discover also provides Cardmembers with tools to help avoid over limit transactions in the first place, like online reminders that alert customers when they approach their credit limit. Proactive outreach to customers who appear having difficulties keeping below their credit limits is another tool we use to help Cardmembers stay within their spending budgets and avoid repeat over limit fees. These measures account for a significant decline in the incidence of over limit fees on Discover accounts.

We do not believe that most consumers would elect to have a credit limit that cannot be exceeded for any reason.[6] However, we intend to offer Discover Cardmembers the ability to block transactions that exceed their credit limit with designated exceptions. Other issuers are offering comparable options. We think that this is another example of an issue that is being addressed in the marketplace, offering consumers a choice that does not require a statutory mandate and regulations to implement it.

[6] A customer near his or her credit limit who has just mailed a check bringing the account balance to zero does not want to be embarrassed or inconvenienced when a transaction is blocked because the incoming payment was not yet posted. Customers are not likely to appreciate the annoyance or extra costs that would result if preauthorized payments for services like utility bills, highway toll passes, and Internet access are blocked, and penalty fees are incurred. Card users might experience more serious consequences if payments for emergency services like late night tow trucks, or gasoline to fill empty tanks, are blocked.

Changes to Account Terms

Credit card account agreements are sometimes criticized as unduly lengthy and confusing, yet H.R. 5422 includes a requirement that is likely to contribute to the so-called complexity. The bill prohibits changing account terms during the life of the account, unless the "specific material reasons" for a change is set forth in the agreement at the time the account is opened. It applies to changes that reduce consumer costs as well as those that might increase them, and even to changes made in response to statutory or regulatory requirements.

This will make lengthy credit card agreements longer still, as card issuers try to anticipate and enumerate every potential change, and the reasons for them, so that account agreements can be amended in response to economic conditions, customer needs, competition or legislative or regulatory mandates.

There is no reason to believe that consumers need, or will read, lists of changes that might be made to their account in the future. The current Delaware requirement that consumers be given advance notice and the right to opt out of changes in terms is preferable. This provides information about actual, as opposed to possible, changes and gives it to the customer when the customer is most likely to need that information. The Federal Reserve has proposed that this requirement apply to all terms changes and mandates a 45-day advance notice.

Payment Allocation

This bill requires a pro rata allocation of payments on accounts with multiple balances at different APRs. By prolonging the time period during which zero or low-APR loan balances will be repaid, this changes the economics of offering low-APR introductory or balance transfer offers. It will result in the elimination or reduced availability of balance transfer offers, depriving consumers of their benefits. The Federal Reserve's proposed rule on this issue – prominent disclosure when promotional offers are made about how payment will be allocated – is a preferable approach that informs consumers about potential costs without depriving them of low-APR credit offers.

Conclusion

H.R. 5244 addresses a wide variety of issues that are already the subject of regulatory rules that are being readied for final implementation, and scrutiny by regulators through the examination process. Other practices that the bill would regulate are being addressed in the marketplace as competitors change their product offerings and policies to win customers from other card issuers. We would urge the Subcommittee to allow these developments to play out before enacting statutory mandates that are difficult to change and may have unanticipated consequences. Should the Subcommittee elect to proceed with statutory changes, we will continue to assist the committee in understanding the impact of its proposals on credit card users, and work to refine the bill to achieve its consumer protection objectives.

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Consumers Union

TESTIMONY OF

TRAVIS B. PLUNKETT,
LEGISLATIVE DIRECTOR

ON BEHALF OF
THE CONSUMER FEDERATION OF AMERICA AND
CONSUMERS UNION

BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
OF THE
UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

H.R. 5244, THE CREDIT CARDHOLDERS' BILL OF RIGHTS:
PROVIDING NEW PROTECTIONS FOR CONSUMERS

APRIL 17, 2008

Chairwoman Maloney, Ranking Member Biggert, and members of the Subcommittee, 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 and Consumers Union, the publisher of Consumer Reports.[2] I appreciate the opportunity to offer our comments on H.R. 5244, the Credit Cardholders' Bill of Rights and on the effect of some current credit card industry practices on consumers.

Given the dramatic changes that have occurred in the credit card industry in recent years – and the harmful impact that some of these changes are having on consumers as this country slides into recession – no industry in America is more deserving of oversight by Congress. We applaud the Subcommittee for examining many questionable practices in the credit card industry over the last year, including the terms and conditions of credit card contracts, unjustified fees and interest rates and marketing and credit extension practices. It is particularly important that you are holding a legislative hearing today that includes testimony from cardholders who are being negatively affected by some of these practices. We look forward to working with you and the Subcommittee to enact legislation that will make this industry more consumer-friendly. In particular, Madame Chair, we urge this Subcommittee to mark-up legislation that you have proposed, the Credit Cardholders' Bill of Rights Act (H.R. 5244,) which takes an important first step in addressing many of the abuses I will speak about today.

H.R. 5244 curbs some of the most arbitrary, abusive, and unfair credit card lending practices that trap consumers in an unending cycle of costly debt, such as sharply escalating "universal default" interest rates that can double some cardholders monthly payments overnight. These tricks and traps have always been unfair, but now, at a time when consumers can least afford it, these practices produce devastating financial repercussions. Moderate-income families with little flexibility in their budgets are particularly hard hit if they have to pay more in unjustifiable fees and credit card interest. Signs that credit card delinquencies and defaults are on the rise should be a further warning that these practices have helped make credit card loans unsustainable for many Americans. The meltdown of the subprime 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.

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

[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] **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.

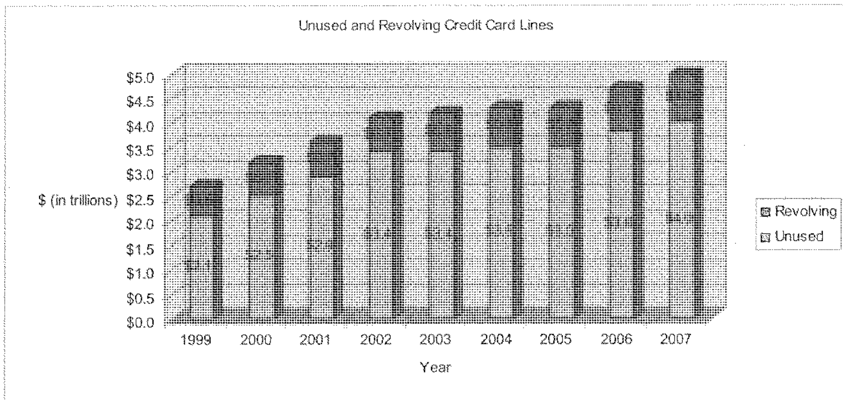
Americans are taking on new credit card debt. This credit expansion has had a negative effect on the least sophisticated, highest risk and lowest income households. It has also resulted in both relatively high losses for the industry and record profits. That is because the industry has been very aggressive in implementing a number of new – and extremely costly – fees and interest rates. We also find that Americans are broadly -- nearly universally -- critical of many of these credit card practices.

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, many 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 explaining in detail how H.R. 5244 takes an important first step in eliminating abusive pricing in the industry.

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

It is conventional wisdom that consumer demand has fueled the growth of revolving debt to about $950 billion.[3] 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,[4] even though the rate of growth in credit card debt in 2007 was the highest it has been since 2000.[5]

[3] As of February 2008, the amount of revolving debt held by Americans was $951.7 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 $818.5 and $866 billion.
[4] 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) 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.
[5] 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.



Source: VERIBANC, Federal Reserve.

The total amount of credit made available by issuers is now about \$5 trillion.[6] The average amount of credit available per household is \$43,007.[7] Of that amount, only 24 percent has been taken on as debt by consumers. According to figures from VERIBANC Inc., there were about \$4 trillion in unused credit lines in the fiscal quarter ending in September 2006. Between December 1999 and December 2007, revolving debt grew by 50 percent, but unused credit card lines made available by creditors grew by 90.4 percent, almost twice as fast.[8]

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.[9]

Issuers increased the number of mailed credit card offerings by six-fold from 1990 to 2005, from just over 1.1 billion to a record 6.06 billion.[10] Since then, solicitations have dropped to 5.8 billion in 2006 and 5.2 billion in 2007.[11] Wealthier families receive the highest number of credit card mailings, but low-income families are more likely to open the solicitations they

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[6] As of December 2007, the total amount was \$4.92 Trillion. VERIBANC, Inc. and Federal Reserve Consumer Credit Outstanding, Table G.19.
[7] There are 114.4 million households in the U.S., U.S. Census Bureau, "American's Families and Living Arrangements: 2006.
[8] VERIBANC, Inc. and Federal Reserve Consumer Credit Outstanding, Table G.19.
[9] Vertis Inc. press release, "Financial Direct Mail Readers Interested in Credit Card Offers," January 25, 2005; "Card Marketing 101," *CardTrack*, September 2002.
[10] Synovate Mail Monitor, press release, "Mail Monitor Reports Record Six Billion Credit Card Offers Mailed in U.S. during 2005," April 27, 2006.
[11] Synovate Mail Monitor, press release, "U.S Credit Card Mail Volume declined in 4th Quarter 2007 as Troubled Issuers Pull Back," February 2008. The drop in solicitations in 2006 occurred primarily because of the merger between Bank of America and MBNA. Synovate stated that the decline in 2007 occurred because some issuers were "straining from the fall-out due to the mortgage crisis and concern about an uncertain economy." However, some issuers like JP Morgan Chase that have not been as affected by economic problems actually increased their mail marketing in 2007.

receive.[12] 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 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.

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

Issuers also spend extremely large sums on many other forms of marketing and advertising, through television, telemarketing, the internet, radio, print and even outdoor billboards. *Nielsen Monitor* reported that credit card companies were among the top advertisers nationally and the fastest growing segment of purchased advertising in 2004, with credit card television advertising growing to $1.7 billion in 2004, a $438 million and 32.4 percent increase over 2003.[13] These figures are before the fourth largest credit card issuer, MBNA, started its first national advertising campaign during the 2005 Super Bowl.[14]

	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%
2006	5.8	.5%
2007	5.2	.5%

Source: Synovate Mail Monitor

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. This allows credit card companies to gain access to mailing lists and 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.[15]

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

The growth of revolving debt in this country to $950 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

[12] 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.
[13] Nielsen Monitor, "U.S. Advertising Spending Rose 6.3% in 2004, Nielseon Monitor-Plus Reports," March 1, 2005.
[14] Sidel, Robin, "Card Issuer MBNA lets the Public Take a Peek at Its Hand," *Wall Street Journal*, January 20, 2005 at C1.
[15] *Ibid.*

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.[16] According to the Federal Reserve Board, about 42 percent of cardholding households pay their credit card bill in full every month,[17] which means that the remaining 50 million or so families that carry debt owe an average of about $17,000.[18]

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.[19] 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.[20] 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 percent of their income owed by families earning over $100,000.[21] The increase in credit card debt has contributed to alarmingly high overall levels of debt for many of

[16] Cardweb.com

[17] "Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances," Brian K. Bucks, Arthur B. Kennickell, and Kevin B. Moore, *Federal Reserve Bulletin*, vol. 92 (February 2006), p. 31.

[18] 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.

[19] 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.

[20] 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.

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

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.[22]

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.[23] 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.[24] Americans under 35 are less likely to pay off their credit card balances every month than average Americans,[25] are paying more for debt obligations than in the past and are increasingly likely to pay more than 40 percent of their incomes on credit card debt.[26] Not surprisingly, more young Americans are declaring bankruptcy than in the past.[27] Moreover, there is increasing evidence that issuers are now targeting high school students with credit card offers.[28] They are also marketing branded debit cards to adolescents, in part to encourage these young consumers to use similarly branded credit cards when they are older.[29]

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

[22] 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.

[23] 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

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

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

[26] *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.

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

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

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

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

more than tripled from 1991 to 2001.[31] Other warning signs are also evident. The proportion of income spent to pay off debts by households headed by individuals 65 to 74 years of age has risen steadily over the past decade[32] while about one in seven senior households paid more than 40 of their income towards their debts in 2001.[33]

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

The Downsizing of Minimum Payments

As credit card issuers dramatically expanded their marketing and extension of credit in the 1990s, they lowered monthly minimum payment amounts. By reducing the minimum payment, issuers could offer more credit, encourage consumers to take on more debt, and ensure that consumers would take far longer to pay off their debts, thus making them more profitable for the industry.[35] Monthly minimum payment rates were reduced from around 5 percent of principal owed in the 1970s to just over 2 percent by the turn of the century.[36] In 2005, 19 million credit card borrowers make only the minimum payments.[37]

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.[38] 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.[39] Moreover, payment habits for many cardholders are not static over time.

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[31] Sullivan, Theresa A., Deborah Thorne and Elizabeth Warren, "Young, Old, and In Between: Who Files for Bankruptcy?" *Norton Bankruptcy Law Advisor*, Iss. No. 9A, September 2001, at 5. The number of older Americans declaring bankruptcy during this period rose from 23,890 to 82,207.
[32] Aizcorbe, Kennickell and Moore 2003 at 28, Table 14. According to the Federal Reserve Survey of Consumer Finances, the median debt services ratio of households aged 65-74 grew by 54% 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.
[33] *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.
[34] 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% of those aged 50-64.
[35] Interview with Andrew Kahr, credit card industry consultant, "The Secret History of the Credit Card," *Frontline*, November 2004.
[36] Kim, Jane J., "Minimums Due on Credit Cards are on the Increase," *Wall Street Journal*, March 24, 2005.
[37] Der Hovanesian, Mara "Tough Love for Debtors," *Business Week*, April 25, 2005.
[38] Opinion Research Corporation, "Consumer Financial Services Survey," November 3-7, 2005.
[39] 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 (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.[40] CFA has concluded that reduced minimum payments were a significant cause of increasing bankruptcies in the last decade.[41]

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.[42] 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.[43] 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.[44] Many major credit cards began increasing their minimum payments requirements in 2005, including Bank of America, Citibank, Discover and JP Morgan Chase,[45] in some cases to as high as 4 percent.[46] All issuers were required to fully phase in the changes by the end of 2006.[47]

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[40] 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.

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

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

[43] Public Law 109-8.

[44] 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.

[45] American Financial Services Association, "Credit Card Minimum Payments Going Up," *Spotlight on Financial Services*, April 2005.

[46] 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.

[47] 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.[48] Since the increases took effect, consumers with interest rates above 20 percent have had to cope with payments that have roughly doubled.[49]

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.[50]

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.[51]

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.[52] 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.[53]

Consumers exiting bankruptcy are often swamped with offers at prime terms – low interest rates and without annual fees.[54] 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.[55]

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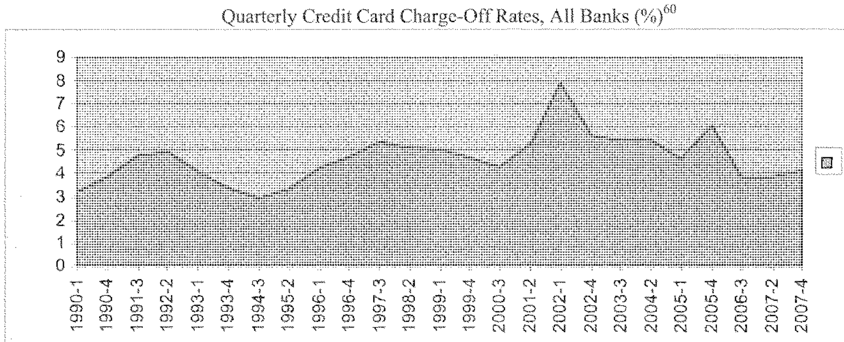
[48] Der Hovanesian, Mara "Tough Love for Debtors," *Business Week*, April 25, 2005.
[49] "Minimum Payments," *CardTrack*, September 6, 2006.
[50] Gavin, Robert, "Credit Card Companies Pursue Subprime Borrowers," *Boston Globe*, September 5, 2007.
[51] Interview with Andrew Kahr, credit card industry consultant, "The Secret History of the Credit Card," *Frontline*, November 2004.
[52] OCC, Statement of Comptroller of the Currency John D. Hawke J., June 28, 2000.
[53] Pacelle, Mitchell, "Pushing Plastic," *Wall Street Journal*, November 5, 2004.
[54] Mayer, Caroline E., "Bankrupt and Swamped with Credit Offers," *Washington Post*, April 15, 2005.
[55] *Ibid.*

C. CARDHOLDERS SHOW SERIOUS SIGNS OF ECONOMIC STRESS WHILE ISSUERS REAP RECORD PROFITS

As the economy has worsened and home foreclosures have increased to record levels, consumers are increasingly having difficulty paying their credit card bills. 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 twelve years. 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.[56] They increased to more than 4 percent in the fourth quarter of 2006 and broke 4 percent again during the later half of 2007. 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 approaching historically high levels. Thirty-day credit card delinquencies are now at their highest point in five years, since the last economic recession ended.[57] The difficulty that many families are having affording their credit card bills may have 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.[58] Moreover, despite rising credit card delinquencies, there is evidence that some families are staying current on their credit card loans but not their mortgage payments, a shift in behavior from past economic crises.[59]

Quarterly Credit Card Charge-Off Rates, All Banks (%)[60]



[56] 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. 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.

[57] 30-day credit card delinquencies during the fourth quarter of 2007 were 4.54 percent, the highest since the last quarter of 2002. Federal Reserve Board, Charge-Off and Delinquency Rates on Loans and Leases at 100 Largest Commercial Banks.

[58] 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.

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

[60] 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.

Despite these losses, the credit card industry continues to be the most profitable in the banking sector, earning a return on assets (ROA) since 1995 that is more than three times greater than that for commercial banks overall.[61] 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.[62] Credit card issuers reaped their highest return on assets ever in 2007, exceeding the record year of 2006. In fact, the credit card industry's return on assets grew every year between 1998 and 2004, and in 2007 was almost 90 percent higher than in 1998.[63]

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 as much profit for the industry.[64] With revolving debt nearly quadrupling since 1990, credit card companies' profitability should remain strong.

Second, credit card issuers earn a significant piece of their revenues from penalty fees alone. In 2007, issuers collected $18 billion in penalty fees, up from $10.7 billion in 2002.[65] 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.[66]

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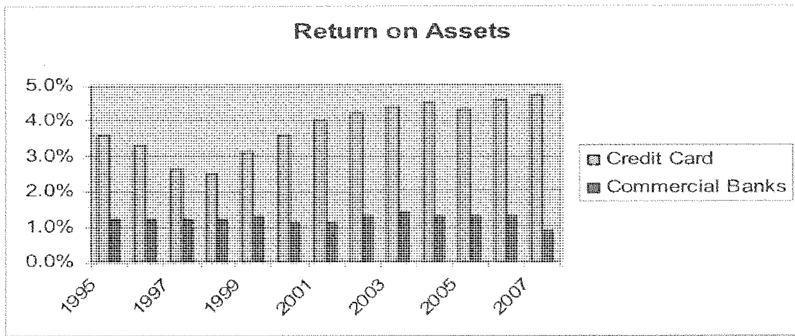
[61] "Card Profits 04," *CardTrak*, January 24, 2005; "Banner Year," *CardTrak*, February 2004; FDIC, *FDIC Quarterly Banking Profile*, Third Quarter 2006 at 5, Table I-A; FDIC, *FDIC Quarterly Banking Profile*, Fourth Quarter 2000 at 4, Table I-A. Commercial banks average return on assets between 1995 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.
[62] 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.
[63] R.K Hammer and Associates, January 2008. The industry's ROA was 2.5% in 1998, 3.1% in 1999, 3.6% in 2000, 4.0% in 2001, 4.2% in 2002, 4.4% in 2003, 4.5% in 2004, 4.3% in 2005, 4.6% in 2006 and 4.65% in 2007.
[64] Interview with Andrew Kahr, credit card industry consultant, "The Secret History of the Credit Card," *Frontline*, November 2004.
[65]CardTrak, "Card Costs," http://www.cardtrak.com/news/2008/01/18/card_fees. Card issuers charged an estimated $30 billion in fees in 2007, about six percent higher than in 2006. More than half, or $18 billion, were penalty fees. Late fees accounted 70 percent of the penalty fees charged. R.K. Hammer and Associates found that $8 billion of the penalty fees were for cash advances. Day, Kathleen and Caroline E. Mayer, "Credit Card Penalties, Fees Bury Debtors," *Washington Post*, March 6, 2005.
[66] "Card Profits 04," *CardTrak*, January 24, 2005.



Source: *CardTrak*, FDIC, RK Hammer and Associates

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.[67]

D. ISSUERS HAVE PURSUED ABUSIVE INTEREST RATE AND FEE 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 resulting in higher credit card debt, which is strongly associated with an increase in bankruptcy filings.[68] To make matters worse, credit 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.[69] 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

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[67] Heller, Michelle, "Gauging the Bottom-Line Effects of Bankruptcy Bill," *American Banker*, April 15, 2005.
[68] 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.
[69] Day, Kathleen and Caroline E. Mayer, "Credit Card Penalties, Fees Bury Debtors," *Washington Post*, March 6, 2005.

from $1,900 to $5,564 without making additional purchases because of fees and penalties, including $1,158 in over-limit fees alone. [70]

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.[71] In its findings in support of the Order, the bankruptcy judge listed claims filed in eighteen separate cases broken down between principal and interest and fees. On average, interest and fees consisted of more than half (57 percent) of the total amounts listed in the claims. In one case, the card company filed a claim in the amount of $943.58, of which $199.63 was listed as principal and $743.95 was listed as interest and fees. In another case, a claim of $1,011.97 consisted of $273.33 in principal and $738.64 in interest and fees. It is almost certain that pre-bankruptcy payments in these cases had more than paid off the real charges made by the consumers.[72]

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."[73] 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.[74]

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,[75] representing about 242 million credit cards. [76] 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.[77] In 1996, a Supreme Court decision

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[70] National Consumer Law Center, "Responsible Consumers Driven into Default," February 22, 2005.
[71] *In re* Blair, No. 02-1140 (Bankrate. W.D.N.C. filed Feb. 10, 2004)
[72] National Consumer Law Center, "Responsible Consumers Driven into Default," February 22, 2005.
[73] "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.
[74] *Ibid*, p. 23.
[75] *Ibid*, p. 1.
[76] CFA calculation based on 691 million credit cards, as reported in, *Ibid*, p. 9.
[77] "The Ugly Issuer," *Credit Card Management*, September 2004.

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.[78] 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.[79] Even more striking, the GAO found that late fees paid by borrowers with typical balances were an average of $37 in 2005.[80] 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.[81] 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.[82] 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.[83] 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.

<u>Penalty Interest Rates</u>

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.[84] For example, representatives for one large issuer told the GAO that they <u>automatically</u> 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.[85] Some consumers with low-rate cards could have their interest rates double overnight for being late on one payment to their credit card.[86] Some issuers also say that they will charge default interest rates for exceeding

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[78] Bergman, Lowell and David Rummel, "Secret History of the Credit Card," *Frontline*, November 2004.
[79] "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.
[80] *Ibid*, p. 20.
[81] "The Ugly Issuer," *Credit Card Management*, September 2004.
[82] Bergman, Lowell and David Rummel, "Secret History of the Credit Card," *Frontline*, November 2004.
[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. 20.
[84] Consumer Action, 2005 Credit Card Survey, "Card Companies Use Common 'Risk Factors' to Impose Unfair Rate Hikes, Finds CA," *Consumer Action News*, Summer 2005.
[85] 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.
[86] Bergman, Lowell and David Rummel, "Secret History of the Credit Card," *Frontline*, November 2004.

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.[87]

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.[88]

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.[89] Some cards even apply penalty rates to debts that were already paid at a lower rate.[90] 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.[91] 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. 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.[92]

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

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[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. 25.
[88] Wheary, Jennifer, Draut, Tamara, "Who Pays? The Winners and Losers of Credit Card Deregulation," Demos, August 1, 2007.
[89] 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.
[90] 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.
[91] Burt, Bill, "Pay One Bill Late, Get Punished by Many," *Bankrate.com*, January 20, 2004.
[92] Credit Card Practices: Unfair Interest Rate Increases, U.S. Senate Permanent Subcommittee on Investigation, December 4, 2007.

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.[93] 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.[94]

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-reason changes: some consumers saw their interest rates triple without explanation.[95] The result of these unfair clauses is that consumers can't depend on the interest rate promised to them.

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.[96] 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.

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.[97] This practice is problematic for the many cardholders who now carry balances at different rates

[93] 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.
[94] "A Credit Card You Want to Toss," *Business Week,* February 7, 2008.
[95] Ibid.
[96] "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.
[97] *Ibid.*

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.

Fewer Consumers Benefit From Lower Interest Rates As Issuers Switch to Fixed Rate Cards

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 at the turn of the century, issuers did not pass the cost savings completely through to their customers.[98]

Over the past six years, it appears that the distribution of credit cards between variable and fixed rates is related to the interest rate picture. As interest rates increase, issuers tend to switch consumers over to variable rate cards. As interest rates began to increase from historic lows, *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.[99] As rates rose further in 2007, *CardTrak* reported that 86 percent of credit card balances were carried on cards with variable rates.[100] Now that rates are declining again, issuers are shifting back to fixed rate cards. Thirty-nine percent of credit card offers mailed in October of 2007 included fixed rate offers, compared to 29 percent during the third quarter of the year.[101]

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.[102] 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.[103]

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[98] "The Ugly Issuer," *Credit Card Management*, September 2004.
[99] "5% Prime," *CardTrak*, November 10, 2004.
[100] "Rate Gap," *CardTrak*, January 18, 2007.
[101] Synovate Mail Monitor, press release, "Synovate Mail Monitor Shows Credit Card Terms Improve, More Fixed Rate Offers, " December 2007.
[102] Daly, James J., "Smooth Sailing," *Credit Card Management*, May 2004 at 31.
[103] CFA calculation from Daly, James J. 2004 and Census Bureau figures.

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. 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 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 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 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, <u>in addition to</u> 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.[104]

A rational market would lead lenders to limit their risk by restricting the 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 have not cut off credit, frozen credit limits or closed the accounts of cardholders that the issuers deem increased risk. Instead they have allowed borrowers to rack up more credit under more expensive terms,[105] making it more likely that the consumer might suffer serious financial consequences.[106]

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[104] "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.
[105] Pacelle, Mitchell, "Growing Profit Source for Banks: Fees From Riskiest Card Holders," *Wall Street Journal*, July 6, 2004.
[106] As the economy slows, there is evidence that some issuers are raising credit standards and tightening access to credit in ways that do not lead to further financial exposure for their existing cardholders. Others appear to be using old tricks, such as using credit scores to suddenly and sharply raise interest rates on existing balances, that will likely destabilize economically fragile households. A Credit Card You Want to Toss," *Business Week*, February 7, 2008.

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 stated so frequently that they adhered to the doctrine of risk-based pricing, it is perfectly appropriate for consumers to ask why they did not see interest rates or fees decline or moderate during that time in response to a more positive credit environment.

The assessment of retroactive interest rates is another sign of abusive rather than genuinely risk-based pricing. As stated above, interest rate increases that apply to past purchases cannot be justified under a true risk-based pricing model. Issuers assess risk based on the best information available on a consumer's credit history. If the risk profile of the consumer declines, the only way issuers could possibly justify a rate increase would be if it were legitimately related to the customer's increased risk, if it did not violate the creditor's agreement to offer credit under certain terms for a specific length of time, and if it were applied prospectively.

Increased expenditures on marketing when consumers reduce their use of credit is also a red flag that pricing in the credit card industry is skewed. As documented above, issuers increased their marketing expenditures significantly through 2005, even as consumers respond less frequently to mail solicitations and showed more caution in taking on new debt. A rational market response to this dynamic would be to pull back on marketing expenditures unless other factors existed that justified this spending, 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 to the public about their real costs to demonstrate that their pricing practices are truly fair.

G. H.R 5244 HELPS CURB MAJOR CREDIT CARD ABUSES

The "Credit Cardholders' Bill of Rights Act" helps restore fairness to the credit card marketplace. The bill would require credit card issuers to take a number of steps to treat consumers more fairly, including:

1. **Ending Bait and Switch Contract Clauses.** H.R. 5244 invokes the basic tenet of fair dealing by prohibiting credit card companies from changing contract rules in the middle of the game through "any time, any reason" interest rate and fee hikes. Instead, they must disclose, up front, the specific, material reasons for which they will unilaterally change contract terms.

2. **Limiting Retroactive Application of Rate Hikes for Consumers in Good Standing.** H.R. 5244 prohibits card issuers from applying "universal default" interest rate hikes retroactively to balances borrowed at a lower rate. As cited above, some issuers still use credit information not related to the account a consumer has with that company, such as a drop in a consumer's credit score, to raise interest rates. While consumers with a perfect

payment history with their credit card company are understandably outraged when their interest rate rises for these reasons, the devastating consequences of retroactive application of these increases is equally egregious. Minimum monthly payments rise, sometimes dramatically. The time to pay-off the balance increases, sometimes by many years, while the total cost of the debt skyrockets. H.R. 5244 limits these destabilizing impacts by prohibiting the retroactive application of rate hikes not related to the cardholder's credit card account.

3. **Preventing Credit Card Companies from Gaming Consumer Payments.** H.R. 5244 prevents card companies from playing costly games with consumer payments by requiring them to apply payments proportionately to card balances with different interest rates. As stated above, when consumers accept card offers for short-term teaser rates for balance transfers and cash advances and higher rates for other balances, credit card companies apply payments *first* to the lower-rate balance, preventing consumers from paying off higher interest balances and imposing unwarranted and costly finance charges. Issuers refuse to apply *any* portion of a consumer's payment to the higher interest rate balance, preventing consumers from paying down *any* portion of the high-cost balance until the lower interest rate balance is repaid. As a result, balances build up at the much costlier rate and finance charges accrue.

4. **Prohibiting Unfair and Hidden Interest Rate Charges on Balances Repaid During the Grace Period.** H.R. 5244 prohibits credit card companies from using "double-cycle billing" to charge interest on balances repaid during the grace period. As mentioned above, this practice allows credit card issuers to sap unwarranted finance charges from the wallets of consumers who usually do not carry balances. Although some credit card issuers have disavowed this practice, some still engage in it. This legislation makes clear that a grace period is a grace period.

5. **Ending Unfair Late Fees for On-Time Payments**. H.R. 5244 ends the classic late-fee gotcha. Consumers who mail their payments well in advance are often socked with a late fee of up to $40 because of card companies' own processing delays or arbitrary deadlines. The abuse has been exacerbated as credit card companies have shortened the time period in which consumers can make an on-time payment. Other consumers make electronic payments on the due-date, only to be hit with a late fee because they posted their payment five minutes after the issuer's arbitrary deadline on that day. The legislation provides that consumers demonstrating that they have paid their bill at least seven days before the due date are presumed to have paid on time and cannot be charged a late fee. It also sets a single uniform time of no earlier than 5 p.m. Eastern by which payments must be received on the due date to prevent companies from setting earlier and arbitrary deadlines that result in late fees. Issuers must also mail credit card bills 25 days before the bill is due, instead of the current rule requiring only 14 days, to help ensure that consumers will have enough time to pay.

We recommend that the Subcommittee include in H.R. 5244 several additional provisions that would enhance consumer protection not yet addressed by the bill, including: a ban on all universal default rate hikes; a prohibition on retroactive application of *any* rate hike to prior balances; a requirement that the size of penalties charged by issuers be directly related to actual costs incurred; and a requirement that credit card issuers ensure that young consumers have the ability to repay the loans they are offered.

We also recommend that the Subcommittee eliminate a provision in H.R. 5244 allowing issuers to charge over-limit fees for three consecutive months, even if the cardholder only exceeds the credit limit with a single transaction. Instead, H.R. 5244 should prohibit issuers from charging over-limit fees if they choose to allow a cardholder to exceed the credit limit. Similarly, a provision requiring consumers to pay all charges for low-credit-limit, high-fees cards before they receive these cards is a well-intentioned effort to ensure that consumers really understand how expensive these cards are. There is a very good chance, however, that unscrupulous lenders will defraud consumers who might pay huge fees before receiving any credit. Therefore, we recommend that the Subcommittee either place significant limits on the fees that can be charged on these extremely expensive cards or give consumers meaningful rights to reject these cards before they are activated.

Testimony of Larry Sharnak
Executive Vice President and General Manager, Consumer Cards
American Express Company

Before the House Financial Services
Subcommittee on Financial Institutions and Consumer Credit
Hearing on H.R. 5244, the Credit Cardholders' Bill of Rights Act of 2008

April 17, 2008

Introduction

Chairwoman Maloney, Congresswoman Biggert and members of the Subcommittee, my name is Larry Sharnak, and I am Executive Vice President and General Manager of Consumer Cards at American Express. In that role, I am responsible for managing our consumer charge card and revolving credit card portfolios in the United States, including our co-brand relationships. I welcome the opportunity to testify today to provide background on American Express and offer our thoughts on H.R. 5244, the Credit Cardholders' Bill of Rights.

I want to thank Chairwoman Maloney and the other members of the Subcommittee for holding this hearing and for the ongoing dialogue on this important issue. As Congress considers any changes around credit card practices, we believe it is important to focus on three key principles:

- **Access** – preserve the ability to price cards appropriately to allow card issuers to serve as many customers as possible.

- **Choice** – provide consumers with the greatest number of competitive choices – in products, services and pricing – to best meet their individual needs.

- **Accountability** – create incentives for transparent pricing and clear disclosures that will ultimately help consumers better manage their use of credit, and encourage responsibility and accountability for both card issuers and consumers.

In my testimony today, I will focus my remarks on two topics:

First, how American Express is unique in the card industry, specifically:

- Our brand has stood for service over the past 158 years;
- Our unique "spend-centric" business model; and
- Our commitment to providing choice and clarity:
  - in the products and services we offer;
  - in the financial educational we provide to consumers; and

- through our card practices and policies.

Second, I will provide our comments on the Credit Cardholders' Bill of Rights Act. We agree with the bill's broad objectives to address many of the concerns that have been expressed about industry practices. However, we believe that if the legislation is adopted in its current form, some of its provisions would have negative, unintended consequences for consumers.

Our Commitment to Our Cardmembers

In giving an overview of American Express, I want to focus on three themes: first, our commitment to providing exceptional service to our Cardmembers; second, our unique business model, and; third our emphasis on choice and clarity – from the products we offer, to our support for consumer education, to our approach on a range of card practices.

American Express is a leading global payments, network and travel company, which for more than 150 years has stood for service, clarity and trust. Our customers depend on us to provide a broad array of products that offer unparalleled value. This year marks a special milestone for the Company as we celebrate the 50th anniversary of the American Express® Card. While we have significantly expanded our business and product offerings over the years to meet the different needs of our Cardmembers, one thing has remained constant: our unwavering commitment to our customers.

American Express has received a number of awards that reflect our commitment to our customers. We were rated "Highest in Customer Satisfaction Among Credit Card Companies" in a recent study by J.D. Power and Associates, which was based on the direct feedback of customers. [1] We were also rated the highest among credit card providers in Forrester Research Inc.'s 2007 Customer Experience Index.

[1] American Express received the highest numerical score among credit card issuers in the proprietary J.D. Power and Associates 2007 Credit Card Satisfaction Study℠. Study based on responses from 7,812 consumers measuring 10 card issuers and measures opinions of consumers about the issuer of their primary

We are very proud of these and other awards. However, we recognize that we must continue to earn the trust of our Cardmembers each and every day. In short, we must ensure that we keep our focus on the customer – now and in the future.

American Express Business Model

American Express operates with a business model different from others in the industry. Unlike other large card issuers, we maintain direct relationships with merchants who accept our card products for payment; we manage the network that processes payment transactions; and we issue cards directly to consumers. In the Visa and MasterCard models, these functions could be distributed across two or three different companies; with American Express, it all takes place within one company.

In addition, our business has a different focus, based on what we call our "spend-centric" model. Our most important metric is the level of Cardmember spending on our network, not the outstanding balances Cardmembers choose to revolve. At American Express, our Charge Cards, which are pay-in-full products, represent the highest percentage of our Cardmember spending.

Lending balances are not a primary area of focus, but rather a byproduct of our business model. We want our Cardmembers to use their American Express Cards and to pay us back. Our business stands in contrast to most other large credit card issuers that generate the majority of their revenue from finance charges assessed on revolving balances.

A 2006 study by the Government Accountability Office (G.A.O.) found that the five largest credit card issuers generated 70 percent of their revenue from finance charges with the remainder coming from other revenue and fees. While income from finance charges is also important to our company, it accounts for a much smaller percentage of revenue than our competitors. For example, our U.S. Card Services segment received 33

credit card. Proprietary study results are based on experiences and perceptions of consumers surveyed in June-July 2007. Your experiences may vary. Visit jdpower.com percent of its revenue in 2007 from net finance charges. Our largest source of revenue comes from facilitating Cardmember spending at our merchant partners to drive their business for which we collect a fee.

Choice and Clarity: Card Products

At American Express, we are committed to providing our customers with choice and clarity. We offer a wide array of card products that offer tremendous value to our Cardmembers, each tailored to meet their specific needs. For example, we offer pay-in-full products, like our Charge Cards, which have no pre-set spending limit and no overlimit fees. We offer credit cards that allow customers to revolve their balances, such as Blue from American Express®. In addition, we offer Clear from American Express, a credit card with no fees – no annual fee, no overlimit fee, no late fee, no fee for balance transfers, no returned check fee, no ATM fee, and a full month to pay. And, we have One from American Express, which deposits one percent of each purchase into a high-yield savings account and offers a full month's grace period on each purchase, even for customers who carry a balance on their account.

Choice and Clarity: Promoting Greater Transparency

In addition to choice, we are committed to ensuring that all terms and conditions associated with our card products are clearly and fully disclosed to consumers. We believe that transparency is critical in building longstanding Cardmember relationships. We recently launched a number of initiatives to foster even greater transparency for our Cardmembers, including:

- "Get Off to the Right Start," a quick reference guide that accompanies all new Blue from American Express Credit Card accounts. This guide highlights important information about the card's terms and conditions in "plain English." We are in the process of developing similar brochures for our other card products.

- "Be Smart About Credit: 10 Tips for Using Your American Express Card," a resource on the American Express website that provides practical guidance for Cardmembers.

- "Credit Cards: What You Need to Know," a multi-year consumer education program in partnership with Consumer Action.

- "LifeSmarts – The Ultimate Consumer Challenge," a national competition for high school students that teaches practical life skills on a variety of consumer topics, including financial services. American Express is one of the leading sponsors of this competition, which currently reaches 100,000 students in nearly 1,000 high schools in 42 states.

We believe these initiatives, coupled with the efforts by the Federal Reserve Board and policymakers to improve credit card disclosures, will significantly benefit consumers. We also think that financial literacy programs are an important part of helping consumers make informed choices about the use of credit, and we applaud members of the Committee for their leadership in promoting financial literacy initiatives through the Financial and Economic Literacy Caucus.

Choice and Clarity: American Express Card Practices

Choice and clarity is also reflected in American Express' policies and card practices. There are a number of practices we simply do not do:

- We do not increase an individual customer's interest rate -- or APR -- for any reason other than the customer's performance on that particular account. If you are an American Express Cardmember, your interest rate will be increased to a penalty rate **only** if you violate the terms and conditions on that specific American Express account.
- We do not charge a fee if a Cardmember exceeds their credit limit during a billing period and is below their limit at the end of the billing period.

- We do not believe customers should be charged to pay their bills, so we do not charge a fee to our Cardmembers when they use any of our payment channels, including the computer or phone.
- We do not engage in double-cycle billing. We do not calculate a customer's interest charges based on a two-month period, which can result in the customer paying additional finance charges. Instead, we calculate interest based only on the current billing cycle.
- We do not actively market to college students.

Interest Rates

Recently, many have raised concerns that credit card customers have not seen the benefits of recent rate reductions by the Federal Reserve. This is not the case for American Express Cardmembers. As the Prime Rate falls, which normally follows any drop in the federal funds rate, the interest rates applied to American Express variable rate credit card accounts are reduced by an equivalent amount. Since the Federal Reserve began reducing interest rates in September 2007:

- American Express has reduced interest rates on all variable rate credit cards;
- American Express has made these reductions automatically, and;
- American Express has passed along all reductions in the Prime Rate directly to consumers.

It is important to note that while these rate reductions have been directly passed on to consumers, American Express' own cost of funds has not come down at an equivalent rate. As you know, the capital markets are experiencing considerable uncertainty, which has had an impact on the cost of commercial borrowing. Even for well-capitalized, A-rated companies, like American Express, interest rate spreads are extremely high. This means that the rate reductions American Express has passed along to consumers have exceeded the reduction in our own cost of funds.

As I mentioned earlier, American Express will not increase an individual Cardmember's interest rate based on their performance with other lenders, or based on a change in our cost of funds. Moreover, we will not raise a Cardmember's interest rate because of their performance on another American Express account. The overwhelming majority of American Express consumer lending accounts, 94 percent, end the year with the same or a lower interest rate than they had at the beginning of the year.

Managing Risk

American Express also manages risk by carefully monitoring the outstanding credit lines of our Cardmembers. While we will not increase a Cardmember's interest rate because of their performance with other lenders, or because of information contained in a credit report, we will use both internal and external information for purposes of managing credit lines and to determine whether to keep an account active. For instance, if we see a Cardholder's credit profile rapidly deteriorating, we may take action to reduce that customer's credit line as a prudent risk management step to limit our risk exposure.

Overlimit Fee Policies

There has been a lot of discussion about overlimit fees, so let me take a moment to explain our policies in this area. First, we offer a number of products that do not have overlimit fees, including our Charge Card and credit cards like Clear and One. For other American Express cards, we charge an overlimit fee **only** if the account exceeds its established credit line at the end of the billing period. If an account goes overlimit during the billing period, but a payment is made that brings the balance under the limit before the end of the billing period, we do not charge an overlimit fee. Many customers who exceed their credit line will make payments during the month that will bring them below their limit prior to the end of the month. Our policy differs from other card issuers who may charge customers a fee when they exceed their credit limit at any point within a monthly billing period.

We also review Cardmember accounts when they exceed their limit to determine if, from an underwriting perspective, it would be appropriate to raise their limit (and avoid an overlimit fee). In addition, we also offer free account alerts, which notify Cardmembers when they are approaching their credit limit to help them avoid overlimit fees. Only a very small percentage of American Express accounts are overlimit in a given month, and because of our policies, these customers are not assessed a fee in most cases.

Billing Statements and Payment Processing

We recognize that the Subcommittee has heard complaints about the timeliness of billing statements and the prompt crediting of customer payments. At American Express, our goal is to make payment as easy as possible for our Cardmembers through whatever payment channel is most convenient for them. Today, over 60 percent of our customer payments are made electronically. In addition, our Cardmembers are increasingly using our website. We receive more than a million site visits a day on average from Cardmembers who are managing their accounts online.

American Express offers – free of charge – a number of alternative payment channels to our Cardmembers, including pay-by-phone and pay-by-computer. If a Cardmember chooses to pay by mail, their payment will be directed to the closest of our regional remittance centers to speed the process of crediting payments.

American Express maintains stringent standards to ensure billing statements are mailed promptly. Currently, approximately 99.5% of American Express billing statements are mailed within three days of the end of the billing period, with the remainder mailed within the next two days. We produce on average 750,000 Cardmember billing statements per day, or 280 million consumer statements annually. Our goal is to produce statements and place them in the mail as quickly as possible to help facilitate timely consumer payments.

We have a USPS Detached Mail Unit with dedicated Postal Service employees onsite at our mail production facility. Mail is picked up 12 times daily (including weekends) and is booked on the first available flights using the USPS Postal One system. This system enables us to place mail on planes promptly and efficiently.

The payment due date for American Express credit cards is set at the product level. The due date for a given product is calculated in the same manner each month and is between 20 – 25 days after the closing date of the billing period, depending on the credit card product. Payment due dates do not change whether a Cardmember carries a balance or pays in full each month. We do not think it is appropriate to adjust a consumer's payment due date based on their payment behavior.

We also make statements available online within 48 hours of the end of the billing cycle, and we offer Cardmembers the option of being notified via e-mail that their statement is available online. We allow Cardmembers to choose their payment due date, and we offer account alerts to remind our customers when a payment due date is approaching.

H.R. 5244, the Credit Cardholders' Bill of Rights

Let me now turn to H.R. 5244. We appreciate the opportunity to comment on the Credit Cardholders' Bill of Rights Act. American Express supports the objectives of this legislation to empower consumers to make informed decisions about their credit card accounts through improved notice and enhanced choice.

We support many of the policies reflected in this legislation. Consumers should have additional tools to manage their accounts, such as allowing them to opt-out from exceeding their credit limit if they would like to do so. We believe that limiting the number of overlimit fees and assessing a fee only if the account is over the limit at the end of the billing cycle are sensible policy recommendations.

Most importantly, we believe that addressing the practice of increasing interest rates for any reason other than the consumer's behavior on the account in question would go a long way toward resolving most of the concerns expressed by consumers who have seen their interest rate increase because of developments not related to that particular account.

While we support the objectives of this legislation, American Express is concerned about several specific provisions contained in this bill that could negatively impact consumers, particularly at a time when lenders are already tightening underwriting standards due to market conditions. Let me briefly describe these concerns.

Advance Notice of All Interest Rate Increases

As currently drafted, H.R. 5244 would require a 45-day advance notice and an additional 90-day opt-out period for any rate increase on a credit card account. The bill treats all rate increases uniformly, whether the rate increase was triggered by a missed payment with a third party (e.g. another lender or a utility) or because a consumer failed to make a payment on the account in question.

The impact of this provision would be to delay card issuers from re-pricing for risk at the time that risk has become readily apparent, thus requiring them to account for that risk in other ways, such as by pricing accounts higher at the outset. It would also reduce incentives for consumers to make timely payments. For example, consumers could run up a balance on their account, make no subsequent payments, and still avoid a rate increase on the account by exercising their right to opt-out. Consumers who pay their bills on time should be protected from arbitrary rate increases. At the same time, consumers who fail to make timely payments on their accounts should be charged an interest rate commensurate with their increased risk profile. There must be shared responsibility and accountability by both the issuer and consumer.

We believe that the legislation should be revised to distinguish between rate increases triggered by a missed payment with another lender or a decrease in a credit score, and a higher APR that is triggered because the consumer failed to pay as agreed on the account in question. Research has consistently shown that most consumers agree that a rate increase based on their performance on the account in question should be treated differently than any other rate increase. Interest rate increases triggered by the customer's performance on the account in question should not be subject to a 45-day advance notice and an opt-out requirement. However, in circumstances where the rate increase results from reasons not related to the specific account in question, we believe it is appropriate to have advance notice and an opt-out.

As we discuss later in our testimony, advance notice and an opt-out should also apply to any terms change that an issuer may make to the account agreement, in lieu of a complete prohibition on "any time for any reason" terms changes as currently contemplated in the legislation.

If these changes were to be incorporated, they would create a strong incentive for issuers to be more transparent in both their pricing and disclosures, which would go a long way in helping consumers better manage their use of credit.

Payment Hierarchy

H.R. 5244 would require credit card companies to allocate consumer payments on a "pro-rata" basis in the event a consumer has two or more different interest rates that apply to balances on the account. We believe this provision would ultimately have a negative impact on consumers because it would undermine the economics that enable credit card issuers to provide promotional and other low-rate offers, which can reduce a consumer's overall effective interest rate. We think it is critical to preserve the ability of issuers to continue making promotional offers to consumers.

Credit card users may carry balances that are subject to different APRs. For example, there may be one APR for purchases, another for cash advances, a third for low-rate introductory offers or for balances transferred from other cards. Card issuers typically allocate payments on these accounts so that lower-APR balances are paid off first. The ability to utilize promotional offers to move higher-rate balances to another card, with a much lower initial rate, benefits consumers and enables them to substantially lower their overall effective interest rate.

Our research has shown that consumers can significantly reduce their overall effective interest rate, often by several percentage points, by taking advantage of low-rate promotional offers. This benefit is greater for the many consumers who are transferring balances from higher rate loans with other lenders. In addition, our data show that consumers who take advantage of promotional or balance transfer offers pay down their accounts at a faster rate and exhibit lower delinquency rates than our average customer.

If this method of repayment is set in law, issuers will be less likely to make promotional offers to consumers. Many issuers have already curtailed balance transfer and other promotional offers in light of the current economic environment, and this legislation would likely accelerate that trend. Ultimately, this will place consumers at a significant disadvantage, by limiting the options of consumers who want to switch among credit card products. Impacting a consumer's ability to change among card products would leave them with fewer options, if they decide the terms of their current credit card are no longer favorable to them.

"Any Time, Any Reason" Contract Changes

H.R. 5244 would prohibit changes to a contractual agreement "at any time for any reason," unless the specific reasons for the change were clearly specified in the original cardholder agreement. It is unclear that this requirement would lead to any meaningful benefit for the consumer. For example, a lender might comply by including an exhaustive list of reasons that could cause the terms of the account to change, even if the chance of implementing those changes was remote. It is questionable whether consumers would see any benefit from such detailed and lengthy disclosures. In addition, this could impede current efforts to simplify credit card disclosures, thereby undermining the intent of the Federal Reserve's recent Regulation Z proposals.

Moreover, if an issuer did not disclose the reasons why an account could change as part of the original cardholder agreement, it would be prohibited from ever changing the terms of the account, even if the change would benefit cardholders. An example would be a change in terms to provide enhanced rewards for a certain card product.

We believe a better alternative would be to require advance notice of any terms change to the account, similar to what is being proposed by the Federal Reserve Board, and allow consumers the choice to opt-out of any terms change by canceling their card and paying off any balances under the existing terms and conditions. This would empower consumers to make informed decisions about how to use their credit card accounts.

Billing Practices

H.R. 5244 mandates that all credit card consumers be given a statutory 25-day grace period. While the provision is intended to provide consumers more time to receive and pay their bills, it does not address underlying concerns about facilitating timely consumer payments. The practical effect would be to give consumers who pay in full each month an additional period of time for which they receive an interest free loan at the expense of consumers who revolve each month. Revolvers would likely pay additional interest as they continue to revolve a balance for those additional days.

Many consumer complaints in this area would be resolved by addressing the issue of due dates that are adjusted based on whether the consumer revolves a balance or pays in full. Our view is that due dates should remain constant regardless of how borrowers choose to use their accounts.

We also believe that more consideration should be given to encouraging issuers to offer at no-charge to consumers on-line statements that are available well in advance of the due date, to provide the option of making payments on-line or via telephone at no charge to the consumer, and to offer e-mail account alerts notifying consumers when their payment due date is nearing.

Additional Comments

It is also worth noting that there are a number of technical concerns with the legislation. For example, the legislation seeks to ban the practice of double-cycle billing, but the definition included in the bill would go well beyond addressing that specific practice. The bill, as drafted, would prohibit the use of the "average daily balance" method of calculating finance charges. The provision would force all issuers, even those who do not engage in double cycle billing, to drastically redesign the terms by which interest free periods are extended to consumers, or in extreme cases, to avoid the provision altogether by ceasing to offer interest-free periods.

Conclusion

As I conclude my testimony, I hope I have demonstrated what is distinctive about American Express. We are committed to providing exceptional service to our Cardmembers. We operate a unique spend-centric business model. And, we demonstrate an unwavering commitment to providing choice and clarity through our products and services, our consumer education, and our business practices. I also want to emphasize that any legislation should focus on preserving consumer access to credit, enhancing choice in the marketplace, and ensuring accountability for both issuers and consumers.

I can't leave today without sharing a few words from some of our Cardmembers who recognize the uniqueness of American Express:

> "The only company that dealt with me humanely, morally, ethically and reasonably was American Express. When I informed them that he [my former husband] was not a legal signature on my card, all charges made by him were wiped off my record. Just like that. . .This action certainly allowed my small family to survive very hard times. Without it we couldn't have eaten many days. I continue to be grateful 20 years later."
> --customer letter

> "I would like to take this opportunity to thank you for your recent letter . . .As you can tell by our payment history of this account, we make it a practice to pay bills on time. This was not an oversight, but a situation beyond my control. Our daughter, who is away at school, became very ill. To make a long story short, a misdiagnosed appendicitis resulted in two hospital stays and two surgeries for her and I was away from home over three weeks in order to be with her. Of course, all my bills were at home, so they were all late this month. I wanted to let you know that American Express is the only company that contacted us and provided us this excusal. Again, I appreciate it."
> --customer letter

> "My wife and I have been Gold Card members for some 30 years. Our experience with American Express has been outstanding. During the past year we have had an extremely unfortunate experience. Our forty year old son was in an

> accident in Thailand and remains in a coma in a hospital in Bangkok. My wife and I have spent nine of the past twelve months at his bedside. . .Mrs. Sirivan Rogers, a customer service representative, went to extraordinary measures to assist us. . . Regardless of what issue I posed – and there were many, she extended herself beyond anyone's expectations. . .She visited our son in the hospital, sent him flowers . . . she arranged for us to use our card for expenses up to $50,000 and arranged systematically for us to make a payment by phone from Bangkok. We have encountered numerous administrative, legal, immigration and financial challenges and whenever I contacted Mrs. Rogers she was there with charm and an expedient resolve."
> --customer letter

I have been with American Express for almost 28 years, and our products, our commitment to our customers, and stories like these are why I am proud of every one of those years.

Chairwoman Maloney, Ranking Member Biggert, and members of the Subcommittee, American Express wants to play a constructive role in this process and hopes that any new policies will enhance clarity and choice for the consumer, without imposing regulation that will undermine competitiveness and choice in the market. Thank you for the opportunity to testify today, and I would be happy to answer any questions you may have.

Appendix

1. "Get Off to the Right Start," a quick-reference guide for new Blue from American Express® Credit Card Accounts

2. "Be Smart About Credit: Tips for Using Your American Express Card"

3. "Credit Cards: What You Need to Know"

4. "Families and Credit Cards"

5. Individual Customer Testimonials

WHAT DOES APR MEAN?

APR, or Annual Percentage Rate, is the finance charge or interest rate you pay when you

1) choose to carry a balance
2) take a cash advance, or
3) do a balance transfer.

UNDERSTAND YOUR CARD'S APR

Different APRs apply to your account. Remember that introductory and promotional offers, which may show lower APRs, may apply only for a limited time.

Your APRs are:

- **Purchase or Standard APR:** See the information listed next to your Card in the enclosed materials or your billing statement.
- **Cash Advance APR:** Prime Rate + 14.99% — Any time you use your Card to withdraw cash at an ATM, you will pay a Cash Advance APR on that withdrawal.
- **Late Payment APR:** Prime Rate + 12.99% — If you pay late, your APRs for all balances except Cash Advances will increase to the Late Payment APR for 12 months. Any introductory or promotional APRs will also increase to the Late Payment APR.
- **Serious Default APR:** Prime Rate + 21.99% — If your payment is returned for insufficient funds, or if within 12 months you make two late payments, or receive 3 over-limit fees, the APR on all balances will increase to the Serious Default APR for 12 months.

If you pay your bill in full each month:
You will have a 20-day interest free period (or a grace period) for purchases. Cash advances or balance transfers have no grace period.

If you do not pay your bill in full each month:
We will assess finance charges based on your average daily balance in that month, including new purchases.

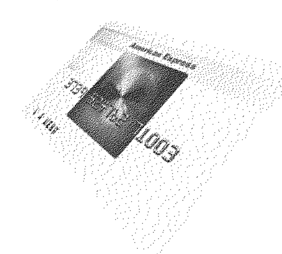
We will assess finance charges until you pay your balance in full. That means if you pay your entire revolving balance in any given month, we will assess finance charges for the portion of the month that you had an outstanding balance. The finance charges will appear on the next month's statement.

If you previously revolved a balance, but paid your last 2 billing statements on time and in full, then you will receive a 20-day interest free period for new purchases.

If you travel abroad:
We will convert any purchases you make overseas with this Credit Card to U.S. dollars using a base conversion rate plus 2%.

BE SMART ABOUT CREDIT

TIPS FOR USING YOUR AMERICAN EXPRESS® CARD



GET OFF TO THE RIGHT START

UNDERSTAND THE KEY TERMS OF YOUR BLUE FROM AMERICAN EXPRESS® CREDIT CARD ACCOUNT

This Quick Reference Guide gives you some important information about your new American Express Card. If you understand your account and manage it carefully, you can avoid paying penalty interest rates (APRs) as well as late and over-limit fees.

This guide does not explain everything about your account, and it does not change any existing terms. To learn all the details about your account, read the Cardmember Agreement, which you'll find inside this Guide.

KNOW HOW PAYMENTS WORK

To keep your account up to date, make sure we receive at least the Minimum Amount Due by the Payment Due Date. If you prefer, you can pay more than that amount at any time.

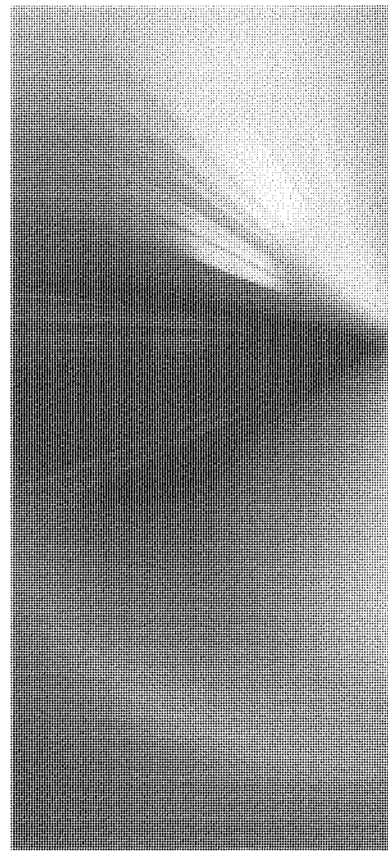
When you make a payment, we will apply it to the part of your balance with the lowest APR, and then to any other balances in order of lowest to highest APR. (For more about APRs, see Understand Your Card's APR.)

You cannot use American Express Balance Transfer Checks (also known as convenience checks) to pay your American Express bill.

LEARN ABOUT FEES

- **Annual Fee:** *$0*
- **Pay-by-phone or Pay-by-computer fee:** *$0*
- **Late Fee:** If your balance is less than $400: *$19*
  If your balance is $400 or more: *$38*
- **Over-Limit Fee** (month end only): *$35*
- **Returned Check Fee:** *$38*
- **Cash Advance Fee:** *3% of transaction amount; $5 minimum*
- **Balance Transfer Fee:** *3% of each transaction, $5 minimum, $99 maximum,* unless otherwise disclosed in the applicable offer. (NOTE: Balance Transfer checks made payable to cash, you, a bank, or a brokerage are treated as a Cash Advance, not a Balance Transfer.)
- **Stop Payment Fee for Balance Transfer Checks:** *$29*
- **Copying Fee** for hard copies of statements that are more than 3 months old: *$5 per copy requested.* (NOTE: You can view and print free copies of your statements that are up to 5 months old online.)
- **Fee to re-open your account:** *$25*

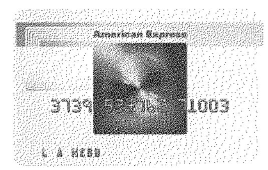
REMEMBER TO REVIEW YOUR CARDMEMBER AGREEMENT ENCLOSED IN THIS BOOKLET



READ YOUR STATEMENT

Every month your billing statement shows you important information about your account. Be sure to carefully read your

- New Balance (the amount you owe),
- Minimum Amount Due,
- Payment Due Date,
- APRs,
- Available Credit Line, and
- Available Cash Advance Limit (which is part of your credit line).



WHAT WE DO NOT DO

- We do not charge a fee to pay your bill (e.g. Pay By Phone or Pay by Computer).
- We do not charge a fee if you go over your credit limit during a billing period and are below your limit at the end of the billing period.
- We do not engage in double-cycle billing.
- We do not practice universal default or change your APR solely because you pay late with any other creditor.

ABOUT ARBITRATION

If you or we disagree about a transaction on your account, either of us may choose to have an impartial arbitrator settle the issue, therefore, the dispute will not be heard in court.

BE SMART ABOUT CREDIT
10 TIPS FOR MAKING THE MOST OF YOUR AMERICAN EXPRESS CARD

1. Choose the Card that's right for you. Think about the features that are important to you so you don't pay for features you won't use. Consider fees, rewards and interest rates. We offer a choice of products designed to meet specific customer needs, from charge cards with rich rewards, no pre-set spending limits and annual fees, to credit cards with no fees at all. See our helpful Card Finder.

2. Take the time to understand your terms and conditions. By signing up for a Card, you agree to adhere to the terms of the account. If you don't, there are penalties. This ensures that customers who adhere to the terms of their account aren't subsidizing those who don't. To help you understand the terms and conditions of your credit card, read Credit Cards: What You Need to Know.

3. Pay your bill on time to avoid late fees and higher interest rates. Paying late can be costly. Note your payment due date. You should also know that American Express will not raise your interest rate or assess fees based on your payment history with other companies.

4. Make payments electronically or by phone, free of charge. It's fast and avoids the time and expense of mail. Sign Up to Pay Your Bill Online. (Note: You'll be prompted to log in to your account first.)

5. Pay more than the minimum due to pay off your balance more quickly and reduce interest charges. By paying only the minimum due every month you will add to the amount of interest you pay over time. This means you'll end up paying more for your purchases.

6. Pay your balance in full each month by the payment due date to take advantage of an interest-free grace period on purchases. Unlike cash or debit cards, using a credit card to make purchases and paying your balance in full each month gives you an interest-free, unsecured loan.

7. Use free alerts to manage your accounts via e-mail or phone. You can sign up for alerts to let you know your payment due date, that your payment has been received, if there is irregular activity on your account, to provide an update on your balance, and to track spending. Sign Up for Account Alerts (Note: You'll be prompted to log in to your account first.)

You can also sign up to receive your statement online as soon as it's issued – free of charge. Sign Up for Online Statements (Note: You'll be prompted to log in to your account first.)

8. Know your credit limit and don't exceed it to avoid over-limit fees and higher interest rates. (See above tip to sign up for alerts to let you know when you are nearing your credit limit.) Over-limit fees and default-tier interest rates will add to the total amount you end up paying for purchases.

9. Know the terms of special offers. Balance transfers and introductory offers can come with lower interest rates for a set period of time. Payments you make while taking advantage of low-rate offers will first be applied to balances carrying the lowest rates.

10. Rest assured that you are never liable for fraudulent charges on your statement. You can check your bill online for additional detail on any charges you don't recognize. Then, simply contact us if you notice any unauthorized charges. Log In to Your Account.

Note: These tips are applicable to all American Express-issued Cards in the U.S.

TIP: Avoid last minute, fee-based payment methods. Look for online bill pay, pay-by-phone or automatic payments that do not carry a fee.

Over-the-credit-limit fee: Charged if you go over your credit limit.

TIP: Know your credit limit. Call your card issuer in advance if you need an increase. Ask your issuer if it has free e-mail services that alert you when you are approaching your credit limit.

Statement copy fee: Charged for extra copies of monthly statements.

TIP: File statements for the past three years in a secure location. If you sign up for online access to your accounts, you can download your statements and keep them in your computer.

Stop payment fee: Charged when you stop payment on a credit card convenience check.

TIP: Be cautious about using convenience checks. If you write one and it is lost, you may not be able to avoid this fee.

Wire transfer fee: Charged when you use your card to transfer money or when you buy money orders, lottery tickets or casino gaming chips.

TIP: Pay for these services with a personal check or cash.

This brochure was created by

Consumer Action (CA) · www.consumer-action.org

CA's site features free credit card surveys with interest rates, fees and other terms for dozens of credit cards, as well as free brochures and guides on choosing and using credit cards. Counselors speak Chinese, English and Spanish. 415-777-9635 and 213-624-8327, TTY: 415-777-9456; e-mail: hotline@consumer-action.org.

American Express · www.americanexpress.com

Find tips on using credit cards, money management, fraud protection, travel, shopping online and more. From the home page, click on "About American Express" and then on "Consumer Resources," then "Ask American Express."

Credit Cards

What You Need To Know

A Consumer Action Publication

Credit is a valuable and necessary financial tool. It can help you establish a credit history, make purchases conveniently, and take advantage of the benefits and services offered by credit issuers.

Not managing your credit wisely can lead to:

- Increased annual percentage rates (APRs)
- Unnecessary fees
- A decline in your credit score
- Denials of future credit

All of these negative consequences can be avoided

Types of Cards

Credit cards

- Revolving credit line
- Pre-set credit limit
- Pay charges in full, pay the minimum due or make a partial payment

Charge cards

- All charges due in full every month
- No interest charged
- No pre-set spending or credit limits

Secured credit cards

- Guaranteed by money deposited in an account
- Credit limit equals the amount of the deposit

Sub-prime credit cards

- Low credit line, large upfront fees, high interest rates
- Marketed to people with lower credit scores

Prepaid or stored value cards

- "Loaded" with funds using cash, debit or credit card
- Value reduced as card is used
- Can be "reloaded" to add more money
- No interest charged
- Initial fees to buy and load the card, subsequent fees to reload

This guide can help you:

- **Learn the different types of cards that are available.**
- **Sort through offers and choose the card that's right for you.**
- **Understand credit card terms and conditions.**
- **Avoid fees and penalty rates.**

Card Offers

There are two types of card offers — pre-approved and invitations to apply. These offers come in the mail, by telephone, online, and in-person at some retail stores.

Pre-approved offers are made based on your credit history. Federal law requires that these contain a firm offer of credit. The only exception is if you have experienced a serious decline in creditworthiness since the offer was made.

Invitations to apply simply ask you to apply for a card. This does not require a firm offer of credit.

To compare basic terms on card offers, look for a box listing interest rates, the grace period and annual fee, among other information. This box, required by law, is often headed with the words "disclosures" or "summary of terms."

Before responding to any offer, you should know that:

- Not all terms are included in the initial offer. Important information can be found only in the "cardholder agreement" that will be sent with your new card.
- You may not qualify for some offers you receive. Once you apply, you may be offered less favorable credit terms.
- Card offers often state: "You have been approved for a credit line of up to $100,000." The key words are "up to." When you apply, you won't know how much credit you will receive. The company can, and often will, give you a lower credit limit.
- "No annual fee" offers may require you to make a minimum number of purchases using the card or you will be charged an "inactivity fee," similar to an annual fee.
- A "fixed introductory rate" is fixed, but only for the introductory period, such as six months. The rate will change after that time and may even become a "variable rate."
- Fixed interest rates can change at any time after a 15-day change-in-terms notice. Fixed rates can also change if you pay late or do anything else to expose yourself to a penalty rate increase — for example, making a late payment or bouncing a check.
- Many offers include the opportunity to transfer a balance from another card without paying a fee. Ask if you can wait until you get the card to transfer a balance. If the balance you want to transfer is higher than the credit limit on your new card, the company will only transfer a portion of your balance, leaving you with a balance on the old card.
- Sometimes cards have low introductory rates that are good for balance transfers or purchases or both. In this case, your payments are typically allocated first to the balances with lower APRs. Higher interest balances are paid down only after balances with lower APRs. Sometimes the low balance transfer rate comes with a requirement that you must make a minimum number of new purchases each month.

If you have any questions about a credit card offer, check the company's website for more information or call the company's toll-free number before you apply.

Card Terms and Conditions

When you receive your new card, you will also receive a "cardholder agreement," a legal contract between you and the card issuer. By using your new card, you agree to honor the terms and conditions in the agreement.

Terms and conditions in the cardholder agreement can change at any time. Changes are usually sent to you by mail. When you use your card after receiving the notice of changes, this means you have accepted the changes, even if you didn't read the notice. Read everything your card issuer sends.

Save your cardholder agreement in a file that is easily accessible, so you can refer to it when you have questions.

Annual percentage rate (APR): A card's interest charge, expressed as a yearly rate.

Variable rates: Interest rates that change according to a set formula, such as Prime Rate + 3%. If your card has a variable rate, the APR changes when interest rates change.

Fixed interest rates: The set APR on your card, which can change only when you receive 15 days notice.

Default or penalty rate: A higher interest rate charged if you pay late, bounce a check or your credit gets worse. Also charged by some card issuers if you pay late on credit cards or loans with other banks.

Cash advance APR: The interest rate you pay when you use your card to get cash. Most cards charge a higher interest rate for cash advances than for purchases.

Daily periodic rate: Your APR divided by 365 days.

Arbitration: A form of dispute resolution that is often binding with no right to appeal. Arbitration provisions may prevent you from suing the company in court or participating in class action lawsuits. However, some companies allow you to take your case to small claims court if the amount you are disputing is within the small claims limit.

Balance transfers: The ability to transfer the balance from one card to another. If applicable, interest on balance transfers begins to accrue immediately.

Convenience checks: Checks linked to your credit card account. They can be used to transfer a balance from another card or to make purchases or payments.

Double-cycle billing: The calculation of your interest considering your average daily balance over a two month period, which may result in additional finance charges.

Grace period: Period in which finance charges do not accrue if you are not carrying a balance.

Minimum monthly payment: The lowest amount that you are required to pay the credit card company each month.

Payment due date: The last day that payment can be accepted without penalty. Your payment may be required to arrive by a deadline on the due date, such as 1 p.m.

Prime Rate: The "index" most commonly used to determine variable interest rates. It can be found in the business section of your newspaper or online.

Avoiding Credit Card Fees

You can avoid fees by carefully managing your account. Here are common fees and tips on how to avoid them:

Annual or monthly fee: Common on charge cards, rewards and airline miles credit cards and on secured and sub-prime cards. Sometimes applied if you don't use your card at least a few times during the year.

TIP: Consider the overall value when comparing fee and no-fee cards. If you are thinking about getting a rewards or airlines miles card, make sure the card's benefits are worth the cost of an annual fee.

Application processing fee: Charged on many sub-prime cards and some secured cards when an account is opened.

TIP: Secured credit cards are generally much better deals than sub-prime credit cards, and you can find secured credit cards that don't charge application fees.

Account reopening fee: Charged if your account is closed or cancelled by the issuer and you ask to have it reopened.

TIP: Pay your bills on time to avoid card cancellation and an account reopening fee.

Balance transfer fee: Charged for transferring a balance from one card to another, this fee is commonly assessed as a percentage of the balance transferred.

TIP: When you apply for a new card, ask about balance transfer fees. Most companies don't charge these fees to new cardholders for the first month or two.

Bounced check or returned item fee: Charged if your check bounces.

TIP: Make sure you have sufficient funds in your bank account to cover your check.

Cash advance fee: Charged as a percentage of the cash advance, with minimum charges common.

TIP: Cash advances are an expensive way to get cash. Not only do you pay a fee, but interest on cash advance balances begins to accrue immediately. Instead, use your ATM or debit card to withdraw cash from your checking or savings account at ATMs.

Foreign currency conversion fee: Charged when you make purchases overseas and the charges have to be converted to U.S. dollars.

TIP: If you plan to use a card while traveling outside of the U.S., shop around to find a card with a currency conversion method that is favorable to you.

Late fee: Charged if your payment is late, sometimes even if it is received on the due date after a certain hour.

TIP: Always pay your bill on time. If you send your payment by mail, allow at least seven days for the payment to reach your issuer. Consider other payment methods, such as online bill pay, pay-by-phone or automatic payments. Ask if your issuer offers e-mail reminders.

Pay-by-phone or computer fees: Charged by some companies to pay your bill by phone or computer.

Spending and saving

Wants and needs. Explaining the difference between wants and needs is an important lesson to help young people develop wise money management and spending habits.

Wants are items you'd like to have but can easily do without, like a new video game or a $4 smoothie. Needs are items you can't live without, like food, housing and getting to work.

You can save money by doing without some of the things you want but don't really need.

Setting limits. If your children have credit cards on your account, agree on a spending limit before you hand over the card. Consider asking your kids to pay their own charges–or maybe ask them to pay just for special items.

Talking money. There are many opportunities to teach children about money.

- Give younger children a piggy bank to save for a toy they want. This illustrates that you can't always get things immediately–you have to save the money to buy them.
- When you go to the store, make a game of comparison shopping by asking your kids to find the products that are on sale.
- Next time your kids demand a costly item, talk about how many hours it takes to earn the money to buy it.

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Consumer Action · www.consumer-action.org

Free information and advice on choosing and using credit cards. Counselors speak English, Spanish and Chinese. 415-777-9635 and 213-624-8327, TTY: 415-777-9456; e-mail: hotline@consumer-action.org.

American Express · www.americanexpress.com

Find tips on using credit cards, money management, fraud protection, travel, shopping online and more, on the American Express "Financial Fitness" web site:

www.americanexpress.com/financialfitness

Families *and* Credit Cards

Youth and credit cards

Adding cardholders to your account

Secondary cardholder policies

Building credit

A Consumer Action Publication

Parents usually are the best people to teach their kids about credit, and since even young children can use credit cards, it's never too early to begin this education.

Many parents believe that giving children a credit card is like giving them training wheels to a lifetime of good credit management. However, bad credit decisions can haunt you for many years.

Early discussions about how to use credit wisely can help kids steer clear of trouble when they become adults, and show them how to get the most out of credit.

It's your call

Give your child a credit card? It's a decision only parents can make.

Consider age, maturity, life needs and your family's spending style.

While cards are available for even the youngest children, many parents postpone the decision until their children become teenagers.

Ask yourself:

- **Am I comfortable with the idea of my child using a credit card?**
- **What would my child use a credit card for?**

  For example:

  A credit/charge card could come in handy for emergencies.

  If your child's school goes on a field trip, she could use a credit card to pay for lunch.

  If your child likes to choose his own clothes, you could let him go shopping by himself.
- **Is my child responsible enough to control the use of a credit card?**
- **Would giving my child a credit card help instill financial responsibility?**

If you decide that you want to give your child a credit card, it's important to understand the ways cards are issued to minors.

Minors and credit cards

Most U.S. credit card companies do not provide individual credit card accounts to minors, because children are not able to enter into legal contracts. Parents who want their minor children to have a credit card can get them a card that is linked to the parent's card account. The minor holding an additional card is called an additional cardholder, authorized user or secondary account holder.

Only the primary account holders are legally responsible for making payments. If the primary account holders fail to make payments, their credit history will be damaged. Depending on the issuer, the additional cardholder's credit may suffer, too.

Additional cardholders

Credit card policies for secondary accounts vary widely depending on the issuer:

- ***Minimum age.*** Some card issuers have a minimum age for secondary cardholders, while others have no age limit.
- ***Account numbers.*** Depending on the issuer, secondary cardholders might be issued a card with the same account number as the primary cardholder, or one with a different number. A separate number can be a benefit if the card is lost or stolen.
- ***Billing statements.*** Depending on the issuer, charges may or may not be grouped by user on the billing statement. When transactions are listed in separate sections on the statement, it is easier to keep track of spending by card.
- ***Credit reporting.*** Most companies report the primary cardholder's payment history on the secondary user's credit report. A few companies do not report this information for additional cardholders under 18.
- ***Responsibility.*** Most card companies do not inquire about additional cardholders' credit histories or income levels. The primary cardholder agrees to be responsible for all purchases and cash withdrawals made by the secondary cardholder.
- ***Marketing.*** Practices targeting secondary cardholders vary by issuer. Secondary cardholders might receive credit solicitations if information about the user is being reported to major credit reporting bureaus. Some companies voluntarily suppress credit reporting information on minors' accounts in order to avoid sending solicitations.
- ***Debt collection.*** If the primary cardholder defaults on the credit card, debt collectors may contact the secondary cardholder but cannot hold the secondary cardholder liable for payment on the account. Negative information about the primary cardholder may be reported to credit bureaus under the secondary cardholders' names. Some companies do not report credit data on minors. Secondary cardholders should dispute credit report information on debts for which they are not liable, and resist the pressure to pay.

Credit & spending management tools

Many card issuers offer controls and tools to help you manage your family's spending.

Online access. Set up online access to credit cards and bank accounts, so you and your kids can track your spending. If you know your balance you'll be less likely to go over budget, incur over-the-limit penalties or face unexpectedly steep bills at the end of the billing cycle.

Statements. Credit, charge and debit cards (and some prepaid cards) list all purchases on each monthly statement, and many allow you to track unbilled activity online between statements. Some companies provide a year-end statement featuring purchase and payment history to illustrate where you have spent your money. Some companies allow you to track transactions by category across your cards.

Alerts. Many card issuers offer alerts to notify you when you are near your credit limit or when you have spent a certain amount on a card. You might be able to set up reminders or warnings for due dates, automatic payments, low balances, withdrawals or out-of-pattern activity. Alerts may be available by e-mail, phone or PDA (personal digital assistant).

Financial calculators. Online calculators make great interactive teaching tools. Show your kids how long it takes to pay off a certain credit card balance or compare how much interest you'll owe according to a loan's term and interest rate.

Charge cards. Some people find that charge cards are easier to control, as they require full payment each month. Since they don't have a pre-set spending limit, they might be a good option for travelers or for making important purchases.

Credit card balancing act

To pay off a credit card balance of $1,000 on a 15% card by making monthly minimum payments of 3% of the balance takes approximately 106 months (almost nine years).

Interest charges can add up to $576 to the original $1,000 balance.

Instead, if you pay $40 every month, it will take less than three years to pay off, at a cost of $206 in interest. Source: Bankrate.com

Credit for the 18-plus set

If your child is 18 or older, and is denied a card because of a lack of credit history, you may choose to co-sign the application. Card companies allow people with good credit to co-sign accounts for people who need to establish credit.

When you co-sign a card account or loan, you are legally responsible for the debt. Your credit record could be damaged if payments are not made on the account.

As a co-signer, you will not receive statements. Check that payments are being made on time by getting the account number and setting up online or phone access to the account. Monitor the account and limit any negative impact to your credit history by making payments.

Alternatives to credit cards

Credit cards are not the only convenient plastic payment method:

Charge cards, like credit cards, allow you to charge purchases. You must pay your bill in full each month, which avoids interest payments and helps you manage spending. Unlike credit cards, you can't carry a balance on a charge card.

Debit cards look like credit cards but the money spent is withdrawn from your checking account. Debit cards can be used to make purchases or to withdraw cash. If you are interested in this option, look for youth checking accounts that come with a debit card.

Prepaid cards, also called stored value cards, look like credit or debit cards but contain only the money you choose to load on it. The card can also be used to withdraw funds at ATMs or make purchases at stores that accept credit cards.

Secured cards are a way for people without a credit history to build credit. These are credit cards backed by money you deposit with the issuer. If you default on your card, you forfeit the amount deposited.

Tips to share with kids

- Review bank account statements and credit card bills closely. Dispute unauthorized purchases within 60 days. Keep receipts and match them against statements.
- Don't lend your credit, charge or debit card to anyone. You can be held responsible for any purchases made.
- Pay more than the minimum monthly payment; even a few dollars more helps. Making minimum payments means it will take longer to pay off your balance and will increase the amount of interest you pay.
- Pay on time, since late payments can raise your interest rate and have a negative effect on your credit history.
- A damaged credit history can affect your life. It can make it difficult to get a loan, apartment or even a job.

Kids away from home

[illegible]

[redacted]

1) Name [redacted]
Card Type
Member Since
Story : Back in the mid 1980's, my husband was perhaps not the best choice of life partners. In the end, he took the credit cards in my wallet without my knowledge and charged a large amount in purchases, which he then returned for cash and disappeared. This left me with a 2 year old, a newborn, and no one to watch the kids. We had been making ends meet by managing apartments, providing us with a 'free' apartment and allowing 'daddy' to stay home with the girls while I worked my University job to provide health benefits and cash for us all. When he left, he also took the month's rental payments from 2 apartment buildings, so the girls and I were out on the street. (My state was a community property state so we were BOTH equally responsible for those rent monies, even though his was a criminal act.)

He had applied for and received a [redacted] card in my name that I didn't even know existed, so of course I had never signed it. [redacted] did not care that the card was obtained through fraud and continued to press me to repay his charges. Although my other cards (local businesses and gas cards primarily) were legal cards, those providers also did not care about the circumstances and continued to press me to pay what I did not have. I felt the right thing for them to do would have been to report his actions to the police and follow through on criminal charges, though they didn't care about morality - just the easiest way to recover their funds.

At that time I was taking home $810 a month, daycare was $410 and rent on the tiny house we found - sans utilities - was $350. The remaining $50 was supposed to feed the 3 of us, pay utilities, transportation, medical costs — everything else! I made $10 too much for any assistance of any kind - even food stamps. I COULD NOT PAY ANYTHING to any of these creditors. I was forced to file bankruptcy with NO debts of my own making.

The ONLY company that dealt with me humanely, morally, ethically, and reasonably was American Express. When I informed them that he was not a legal signature on my card, all charges made by him were wiped off my record. Just like that. No threats, no demand letters, no collection calls, no lawyers. And no negative report against my credit history.
This action certainly allowed my small family to survive very hard times. Without it we couldn't have eaten many days. I continue to be grateful 20 years later.

Not every card holder uses it for travel expenses, vacations, boats and luxuries. NO every card holder cares that they could get funds in any foreign country or that they could stay in a nicer lounge in some airports. Some of us rely on the card for necessities only, and to get past rough financial times. Some of us use it to survive.

My girls are now in their 20's, and I am sincere when I say my American Express card allowed them to get there. They were the only creditor that demonstrated true humanity - not to mention followed their own written contract with me!

I realize this isn't the 'usual' letter you get in support of AmEx, however, it just may be the most sincere! thanks again for showing me that big business CAN succeed with heart!

[redacted]

11/12/07

NOV 2007
Received
Judson C. Linville
Submitted to ECR for
Response

Mr. Jud Linville
American Express
777 American Express Expressway
Ft. Lauderdale, FL 33337-0001

Dear Mr. Linville,

I would like to take this opportunity to thank you for your recent letter dated October 29, 2007 (enclosed). I appreciate this kind gesture.

As you can tell by our payment history of this account, we make it a practice to pay bills on time. This was not an oversight, but a situation beyond my control. Our daughter, who is away at school, became very ill. To make a long story short, a misdiagnosed appendicitis resulted in two hospital stays and two surgeries for her and I was away from home for over three weeks in order to be with her. Of course, all my bills were at home, so they were all late this month. I want to let you know that American Express is the only company that contacted us and provided this excusal. Again, I appreciate it.

Thank you for your consideration.

[redacted]

[redacted]

American Express
777 American Expressway
Ft. Lauderdale, FL 33337-0001

[redacted]
Saint Louis, MO [redacted]

02139

October 29, 2007

Dear [redacted]

We understand that life can get busy and sometimes even everyday things can slip through the cracks. You may not have noticed, but you were recently late on a payment on your [redacted] account ending in [redacted] This typically would have resulted in a late fee and an increase in your APR.

However, we greatly value your membership and, upon careful review of your account, we have decided to grant a one time late fee exception and will not be increasing your APR as a result of your late payment.

We want you to continue to enjoy the same great benefits you receive today. Remember to make all your future payments by the payment due date on your monthly billing statement and to follow the terms in your Cardmember Agreement. This way, you will always avoid late fees and APR increases due to late payment.

In order to help you pay on time, American Express provides two great tools to make monthly payments hassle-free:

- **Make your payments on-line from virtually any location at americanexpress.com/payonline or by phone at 1-800-472-9297.**

- **Get notified when your payment is due by signing up for automatic text message alerts or e-mail statement alerts at americanexpress.com/alerts.**

Please do not hesitate to call us if you have any questions. You can always reach us by calling the number on the back of your Card.

Your membership is important to us. We thank you and look forward to serving you in the future.

Sincerely,

Jud Linville
President, Consumer Cards
Member Since 1989

[redacted]
Big Bear Lake, California [redacted]
Email: [redacted]

DEC 2007
Received
Alfred F. Kell...
... for
Response

Mr. A. Kelly, C.E.O.
American Express, Executive Offices,
200 Vessy Street,
New York, New York, 10285-4900

November 24, 2007

Dear Mr. Kelly:

Subject: A letter of appreciation

My wife and I have been Gold Card members for some 30 years. Our experience with American Express has been outstanding.

During the past year we have had an extremely unfortunate experience. Our forty year old son was in an accident in Thailand and today remains in a coma in a hospital in Bangkok. My wife and I have spent nine of the past twelve months at his bedside.

We arrived in Bangkok with adequate cash but quickly found out the urgent medical needs and costs were far beyond the cash we had in hand. We went to your Ari/Bangkok office and met the most remarkable woman.

Mrs. Sirivan Rogers, a Customer Service Representative, went to extraordinary measures to assist us. She involved her manager, Ms. Panchita Suansilpphong, in our plight. The two of them could not do enough for us. Throughout the nine month sojurn, Ms. Rogers called my wife and me every week to ask how she could help. Regardless of what issue I posed--and there were many, she extended herself beyond anyone's expectation. She visited our son in the hospital, sent him flowers, called us before she left on vacation to give us a substitute contact and offered the services of a friend to bring us things from the U.S. More importantly, she arranged for us to use our card for expenses up to $50,000 and arranged systematically every month for us to make a payment by phone from Bangkok. We have encountered numerous administrative, legal, immigration and financial challenges and whenever I contacted Mrs. Rogers she was there with charm and an expedient resolve.

Personally, I have had a 45 year career as an H.R. executive--I have never met an employee as dedicated and service oriented as Mrs. Rogers. Whatever your finest employee recognition award is, she deserves multiples.

I would be thrilled to speak to anyone or write to anyone in a testimony to her incredible dedication to service. I wish your company motto could read: "American Express don't leave home without it or Mrs. Rogers". Make her your star performer in Asia--she deserves it.

Thank you for employing such exemplary people in your world of service.

Sincerely yours,

[redacted]

Smoke and Mirrors

The need to protect consumers from the deceptive practices of the credit card industry

Testimony of

Consumer Action

Linda Sherry
Director, National Priorities

Before

The House Subcommittee on Financial Institutions and Consumer Credit

The Honorable Carolyn Maloney, Chair

Legislative Hearing on H.R. 5244,
The Credit Cardholders' Bill of Rights:
Providing New Protections for Consumers

April 17, 2008

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THE NEED TO PROTECT CONSUMERS FROM THE DECEPTIVE PRACTICES OF THE CREDIT CARD INDUSTRY

H.R. 5244, "The Credit Cardholders' Bill of Rights" takes aim at many of the unfriendly—even abusive—practices of the card industry. Consumer Action[1] would like to thank Rep. Carolyn Maloney, Chair of the Financial Services Subcommittee on Financial Institutions and Consumer Credit, and her staff for their expertise in crafting this bill.

The Honorable Mrs. Maloney, in urging her colleagues to take swift action to reform major credit card industry abuses, rightly notes that Americans are falling deeper into debt at a particularly troubling time in the economy, when recent reports[2] reveal that revolving credit, mostly credit card debt, is growing at rates not seen since 2001.

This means credit cardholders are sitting ducks for the repricing strategies of card issuers, who write themselves a blank check to change rates, fees and other terms at any time, for any reason. In the last year the justifications have been expanded to include the particularly nebulous "market conditions" loophole that has already led to rate hikes at two of the top issuers.[3]

In this testimony, I will present some reasons that Consumer Action believes this legislation is so badly needed:

1) The industry continues to abruptly and unexpectedly change the terms of existing cardholder agreements, often leaving consumers with sharply increased minimum payments on existiug balances.
2) The industry relies on three refutable mantras about risk and access to credit in its attempts to block substantive regulations, which despite excellent counterarguments, have taken on a life of their own.

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[1] Consumer Action (www.consumer-action.org) is a national non-profit consumer education and advocacy organization founded in San Francisco in 1971. Consumer Action serves its members and individuals and community-based organizations nationwide by advancing consumer rights, referring consumers to complaint-handling agencies and publishing educational materials.
[2] "February Debt," Michael McKinstryCardTrak.com, Wed, April 9, 2008, http://www.cardtrak.com/news/2008/04/09/feb_debt
"Some Debt Trends Are Good. This Isn't One of Them," Floyd Norris, New York Times, Jan. 12, 2008, http://www.nytimes.com/2008/01/12/business/12charts.html
[3] "Fed cuts rates for banks; banks hike credit rates," David Lazarus, Feb. 12, 2008, Fresno Bee

3) The industry is unwilling to provide detailed information about how it does business.

The Maloney bill would limit some of the most unfair and deceptive tactics used by the industry including universal default, "any-time, any-reason" rate changes, retroactive application of interest rates for credit-based repricing, and it would guarantee rights to a fixed credit limit that cannot be increased and a meaningful opt-out when terms change.

Issuers keep finding new and creative ways to increase the costs that credit cardholders pay. Yet consumers can't just walk away and find an issuer with fairer terms, even if their credit history is okay, because the dominant issuers have nearly identical terms. Today, a handful of issuers control over 80 percent of the cards. In 1990, the Top 10 issuers held 56.5 percent of the market. By 2004, the Top 10 market share leaped to an estimated 89.5 percent.[4] This lack of consumer choice is a primary reason why substantive regulation, such as "The Credit Cardholders Bill of Rights" is so important.

As I was writing testimony for today's hearing, I paged through dozens of recent credit card complaints received by Consumer Action. On average, in the past year, Consumer Action received two credit card complaints per day. The consumers who reach out to Consumer Action are desperate; many have already contacted the companies and regulators about their grievances and have gotten nowhere.

Thirteen years after I joined the Consumer Action staff and began to advocate for the rights of credit card holders, I am dumbfounded that consumers' complaints about abusive credit card tactics continue. Their common voice gains volume in an unflagging litany of unfairness, while nothing is done to protect them.

When will our leaders in Congress enact strong federal regulation to protect consumers from abusive practices and force the credit card industry to drop its bait-and-switch tactics? Such protection is way overdue. We should not sit by as the industry lures people in at unsustainably low interest rates just to jack up the rates a couple months later, all the while exposing cardholders to even higher, punishing rates if, heaven forbid, they pay one day late.

Consumer Action's complaint database shows there is no wiggle room for cardholders. No concessions are given. People are told, "We can change your interest rate and terms at any time for no reason." A cardholder tells us she has paid $14,000 in interest and fees on a credit limit of $6,000, and she still owes $11,000 and change. We flinch when a legitimate dispute over billing favors the merchant and leaves a consumer holding the bag for defective, potentially unsafe tires for the family car. We cringe at a story about late fees and interest piled on a zero balance card to which an automatic charge was added without the cardholder's knowledge while she was stationed overseas.[5]

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[4] "For credit card issuers, there's plenty of room at the top," June 6, 2006, Jeremy Simon, CreditCards.com, http://www.creditcards.com/For-Issuers-Theres-Plenty-of-Room-at-the-Top.php

[5] These are actual examples taken from recent consumer complaints received by Consumer Action (www.consumer-action.org).

We believe the issuers when they say revolving credit is a risky business. It is risky for cardholders as well as card issuers—yet that business remains immensely profitable.[6] The risk should be to the banks that offer revolving credit—not to individuals who are granted credit and attempt to follow rules written in disappearing ink.

Changing the rules in mid-game

"Any time, any reason" repricing needs to go. HR 5244 would prohibit companies from arbitrarily changing contract terms.

Consumers are taking on more debt, which makes them more vulnerable to the repricing tricks of the industry. Consumers may reasonably ask, "What exactly are we buying?" Shoppers' expectation that prices will be honored does not hold up in the credit card world.

When cardholders accept the offered price they don't know how "market conditions" will change and impact the cost of carrying the balances they took on at a lower interest rate. Consumers should not need a crystal ball when they enter a contract.

Consumer Action last week reviewed online disclosures at five top credit card lenders, Bank of America, Chase, Citi, American Express and Capital One. All write themselves a blank check to change rates, although Citi will not make changes for two years, at which time it will assess "market conditions" in evaluating the account. This is comforting!

Some of the following disclaimers are so broad they seem comic. But given the damage wreaked on struggling families, this is not a laughing matter. (In these examples, boldface emphasis is added by Consumer Action to assist the reader.)

> Bank of America[7] states: *Account and Agreement* ***terms are not guaranteed for any period of time; all terms, including the APRs and fees, may change*** *in accordance with the Agreement and applicable law. We may change them based on information in your credit report, market conditions, business strategies, or for any reason.*
>
> Chase[8] states: *Rates, fees, and terms may change: We reserve the right to change the account terms (including the APRs) at any time for any reason, in addition to APR increases that may occur for failure to comply with the terms of your account.* ***The***

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[6] "Credit Card Issuers Profits Grew," Ellen Cannon, Bankrate.com, Jan. 9, 2008
Credit card issuers earned $90.1 billion from interest charged to cardholders (up from $89.4 billion in 2005). They earned $55.2 billion from fees (up from $54.8 billion in '05). The net pretax profit was $36.8 billion, up from $35.7 billion in '05. (http://www.bankrate.com/yho/story_content.asp?story_uid=20776)

[7] Bank of America web site, April 11, 2008.
http://www.bankofamerica.com/creditcards/index.cfm?context_id=marketing_detail&offer_id=ECOMM0908API00400800122011EN000&left_hig=all_cards

[8] Chase web site, April 11, 2008.
https://app.firstusa.com/ICAppServlet?SPID=BLNS&PID=none&CELL=66rs&AFFID=&CLICK=&CID=&PROMO=DF01#

> ***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.*** *Any changes will be in accordance with your account agreement.*
>
> Citi[9] states: *When can we change the rates, fees, and terms of your card agreement? We will not voluntarily increase your rates and fees or change other terms of your card agreement until your card expires, typically in two years.* ***At that time, we will review your credit history and general market conditions.*** *If we decide to make changes after our review, you will receive advance notice and a right to opt out. If you opt out, we will close your account. You can then pay the remaining balance under the old rates, fees, and terms. Of course this paragraph does not apply to the automatic default APR and Prime Rate changes. It also does not apply to changes required by law, our regulators, or our network providers.*
>
> American Express[10] states: *The terms of your account, including APRs, are subject to change. The APRs for this offer are not guaranteed; APRs may change to higher APRs, fixed APRs may change to variable APRs, or variable APRs may change to fixed APRs.* ***We may change the terms (including APRs) at any time for any reason,*** *in addition to APR increases for failure to comply with the terms of your account. Any changes will be in accordance with your Cardmember Agreement.*
>
> Capital One[11] states: *Can You Increase My APRs? Your APRs can increase to the Default APR if your payment is received late (3 or more days after your payment due date) twice within any 12 billing periods. If we increase your APRs for late payments, we will return you to your prior APRs if you make at least the minimum payment on time for 12 consecutive billing periods.* ***In the future, we may increase your APRs if market conditions change.*** *If we increase your APRs for any reason other than if you paid late as disclosed above, we will notify you in writing of your options in advance, including the right to opt out.*

Many of the disclosures outlined above refer to a cardholder agreement, or contract. It remains a fundamental unfairness that credit card issuers do not supply the full contract terms until after the consumer has applied for and received the card. Therefore pre-application solicitation disclosures that state all changes are in accordance with cardholder agreements are meaningless.

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[9] Citicards web site:
https://www.accountonline.com/ACQ/DisplayTerms?sc=4DNZ18A73000000000W&app=UNSOL&siteId=cb&langId=en&BUS_TYP_CD=CONSUMER&DOWNSELL_LEVEL=2&BALCON_SC=&B=M&DOWNSELL_BRANDS=M,M,&DownsellSourceCode1=4DNZ28E73000000000W&B1=M&DownsellSourceCode2=4DNZ38C73000000000W&B2=M&t=t&uc=2J9&productConId=BM4DNZ1

[10] American Express web site, April 11, 2008
https://www201.americanexpress.com/cards/Applyfservlet?csi=29/24000/b/10/3384663335/338033120336/20/n&from=0&mgmID=undefined

[11] Capital One web site , April 11, 2008
http://www.capitalone.com/creditcards/products/10415/14/disclosures.php?linkid=WWW_Z_Z_v1_CP41514_D3_01_T_CP41514D

In-house universal default

In this era of large conglomerate financial services institutions, many companies assess customer risk across the entire suite of products they offer. This is a little known risk assessment tool that could be called "in-house universal default."

For instance, a consumer with a checking, mortgage and credit card from the same institution is placed in an especially precarious position. While many card issuers say they do not use risk-based pricing based on how their customers perform at other financial institutions (universal default), they do in fact look at all the customer relationships under their own umbrellas.

A consumer who bounced a check or paid their mortgage late on other in-house accounts could get hit with an interest rate hike. This is a clear downside to the oft-touted convenience of having all of your financial services at one institution.

Arguments against regulation

As we fight for the rights of credit cardholders, we continually hear three dubious messages from the industry and its hired consultants:

- The cross subsidization inherent in risk-based pricing benefits creditworthy consumers through lower prices.
- Regulation and legislation would limit access to credit cards for low-income households.
- Risk based pricing deters irresponsible credit use ("moral hazard" argument).

These theories have been countered in research by respected academics including Adam J. Levitin, Cathy Lesser Mansfield and Lawrence M. Ausubel. Some of these research papers have been entered into the public record at previous hearings before this subcommittee.

Ausubel[12] has developed an economic model that appears to show that even under robust competition and "perfectly optimizing behavior" by consumers, universal default clauses may result in penalty interest rates exceeding the enhanced risk faced by the issuers (i.e. opportunistic pricing). He notes that universal default may tend to increase the difficulty for consumers to emerge from debt without serious defaults or bankruptcy. (Default and bankruptcy drive up costs for all cardholders.)

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[12] Lawrence M. Ausubel: "Penalty Interest Rates, Universal Default, and the Common Pool Problem of Credit Card Debt" (Preliminary paper, jointly authored with Amanda E. Dawsey of the University of Montana)

Mansfield in her commentary[13] on credit card use among low-income consumers argues that even if credit card companies were forced to reduce charges, they could still turn a respectable profit because many low-income consumers need and use cards to pay off balances over time, which generates interest income. She also notes that anti-predatory lending regulation at the state level has not decimated the market for affordable loan products.

Levitin refutes the moral hazard argument[14] in his critique[15] of an American Bankers Association paper, which predictably concluded that there is no basis for credit card price structure regulation. He counters that the moral hazard argument is flawed because issuers often determine credit risk by factors that are out of consumer control and that are possibly inaccurate to begin with. Levitin notes: "A consumer simply cannot know whether opening up an additional line of credit will result in a higher interest rate or not under unilateral term change provisions." You can't game the system if you don't know the rules.

Lack of transparency

Credit card companies are aggressively hawking their products while withholding answers that could help card users make wiser choices about the cost of credit.

What do we really know about the credit card industry? It's difficult enough to find accurate pricing information, especially when faced with "any time, any reason" contract loopholes. We know little about how the industry makes its profits: Which proportions of its vigorous profit comes from interest on revolving balances, interchange fees, penalty interest rates or penalty fees? We just don't know.

When the U.S. General Accountability Office (GAO) conducted a study of the credit card industry in 2006, it stated that it was not able to accurately determine the extent to which penalty interest and fee charges are contributing to card issuer revenues and profits, because limited information is available from publicly disclosed financial information and the issuers told the GAO that their systems could not provide this information in detail.

HR 5244 would require more detailed data collection by the Federal Reserve about credit card pricing. Like other researchers in the field, we would welcome such public information.

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[13] Cathy Lesser Mansfield: "A Commentary on Beyond Usury: A Study of Credit Card Use and Preference Among Low-Income Consumers by Professor Angela Littwin." Mansfield is a professor of law at Drake University Law School in Des Moines, Iowa.

[14] When someone does not bear the full costs of his actions, he is likely to engage in riskier behavior than he would otherwise, and that risk-based repricing will effectively dissuade risky credit behavior.

[15] Adam J. Levitin. "A Critique of the American Bankers Association's Study on Credit Card Regulation," 2008. Available at: http://works.bepress.com/adam_levitin/4

For more than two decades, Consumer Action regularly has examined credit card rates and charges in order to track trends in the industry and assist consumers in comparing cards.

During our credit card survey we call companies' toll-free numbers posing as consumers. This gives us insight into what people face when they call to ask questions about the cost of credit. We believe consumers should be able to obtain clear and complete facts about credit card rates and charges, especially before they apply for credit.

In the past two months Consumer Action has collected data for its 2008 Credit Card Survey with the assistance of graduate and undergraduate students under the supervision of Professor Irene Leech at the Virginia Institute of Technology. We are surveying cards issued by the Top Ten companies, the lowest rate cards we can find, and cards issued by large national credit unions.

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

Sheree Jones, one of the Virginia Tech students surveying on behalf of Consumer Action, noted that most of the issuer websites lack in-depth information beyond APR and some of the more common fees, and that the representatives are limited in their knowledge of terms. Questions such as, "How would you let me know if you applied a different rate to the card?" commonly drew "don't know" answers, noted Jones.

And not only do the representatives lack key knowledge, they are downright dismissive and unpleasant in some cases. Jones recounts that Bank of America's representatives were rude when she tried to ask questions. "At first, the representative answered my questions so fast that I could not understand what he was saying. Every time he finished an answer he would ask if I was ready to apply for a card. When I kept asking questions, the representative showed he did not want to answer the questions, proceeding to talk over me as if I was not speaking. Then he just started asking me questions that related to me applying for the credit card. As I tried to hang up, he tried hardest to persuade me to apply now for a credit card and would not let me off the phone, almost forcing me to hang up."

At Everbank, an issuer of low-rate cards, the student surveyor noted, "After being transferred approximately five times, a representative claimed not to understand why I kept being transferred back and forth between customer service and the application department. She started raising her voice, asking why I kept calling (even though I had only called twice but had been transferred five times), why I asked so many questions, and questioned the reason for my call."

This is an outrageous way to treat potential customers, who have a right to ask about the costs associated with a credit card, in as much detail as they see fit.

The student surveyor also noted that:

- The information some credit card companies had on their websites conflicted with what the representative said.
- Many of the cards with high fees had their information in very small print on their web sites and that the disclosure statement [required by law] was not easily accessible.

Credit Cardholders Bill of Rights

Before closing, I would like to bring to your attention just how important the issue of credit card reform is to your constituents. Consumer Action provides a free online "Take@ction" center on its website at www.consumer-action.org. To date, in the 110^{th} Congress alone, 17,733 individuals have visited our site to send letters to ***their*** Representatives and Senators asking for legislation to protect cardholders from abusive credit card industry practices. This is a truly "hot button" issue for the people you represent!

I thank you for your diligence in investigating credit card industry practices and I urge you to support legislation to protect consumers who use credit cards. HR 5244 would change the way most credit card companies do business and provide significant consumer protections. This is a nonpartisan issue. Please work together to pass HR 5244 today.

Linda Sherry
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TESTIMONY OF
STEPHEN M. STRACHAN,
York, PA

Subcommittee on Financial Institutions and Consumer Credit
United States House of Representatives

April 17, 2008

Containing: Testimony and Addendum = 11 pages
Exhibits #1-18 (total exhibits = 36 pages)

Madam Chair and Members of the Subcommittee, 04/17/2008

My name is Stephen Strachan and I am a small business owner residing in York, PA. Thank you for this opportunity to air experiences, grievances, and suggestions for inclusion to future amendments to the Truth in Lending and Fair Credit Reporting Acts. I have been importing fresh flowers for over 27 years, acting as importer, broker, and wholesaler. The international nature of my business has required a considerable amount of travel along with a comprehensive knowledge and working understanding of banking, finance and general procedures relevant to international trading in perishable commodities. I have supplied a brief CV along with written testimony for your review. As a small business owner, my businesses, clients, family and I were severely impacted by dubious practices that are now loosely and vaguely refer to as "Risk-Based-Pricing", "Credit Scoring" and "Universal Default", and addressed in HR5244. My testimony is representative of similar experiences befallen and continuing to plague small business credit card holders. During the period in which I experienced the lion's share of lender abuse, I was the U.S. partner with three Australian joint ventures in CA during a 9-year tenure as an Australian Trade representative (AUSTRADE), a partner and principal in a wholesale floral distributor in NY, and operated my business in CA importing and distributing fresh floral products and commodities. It was during this time that I was forced to cut back medical benefits, reduce hiring, and eventually shut down businesses due to predatory abuses suffered at the hands of some lenders that effectively left me with an insufficient access to working capital. Throughout my career, traditional financing for my flower businesses has been elusive due to the Perishables nature. Personal credit limits totaled over $500,000, and low-APR promotional offers are still received regularly. I continue to maintain a high FICO score (782). Deficits were met by utilization of my credit as loans to my business as required, at affordable rates literally unobtainable otherwise. I had no reason to foresee the abuses that I came to experience.

Over a 4-year period from 2001-2004, I had over 140 payable vendors to whom checks and wires were sent regularly. My experiences with one vendor, Bank One/Chase , represents the sum total of credit issues that I wrestled with then and must still deal with today. Repeated consecutive occasions saw Chase Bank "computer updates" delete part of my mailing address after moving offices and notifying Chase. At first, statements arrived as normal. I was then told by a Chase "Supervisor" that they were not required to send out statements. In another case, another Chase account was even overpaid many years early after consecutive multiple APR increases, all the while receiving 3.99% "Life of Loan" offers on the same account. I was unable to confirm a final payoff amount and overpaid the balance by over $700. A Chase supervisor's comments resulted in my most favored card account being closed, only to reopen ~16 months later, all the while offering me 3.99% on my $70,600 "closed" line. Four credit card accounts with Chase saw APR increases to as high as 30% on existing balances. Litigation was the only recourse left to me in order to recover excess finance charges. Payments to Chase have been posted weeks late, and in some cases, not at all. At other times, Chase credit limits were continually adjusted downward following my balances. When a finance charge was added, I was then pushed me over the artificial limit generating yet another fee and rate hike. On yet another instance, a senior Chase supervisor combined multiple accounts but dropped the total credit limit, creating an appearance of much higher but artificially-inflated "Debt-to-Credit ratio" hence lowering my FICO score and leading to higher APRs again. The events surrounding my Chase credit card accounts are unparalleled with 139 other vendors. The only consistency that I expect has now become punishment for following the rules. I was naive in thinking that the lenders would do the same. Regularity of monthly rate increases became the norm. Lenders have shown themselves to be negligent in adequately disclosing such a treacherous predisposition, and must be held accountable to strong, meaningful legislation. The effects of my experiences resulted in the disruption of small business employment and personal sacrifice that still impacts me and mine daily. I offer a further detail of negligent abuse and an explanation of what happened in the following pages of testimony.

My contention is that the marketing, acceptance, granting, and subsequent usage of credit has created a situation in which lenders satisfy their shareholders at the expense of American stability. Responsible borrowers, in choosing and using *seemingly* generous credit card offers, get stuck between a proverbial "rock and a hard place". A choice between usurious 200-500% increases in APR or election of total account closure is extortive and detrimental. Either choice negatively impacts a Cardholder's credit score, predominantly expressed as a "*Debt-to-Credit Ratio*". A higher "Debt-to-Credit Ratio" then triggers "Universal Default". Contrary to TILA, consumers can no longer make an educated, free choice as to which bank or what terms to accept. Inaccurate and omitted CBR data gleaned from the lenders themselves serve to further fuel an already caustic situation. Fundamental freedoms of choice in lender, terms, and repayment are a constantly shifting morass of opaque algorithms (I question whether or not even Dr. Stephen Hawking could navigate these murky proprietary waters!) Lenders' powers to flagrantly abuse the system is neither disclosed in the "Schumer Box", nor subject to a free-market ethical influence as intended in TILA, FCRA, and FDCPA.

Major credit card lenders have adopted *virtually identical* language in the Arbitration Clauses of their Cardholder Agreements. It has thus become *impossible* for most American consumers to pursue redress or relief through court (CA being the exception). It is difficult to challenge the Arbitration Clause now that I reside in PA when confronted with expenses of extended litigation. The opportunity to shed some light on such predatory practices in this and other venues promises to have a more widely-distributed and profound effect on the issue. As proven, it is not necessary to violate any logical or commonly accepted definitions of "default" in order to be placed in "*Universal* default", but only to use the credit available (thus already earned, assigned, and granted). An onslaught of "Universal Default" began in the 1990s contemporaneous with unfettered real estate speculation. This funding, in many cases, was made possible through the usage of "easy money" promulgated by low-APR credit offers. Applications of Universal Default are illustrated in the following timeline detailing one account with Chase. Other vendor accounts do not exhibit such predatory penalty during this or any other time.

For example, my initial credit line with another bank was $50,000 at Prime + 1% (~5% total at the time). I was "rewarded" with two subsequent credit increases to $54,000. Absent of "defaults", the APR was increased to 20.21% *retroactively*. Responsibly, I "Opted Out" of this 400%+ increase. What accountable adult would do otherwise? My account was closed, instantly raising my "Debt-to-Credit Ratio". Litigation ensued against the bank, part of a vicious cycle shared by U.S. Bank, Bank One, Chase Bank, CitiBank, American Express, and MBNA (Bank of America) following suit. In a short period of time, various lenders unilaterally lowered my available credit lines by ~$200,000 (~40%) in the wake of an avalanche of "Universal Default". My "Debt-to-Credit Ratio" then had the *appearance* of higher risk due to this *artificially induced* increase. MBNA appreciating my patronage by considering ~$150,000 of payments not even reflected in my FICO score, and froze my original APR keeping a good customer to this day. However, another account with MBNA does not even appear on my CBR.

Bank One/Chase Bank "British Airways Visa Signature" Acct. #xxxx xxxx xxxx 5024
Opened ~08/06/1999 Initial Terms: Limit $25,000 APR: 10.90%
~08/99-06/00 1st Revision: Combined Card Lines New Limit $65,000
Account #3574 ($40,000) rolled in to Account #5024)
~06/13/2000 2nd Revision: Combined Card Lines New Limit $90,000
~08/00-11/02 Account #2529 ($25,000) rolled in to Account #5024 APR: 10.90%
Sep-Oct/2002 Checks not posted by Chase/All replaced with EFTs/bank wires.
No checks posted to any Chase accounts #5024/7434/1007. All replaced with EFTs.

~09/13/2002	3rd Revision:	$1783 Due 10/04/2002	Paid $1750, Check #6243
~09/18/2002	3a)	$1750/Chk #6243 never posted	Paid $1783, Check #6251
~10/??/2002	3b)	$1783 Payment #6251 Posted	APR increased to 19.99%
~09/09/2002	3c)	$35 Late Fee Posted	1st Payment 17 days early

~10/07/2002	4th Revision: $1750 Due 11/02/2002	$1750 Wired #B11280922
~10/07/2002	4a) $1750 Wire Payment Posted	APR unchanged at 19.99%
~10/08/2002	4b) $35 Late Fee Posted	Payment 25 days early
~11/25/2002	5th Revision: $3524 Due 12/02/2002	Paid $3524, Check #6356
~11/28/2002	5a) $3524 Payment Posted	APR unchanged at 19.99%
~04/23/2003	6th Revision: Decrease Line $70,600	APR increased to 22.99%
~10/??/2003	6a) Line almost exactly at balance	APR variable Prime + 18.74
~06/??/2004	7th Revision: $4014 Fin. Chg. credit	APR increased to 24.99%
***	Every ~03-31 days: Low-APR Promo Check: $70,600 Limit @ 3.99%/Life of Loan.	
~07/??/2004	8th Revision: Account overpaid	~$719.70 credit balance
~08/16/2004	8a) Paid Off bal. for 3.99% life promo.	Credit balance $00,000.00
8/04/04-0920	8b) Call to confirm $69,000 available	"OK after 2 days bill cycle"
~08/04/2004	8c) Refusal to honor Conv. Check	Chase Supervisor level
~08/04/2004	8d) Personal insinuation re payoff	Chase Supervisor level
~08/04/2004	8e) Conv. Checks blamed on Mktg.	Chase Supervisor level
~08/04/2004	9th Revision: Account closed by Chase	Rec. ~$720 credit refunded
~08/16/2004	10th Revision: $65 Annual Fee charged	APR increased to 25.24%
~08/04/2004	11th Rev: Unauthorized hard inquiry	Account already closed.
	11a) Negative Experian data wrong	FICO drop due to Inquiry?
	11b) Attempts to remove inaccurate report unsuccessful to date.	
~08/05/2004	12th Revision: Unauthorized inquiry #2	Account was already closed
	12a) Inaccurate Experian data *twice*	FICO drop due to Inquiry?
~10/??/2004	13th Revision: $65 Annual Fee refunded	APR increased to 25.49%
~12/??/2005	14th Rev: Rec. new card 16 months later	APR increased to 28.24%
	14a) New card arrival. Improved FICO with now lowered D-C Ratio	
~04/??/2006	15th Revision: Account paid in full	APR increased to 28.74%
~06/??/2006	16th Revision: Account paid in full	APR increased to 28.99%
~07/??/2006	17th Revision: Account paid in full	APR increased to 29.24%
~10/06/2006	18th Revision: Account paid in full	APR decreased to 28.74%
~11/06/2007	19th Revision: Account paid in full	APR decreased to 28.49%
~12/??/2007	Equifax shows account as $0 credit limit.	Data reporting by Chase?
~01/06/2008	20th Revision: Account paid in full	APR decreased to 28.24%

My highest total credit line was with Chase, applied for and agreed upon at APRs ranging between ~3.99-10.90%. As balances were paid down, Chase lowered my credit limits to points virtually skirting the remaining balances, all the while increasing the APR. I paid off a high balance years early by over $700 when I was *unable* to confirm the final payoff amount in response to a 3.99% "Life-of-Loan" offer simultaneous to an APR increase up to ~25%. Obviously, a locked in 3.99% offer and using my overpaid credit balance was preferable to a continually rising APR already running at 25%!

Before depositing that check, I called to confirm my credit balance and was told that the checks would not be honored. I asked, "Why not, you send them to me every month?" (this offer came from Chase every month even *during a 16-month period when the account was supposedly closed!*) I was told by Chase: "The 'Marketing Department' sends those out". The Chase supervisor asked me "Where did you get the money, from another credit card?" Frankly, I didn't see that question as appropriate, but gave a truthful, courteous reply anyway. After my APR climbed to ~25%, my wife and I used other funds in order to halt further increases. The Chase supervisor made *personal* insinuations about funds having initiated from my wife's account and *summarily closed mine*! Two "hard" inquiries were performed by Chase on consecutive days after the account was supposedly closed. Surprisingly, about 16 months later a new card arrived with the same $70,600 limit, still carrying a high default APR.

A competitive APR with my original credit line is sensible and reasonable, but any decrease of credit limit again would be tantamount to another example of manipulation of my Debt-to-Credit Ratio, as has already been witnessed, and "Universal Default" or "Risk-Based Pricing" types of adjustments are unwarranted. Another Chase account (#8554) witnessed several instances in which Chase "computer glitches" deleted part of my mailing address repeating a consecutive non-receipt of statements. With all other Chase accounts, as soon as *any* instance of error was discovered, payments were immediate. "Universal Default" was instituted, spreading like a virus to other credit accounts.

Chase #5024 was my favored and most utilized credit card. I made use of its previous $90,000 limit as it helped me to earn international air travel by rewarding miles. Balances now are paid each month or Advances/Transfers limited to low-APR "Life of Loan"-type products. In ~2002, Chase Bank's "Customer Service Representative" and "Supervisors" recommended combining individual accounts together so as to have more efficient accounting with the *equivalent total* credit line. I had already experienced an instance in which Chase actually *lowered* the total credit line instead of *combining* those individual card limits. The Supervisor promised me such a thing would not happen *again*. Inevitably, Chase did it again. Numerous subsequent telephone calls to that Supervisor were futile. Previously, Chase had "rolled in" two or more accounts with no problems. In 2002, payments made on three separate Chase accounts never posted and were paid by phone. Those checks were later voided, and have not been presented for payment.

While visiting a client in Sacramento, I was notified that a "Convenience Check" had not been honored by Chase Bank. A few days earlier, while still in CA, *more* than sufficient credit was available on the account to accommodate the check. A "Credit Decrease" notice had been bulk-mailed out, arriving *after* the check had been presented. There are instances in which I would like to avail myself of promotional offers but Chase and other lenders have proven themselves to be perfectly capable of "changing the rules in the middle of the game". It is thus difficult to expose myself to these predatory practices *again* without the assurance of the sanctity and stability of the "rules". As long as I hold up my end of the bargain, I expect the lender to honor theirs. Chase handling of my auto loan has gone much more smoothly than their credit card practices; after my auto loan was approved there was no billing uncertainty. Any issues *can* be addressed, as was the case with MBNA #0028.

In the case of Chase #7434, I applied in response to a deep discount Dell Computer promotion. I was declined for the card, initially so, the ~$6000 purchase was the made at the higher price. A short time later, that very card arrived in the mail, along with a $25,000 credit line *far* exceeding my original $6000 purchase request. Chase #8554 saw consecutive "computer updates" resulted in my not having received several statements, drastic APR increases, account closure, and ultimately, applications of Universal Default by almost all of my credit card lenders, *regardless of merit* for "default". The period surrounding the merger of Bank One with Chase in 2004 seems to have been the period in which the vast majority of my problems with them occurred. Their practices were virtually indistinguishable.

The maneuvering of credit scoring formulas as parameters of risk continually seems to slip under the radar of Congressional and media-driven oversight. Naturally, assignment of a credit limit is well within the bailiwick of the lender. However, unilaterally influencing credit limits and reporting in order to trigger application of "Universal Default" as a tool to raise finance charges is unconscionable, unethical, only serving lenders, thus creating a subsequent windfall of profitable and cascading abusive tactics. Omission of reporting to CBRAs has a similar impact to that of most erroneous data…raising "Debt-to-Credit Ratio". Fair, Isaacs Credit Organization's (FICO) scoring platform remains a "*Black Box*" and a critically over-weighted mechanism influenced to produce *lower* scores and create a sense of "increased risk" resulting in higher APRs. Cardholders are presented with a *fait accompli* due to oft unwarranted "Changes in Terms". Forced choices of "Opting Out" or account closure victimizes Cardholders by utilizing a hammer of Universal Default via the sleight of hand of Credit Scoring.

Banks' unrestrained powers of manipulation merely by lowering credit limits or omitting accounts from reporting are not evident metrics of FICO or other scoring systems, and can not be disputed by the consumer. As long as lending institutions stand to profit from *lower* credit scores, *unilateral* and *arbitrary* applications of Universal Default permit lenders to freely initiate a discretionally capricious exploitation of "Debt-to-Credit Ratio" with no apparent or previously agreed upon rhyme or reason. Some lenders have come to "Shoot first, deny responsibility later". It is necessary for me to have filed a "Consumer Statement" and "Dispute" due to a Chase credit line inaccurately listed on my CBR. Lenders are not accountable to any *as yet effective* ombudsman since OCC oversight protects corporate interest at the expense of American Cardholders. OCC participation in a landmark action against Providian was not effectuated until an activist prosecutor, in effect, obviated OCC action.

As of April, 2008, my FICO score was ~782, statistically among the very lowest risk tier of credit Cardholders. I have paid a king's ransom due to extortive and usurious finance charges in order to sustain a high score while still honoring other existing commitments. Post 9-11, it was necessary to severely downsize business so as to meet ballooning finance charge payments. Medical insurance benefit reductions, insufficient in addressing the shortfall, hurt employees most in need of coverage. During slower cyclical seasons, reduced cash flow proved inadequate in meeting continually escalating and top priority repayment demands while satisfying other obligations. A distribution and logistics warehouse opened in CA could not be amply capitalized. Hiring cutbacks of drivers and warehouse workers were not enough, and another joint venture in NY was closed due to budgetary constraints. In addition to budget slashing and hiring cutbacks, personal assets were liquidated at fire-sale prices to address compounding finance charges; investments appreciating ~7800% in replacement value 2-3 years later. Downsizing and personal sacrifice were just not enough

I understand a contract to be just that...a legally-binding, mutually agreed-upon and established arrangement. I survived the experience, albeit worse for wear. The "800-pound gorilla" is the relationship that exists between scoring/reporting agencies such as Equifax, Experian, and TransUnion vis-à-vis lenders themselves. Lenders practice *carte blanche* in influencing proprietarily opaque scoring algorithms. Simply *raising*, *lowering*, or *omitting* credit limits affects the most basic platform of a credit score, the "Debt-to-Credit Ratio". To encapsulate all the credit card ordeals relevant to this testimony and quantify direct and indirect loss in a five minute verbal testimony is difficult, to say the least. I assembled a world-class collection of *investment* grade vintage guitars. To meet escalating demands of credit card lenders, it became necessary to very prematurely sell this investment in order to address an ever-worsening situation. In 2-3 years, the actual market replacement value of that investment appreciated to over $2 million but was liquidated for a fraction of its worth.

Over the past several years, credit card lenders have launched marketing campaigns directly targeting small-business owners as "Business Lines of Credit". These *ersatz* "Business" lines are underwritten by the *personal guarantee* of the applicant(s), and report to CBRAs by referencing the Social Security Number. The type of *entity* often not matter. Specific demographics of high school and college-level students are target-marketed in record numbers. Lenders appear to be "priming the pump" for the next round of Universal Default and "*potential* prey," regardless of "Risk-Based Pricing" or whatever label is used this time around. Waters are muddied by the terms "Business" and Personal" as millions of small, closely held corporations utilize *personal* credit on a regular and growing basis.

I have operated four small businesses since ~1993. I ultimately ended up relocating my remaining business from CA to PA in ~2004. "Changes in Terms" notices and APR increases kept coming even in the *absence* of defined "default". Post 9/11, I was assigned ~$500,000 in credit lines due to strength as a lowest risk borrower. My Accounts Receivable (perishables) were not of a nature conducive to borrowing. As Promotional Offers ended, I paid off balances before the APRs converted and availed myself of other low promotional offers.

All accounts are still monitored regularly so as to preclude any "default". It is that same responsibility that has come to define me as a man. Integrity, professional ethics, and that *very* sense of honor are what make my testimony here today possible. This usage was then utilized as a basis upon which lenders instituted "Universal Default". I was "fortunate" to have repaid debt early in this process. I do not envy Cardholders more recently affected in light of the current economic climate.

By common definition, "Default" refers to either: 'Missing payments', 'Exceeding a credit limit', or 'Payment not honored by the bank'. However, from ~2002, I experienced up to 400%+ increases of agreed-upon APRs retroactively on existing balances with *no* regard to bank violations or consideration of responsibilities expected of the lenders. At one point, Chase lowered my limit so close to the balance that a finance charge surpassed the limit. Chase removed fees incurred after several telephone calls but still continued to increase the APR.

Fair, Isaacs Credit Organization (FICO, a closely participating partner of Equifax) has obviously not addressed the issue to date. Tens of millions of Americans have been essentially deceived out of hundreds of billions of dollars. FICO, in lock-step with the lending institutions, bears some responsibility for this meltdown, as well. FICO is very quick to factor in the *appearance* of a "negative report", *whether factual or perceived*. However, "Default" works both ways. In the absence of *actual* default on the consumer's part, lenders are able to essentially default on contractual terms and use FICO as a shield. By the same token, a lender merely *omitting* the report of entire credit lines can have an even worse effect than simply lowering it. "Correcting the record" is an exercise in futility.

Throughout this entire experience I have witnessed massive swings in my FICO score. My CBR clearly shows no late payments, no bad checks, or exceeding of credit limits. We have twin 15-year old girls, both Honors students in high school. Due to the fact that I'm still digging myself out of debt, the onus of mortgage, groceries, college tuitions, etc. are on Sherry's full-time employment. Keeping vendors satisfactorily paid and making ends meet in business makes retirement look to be a very remote possibility at this juncture.

Recently, some lenders have indicated suspension of "Universal Default" as has been so widely utilized over the past decade or so, in favor of "Risk-Based Pricing". I submit to you that the current economic crises we now find ourselves in have their roots in the lending institutions' exploitive victimization on the heels of very successful marketing campaigns. They have done immeasurable damage. Credit was made available with certain terms, and summarily violated, often at the behest of the lenders themselves. As long as a situation exists in which financial lending institutions benefit from lower FICO scores (along with dubious OCC oversight), financial damage has been, and will continue to be, heaped upon responsible Americans. Lenders that have taken advantage of lax TILA and FCRA enforcement *must* be held accountable for the depth of economic damage and financial hardship that we all now endure. *Punitive reparation* for unethical practices and *oversight* to prevent future recurrence are long overdue. Reasonable expectations of "Due Process" as inferred under both the 5th and 14th Amendments are not secure in light of the denial of legal redress as stated in the Arbitration Clause. Due Process must be restored.

It now appears that small business owners are regular prey of credit card lenders. However, heaven forbid that these businesses actually *use* credit they've earned! Lacking *pro-consumer* oversight, this "domino effect" promises to continue unabated. FICO's role is *not* to be understated, and the time for reparation, recompense, and accountability has come. Bank of America is reportedly in another round of "Universal Default", albeit under another label. Such hardship contributes greatly to the further degradation of the American family's unity and hopes. Mortgage meltdown threatens to be paled by credit card "default" in comparison, and is likely to be an indirect result of this rampant opportunism already. TILA, FCRA, and FDCPA are clearly well overdue for update and amendment.

Basic tenets of HR5244 are cogent. In support, please consider the fact that CBRA-scoring firms and their heavily-weighted effect on lending policies and terms may emerge unscathed in the sense that their own reports reflect recondite, omitted, and highly dubious, data supplied by their corporate clients themselves. Opaque algorithmic formulas used by FICO and others do not necessarily address key points, several of which reflect salient indicators of the consumer's credit card use, payment patterns, and probity, such as:

1) *Credit Limit Adjustment Relevant to "Debt to Credit Ratio"*:
The power to *lower* a Cardholder's credit limit rests solely with the lender in exactly the same way it does to *raise* limits. This is the single most effective, important, and historically relevant contributing aspect of "Universal Default". As long as the lender stands to profit from lower scores, the entire system begs manipulation.

2) *Consideration for Early Payment* of Statement Amounts Due (see #4):
No scoring consideration is made for payments received *before* Due Date. However, a payment be received after the Due Date the Cardholder is considered "in default".

3) *Consideration for Excess Monthly Payment* of Statement Amounts Due:
A "Minimum Payment" currently receives the same scoring similar regard as a much *larger* payment. Similarly, *additional* payment(s) throughout the course of the billing cycle receive the same consideration as the receipt of a Minimum Payment.

4) *Consideration for Full Payment of Statement Balance:*
Due to the fact that scoring systems are opaque, it is unclear as whether or not the Cardholder's score is positively impacted or not when Statement Balance is paid in full. The mere fact that such a point remains unclear is illustrative of the abstract and virtually incomprehensible nature of FICO, and questions the wisdom of our heavy reliance on credit scoring as a whole, at least in the absence of fact-checking.

5) *Arbitration Clause Supersedes Due Process:*
Redress and reparation (outside the State of CA) are not realistic expectations for the average Cardholder. This "trumping" of Due Process is not referenced in the "Schumer Box". Representation in Arbitration is expensive and exists only *ex post facto.* Absent an ability to pursue legal remedy through the court, unchallenged lenders run rampant over the Cardholder's innate expectation to a doctrine of fairness. Currently, lenders operate with impunity and little fear of penalty.

6) *Scoring Products and CBRA as Actively Engaged Partners of Lenders*:
Since CBRA scoring is so heavily weighted by lenders, impermeable formulas and "*Black Box*"-type proprietary technology has been foisted upon Cardholders with no regard for veracity supplied by the lenders themselves. Cardholders have the ability to challenge details comprising the *printed* CBR, but actual elements relevant to credit *scoring* are *impossible* to either navigate or confirm. This system is ripe for abuse and/or error. "FICO 2008" may or may not address issues that have ravaged Cardholders in favor of corporate clients. I trust that testimony given here today will reflect in a new version of FICO scoring. Ability to dispute some types of inaccuracies is difficult, at best, and impossible in practice.

For example, a false/erroneous report was posted on a CBR in ~2003/2004. This negative listing then further spread to another database. I was successful in correcting the record with one, but have thus far *not* been successful in getting the other CBRA to correct their report, even after supplying necessary documentation.

This inaccurate and damaging record threatens to remain on my CBR for years, and has resulted in illiquidity of considerable financial resources. Additionally, finance charges subsequently paid that originated with such erroneous reports are funds that are unavailable to me with which to pay off *legitimate* debt. All subsequent attempts to correct the offending CBRA's records have met with resistance and difficulty; they point to one party, that party points to another party, and so on. Frequently, CBRAs and vendors would not even believe that I was truly *me* due to the fact that data used to verify my identity was wrong in the first place! The whole situation is somewhat akin to untying the proverbial *"Gordian Knot"*. As recently as this week, repeated attempts to correctly revise inaccurate, false, and/or totally omitted records in order to even *attempt* to begin the process of dispute and recompense have been futile.

7) *CBRA Steps to Prevent "File-Sharing" vs Debt-to-Credit Ratio Manipulation*:
What little that has been made public about "FICO 2008" appears to address abilities of some parties to positively influence credit reports by "File Sharing". However, what steps does "FICO 2008" take to curtail the *lender's* ability to *negatively* impact a Cardholder's report? It is imperative that CBRAs *and* scoring programs adhere to a strict posture of neutrality. Fact-checking for accuracy is in the best interest of the CBRA rather than be faced with the dissemination of inaccurate reports and scores. Lenders' omissions are often even more damaging than simple errors or adjustments. Such erroneous data is supplied by lenders and only serves to further their interests.

8) *Data Dumping"*:(also see #9-10):
Currently, FCRA statute allows for some CBR data to remain for seven years, while "Public Records" remain for ten years. "Hard Inquiries" (*reportedly* initiated at the Cardholder's behest) remain for a shorter period. I have experienced many instances in which relatively ancient credit records have gone *far* beyond these statute periods and "fallen off" my CBR for *years*, only to reappear. It may be possible that this occurs as a product of credit card industry consolidation and database updating. My CBR references many long dead accounts (all positive references and paid/closed satisfactorily) that create the impression that I have many accounts that I don't have, while many other current accounts are not even mentioned. How does FICO weigh such references, and how do these "phantom" accounts, albeit all *positive* references in this case, impact my score? Many accounts and credit lines are omitted in favor of others that are totally unrecognizable to me. Lenders make weighty decisions with their own faulty data, and consumers suffer.

9) *CBRA Adherence to FCRA Statutes*
Recent CBR reports mention old paid off/closed "Installment Accounts"...several automobiles from long ago. *Beyond* statute references may reflect inherited industry consolidation. Credit score "advice" supplied by CBRs is off the mark inferring that having "too many" accounts is bad, although closing *current* accounts and their attendant credit limits simply *raises* a Cardholder's "Debt-to-Credit Ratio". Perhaps the sensible and responsible solution would be accurate and timely reporting.

10) *"Zombie Debt"*:
Of late, there has been a spate of old, written-off, negotiated, clerically incorrect and other literally *ancient* debt (in some cases not even "debt" at all!) that has been sold and resold to collection agencies over the years. The average consumer is very likely to have underpaid (and been forgiven) a dollar here or a few cents there at one time or another. Likewise, not *every* creditor is *accurate* in their records or collections based on some possibly incorrect records. "*Zombie Debt*" is debt that has "risen from the grave". This form of "fishing" has created a virtual cottage industry and impacted the economic well-being of many Americans.

Consumer protection afforded by the terms of FDCPA has been ignored by some unscrupulous 3rd-party collection firms regardless of statutes of limitation, accuracy, relevance, or ultimate cost. The consumer is left to fend for him/herself against inevitable impact on the FICO score. CBRAs obviously do not require supporting documentation or proof from reporting members, nor does the consumer's side of the story appear to have any legitimacy until well *after* financial damage has been done, *if* then.

I have made it a point to educate myself as to the "finer points" of credit card policy, lending practices, and phrasing. Under current credit card policy, how does the average consumer prepare for an eventuality that is today's reality? Informed Cardholders who truly understand the nature of this beast are either increasingly rare consumers or among the growing ranks of Cardholders who have been "raked over hot coals", as I have.

As a business owner, it is necessary for me to carry and finance Accounts Receivable and Payables. On occasion, some accounts fall behind and it is normal and at times necessary to contact the debtor personally. However, when it comes to credit card lenders, it is a rare day indeed when any sort of "personal contact" is made with a Cardholder. It is commonly accepted for lenders to "bulk mail" innocuous "Changes in Terms" letters virtually *indistinguishable* from "junk mail" solicitations. I often receive my monthly statement accompanied by a solicitation from the same exact lender on the same precise day in a *separate* envelope. I have learned from my experiences to peruse *everything* that comes from my credit card lenders. It is only this "obsessive compulsion" that has literally "*spared* me" from further duress and financial harm, since it is in the economic best interest of the lender to raise APRs, increase Finance Charges, impose Late Fees, etc. An upcoming payment or balance due warrants a telephone call or e-mail.

I have had repeat instances of "computer updates" being deemed responsible for not having received several monthly statements for Chase #8554, now closed. When I moved my office and notified Chase of the change, statements arrived smoothly for a couple of periods until a "computer update" deleted part of my address, necessitating requests for copies of 3 missing statements. Others arrived long after their Due Dates. Previously, my payment pattern was consistent and regular. I finally spoke with a "Customer Relations Escalation Specialist". Chase admitted the errors and reversed *most* of the various penalty charges levied. I refused to accept having to pay for *all* of the bank's "Telephone Payment Fees" so as to cover for the lender's *own* errors, so the account was closed, negatively impacting my FICO score making the already bad situation even worse. Unfortunately, Chase lost a customer due to a petulant Customer Service Representative and numerous errors. The account balance was then paid off and closed. To expect the Cardholder to foresee and pay for a lender inaccuracies is both irresponsible, unrealistic, and ultimately *not* in either party's best interest.

Conversely, I must give credit where due. Experiences with American Express have been thoughtful, yet mixed. My disagreements with American Express are not with service or courtesy, but in question of practice with the same product's marketing and promotion to prospective clients in one way and established clients in another. Similarly, Bank of America's policy of treating one "type" of account differently than another leaves me bewildered...both accounts are *mine* yet virtually unrecognizable as such, so one naturally gets more attention and use than the other. Bank of America is likely to have inherited this example of dual account treatment. This "unequal treatment" by a lender of multiple accounts with the same Cardholder is illustrative of runaway corporate bureaucracy.

Within the past year, I took advantage of a low-APR Cash Advance promotion which was paid back a few months later, including the Transaction Fee and accrued daily interest, the DPR of which was gleaned from the bank statement itself. Shortly after the initial loan posted, I received a "FICO Alert" from a subscription CBR service reflecting a small *drop* in my score.

I took no issue with that as that was expected. However, after paying back the loan, fee, and interest, the next "FICO Alert" I received showed *another* small drop in score. Rather than being "rewarded" for paying back my loan several years *early*, it appeared that I had actually been "penalized". As previously stated, FICO's "Black Box" algorithms are mysterious in their machinations. In considering all my other accounts individually or in totality, my usage during that period, and all payments made, there is absolutely *no* logical or useful pattern distinguishable by which to gauge future credit usage and FICO score protection or improvement. In retrospect, my score was actually 2% *better* when my debt level was *higher*, the exact opposite of any sort of rational analytic expectation. This has been a recurring theme throughout the past year or so, and is especially pronounced as of late. Experiences with Bank One/Chase time after time reflected lender errors often made worse by CBRA reporting and then magnified exponentially as a result of data used in scoring.

Subcommittee Members, as a 55-year old businessman, I find credit card lending policies and the inherent predatory practices thereof to be *confounding* at the least and *appalling* at best. *Basic* principles of ethics, courtesy, and "The Golden Rule" appear to have no place in the arena, breeding resentment and further negativity. Do schools prepare young adults for such *treacherous* behavior...the credo *"Use Credit Wisely"* is best taught *defensively*, as well. My father's advice to *"Pay Yourself First"* was sage wisdom. Taught to honor my obligations, promises, and debts to others, those have *always* taken priority over my own immediate wants. Please consider my contribution here today as an introduction to my participation in the legislative process. I have also shared these experiences with the NY Times, ABC News PBS/Frontline, Business Week, the Washington Post, and others, as well as involving myself with relevant litigation. My credit card accounts currently represent a widely varying complexion of corporate policies and cultures, including U.S. Bank, Bank of America, MBNA, American Express, CitiBank, Capital One, Advanta, Chase Bank, etc. This broad exposure to such diverse approaches to public relations and credit card policy practices, in addition to my many years as a credit card user, give me a well-rounded view as to how similar products are treated in such disparate manners. Throughout the entire credit card experience, I have developed an insight into patterns of abuse that the Committee and Subcommittees will find helpful to rein in predatory lending tactics in the future, and recognize other exceptions that may not have been quite so evident for TILA and FCRA. I welcome your questions and offer my support.

Thank you.

Stephen M. Strachan
2635 Springwood Road
York, PA 17402

(717) 741-4345 (Private)
(717) 840-0193 (Facsimile)
(213) 798-6868 (Mobile)
sevensea@earthlink.net

Addendum

1) Brief Curriculum Vitae (2 pages)

2) "Truth in Testimony" Disclosure Form (1 page)

3) Equifax FICO and Experian PLUS scores (dated 03/08/2008 through 04/12/2008) (7 pages)

4) DELETED

5) DELETED

6) DELETED

7) DELETED

8) DELETED

9) Account Closure Letter received from Bank One (dated 08/04/2004) (1 page)

10) Declination Letter from Bank One (dated 08/05/2004) (1 page)

11) Credit Line Decrease Letter received from Bank One (dated 04/23/2004) (1 page)

12) Promotional Low-APR Checks received from Bank One/Chase (received 08/2004) (1 page)

13) Communication to/from-Bank One/Chase re: bank error exceeding limit (05/2004) (6 pages)

14) Note to bank/securities attorney re: Chase #5024 closure (dated 08/04/2004) (2 pages)

15) E-mail Recap of card activity to NYT/PBS Frontline producer (dated 08/23/2004) (7 pages)

16) Excerpt (page #5-6) of NYT article "The Plastic Trap" (published 11/21/2004) (2 pages)

17) OCC Advisory Letter to banks re: "Credit Card Practices" dated 09/14/2004) (1 page)

18) E-mail from bank/securities attorney re: Arbitration elimination (received 09/03/2005) (1 page)

Partial index of terms referred to in written testimony:

TILA	Truth In Lending Act
FCRA	Fair Credit Reporting Act
FDCPA	Fair Debt Collection Practices Act
APR	Annual Percentage Rate
DPR	Daily Percentage Rate
CBR	Credit Bureau Report
CBRA	Credit Bureau Reporting Agency
FICO	Fair, Isaacs Credit Organization (also refers to credit score)
Fait accompli	Predetermined "lose-lose" choice in either case
Gordian Knot	Reference to a virtually impossible task
OCC	Office of the Comptroller of Currency
EFT	Electronic Funds Transfer

Brief Synopsis of Professional Career Experience
To accompany written testimony to U.S. House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit Hearing (04/17/2008)

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EX-1
(2 pages)

Stephen M. Strachan
2635 Springwood Road
York, PA 17402
(717) (telephone) / (mobile)
(717) (facsimile) /

Age: 55
Birthplace: Akron, OH
Education: College and trade
Status: Married
Employment: See following

Gemstar International, LLC York, PA 2006 – present Managing Director/Buyer/Sales	Seven Seas Trading, Inc. Carpinteria, CA 1992 – present President/Lead Buyer/Sales	Zurel USA, Inc. Seattle, WA 1990-1992 US Manager/Division Buyer
All Flower Handling, Inc. Los Angeles, CA 2000-2003 Director/Co-owner	Michael's Wholesale Florist Denver, CO 1986-1990 Director/Head Buyer/Sales	Strachan Wholesale Florist Dallas, TX 1981-1986 Director/Head Buyer

Above references share similar responsibilities/administrative functions within same industry.

a) International purchasing for wholesale, retail, and mass market on both preorder and out-of-inventory bases. Seasonal adjustments/international holidays, geopolitical factors, market psychology.

b) Sales and brokerage of fresh floral products and foliages to wholesale, retail, and mass market.

c) U.S. Custom import duties and classification, statistics, Form 7501, inspection/clearance.

d) Import of perishable commodities. International air and marine freight logistics/handling.
International and domestic fuel and security surcharges (pre- and post-9-11 revisions).
Air freight requirements in order to ensure available lift and related scheduling.
Familiarity with various equipment on import, export, and transfer-point sides of equation.
Marine/land bridge perishables cargo contracting, sourcing, funding, shipping, sales.

e) 3rd-party re-export brokerage in Europe. Cargo consolidation at origin/Certificates of Origin.
Brokerage within USA to consolidate/import/export to/from Europe, Taiwan, Australia.

f) Familiarity with U.S. Customs and Border Protection (USCBP)/post 9-11 security applications.
U.S. Dept. of Agriculture / Dept. of Homeland Security (USDA/APHIS-PPQ/DHS).
PQ determination/fumigation/destruction/re-export to point of origin processes.
Rudimentary/practical familiarity with Entomology and Pathology relevant to commerce.

g) Perishable commodities domestic cargo shipping and freight handling, local cartage/drayage.
Perishable/packing parameters/environment, accountability, freight contract negotiation.

h) Brokerage and import from Europe, Australia, New Zealand, South Africa, Thailand and others.
Packing specifications vis-à-vis marketability, drop-shipping, consultancy.
New multi-year turnkey perishables marketing programs. Emerging markets.
Familiarity with governmental licensing/permit requirements, overtime accounting.
Counsel with USDA/APHIS-PPQ (district and federal) for classification/determination.
Foreign currency exchange contracts/forward spreads/EUR, AUD, NZD, ZAR/foreign banking.

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Brief Synopsis of Professional Career Experience
To accompany written testimony to U.S. House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit Hearing (04/17/2008)

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i) Export wild harvest gourmet mushrooms to Europe. Contract, funding, packaging, Mycology.
Supplier to international gourmet food exposition-Paris, France (~1991).
U.S. Customs clearance and EEU import solutions both pre- and post-NAFTA and 9-11.
Source proper packaging to prevent challenging loss due to water vapor evaporation.

j) Export wholesale sundry/dry goods, and marketing to Australia/U.S. via air and surface freight.
Perishable trend/demand of collectibles, sourcing relationships, financing/shipping.

k) "Chain of Life" temperature/humidity control to ensure shelf life of perishable commodities.
Perishables inventory control, product rotation, forced-air and vacuum pre-cooling.
Labeling for redistribution, lot-splitting and sorting/general warehousing functions.
Post-fumigation expedition/pre-cooling processes to mitigate loss. Marine survey reports.

l) Australian Trade Representative to U.S., Canada, Europe ("AUSTRADE" for 9 years)
Staffing requirements, payroll, banking, accounting, and bookkeeping, budget
Familiarity with Export Insurance programs, government incentives for exports.

m) Keynote speaker: Specialty Cut Flower Association, Australian Grower Association,
California Cut Flower Commission, WF&FSA (wholesale florist trade group).
Consultant for general industry issues relevant to import challenges and export demands.
Convention/trade show organization, set-up and attendance.

n) Successful turnaround of U.S. division of bureaucratic Netherlands multinational corporation.
Realized first consistently profitable quarters since inception (8 years) via creative innovative programs.
~100 year old corporate culture presented challenging and powerful opportunities for trials.

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Equifax Personal Solutions: Credit Reports, Credit Scores, Protection Against Identity Th .

(1/7)

At Equifax, your opinion matters. That's why we've been listening carefully - making changes to the Equifax Member Center to better benefit you. See for yourself! You'll discover simpler navigation, enhanced Credit Score and Credit Report summaries and easy-to-customize alerts. Check out our Member Center Quick Use Guide

Your FICO® Score as of 04/02/2008

EX-3
(7 pages)

782

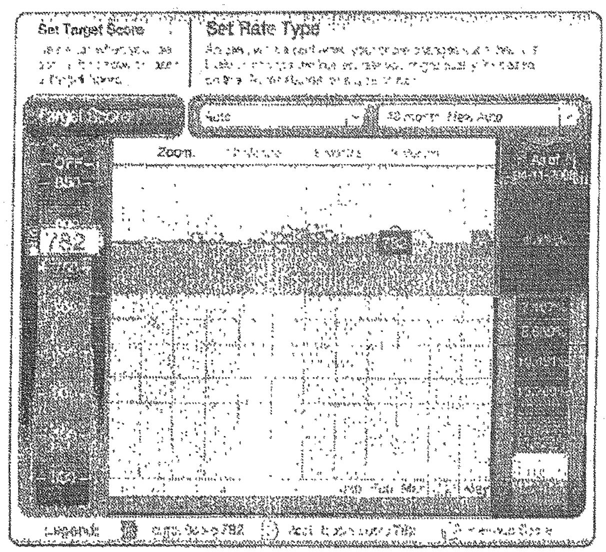
Based on Alert

Trend

What triggers your score alerts?
→ Credit Alerts
→ Score Bands
→ Target Score

How Lenders See You

Score Trending



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2/7

Welcome Stephen Strachan, LogoutContact Us | Site Map Quick Search SEARCH

EQUIFAX

Score Watch™

What Your Score Means

YOUR SCORE As of 03/08/08

795

Based on: Alert

- The Bottom Line
- Average Loan Rate Finder
- How Lenders See You
- A Guide to Your Credit Score

FICO Score Range

Your score is

The Bottom Line: What a FICO® Score of 795 means to you

Your score is well above the average score of U.S. consumers and clearly demonstrates to lenders that you are an exceptional borrower.

- It is extremely unlikely your application for credit cards or for a mortgage or auto loan would be turned down, based on your score alone.
- You should be able to obtain relatively high credit limits on your credit card.
- Most lenders will consider offering you their most attractive and most competitive rates.
- Many lenders will also offer you special incentives and rewards targeted to their "best" customers.

It is important to understand that different lenders set their own policies and tolerance for risk when making credit decisions, so there is no single "cutoff score" used by all lenders.

How Lenders See You

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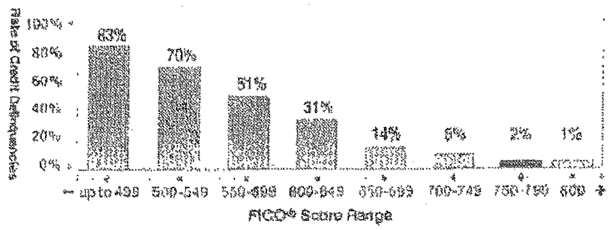


Most lenders would consider consumers in this score range as extremely low risk.

Delinquency rate is defined as the percentage of borrowers who reach 90 days past due or worse on any credit account over a two year period.

Average Loan Rate Finder

See how a score influences what interest rate you may receive.

Select loan type and locale to see average rates:
Category: Mortgage
Loan Type: 30 yr Fixed Conforming
State US Average
Go

Interest Rates as of 03/10/2008

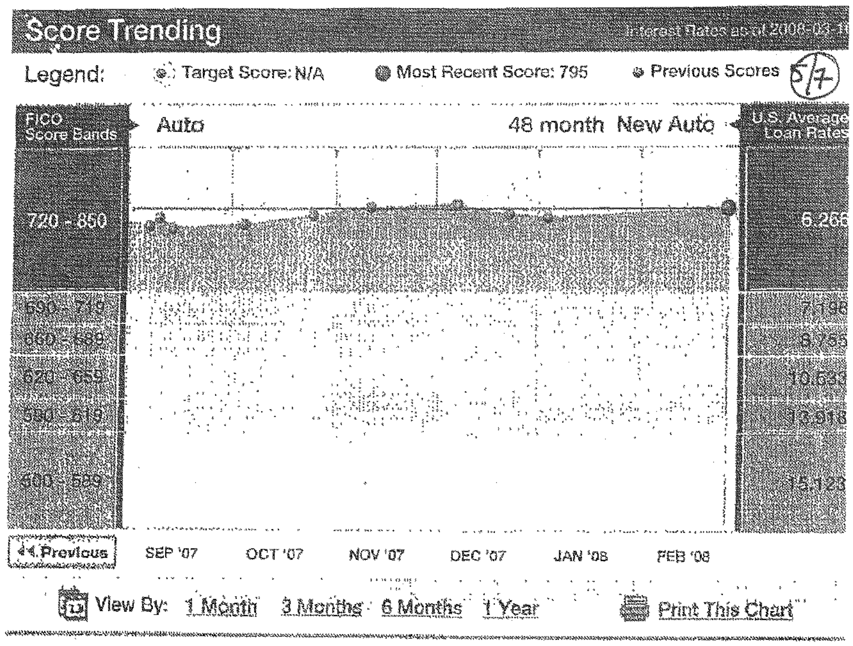
FICO Score	Avg Rates
760- 850	6.022%
700- 759	6.244%
680- 699	6.421%
660- 679	6.635%
640- 659	7.065%
620- 639	7.611%
600- 619	8.922%
580- 599	9.490%
550- 579	9.955%
500- 549	10.489%

A Guide to Your Credit Score

Pay your bills on time.
Delinquent payments and collections can have a major negative impact on your score.
Keep balances low on credit cards and other "revolving credit".
High outstanding debt can affect a score.

For more tips on how to understand your score, Learn More

04/14/2008 22:24 FAX 7178400183 GEMSTAR INTL 037/043



5/7

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Credit Expert

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View Full Report **Printable Report** **Dispute Information** **Credit Report Guide**

Prepared for: **STEPHEN M STRACHAN** Report Date: **4/8/2008**

Personal Profile | Credit Summary | Public Records | Credit Inquiries | Account History | Credit Score

PLUS Score® Report

A PLUS Score is a numerical representation of your credit worthiness. The majority of lenders use some sort of credit scoring model to help predict what kind of credit risk you may be. For each bureau's score and explanation, click on the colored tabs below.

EXPERIAN | EQUIFAX | TRANSUNION

PLUS Score from Experian

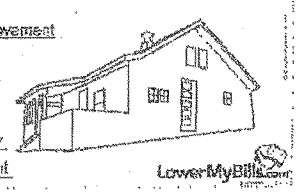
This PLUS Score is based on information from your Experian credit report.
Your PLUS Score is calculated using the information in your credit report. Since information often differs among your three bureau reports, your PLUS Scores based on those reports will also vary

Your PLUS Score is: 783 on a scale of 330 - 830.

Your Credit Category is:

Very Poor Poor Fair Good **Excellent**

Percentile: Your credit rating ranks higher than 94.80% of U.S. consumers.



Score Details ? Help

About your PLUS Score:

Your PLUS Score is formulated using the information in your credit file. Your score helps potential lenders, landlords, and employers quickly gauge your credit history and decide what kind of a risk they are taking if they approve your application. Your PLUS Score can range between 330 and 830, with a higher score indicating a lower risk. There are many scoring models used in the marketplace. The type of score used, and its associated risk levels, may vary from lender to lender. But regardless of what scoring model is used, they all have one purpose: to summarize your creditworthiness. Keep in mind that your score is just one factor used in the application process. Other factors, such as your annual salary and length of employment, may also be considered by lenders when you apply for a loan.

What your PLUS Score means:

Factors in your credit file indicate you have excellent credit. Lenders will likely offer you the best rates and terms.

What this means to you:

Credit scoring can help you understand your overall credit rating and help companies better understand how to serve you. Overall benefits of credit scoring have included faster credit approvals, reduction in human error and bias, consistency, and better terms and rates for American consumers through reduced costs and losses for lenders. While lenders may use different scoring models to determine how you score, and each major credit bureau has its own method for calculating credit scores, the scoring models have been fairly well standardized so that a score at one bureau is roughly equivalent to the same score at another.

What factors raise your PLUS Score:

- You have paid your bills on time and currently do not have any overdue accounts or derogatory information, such as a collection, charge-off, or bankruptcy, on your report.

- You have a good cushion of available credit between your current balance and your credit limits on all open trades. This has a positive affect on your credit score. This cushion shows lenders that you are unlikely to overextend yourself

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Credit Expert

(7/7)

financially.

- The total balance on all your credit cards is relatively low compared to your total available credit limit. This has a positive impact on your credit score.

- Your average credit limit for your major credit cards, such as Discover, VISA, MasterCard, or American Express, is high. This tells lenders that you have enough financial experience, and they will be more likely to see you as a good credit risk.

What factors lower your PLUS Score:

- Credit scores are calculated based on various factors in your credit report. Currently, your credit report does not show any significant negative or derogatory information. You can be proud of the fact that you are building a good credit history, so continue with your positive credit behavior!

Consumer Statement:

Statement: No Statement(s) present at this time

DISCLAIMER

The PLUS Score℠, developed by Experian, is not an endorsement or guarantee of your credit worthiness as seen by lenders. The different risk levels presented here are for educational use only. Your PLUS Score can help you understand what factors impact your credit score.

Please be aware that there are many scoring models used in the marketplace, and each lender's scoring model has its own set of factors. How each lender weighs their chosen factors may vary, and the exact formula used to calculate your score is proprietary. In general, the higher your score, the better your chances are of obtaining favorable rates and terms.

Your PLUS Score was calculated using your actual data from your credit file on the day that you requested your report, making it comparable to most scoring models in the industry. Keep in mind however that other factors, such as length of employment and annual salary, are often taken into consideration by lenders when making decisions about you.

Also note that each bureau uses its own set of data, resulting in a separate PLUS Score for each of your credit files.

04/14/2008 22:20 FAX 7178400193 GEMSTAR INTL 003/043

CARDMEMBER SERVICE
P.O. BOX 8650
WILMINGTON, DE 19899-8650

BANK ONE.

Ex-9
(1 Page) 1/1

August 4, 2004

VISIT US ONLINE AT WWW.CARDMEMBERSERVICES.COM

STEPHEN STRACHAN

Rec. 8/10/04
Not requested!

RE: Account No: 5024

Important information is provided below regarding your credit card account.

Dear Stephen Strachan:

As your credit card company, we value your business. It is important to us that we provide you with timely information regarding your account.

After careful consideration, we have decided to close the above-noted account for the following principal reasons:

* high balances owed on bankcards
* balances too high compared to crdt limit
*

This decision was based in whole or in part on information provided by the consumer-reporting agency noted below. Other than providing information, this agency played no part in our decision. If you have questions about our decision to close your account, we suggest that you first obtain a copy of your credit report from this reporting agency:

Experian: (888)397-3742, P.O. Box 2002, Allen, TX 75013

Under the Fair Credit Reporting Act, you are entitled to receive a **free** copy of your credit bureau report from this agency if you request the report within 60 days of the date of this letter. We encourage you to obtain and review a copy of this report. If you then suspect that there are errors in your credit bureau report, you may work with the credit bureau agency to correct those errors.

(continued)

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04/14/2008 22:20 FAX 7178400193 GENSTAR INTL 004/043

CARDMEMBER SERVICE
P.O. BOX 8650
WILMINGTON, DE 19899-8650

VISIT US ONLINE AT WWW.CARDMEMBERSERVICES.COM

BANK ONE.

EX-10
(1 page) (1/1)

August 5, 2004

Rec 8/11/04

STEPHEN STRACHAN

I did not request that this account be reinstated. Any inquiry was unauthorized

RE: Account No: 5024

Information is provided below regarding your request to reinstate your account.

Dear Stephen Strachan:

As your credit card company, we value your business. It is important to us that we provide you with timely information regarding your credit card account.

Thank you for your recent inquiry concerning your above-noted credit card account. We regret that, at this time, we are unable to reinstate your account for the following principal reason(s):

* High Balances Owed On Bankcards
* Balance Too High Compared To Crdt Limit
*

This decision was based in whole or in part on information provided by the reporting agency noted below. Other than providing information, this agency played no part in our decision. If you have questions about our decision, we suggest that you first obtain a copy of your credit report from this reporting agency:

Experian: (888)397-3742, P.O. Box 2002, Allen, TX 75013

Under the Fair Credit Reporting Act, you are entitled to receive a **free** copy of your credit bureau report from this agency if you request the report within 60 days of the date of this letter. We encourage you to obtain and review a copy of this report. If you then suspect that there are errors in your credit bureau report, you may work with the credit bureau agency to correct those errors.

(continued)

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04/14/2008 22:20 FAX 7178400133 GEMSTAR INTL 005/043

CARDMEMBER SERVICE
P.O. BOX 8650
WILMINGTON, DE 19899-8650

VISIT US ONLINE AT WWW.CARDMEMBERSERVICES.COM

BANK ONE.

EX-11
(1 page)

1/1

April 23, 2004

STEPHEN STRACHAN

RE: Account No: 5024

Important information is provided below regarding the credit line for your account.

Dear Stephen Strachan:

As your credit card company, we value your business. It is important to us that we provide you with timely information regarding your credit card account.

After careful consideration, we have decreased the credit line on your above-noted account to $70600 for the following primary reasons:

* high balances owed on bankcards
* balance too high compared to crdt limit
* using too many bank card accounts

This decision was based in whole or in part on information provided by the reporting agency noted below. Other than providing information, this agency played no part in our decision. If you have questions about our decision to decrease the credit line on your account, we suggest that you first obtain a copy of your credit report from this reporting agency:

Experian: (888)397-3742, P.O. Box 2002, Allen, TX 75013

Under the Fair Credit Reporting Act, you are entitled to receive a **free** copy of your credit bureau report from this agency if you request the report within 60 days of the date of this letter. We encourage you to obtain and review a copy of this report. If you then suspect that there are errors in your credit bureau report, you may work with the credit bureau agency to correct those errors.

(continued)

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04/14/2008 22:20 FAX 7178400193 GENSTAR INTL 006/043

BRITISH AIRWAYS

Three convincing reasons to stay with us.

1/1 PG1

EX-12
(1 page)

Per $50,000 payment on account.
Rec 08/2004

************AUTO** 3-DIGIT 174
Stephen Strachan

Your credit access line: $70,600

RE: Account ending 5024

Dear Stephen Strachan:

We want to be your number one credit card. We noticed that you recently made a large payment to your British Airways Visa® account and want to make sure we're not losing your business. That's why we want to remind you again of these low-rate reasons to stay — it's our way of showing you that your business is important to us.

3.99% APR for the life of the balance†

Enjoy a low 3.99% APR†.

Take advantage of this offer and you'll enjoy bigger savings in your pocket — and more breathing room in your budget — with a special low **3.99% fixed APR for the life of the balance†** when the enclosed checks post to your account by September 30, 2004.

Please use this money-saving "thank you" to your advantage today.

Use your low-APR Convenience Checks to save with your British Airways Visa® account, to deposit for extra cash, or consolidate higher-rate balances. Write them for any amount up to your available credit access line — and enjoy the money-saving result.

Sincerely,

Carter Franke

Carter Franke
Chief Marketing Officer

P.S. Your checks must post to your account by September 30, 2004 to take advantage of your special savings. Use all three low-rate Convenience Checks.

Miles will not be earned on these checks.

†IMPORTANT INFORMATION:

- **Promotional APR:** Your low promotional APR will apply only to the transferred balances and purchases made with the attached checks which post to your account by September 30, 2004 and will remain in effect for each check until the balance for that check is paid off, subject to the Payment Allocation described on the reverse side. Any other promotional offer you may have does not apply to the enclosed checks.
- **Transaction Fees:** The Transaction Fee for each Convenience Check in this offer is 3% of the amount of the check, with a minimum of $5 and a maximum charge of $50.
- **Right to Decline:** Checks that post after the void date printed on the check or that are made payable to Bank One or one of our related banks will be declined.

(Continued on reverse side) **Visit us at www.cardmemberservices.com for exclusive cardmember offers.**

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04/14/2008 22:20 FAX 7178400193 GENSTAR INTL 007/043

EX-13
(6 Pages)
1/6

Stephen M. Strachan
c/o Seven Seas Trading, Inc.
P.O. Box 1115, Carpinteria, CA 93014
Phone (213) .., Fax (717)

To: Ms. Dawn Turk
Bank One
Card Member Services

26 May, 2004

Fm: Stephen Strachan

Re: 1007

Dear Dawn,

Following you will find the "Credit Card Over Limit" report that was made to Experian in reference to my account # ·1007.

As we discussed, my credit limit was decreased to $27,250 on 04/23/04. When finance charges were applied to the account on May 04, the account was forced into an "Over Credit Limit" situation. I called on May 10 and the situation was rectified internally within Bank One by a slight increase in the credit limit and a waiving of the Over Limit Fee. However, the report had apparently already been forwarded to Experian...apparently, that had not been addressed at the same time on May 10. I was notified by Experian on May 22 that this information now appeared on my Experian credit bureau report. You and I spoke today, May 26...per your request, I have printed out a copy of the information and am faxing that to you directly. You agreed to supply me with a letter explaining/correcting the situation that has occurred.

Please feel free to contact me should you have any questions or concerns. I would appreciate it if you would fax your letter to me at either of the following fax numbers:

or

I can be reached by telephone at the following numbers, should you require:

or
or

Dawn, thanks for your assistance in getting this cleared up. I apologize for any inconvenience.

Sincerely,

Stephen M. Strachan

22/43

(2/6)

CreditExpert

My Credit Center | PLUS Score | Credit Too

My Credit Center: | View Current Report | View Archived Reports | View Alerts | Edit Profile

Daily Monitoring Alerts

Enjoy peace of mind knowing your Experian credit profile is scanned every day to keep you informed of key changes that r
Actively monitoring your credit can be your first line of defense against identity fraud and inaccuracies that may affect your
You can rest easy knowing Credit Manager is monitoring your credit for you.

You have 0 unviewed monitoring alerts.

When we checked your credit file, we did not find changes to these items:

- New Inquiries
- Potentially Negative Information
- Public Records
- New Accounts
- Address Changes

Disclosure
Each monitoring alert is available on this report for 90 days from the date the alert is posted, with the most recent addition at the monitoring alert category. Please note that you are notified of the key change(s) detected to your file within 24 hours, therefore, I is posted and the date you are notified may differ by one calendar day.

New Inquiries

The following inquiries are "hard" or voluntary inquiries and were generated because you authorized the companies listed to your credit report.

Alert Date	Business Name	Inquiry Date

Back To Top

Potentially Negative Information

An item is "potentially negative" when a creditor reports that you have not met the terms of your agreement with them, which payments, accounts that have been charged off, accounts sent to collection, bankruptcies, liens, judgments, etc

Alert Date	Business Name	Balance Date	Balance Amount	Status Date	Payment Stat
5/22/2004	FIRST USA BANK N A	---	---	---	Bank/Credit Card Over

Back To Top

Public Records

Public record information includes bankruptcies, liens, judgments or garnishments and comes from county, state or federal co

Alert Date	Reporting Court Name	Public Record Amount	File Date	Type

Back To Top

New Accounts

New accounts include bankcards, credit cards, and loans including car, business, home equity, mortgage, retail, and student

(23/43)

04/14/2008 22:20 FAX 7178400193 BEMSTAR INTL ☑009/043

2E 2004 14:41 FR FIRST USA 302 985 1633 TO

3/6

Cardmember Service
Three Christiana Centre
201 North Walnut Street, DE1-1445
Wilmington, DE 19801
Tel (800) 216-4367
Fax (302) 985-1633

Fax

To:	STEPHEN M. STRACHAN	**From:**	DAWN TURK
Fax:		**Phone:**	1-888-298-5623 EXT. 1484
Phone:		**Pages:**	(Including Cover Sheet) 2
Re:	1007	**Date:**	May 27, 2004

☐ **Urgent** ☐ **For Review** ☐ **Please Comment** ☐ **Please Reply** ☐ **Please Recycle**

■ **Comments**

24/43

24L-

04/14/2008 22:20 FAX 7178400193 GEMSTAR INTL 010/043

MAY 26 2004 14:41 FR FIRST USA 302 985 1633 TO

Three Christina Centre
201 North Walnut Street
Wilmington, DE 19801

BANK ONE.

4/6

I didn't charge AT ALL to put the account in "over credit line" status — I haven't placed any new charges on the card for 2 years!!! Bank One lowered the limit — after finance charge was added in, account went "over limit"

May 27, 2004

Mr. Stephen M. Strachan
P.O. Box 115
Carpinteria, CA 93014

INCORRECT ADDRESS

Re: 307

Dear Mr. Strachan,

Thank you for your recent inquiry regarding you credit card account.

Bank One acknowledges that you did not intentionally or irresponsibly charge the above referenced account over the credit line.

We have since corrected the situation with the credit bureau reporting agencies. The account should not reflect as ever being over the credit line by any credit bureau reporting agency as of this date.

Thank you for calling this to our attention.

Sincerely,

Dawn Turk
Lending Operations
1-888-298-5623

25/43

Statement [illegible] 007 **YAHOO!**

New Balance	Payment Due Date	Past Due Amount	Minimum Payment
$27,542.44	05/25/04	$0.00	$842.44

Amount Enclosed $ [illegible]

5/6

8424402754244?

STEPHEN M [illegible]

CARDMEMBER SERVICE
P.O. BOX [illegible]
PALATINE IL [illegible]

[illegible]5000 150 28[illegible] [illegible]0373[illegible]

YAHOO!

Statement Date: 04/01/04 - 05/04/04
Payment Due Date: 05/25/04
Minimum Payment Due: $843.44

CUSTOMER SERVICE
In U.S. 1-[illegible]
Español 1-[illegible]
TDD 1-[illegible]
Outside U.S. call collect 1-302-[illegible]

VISA ACCOUNT SUMMARY

Previous Balance	$27,951.73
Payments, Credits	- $1,000.00
Purchases, Cash, Debits	+ $0.00
Finance Charges	+ $590.71
New Balance	$27,542.44

Account Number:	[illegible]1007
Total Credit Line	$27,250
Available Credit	$0
Cash Access Line	$5,450
Available for Cash	$0

ACCOUNT INQUIRIES
P.O. Box [illegible]
[illegible]

PAYMENT ADDRESS
P.O. Box [illegible]
[illegible]

VISIT US AT:
www.[illegible]

PAY $1000— Mail Date 5/17/04

The YAHOO! Rewards Summary

Want to know your total number of Yahoo! Points earned?
Go to http://[illegible].yahoo.com and link your account.
Already linked? See your total at http://points.yahoo.com.

TRANSACTIONS

Trans Date	Reference Number	Merchant Name or Transaction Description	Amount Credit	Amount Debit
04/2[illegible]	7[illegible]	PAYMENT - THANK YOU	$1,000.00	
05/04		*FINANCE CHARGE*		$590.71

FINANCE CHARGES PERIODIC RATE(S) AND APR(S) MAY VARY

Category	Daily Periodic Rate 3[illegible] days in cycle	Corresponding APR	Average Daily Balance Previous Cycle	Average Daily Balance Current Cycle	Finance Charge Due To Periodic Rate	Transaction Fees	FINANCE CHARGES
Purchases	.0[illegible]%	1[illegible]%	$0.00	$27,817.3[illegible]	$590.71	-	$590.71
Cash advances	.0[illegible]%	[illegible]	-	-	-	-	$0.00

Total finance charges $590.71

Effective Annual Percentage Rate (APR): [illegible]%

Grace Period Type: A (Please see back of statement for the Grace Period explanation.)

The Corresponding APR is the rate of interest you pay when you carry a balance on purchases or cash advances.
The Effective APR represents your total finance charges - including transaction fees such as cash advance and balance transfer fees - expressed as a percentage.

800-219-0015 Security

Lisa 5/10 - 1735

Bal 27,542.44 (over limit)

Ruby 5/2[illegible] - 1620
Said Experian would update every 30 days.
Said I was sent a letter showing my limit raised to cover over limit situation caused. I did not receive letter. I requested another letter.

Luisa - 5/10 - 1755
Dropped limit due to [illegible] of unsecured debt (I knew that already). She will "[illegible]" what can be done about the overlimit created by reduction in limit.
Anesha - increase to 27,700.50 as to avoid over limit situation. I questioned the legality of such practice.

26/43

Dawn: 302-985-1633. FAX
Tick Fax the Experian printout to [illegible]
[illegible] letter [illegible]

26/43

04/14/2008 22:21 FAX 7178400193 GEMSTAR INTL 012/043

CARDMEMBER SERVICE
P.O. BOX 8650
WILMINGTON, DE 19899-8650

BANK ONE

6/6

VISIT US ONLINE AT WWW.CARDMEMBERSERVICES.COM

April 23, 2004

STEPHEN M STRACHAN

CARPINTERIA CA 93014-1115

Limit raised back to 27,700 by "Anesha" at 800-219-0015 on 5/10 - 1755 EST.

RE: Account No: 1007

Important information is provided below regarding the credit line for your account.

Dear Stephen M Strachan:

As your credit card company, we value your business. It is important to us that we provide you with timely information regarding your credit card account.

After careful consideration, we have decreased the credit line on your above-noted account to $27250 for the following primary reasons:

* high balances owed on bankcards
* balance too high compared to crdt limit
* using too many bank card accounts

This decision was based in whole or in part on information provided by the reporting agency noted below. Other than providing information, this agency played no part in our decision. If you have questions about our decision to decrease the credit line on your account, we suggest that you first obtain a copy of your credit report from this reporting agency:

Experian: (888)397-3742, P.O. Box 2002, Allen, TX 75013

Under the Fair Credit Reporting Act, you are entitled to receive a **free** copy of your credit bureau report from this agency if you request the report within 60 days of the date of this letter. We encourage you to obtain and review a copy of this report. If you then suspect that there are errors in your credit bureau report, you may work with the credit bureau agency to correct those errors.

(continued)

27/43

Ex-14
(2 pages)
1/2
1/2
Wed/08-04/1815 EST

Michael–

Following is a recap of the latest Bank One debacle – in brief:

1) I paid the approximately $70,000 balance down to a credit balance of about $700 in approximately 60 days or so. In doing so, funds that could have been used to finance my business went to pay off 24.99% APR debt.

2) I received "Convenience Checks" in the mail on 08/02/04 (3.99% for life of balance up to the amount of my credit line – $70,600.)

3) I wanted to use the offer for a $69,000, low-interest loan, and in doing so, would have satisfied my vendors. I called Bank One before I deposited the check so as to be sure I wouldn't have yet another embarrassing moment when the check was presented to them for payment.

4) I was connected to "Josie S." in their Orlando, FL site. She said she pulled my Experian report and that since my debt levels were high, would not only not honor a $69,000 check, but when I asked her what amount I could write the check for, she stated "nothing", and that my credit limit would be even further reduced (it was reduced from $90,000 to $70,600 recently (April, 2004 statement)). Since I was told that no check would be honored, [illegible]

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28/43

2/2 2/2

Since I've not been advised that it's closed.
5) At approximately 1845/04, while writing this letter to you, I again called Bank One and was informed that my account was closed (apparently by "Josie S.", although I can only assume that. I then spoke to another person in "Portfolio Risk Review" (877-399-) who confirmed that the account was closed due to "high debt levels reported by Experian of $220,000."
6) Experian's records do not reflect approximately $100,000 of unsecured debt that has been paid down in the past couple of months, as well as several other "irregularities" — that's another topic.
7) As you can see from the mailer accompanying the checks, the invitation was quite clear — in retrospect, I'm not sure if I did the right thing by calling first or not — as I explained, this $70,000 out of cash flow may be the end of my business after fighting to "do the right thing."
8) It's debatable whether or not TILA applies — I don't know if my card would have been good or not yesterday. I only know that I wasn't worth $1.00 of risk today (although the Bank One computer, up through this morning, still stated my credit limit of $70,600 and credit balance ($719.70).
9) "Elizabeth" confirmed my refund request of $719.70 to be sent in 7-14 business days at 1845/04.

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29/43 RSVP — Best — Thanks — [illegible]

1/7

Stephen Strachan

E-Mail to NYT relevant to 2004 NYT/PBS Frontline Project

From:	Stephen Strachan [sevensee@earthlink.net]
Sent:	Monday, August 23, 2004 10:36 PM
To:	Nelli (New York Times) (E-mail)
Cc:	Robin (New York Times) (E-mail)
Subject:	NYT/PBS Project Overall

Nelli/Robin: Following is the overall view I promised. It's taken a lot of time and careful research into my files so as to be as objective and factual as is humanly possible. Sorry for the delay, but I think your patience will prove to have been worth the wait.

EX-15
(7 pages)

[redacted]

[redacted]

[redacted]

[redacted]

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(27)

[redacted]

5) Chase #8554 XXXX (Chase Platinum Mastercard)
 a) Account opened approximately April, 2001.
 b) Primary usage is for personal, family, and household, as well as limited company use. Original credit limit was $15,000.
 c) Closing balance as of statement ended 06/14/04 was $9,711.26
 d) APR on purchases as of statement ended 06/14/04 was 15.99% (originally 12.99% with 1.99% promotional for 9 billing cycles. APR for cash advances 19.99%.
 e) Finance charge from statement ended 06/14/04 was $134.89
 f) Minimum payment due from statement ended 06/14/04 was $194.00.
 g) Payment of $500.00 was made 06/21/04.
 h) Credit limit was increased from $15,000 to $16,500 approximately 05/2002, and then again from $16,500 to $18,500 approximately 07/2002.
 i) I changed my mailing address around July, 2002 and notified Chase in writing accordingly in the space provided on the statement stub. Chase made an error in data entry, apparently, so statements were interrupted. I corrected the record with them, only to have the same thing occur <u>again</u> just a couple of months later. Even though statements were returned to them, I was not notified or contacted until I called Chase. I had been reported to Experian as delinquent, penalized with a "Late Payment Fee", and my APR was increased to 23.99%. When I confronted Chase, their representative refused to waive a "telephone payment fee", even though it was readily admitted that the error had been Chase's on both occasions. I was unwilling to be further penalized or inconvenienced by Chase, so the account was closed. After <u>much</u> telephoning and complaining, a supervisor finally reviewed the entire sequence of events and waived all late fees, credited back all excess finance charges, and reinstated the account back to the previously existing rate of 11.99%. Additonally, she agreed to correct the record with Experian, as my FICO score had plummeted by approximately 47 points because of the error. Meanwhile, due to the intransigence of both the original phone representative and myself, my account remains closed to this day.
 j) Generally, I would have to say that Chase is far and away the most disorganized and seemingly "shoot themselves-in-the-foot" compared to any other, even among those that gave me worse treatment.
*** k) The most recent statement ending in August, 2004 shows yet <u>another</u> late payment penalty of $35.00. This payment was made a full 17 days <u>before</u> the due date, but was posted a full 7 days <u>after</u> the due date. Chase's representative told me that they could not make adjustments to closed accounts (just add fees, apparently).

Bal 04/14/08
$0
Acct Closed

[redacted]

[redacted]

4/7

8) [redacted]

Bal 04/14/08
$Ø

9) Bank One/Chase #1007 XXX (Bank One Yahoo! Visa)

a) Original account was Yahoo! Visa offered through First USA Bank.
b) Original credit limit was $25,000. Another First USA account (#5139) with a limit of $25,000 was rolled into this one for a total credit limit of $50,000.
c) The Yahoo! account was opened approximately August, 2000 The other "First USA Platinum Card" account was opened approximately November, 2000. These two accounts combined 05/21/2001 under the Yahoo! account number.

Bal 04/14/08
~$4600 –

c) Primary use is for personal. family and household incidentals. There have also been occasions in which a balance transfer or promotional cash offer was attractive enough to act on.
d) Closing balance as of statement ending 06/02/04 was $27,041.17.
e) APR for purchases was 22.99% as of statement ending 06/02/04. Frankly, it's very difficult to tell what the originally agreed-upon APR was in the first place as there have been so many changes, both upward and downward.
f) As the usage of this card was primarily for promotional cash offers and balance transfers, the standard, fixed APR was between 12.99%-14.99% after any expiration of promotional time period offers that I availed myself of.
g) Finance charge for the statement ended 06/02/04 was $498.73.
h) Minimum payment as of statement ended 06/02/04 was $__________.
i) Payment of $1,000 was made 06/08/04.
j) My credit limit was decreased from $50,000 to $40,200 on 06/20/02. This was dangerously close to the balance on the card ($40,093.87 as of 07/03/02).
k) My credit limit was decreased again from $40,200 to $39,800 on 10/07/02. This again was dangerously close to the balance at the time ($39,545.68 as of 10/03/02).
l) **It's become obvious to me that Bank One's intention was simply to continue decreasing my credit limit so as to eventually close the account. I suppose that if my account went "over the limit" as a result of the razor-thin tolerance that was left between my current balance and newly-lowered credit limit, it would therefore also allow Bank One to add penalties and additional rate hikes of the APR. This theory became evident with another account I have with Bank One.**
m) My APR was increased from a nominal 8% to 14.99% to 22.99%.
n) My credit limit was decreased again from $39,800 to $27,250 effective from 04/23/02. At the time of this most recent credit limit decrease, my balance was again dangerously close and was actually forced over!!! ($27,542.44 as of 05/04/04). This placed me in an "over the limit" situation for which I was penalized by Bank One and reported to Experian. I began calling Bank One to correct this situation on 05/10/04. I had been notified by Experian of the derogatory report placed by Bank One. When I confronted

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Bank One, they admitted their 'mistake' and actually had the audacity to raise my limit to $27,650 to cover the difference. I was promised that corrective measures would be taken with Experian, but as of the end of May nothing had changed...In fact, that same incorrect derogatory report was still on my Experian report as recently as the end of July. I do have a letter from Bank One clearly stating that the "over-the-limit" situation was not due to anything that I did, but rather, a Bank One error. In fact, I have not used the account for over two years.

o) Bank One holds an 'Undisputed First Place" position in the ranks of dishonorable dealing and dubious business practices with regard to their credit card divisions. This holds true for all 3 accounts listed here. When First USA was responsible for the administration, I found people to be more reasonable and realistic. What Bank One did (and continues to do) to me is unconscionable, unethical, undeserved, bad business and arguably legal.

10) Bank One/Chase #7434 XXX (Bank One e-Card)

a) This account was originally with First USA Bank, and was first applied for due to its being an advertised incentive (0% APR) with the purchase of a Dell computer system. I applied over the telephone with Dell while buying a new client/server system for my California office.

b) When I applied for the First USA/Dell Computer card, I was declined. I bought the computer system anyway, and simply used my American Express, I believe. Imagine my surprise when, approximately 01/22/2001a brand new First USA/Dell Computer credit card shows up at my office with a credit limit of $25,000!!! So much for being declined, and so much for a 0% APR incentive!!! I expected to receive a letter of declination, but instead received a $25,000 credit line (the computer system was maybe 1/3 of that amount).

Bal 04/14/08 $ Ø

c) Primary usage of this account has been for family and household incidentals, as well as balance transfers and promotional cash offers.

d) Closing balance as of statement ending 06/09/04 was $9,424.04.

e) Finance charge as of statement ending 06/09/04 was $194.40.

f) Minimum payment due as of statement ending 06/09/04 was $235 00.

g) Payment of $750.00 was made 06/17/04.

h) APR on purchases as of statement ending 06/09/04 was 24.99%, and 24.99% for advances. The original APRs were all promotional (approximately 2.99%-5.99%). At the expiration of the promotional periods, the default APR was approximately 15.90% for purchases and 19.49% for cash advances.

i) My credit line increased from $25,000 to $30,000 approximately 12/11/2001.

j) My credit line was then decreased from $30,000 to $18,500 approximately 06/20/02. This credit line decrease was, again, dangerously close to the balance ($18,246.03 as of 06/11/02).

k) A payment sent was returned by the USPS approximately September, 2002. This showed up on my 09/11/2002 statement as a non-payment, accompanied by a late fee. It was a "no win" situation, so I accepted the late fee and made arrangements for a telephone payment so as to both honor my commitment and avoid a negative report on my bureau report. The following month, a situation occurred in which the account went late again. Aside from a clerical error on the part of my bookkeeper (whose duties include all this bill paying), I assumed the full responsibility for her error...what choice? I was severely punished by First USA (see following)

Not error! Payment made - never posted. Check voided later

l) Due to these back-to-back foul-ups, my APR on **ALL FIRST USA ACCOUNTS** was increased drastically (this account alone went up to 19.99% from its promotional APR). At the time, the total outstanding balances due to First USA were approximately $160,000, and now all 3 account balances jumped...in some cases, as high as 24.99%!!!

04/2002 Chase period late or no postings, returned mail, etc. Statements missing 8554

m) I contacted First USA, and questioned them as to why my APRs had been increased so much. After all, when the first payment came back in the mail, I contacted First USA, made a phone payment commitment, and stuck to it. I was reassured that since I did so, there was no report made to the credit bureaus. When I queried about the huge increase in APR, I was told that just like it says in the Cardholder Agreement about being late twice in a 6-month period, likewise I should wait about 6 months and the APRs would roll back assuming the account remains in good standing. That sounded perfectly reasonable, so I had no reason to doubt it.

n) My APR was increased again from 19.99% to 22.99% approximately 04/10/03 (prime + 18 74%).

o) My APR was increased yet again from 22.99% to 24.99% approximately 12/03/03. Throughout all these APR increases, I hadn't used any of my First USA/Bank One accounts for over 2 years!!!

p) Practically concurrent with the latest APR increase to 24.99%, (now) Bank One actually had the audacity to increase my credit limit from $18,500 to $21,300!!! Apparently, there was confusion as to whether or not I was a good risk or a bad risk, but as long as I was a foolishly profitable risk I was a risk worth taking...or so I thought.

Only Bank One/ Chase

q) Effective 04/23/04, Bank One decreased my just-recently increased credit limit from $21.300 down to $11,050. Once again, this was very close to my balance at the time ($10,749.84 as of 04/09/04).

r) Just as a bit of added entertainment, I wanted to tell you that Bank One decreased my credit line

April 2008 [illegible]

34/43

yet again again, from $11,050 to $9,150 approximately 08/04/04 (balance was $8,610.33 at the time).
s) In retrospect, it would have been a lot simpler had I truly been turned down in the beginning like I was told.

11) Bank One / Chase #5024 XXXX (British Airways Visa Card) 6/7

a) Originally opened with First USA approximately August, 1999. The original credit limit was $25,000. I had another First USA account (#3574) that had a $40,000 credit limit that was combined with the British Airways card to total $65,000. These were combined some time between August, 1999 and June, 2000. A third First USA account (#2529) was also rolled in to the British Airways card, for a grand total credit limit of $90,000

b) This was my main card of choice, as my business afforded me regular opportunities to travel. The British Airways Frequent Flyer program worked very well, so the unusually high credit limit was a definite convenience. Usage was broad, ranging from balance transfers to promotional cash offers for the company to travel expenses as well as daily various and sundry charges. I used this card at almost every opportunity for personal and household expenses. Bal 04/14/08 $Ø

c) Closing balance as of statement ending 06/07/04 was $68,601.91.

d) Finance charge as of statement ending 06/07/04 was $1,357.08.

e) Minimum payment due as of statement ending 06/07/04 was $1,370.00.

f) Payment of $50,000 was made via Fed-Ex 06/18/04. Various credits ($4,013.93) were issued to the account 05/20/04. Another payment of $11,000 was posted 07/22/04, and another final payment of $5,000 was made via Fed-Ex and posted 08/03/04. These payments and credits paid off the account, and left a credit balance of $719.70.

g) APR on purchases was originally 10.99 %, and increased to 19.99% approximately April, 2003. (I'm not sure of the date. It's very difficult to "reverse engineer" First USA/Bank One statements). The APR was increased from 19.99% to 22.99% right around the time of the First USA/Bank One merger, and then was increased yet again from 22.99% to 24.99% approximately July, 2004.

Checks Received Thru 2005 for ~~(i)~~ (j)

h) My credit limit was decreased from $90,000 to $70,600 approximately 04/23/04. True to form, the difference between my balance due at the time ($70,318.97 on 04/07/04) and this newly-decreased credit limit was razor thin.

i) As recently as February, 2004, I was still receiving convenience checks offering 3.99% fixed APR for the life of the loan up to my available limit of $90,000 at the time. These checks are still arriving, albeit for a lower $70,600 limit as recently as August 3rd, 2004!!!

j) On August 4th, 2004, I checked with Bank One to confirm that my account was, in fact, paid off. I intended to avail myself of the 3.99% fixed APR. My account balance was confirmed to be zero, plus an additional credit balance of $719.70. And, yes, the checks were also confirmed as valid up to my available $70,600 credit limit. However, before I merely wrote myself a check for $69,000, I thought it prudent to call Bank One first (I've already had a taste of their somewhat "dubious" ethics and "truth in lending"). I planned to use the money to satisfy some other higher interest debt, and 3.99% fixed was an attractive offer. To make a long story short, I was not only told that a $69,000 check would not be honored, but that I couldn't even write a check for $1.00!!! I was told further that my account was closed!!! Not because of late payment or NSF checks or going over the limit, but allegedly due to my unsecured debt level (approximately $100,000 of it had already been paid off to Bank One themselves, but they had not reported it to Experian!!!)

k) I received a refund check for my credit balance of $719.70.

l) I also received a statement asking for $167.57 back to cover finance charges for approximately $4,600 for the previous month. Another entry on the statement was a $65 Annual Membership Fee (needless to say that's been removed now). The statement (closing date of 08/06/04) also states that my Total Credit Line of $70,600 has $0 available, and my Cash Access Line of $14,120 also has $0 available.

m) I also received a letter dated August 5th, 2004, stating that "my request for reinstatement has been declined". I did not request any such reinstatement. In fact, my account was already closed on the 4th!!! I reconfirmed that fact on the 5th, but never authorized another inquiry!!! Not only did that unauthorized inquiry cost me more valuable FICO points, but my account had just been closed!!!

n) Where's the "truth in lending"??? I received yet another 3.99% offer up to $70,600 on August 16th!!!

[redacted]

04/14/2008 22:22 FAX 7178400193 GEMSTAR INTL 021/043

[redacted]

7/7

Anyway, Nell, there should be sufficient data here for you to develop a list of questions or topics you'd like to cover. There are a few spots in this overall that need to be polished up, but it is true and factual to the absolute best of my knowledge.

Please contact me at your earliest convenience, and we can move on to the next step.

All the Best,

Stephen Strachan
Seven Seas Trading, Inc.

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NY Times excerpt (11/21/2004)

1/2

too much debt, has missed or is late on payments to other creditors, or is otherwise mishandling their personal finances, it is not unreasonable to determine that this behavior is an increased risk. In the interest of all of our customers, we must protect the portfolio by adjusting a customer's rate to compensate for that increased risk."

EX-16 (2 pages)

The Credit Score

The interest rate on a credit card is theoretically correlated to the likelihood that a borrower will make good on his debts. Lenders typically measure those odds by a three-digit number known as a FICO score

Calculated by and short for the Fair Isaac Corporation, a company in Minneapolis, that score has become the most vital of statistics to many Americans

Credit scores are used to determine everything from how much a person can borrow to how much he or she pays for life insurance to whether he or she can rent a home. A utility company in Texas even experimented last summer with using credit scores to set prices for electricity.

The number crunchers at Fair Isaac do not make lending decisions. They simply take information collected by the three largest credit-reporting agencies, Experian, Equifax and TransUnion, and apply mathematical formulas to boil it down to a single number on a scale that runs to 850.

"Lenders use that score, almost like a thermometer, to determine if they're going to grant credit or not," said Tom Quinn. a spokesman for Fair Isaac. He estimated that his company had calculated a credit score for about 75 percent of American adults.

The average FICO score is 720, he said. A score below 620 lands a consumer in the riskiest category, known as subprime, and virtually ensures the highest borrowing rates, if the consumer can obtain any credit at all Credit reports generally note only those payments made at least 30 days late

Consumers with better-than-average scores are usually, but not always, eligible for the lowest rates. As Steve Strachan, a flower importer in York, Pa., learned, a relatively high credit score does not guarantee favorable terms.

A thick credit report on Mr. Strachan from January showed a FICO score above 730, but by then he had already been through a battle with the issuer of a card that had once been his favorite method of payment.

In the 1990's, Mr. Strachan traveled frequently from his home on the West Coast to Amsterdam and other foreign cities to meet with suppliers of tulips and exotic flower varieties that he distributed to domestic florists and wholesalers. He obtained a WorldPerks Visa card that rewarded him with seat upgrades through Northwest Airline's frequent-flier program

"I used that card whenever I possibly could because of the travel benefits," he recalled. sitting in his living room before stacks of credit card bills. change-of-terms notices and other correspondence between him and several lenders. "Never paid a penny of interest."

He was such a valued customer then, he said, that US Bank, which issued the card, had extended him a high credit limit of $54,000 even though the card rate was just one percentage point above the prime rate When the economy wilted after the collapse of the stock market in early 2000, so did Mr.

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Strachan's business He began using his credit lines on that Visa card and a few others to stay afloat, paying smaller portions of his growing balances

Then. in May of last year, US Bank sent Mr. Strachan a letter telling him that it planned to raise the card's rate to 20 21 percent, nearly quadrupling the existing rate of 5.25 percent.

"I wasn't late, and I didn't go over the credit limit, and I didn't write bad checks," Mr. Strachan said A representative of US Bank told him he was using too much of his available credit, he said.

A U.S Bank spokesman declined to comment on Mr Strachan's account.

The monthly interest charge on his $50,000 balance jumped from $209 in June to $756 in July and $808 in August He eventually persuaded the bank to restore the original rate, but the bank closed the account, shutting off a key source of credit.

By then, Bank One, another creditor, had compounded Mr. Strachan's woes He was carrying a balance of about $70,000 on one account when the bank started raising his rates, first to 19.99 percent in April 2003, then to 22.99 percent the next month, then to 24.99 percent in June. By October of last year, he was incurring a monthly finance charge of about $1,500 on a $77,000 balance.

"It was like they almost all had a little meeting in the back room and said. 'Let's get Strachan,' " he said of his creditors. "How does it serve them to treat people like that? Are they trying to force them into bankruptcy?"

Lawyers he consulted advised Mr Strachan to take the easy - and increasingly popular - way out by filing for bankruptcy protection, but he refused. He is struggling to make good on his debts "because I have principles and ethics "

But the battle to dig out of a deepening hole has taken a toll. Mr. Strachan said he had lost 30 pounds and described himself as a "broken man."

Lately, he said. Bank One has periodically reduced his credit limit to a level just above his remaining balance, leaving him little margin for error. Some months, he said, if he were to pay only the minimum due, the ensuing finance charge would put his balance over the limit, triggering a penalty fee

By doing that, he said, "They create their own little monster."

The Regulators

Consumer complaints prompted the Office of the Comptroller of the Currency, which oversees the nationally chartered banks that constitute most of the major card issuers, to warn banks about giving fair notice of term changes and about sending out tempting offers to people who are unlikely to qualify for them

Julie Williams, the acting comptroller, said in an interview that as long as the lenders were not intentionally deceiving their customers, they were free to set whatever rates and fees their home states allow. If customers do not want to pay a particular rate, "they have choice," she said. "They can find another card "

But consumers clearly are unhappy with the choices they have. About 80,000 people lodged complaints

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AL 2004–10

OCC ADVISORY LETTER

Comptroller of the Currency
Administrator of National Banks

Subject: Credit Card Practices

TO: Chief Executive Officers of All National Banks, Department and Division Heads, and All Examining Personnel

PURPOSE

The Office of the Comptroller of the Currency ("OCC") is issuing this advisory letter to alert national banks to the OCC's concerns regarding certain credit card marketing and account management practices. These practices may entail unfair or deceptive acts or practices and may expose a bank to compliance and reputation risks.

Three practices, in particular, have come to the OCC's attention and are addressed in this guidance. The first practice is soliciting for credit cards that advertise credit limits "up to" a maximum dollar amount, when that credit limit is, in fact, seldom extended. The second practice is using promotional rates in credit card solicitations without clearly disclosing the significant restrictions on the applicability of those rates. The third practice is increasing a cardholder's annual percentage rate or otherwise increasing a cardholder's cost of credit when the circumstances triggering the increase, or the creditor's right to effectuate the increase, have not been disclosed fully or prominently.

DISCUSSION

"Up to" Marketing

Promotions for credit cards with credit limits "up to" a specified dollar amount are common in the credit card industry, and such marketing can be appropriate and beneficial to customers when the "up to" amount of credit offered is not essentially illusory,[1] a meaningful number of applicants receive a significant credit line,[2] material information about the cost and usefulness of

[1] In a recent advisory letter, the OCC noted the compliance and safety and soundness risks and concerns presented by credit card programs under which a nominal credit line is consumed by fees. *See* OCC Advisory Letter 2004-4, "Secured Credit Cards," at 4 (April 28, 2004). The OCC advised that banks should not "offer unsecured credit cards if the amount of fees charged to the card upon issuance substantially reduces the amount of initial available credit and card utility." *Id.* at 6.

[2] Credit lines should be established commensurate with a borrower's creditworthiness and ability to repay the assigned limit in accordance with the terms of the card. "Credit Card Lending, Account Management and Loss Allowance Guidance" at 2, attached to OCC Bulletin 2003-1 (January 8, 2003).

the card is clearly and conspicuously presented, and disclosures are made in accordance with Regulation Z, 12 CFR part 226 On the other hand, certain practices present high compliance and reputation risks. Accordingly, national banks should not:

- Target consumers who have limited or poor credit histories with solicitations for credit cards with a maximum, or "up to," credit limit that is far greater than most of these applicants are likely to receive.

- Provide most applicants with a "default credit line" (the lowest credit line available) that is significantly lower than the maximum amount advertised, while failing to disclose fully and prominently in the promotional materials the default credit line and the possibility that the consumer will receive it

- Advertise the possible uses of the card when the initial available credit line is likely to be so limited that the advertised possible uses are substantially illusory.

To further mitigate associated risks, national banks should strongly consider providing and disclosing readily exercisable mechanisms for consumers to cancel the card at little or no cost when they learn the actual credit limit granted.

Promotional Rate Marketing

Another common industry practice is to use a promotional rate to attract customers and to induce new and existing customers to transfer balances from other credit cards. A typical promotional rate solicitation involves representations that an applicant or current cardholder may for a limited time receive a reduced annual percentage rate ("APR") on certain credit card charges or transactions. The reduced APR generally will be in effect only for a specified number of months. Additionally, the low APR may be subject to other material limitations, and other features of the promotion may limit the consumer's ability to benefit from the program. For example, the promotional rate may apply only to transferred balances and not to new purchases during the promotional rate period, or the borrower's payments during the promotional rate period may be applied first to balances transferred pursuant to the promotional rate solicitation, and only after such transferred balances are paid off are payments applied to balances that are accruing interest at the ordinarily applicable (and higher) APR. In addition, consumer benefits from low initial APRs may be offset by the imposition of fees on any balances that are transferred.

Promotional rate offers may be beneficial to consumers, and the typical limitations and features described above are not, taken alone, contrary to law Problems may arise, however, if material terms are not appropriately disclosed in promotional materials. Accordingly, national banks should not:

- Fail to disclose fully and prominently in promotional materials and credit agreements any material limitations on the applicability of the promotional rate, such as the time period for which the rate will be in effect, any circumstances that could shorten the promotional rate period or cause the promotional rate to increase, the categories of balances or charges to which the rate will not apply, and if applicable, that payments will be applied to promotional rate balances first.

- Make representations that create the impression that material limitations regarding the applicability of the promotional rate do not exist.

- Fail to disclose fully and prominently in promotional materials and credit agreements any fees that may apply (*e.g.*, balance transfer fees) in connection with the promotional terms.

Repricing of Accounts and Other Changes in Credit Terms

Credit card issuers may increase a consumer's APR to address credit risks that arise when a consumer fails to make timely payments on the account, and some credit card issuers may increase the APR when a consumer fails to make timely payments on other accounts, including accounts with other creditors. Some credit card issuers also may raise the consumer's APR for other reasons, such as the consumer's increased use of credit, failure to make more than the minimum monthly payment on the account with the issuer, or other behavior that reflects adversely on the consumer's credit rating. Credit card issuers may take other actions that also effectively increase the cost of credit for some consumers, such as shortening the due date for receipt of payment or raising the amount of fees for late payment, exceeding a credit limit, or obtaining a cash advance.[3]

These practices may well be appropriate measures for managing credit risk on the part of the credit card issuer. However, certain practices in connection with repricing credit card accounts and changing terms of credit card agreements may raise heightened compliance and reputation risks. Accordingly, national banks should not:

- Fail to disclose fully and prominently in promotional materials the circumstances under which the credit card agreement permits the bank to increase the consumer's APR (other than due to a variable rate feature), increase fees, or take other action to increase the cost of credit, such as, if applicable, failure to make timely payments to another creditor.

- Fail to disclose fully and prominently in marketing materials and credit agreements, as applicable, that the bank reserves the right to change the APR (other than due to a variable rate feature), fees, or other credit terms unilaterally.

CONCLUSION

The practices described in this advisory letter may involve unfair or deceptive acts or practices, or other violations of laws or regulations. These practices also can damage a bank's reputation and good name, and are contrary to the standards under which the OCC expects national banks to operate. Accordingly, in the OCC's view, a national bank should take steps necessary to avoid

[3] In some circumstances, the credit agreement specifies when the credit card issuer may increase the APR, increase fees, or otherwise change the applicable credit terms. In other circumstances, the credit agreement permits the credit card issuer to make unilateral changes in terms.

engaging in such practices. In the event the OCC finds a national bank to be engaged in the practices identified in this advisory letter, it will take all appropriate supervisory action necessary to address the matter.

Questions concerning this advisory letter may be directed to the Community and Consumer Law Division at (202) 874-5750, the Credit Risk Division at (202) 874-5170, the Compliance Division at (202) 874-4428, or the appropriate supervisory office.

Julie L. Williams
First Senior Deputy Comptroller and
Chief Counsel

Emory W. Rushton
Senior Deputy Comptroller and
Chief National Bank Examiner

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Stephen, your last point is the most salient. The primary difficulty in pursuing claims for you, since you have now relocated out of California (which has struck down arbitration clauses in credit card agreements), has been the uniform existence of arbitration clauses in the agreements. These clauses make it impossible for lawyers to handle any claims, because the claims are too small to cover the costs and fees of the case and because the clauses preclude class actions. Thus, because all of the agreements include the clauses, no one can really challenge the violations by the credit card companies, and they continue on without any penalty or deterrent. The point of this case is to destroy the clauses so that the substantive cases may then be pursued on a representative basis. Whether a particular card issuer has or has not breached its agreement with you is wholly irrelevant. The point of this case is that they all conspired, during identified meetings and in specific emails, to include arbitration clauses which they knew would act as an unfair and deceptive restraint on cardholders' ability to resolve legitimate claims of breach and the imposition of unlawful or unfair fees, charges and terms. Thus, the claim is an antitrust claim, which outlaws conspiracies among competitors to set and agree upon market impacting terms. There is no doubt that such a conspiracy happened, because I witnessed some of the meetings at ABA conventions and otherwise where the credit card issuers all agreed to basically do the same thing. So, this is indeed a stepping stone case. That said, however, I think you may have a very interesting point concerning antitrust injury. To the extent your credit score has been lowered because you have been unable to challenge unlawful change in terms provisions and other aspects of certain credit card practices, it may be that that is an antitrust injury. Of course, Fair Issacs doesn't know why the score is lower, so it wouldn't be a defendant, but I think we might be able to construct an economic analysis to show that the arbitration clauses have had an indirect effect on credit scores, because they prevent people from challenging charges, fees, etc. they otherwise would challenge. I would want to talk to an economics expert, but I definitely see some potential there. I will call you later today.

Rec
09/03/05

Arbitration
Elimination

Michael D. Donovan

For Release Upon Delivery
10:00 a.m., April 17, 2008

TESTIMONY OF

JULIE L. WILLIAMS

CHIEF COUNSEL AND FIRST SENIOR DEPUTY COMPTROLLER

OFFICE OF THE COMPTROLLER OF THE CURRENCY

BEFORE THE

**SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT**

OF THE

COMMITTEE ON FINANCIAL SERVICES

OF THE

U.S. HOUSE OF REPRESENTATIVES

APRIL 17, 2008

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

INTRODUCTION

Chair Maloney, Ranking Member Biggert, and members of the Subcommittee, I appreciate the opportunity to appear before you today to provide the Office of the Comptroller of the Currency's views on H.R. 5244, the "Credit Cardholders' Bill of Rights Act of 2008." Although credit cards provide consumers with many benefits, they also generate complaints about fees, billing, and marketing practices. Congressional oversight, through hearings such as this, has encouraged improvements in some of those practices, and this hearing is a valuable opportunity to explore the benefits and consequences of possible legislative responses as well.

The OCC's perspective on these matters is informed by our experience as the supervisor of national banks' credit card operations, which today involve management of over 75 percent of the U.S. credit card debt outstanding.

In testimony before this Subcommittee last year, Comptroller Dugan provided extensive background on the evolution of the credit card industry, benefits and current concerns about credit cards, the OCC's comprehensive approach to supervision of national banks' credit card operations – including our approach to examinations, the consumer complaint process, and enforcement actions – and the need for reform of credit card disclosures and certain other credit card practices.[1] As the Comptroller noted, even though the OCC does not have rulemaking authority with respect to credit card disclosures and marketing practices, we have been proactive in issuing supervisory

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[1] Testimony of John C. Dugan, Comptroller of the Currency, before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services of the U.S. House of Representatives (June 7, 2007), available at: http://www.occ.treas.gov/ftp/release/2007-54b.pdf.

guidance that has resulted in improvements in national banks' practices in both areas. The OCC initiated the development of the interagency "Account Management and Loss Allowance Practices Guidance," which led to new standards for minimum payment requirements, workout programs and reforms in overlimit practices. These changes were necessary to deter prolonged negative amortization of credit card debt and to ensure that borrowers with very serious financial difficulty could be enrolled in workout programs that would amortize their debt within 5 years.[2] We also issued guidance to national banks on inappropriate disclosure practices associated with universal default, unilateral change-in-terms, and certain pricing strategies, which resulted in improvements in those practices.

As the Comptroller stated in his testimony, we believe that certain key principles should guide any new credit card legislation and regulation. My testimony focuses on those principles and their application to H.R. 5244.

First, it is important to recognize that credit cards are different from home mortgages or car loans in fundamental respects and, as such, require significant and different credit risk management techniques. Unlike a mortgage or car loan, a credit card is unsecured, revolving, open-end credit. The amount outstanding on a credit card, at any given time, is subject to the customer's credit limit so that as the customer pays down the balance of an account, he or she may then make new charges up to the limit (the extension of credit thereby "revolves" as payments are made and new charges are

[2] OCC Bulletin 2003-1, Credit Card Lending: Account Management and Loss Allowance Guidance (Jan. 8, 2003). Prolonged negative amortization refers to when the required minimum monthly payments are not enough to cover all finance charges and fees assessed during the billing cycle and these unpaid charges and fees are then added to the balance.

incurred). Credit card lenders qualify customers for a specified interest rate, credit limit, and other terms, based on an assessment of the consumer's creditworthiness at the time the account is opened. However, each charge made to the credit card is a new, unsecured extension of credit that is not separately underwritten at the time of the transaction. Thus, given the fundamental nature of revolving, open-end credit, the credit risk faced by a credit card lender is dynamic and changing. And, credit card lenders appropriately rely on risk mitigation tools to address changes in the customer's credit risk profile.

The risk mitigation tools used by credit card lenders to address changes in the credit risk profile of customers may include freezing or reducing credit lines, closing accounts, shortening account expiration dates, and "re-pricing" (changing the rate of interest charged) for outstanding balances on an account. Changes in a customer's creditworthiness and other factors affect credit risk assumed by credit card lenders for both existing balances that a customer has not repaid, as well as for future transactions by the customer. In other words, when a credit card customer does not pay his or her balance in full, that action by the customer creates risk to the lender for the unpaid balance as well as any future charges.

As a fundamental safety and soundness matter, given the nature of unsecured, revolving, open-end credit, credit card lenders need to be able to respond to changing circumstances that affect their risk exposure and operating costs. And, because the nature and degree of these risks can differ on an account-by-account basis, they need to be able to employ appropriate risk mitigation options, such as those described above, to address these risks. As described in more detail later in my testimony, we have serious concerns that certain provisions of H.R. 5244 would deprive credit card lenders of options that are important to effectively manage those risks.

Second, the ability and means by which credit card lenders change credit card terms must not be one-sided – it must take account of implications for the customer. Customers should be given meaningful notice of the terms and conditions of their credit cards, and the circumstances under which those terms may change. This enables them to make informed choices and compare the features of competing credit cards and to recognize when their actions, such as failure to make payments due on the card, or defaults on other obligations, may affect their credit card interest rates, fees or other terms.

The OCC has long-advocated a new approach to consumer disclosures – for credit cards and consumer credit generally – based on robust consumer testing to develop disclosures that customers can understand and that effectively convey the information customers most want and need to know. Improved disclosure industry-wide can have multiple benefits for consumers: it can lead to informed consumer choice, stimulate competition to provide consumers the terms they want, and it can lead to transparency in credit card practices. While we do not have rulemaking authority in this area, we have been encouraged by the proposal by the Federal Reserve Board to revise provisions of its Regulation Z governing credit card disclosures, and by the Board's use of consumer testing to develop the proposal. In a comment letter filed with the Federal Reserve Board last year, Comptroller Dugan supported many aspects of the proposed rule, which reflected this new approach – and also urged that the Board do more in certain respects.

Third, and a key element of the Comptroller's recommendations to the Federal Reserve Board, is the need for credit card customers also to have meaningful choice when faced with proposed increases in credit card interest rates. Specifically, the Comptroller urged that before a credit card lender could increase the interest rate on an account for reasons other than the customer's default on the account itself, the customer generally should be given a reasonable opportunity to opt-out of the change and pay off the outstanding card balance according to the old terms. The credit card lender could close the account to new transactions, or could choose to keep the account open under the old terms for a fixed period of time, such as the account expiration date. This would allow the credit card lender either to confine its risk to the existing balance and potentially limited new balances, or to price for the risk of continuing the relationship.

But, where a customer defaults on his or her obligations under the card itself, the risk to the credit card lender is clear and immediate, and, with appropriate up front notice, the consequence of increased rates on the consumer's existing balance and on future transactions should not come as a surprise to the consumer.

Finally, we recognize that many provisions of H.R. 5244 are an understandable reaction to shortcomings in practices – including the lack of meaningful notice and meaningful choice described above. Where the reaction takes the form of a requirement or restriction that reduces returns from one aspect of a credit card lender's operations, there may well be "trade-offs" between the potential benefits and consequences of such a reaction. Credit cards are a fee- and interest rate-based business, and a credit card lender's response to a restriction in one area may well be to alter practices so that the same return can be achieved through other means. Thus, for example, if credit card lenders are restricted in their ability to price particular customer segments for the risks and costs posed by those customer segments, the alternative may be that those costs are spread over a broader range of credit card customers. Put another way, taking aim at risk-based pricing will likely cause prices to increase on some portion of customers that are not engaged in risky behavior. These are not necessarily safety and soundness matters, but they are important considerations in assessing the ultimate benefits that would result from particular legislative responses in this complex and competitive business.

COMMENTS ON H.R. 5244
"THE CREDIT CARDHOLDERS' BILL OF RIGHTS ACT OF 2008"

Provisions Affecting Credit Risk Management

Section 2: "Credit Cards on Terms Consumers Can Repay." Section 2 of H.R. 5244 contains several provisions that would significantly restrict a credit card lender's ability to manage and price for credit risk. Among other things, a credit card lender would be prohibited from using adverse information clearly relevant to a customer's credit risk profile as a basis for increasing the interest rate on an outstanding credit card balance, unless the information pertained to the customer's performance on the credit card loan itself. In those situations where a creditor could increase the interest rate, customers would receive a 45 day advance notice. Customers could continue to use the credit card to incur debt for 45 days after this notice of the proposed rate increase, yet could subsequently opt out of an increased rate thereafter. This section also provides that credit card customers may cancel their cards without penalty at any time from the date they receive notice of the interest rate increase until the third periodic statement after the effective date of the increase is received. The customer would be permitted to repay the outstanding balance that existed before the effective date of the increase under the rate and terms in effect before notice was received.

Finally, section 2 would prohibit creditors from changing any term of the credit card agreement until renewal of the agreement, except for specific material reasons and subject to specific limitations contained in the agreement when the account is opened.

These provisions are complex, but their practical effect is to significantly restrict a credit card lender's ability to respond to increased credit and changing costs. For this reason, we have substantial supervisory concerns about the effect these provisions would have on prudent risk management practices. For example:

- A credit card lender's ability to price for changing risks presented by existing credit card debt that has not been repaid by a customer would be limited solely to circumstances in which the consumer has defaulted on the credit card account itself, and in no other circumstances – even if the customer in those other circumstances were provided with notice of the potential change and the opportunity to opt out of the change and close down the account under its old terms.
- In situations not involving a default on the card itself, a credit card lender could not use information highly relevant to its risk exposure to adjust its pricing for the risk of credit card debt that a customer has not repaid. Specifically, information about deterioration in a customer's creditworthiness,

such as defaults on other credit or deterioration of a credit score, is very relevant to a creditor's assessment of a consumer's credit risk. And, depending upon the severity of the credit risk, it also may justify a pricing adjustment on the account. But a credit card lender could not use this information – even with notice to the customer and with an opportunity for the customer to opt-out – to re-price existing account balances. The effect of this restriction is particularly severe when the existing balance is at the maximum credit limit on an account where credit risk has increased. In such cases, the creditor is left with limited risk mitigation options – to close the account or severely constrict any remaining available credit. However, this result may not be beneficial for or desired by many consumers.

- In addition to restricting a creditor's use of risk-based re-pricing, section 2 also could restrict a creditor's ability to use other risk mitigation tools, such as closing an account or reducing a credit line, even though these steps would be a prudent course in response to adverse changes involving the consumer's creditworthiness or other factors bearing on the lender's costs and risks. This is because circumstances in which a change in terms may be an appropriate response to increased credit risk cannot always be anticipated and specifically identified in a credit agreement at the time the account is opened.

Comptroller Dugan has advocated a principled, but different approach, which we believe is fundamentally fair to credit card customers and consistent with safe and sound credit card lending practices – credit card customers should be provided with advance notice and a right to opt out of certain changes in terms. Specifically, if a creditor seeks to increase the interest rate on an account to address increased credit risk due to a deterioration in a consumer's credit score or default on an account with another creditor, it must first provide the consumer with a reasonable advance notice and an opportunity to opt-out of the changed terms and to pay down the outstanding card balance in accordance with the existing terms. If the consumer opted out of the rate increase, the credit card lender could then mitigate the change in credit risk on that account by using other risk management tools, such as by closing the account to new transactions or reducing the credit line.

An opt-out structured in this manner would preserve the credit card lender's ability to monitor and respond to changes in a consumer's creditworthiness using all relevant information and available risk management tools, while recognizing that certain price adjustments should be preceded by advance notice and an opportunity for the customer to make alternative credit arrangements. It also would provide the customer with meaningful information at a critical point in time in advance of any rate increase, and it would provide the means for the customer to avoid any increased costs. With an opt-out, the customer would have the choice of declining the rate change and seeking a new credit card from another credit card lender, or agreeing to an increase in rates in order to retain use of the card.

By contrast, when a credit card customer defaults on his or her obligations under the terms of the credit card itself, the credit risk consequences are more direct and immediate, and, provided appropriate up front disclosure has been given, the customer should not be surprised when the credit card lender takes action to address this risk. Consequently, while we believe advance notice should be provided in these instances before increased rates become effective for existing and future balances, we do not favor a requirement that these customers be provided the right to opt out of a risk-based pricing adjustment that is based on the customer's repayment performance on the credit card itself.

Section 3(d): "Consumer Right to Reject Card Before Notice is Provided of Open Account." Section 3(d) would prohibit a credit card lender from furnishing any information to a consumer reporting agency before a credit card customer uses the card or activates the account. While this provision may be intended to address concerns about the impact of such reporting on a customer's credit score if the customer declines to accept the card, it also raises substantial risk management concerns. In evaluating the risk posed by a potential customer, it is important for a lender to know the credit lines the customer has available, and what has been used. Section 3(d) would effectively mask this information. Thus, for example, a customer could accumulate multiple, unactivated credit cards, which would be unreported – and unknown to the lenders assessing that customer's risk. The customer's real credit risk could be very different from what it appeared to be.

Provisions That May Have Unintended Consequences For Credit Availability And Costs

Other sections of the bill would prohibit or otherwise impose restrictions on particular credit card practices and fees. The issue here is not necessarily fundamental safety and soundness, but what the practical result of these changes would be – and whether limits on certain practices and charges would have unintended consequences that are detrimental to consumers in other respects. Careful consideration of these potential trade-offs are essential to evaluating the ultimate effect of these provisions H.R. 5244. This issue is illustrated by two provisions discussed below.[3]

Section 3(f): "Pro Rata Payment Allocations." Section 3(f) would require a pro rata allocation of payments among the outstanding balances accruing interest at different rates, with the largest balances receiving the greatest share of the payment. This provision responds to concerns that consumers may not understand how their payments on a credit card may be allocated to portions of their existing balance that carry different rates of interest, and that a creditor's payment allocation practices can increase the relative cost of using the account when it includes features that carry different rates. (For example, a customer's outstanding balance might include a portion reflecting a balance transfer bearing a very low rate, a portion with the regular account rate, and a portion with a typically higher rate for a cash advance.) The Federal Reserve Board has proposed to address these concerns through enhanced disclosures about the allocation of payments to balances subject to different interest rates, such as a lower promotional rate for balance transfers. Their Regulation Z proposal does not impose restrictions on how creditors must apply payments among balances subject to different interest rates.

Credit card lenders compete for new customers by offering temporarily low interest rates on balance transfers, and many consumers who receive meaningful disclosures can benefit – sometimes substantially – by lowering their borrowing costs when they transfer credit balances to a lower-cost account. If restrictions are imposed on

[3] Other such provisions are section 3(g), which would require that periodic statements be sent by the creditor to the consumer not less than 25 days before the payment due date, and section 4, which would regulate fees and practices relating to overlimit transactions.

payment allocation methods, instead of addressing these issues through enhanced consumer disclosures, the likely consequences will be reduced lender competition, fewer low-rate promotional programs that benefit customers, and changes to the way credit cards are priced – including the re-imposition of annual fees. These are examples of the trade-offs that should be considered in connection with requiring the approach to payment allocation that would be dictated by this section.

Section 3(a): "Double Cycle Billing Prohibited." As many observers have noted, some issuer practices that have prompted many customer complaints also may be so complex and difficult to explain that disclosures cannot adequately inform consumers so that they can avoid adverse effects of such practices. A frequently-cited example of such a practice is so-called "double-cycle billing." Double-cycle billing permits a creditor to compute the finance charge based on two billing cycles if a consumer, with no prior balance, makes only a partial payment of the balance by the payment due date. In effect, with double-cycle billing, the "grace period" for making payments without incurring a finance charge is retroactively eliminated.[4]

Section 3(a) would prohibit creditors from charging interest on any amount, even if less than payment of the full balance, if it would otherwise be subject to a grace period and is paid within that time period. While the heading on this provision indicates that it is intended to prohibit double-cycle billing, it would in fact apply much more broadly.

[4] To illustrate, if a consumer who made $1,000 in purchases in month one pays only $990 of the balance on the payment due date, $10 is carried over into the month two billing cycle. If the credit card issuer uses the double-cycle billing method and no new transactions are made in month two, finance charges on this account would be calculated taking the average daily balance of $1,000 in month one and $10 in month two, instead of calculating it on just the average daily balance of $10 in month two. U.S. Government Accountability Office Report No. 06-929, "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," at pp. 27-28 (Sept. 2006).

Section 3(a) would apply to, and limit the use of, the average daily balance method of computing interest on credit cards, which is one of the most common balance computation methods used.[5] In contrast to double-cycle billing, the average daily balance computation method generally has not been the source of consumer complaints.

Here again, if the average daily balance computation method ultimately is prohibited in addition to double-cycle billing, costs will increase and creditors will look for other sources of compensation. If prohibition of the average daily balance computation was not the intent, however, we would be pleased to provide the Subcommittee with technical comments on how the scope of section 3(a) could be revised to specifically target double-cycle billing.[6]

The Congress may make the determination that disclosures alone are not adequate to address consumer protection concerns about credit cards, and may conclude that it is appropriate to prohibit certain market practices. As noted at the outset of my testimony, this decision will involve weighing the benefits and consequences, or "trade-offs," of particular responses. When weighing the merits of such proposals, it is important to bear in mind that creditors may react to stringent new regulation by increasing the price of credit cards for all consumers and by reducing the type and amount of credit that is available. Also complicating the equation is the possibility that a severe reaction by card issuers to market restrictions could add stress to general consumer economic conditions.

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[5] With the average daily balance method, a borrower that revolves the balance by not paying the entire amount due by the due date must pay interest charges that are computed by multiplying the average daily amount outstanding for that billing cycle (only) by the daily rate of interest. Section 3(a) would bar this because it provides that "the creditor may not impose or collect an interest charge on the portion of the credit that was repaid" within the specified grace period for the current cycle.

[6] *See, e.g.*, 12 CFR 226.5a(g)(2) (Regulation Z definition of "two-cycle average daily balance").

Finally, there is no doubt that the recent scrutiny of credit card practices by Congress and this Subcommittee in particular, and the debate over legislative and regulatory responses such as H.R. 5244 and the Federal Reserve Board proposal, have yielded positive results. Some practices that the bill targets – such as double-cycle billing – already have been largely eliminated by national bank credit card issuers. As described earlier in my testimony, better disclosure has multiple benefits – informed consumer choice, greater competition by lenders to provide consumers with the terms they want, and the benefits that flow from transparency. Enhanced transparency, aided by the spotlight of Congressional oversight, has prompted credit card lenders to change practices that were difficult to explain and defend. This hearing continues the valuable process of enhancing transparency as well as exploring the benefits and consequences of legislative responses.

CONCLUSION

Thank you, Chair Maloney, for the opportunity to testify on these issues. I will be happy to respond to any questions you might have.

Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit
Statement of Susan Wones
on
The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers
April 17, 2008

Good morning, Madam Chairwoman and Members of the Subcommittee. I am Susan Wones, from Denver, Colorado, and I want to express my appreciation to the Subcommittee for inviting me to come to Washington again to share my experiences, which I think show the need for the legislation you are considering. I am pleased that I am able to testify this time!

Since 2003, I have had three credit cards through one bank. First, I had a Disney rewards card. When I signed up, I knew it would go from an introductory rate of 0% to 7.9%. But later I discovered it had gone to 14.9%, and although I tried I could not get it lowered. It had a $6,000 limit. Once I got up to around $6,000, though, the rate jumped from 14.9% to 25% - even though I had never gone over the limit. So, I decided to cancel it and pay off the balance. But after I closed the account, the credit card company still tried to increase my rate to 25% on the balance I owed. I don't think that's fair, and that would not be permitted under H.R. 5244.

After this, I decided to open up a new account, a rewards credit card that donated all of my rewards to the ASPCA, the American Society for the Prevention of Cruelty to Animals. That new card had an introductory offer of 0% interest and had an initial credit limit of $2000. During the middle of one monthly billing cycle I went $15 over my limit and they raised my interest rate to 23.24% and charged me a $39 over-the-limit fee – even though my beginning and ending balances for that billing cycle were under my limit. I knew that I was close to my limit but I figured that once I hit my limit the charges wouldn't be approved – but in fact the charges that took me over the limit *were* approved and I think that was because the company wanted to be able to charge the fee and raise my interest rate. After that, a few months later, the bank told me they were raising my interest rate to 32.97% on this account, so I closed the account. I understand H.R. 5244 would let people like me tell the card companies not to approve any charge that would take them over the limit. I think that would be a good thing.

My third bank credit card is a non-rewards card that also has a $2000 limit and is at a 7.9% interest rate. Finally, I have one other credit union card that has an interest rate of 10%.

I understand credit card interest rates are set based on risk and if the company is charging somebody a higher interest rate it is because they think there is a higher risk that the card holder will not pay the bill. So, it makes no sense to me how the same bank can issue me three different cards, with different rates -- one at 14.9% which they tried to raise it to 24.99%, another one at 7.9%, and a third that had a 0% introductory rate and now is at 20.99%. If they were truly rating me for risk, shouldn't the cards have either the same or close to the same interest rate? Or, if they think I am overextended – which they stated in a letter sent to me last week – why would they continue to issue me new credit cards? There's just one me, and just one risk that I won't pay or be slow to pay.

Furthermore, my credit union posted my FICO score of 726 on my account, which I understand means my credit is good and there's a low risk that I won't pay my debts. The bank said in its letter of last week that they raised the rate on one of my cards because of the "risk level" shown in my credit report. What is the reason for raising my interest rate if I am, according to my FICO score, such a good credit risk? H.R. 5244 would end this practice of increasing interest rates based on what is going on with my other accounts, outside of the bank's accounts, and I think that is the fair thing to do.

In the recent letter the bank offered to discuss payment programs with "reduced rates and fees," but I still don't agree that I am a credit risk because I don't agree I'm overextended. All I know is that I try and be a good customer and I don't think that I have been treated fairly in return. I don't believe that is fair for me to pay my bills on time and live by the rules of the contract and still be penalized. This system must be reformed so that customers like me are treated fairly and equitably.

Senator Ron Wyden

Testimony to Financial Services Subcommittee on Financial Institutions and Consumer Credit

First, I want to commend the Chair's and Senator Levin's work on trying to create a better credit card environment for consumers. Many credit card practices are unconscionable and should not be allowed and I believe you are taking appropriate and timely action to address these problems.

Credit card debt is now clobbering American families like a wrecking ball. Coupled with $110 a barrel oil, and the sub-prime mortgage mess, credit card debt is now the third leg of a very wobbly economic stool on which millions of American families sit.

The trouble with credit cards is that all too often the marketplace fails the millions and millions of Americans who want to manage their money responsibly.

Many credit card issuers stack the deck against the consumer before the consumer ever even knows what the deck looks like. A consumer will apply for a credit card and not know what kind of an agreement he will be given until after his credit score gets knocked because of the credit check he had to go through to get the card. Or, a consumer may have a great interest rate on a card and always pay that card on time, then suddenly realize one day that the interest rate has skyrocketed because he has charged too much or missed a payment on a totally unrelated credit card.

Many of these practices are unconscionable, and I applaud my colleagues for their efforts to combat them.

However, I believe that while we consider how to address these particular problems, we should also consider how we can create a more level playing field so consumers can get a fair shake. Right now, issuers hold all the cards. Sure, issuers say that their customers can change credit cards anytime, but in reality, they can't. Credit scores are a large factor in determining which credit card a consumer applies for, and the number of times that you have applied for credit recently, and the length of time that you have held a single card, count towards your credit-worthiness. So, while issuers say their market is competitive, the reality is that consumers who may want to change their credit cards often can't do so because they need to protect their credit scores.

This makes the choice of which credit card to apply for an important and long-lasting decision. But, if there is no information for the consumer about all of the card issuer's practices at the time of application, how can a consumer make an informed choice? Once they receive the card and have a 42-page credit card agreement that bears a strong resemblance to the complexity of our tax code, how can they know that they'll be treated fairly? If, in the unforeseeable future, an issuer comes up with a new term as unfair as "universal default," how can a consumer know that it is something to pay close attention to?

I believe that the committee should consider, in addition to the Chair's Credit Cardholder's Bill of Rights, an ongoing system that would arm consumers up front with the kind of information they need to make informed choices. Such a system would encourage better practices by rewarding issuers that abandon unfair practices, or that innovate consumer-friendly ones.

That is why I and Sen. Obama introduced the Credit Card Safety Star Act. It creates a system that gives consumers an easy, visual cue that tells them whether the credit cards they're about to use are relatively safe, or require close scrutiny by the cardholders to understand how it works.

I believe the challenge to creating an ongoing system is two-fold:

1. We need to protect the consumer from rip-off lending practices, and educate the public on steering clear of marketplace abuses, and
2. We need a new approach to government oversight over the credit card industry that will reward credit card companies who do right by their customers.

Our legislation would address both objectives by directing the Federal Reserve to establish a safety rating system for credit cards. Cards with terms that are consumer friendly would be rated up, while cards with tricky terms that tend to get consumers in trouble would be rated down.

I want to be clear: in my rating system, there is no need for rating terms that are already well understood in the marketplace and have vigorous competition over them. This includes annual fees, interest rates, and rewards, which are not included in the legislation.

Our bill focuses on the trickier parts of agreements – parts that are never advertised and are buried in legal mumbo jumbo, larded with qualifiers, exemptions, and waivers, and incomprehensible to anyone who doesn't spend their free time reading the Uniform Commercial Code. It also rewards issuers for particularly friendly practices.

For example, credit card agreements that in which the terms can be changed at any time for any reason will get an automatic one-star rating. Credit card agreements that give consumers 90-days notice before the issuer intends to change the terms, with an option for the consumer to opt out and continue paying off their balance under the old terms, would be rated up.

Senator Obama and I see our proposal as operating in much the same way as the five-star crash rating system for new cars. The rating system for cars has worked: Americans have become better educated about how their cars will protect them in a crash, and the rating system has created stronger incentives for the industry to build safer cars.

Under our legislation, credit cards with five stars would be deemed the safest, while those with one star the least safe.

Credit card companies would have to display the ratings on all their marketing materials, billing statements, agreement materials and on the back of the card itself. Consumers would also be able to see the ratings for their card and how their card got that rating on a stand-alone Federal Reserve website.

The Federal Reserve will be responsible for updating the star system and making sure that if new terms or practices come to market, those terms or practices are assigned an appropriate rating.

Additionally, my legislation creates a Credit Card Safety Star Advisory Commission which would study the effectiveness of the star rating system. The Commission would also implement a study that would examine whether it would be better to eliminate certain unfair practices rather than simply giving them a rating under my system.

The safety star rating will increase competition between credit card companies over the fairness of the terms in their contracts, which will create an incentive for them to use fairer terms for more credit cards. When the Crash Test rating first came out, most cars only received one or two stars. Now, thanks to competition, many of them receive four or five. I believe the Safety Star rating will produce a similar result.

Card issuers currently compete on their ability to advertise, mostly advertising their interest rates and annual fees, but not on the fairness of their credit card contracts. It's like pitting Joe Camel against the Marlboro man to hide the fact that cigarettes are bad for your health. Card issuers advertise their great interest rates and their great rewards and try to tell you that their card will cost you less to use. Then they bury the information about early deadlines and arbitrary rules, and the card ends up costing you more. Consumers deserve to have the tools to make informed choices about what they buy. My bill will level the playing field and help people decipher the impossible texts of their agreements.

The Chair, Sen. Levin and others have introduced legislation to ban various practices and I certainly would support banning these egregious practices. However, card issuers will invent new practices, no matter how many are banned. This is a sophisticated industry. If all we do is ban existing bad practices, issuers will always be ahead of the game, and they will develop new unfair practices. That is why we need a new approach that would be built around empowering consumers in the marketplace.

Millions of Americans are walking on an economic tightrope. I would use classic American free market principles to help consumers make better choices while forcing credit card companies to compete, not on the basis of who can best craft abusive practices, but on the basis of who treats consumers the most fairly.

BARNEY FRANK, MA, CHAIRMAN

U.S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

SPENCER BACHUS, AL, RANKING MEMBER

February 13, 2007

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Chairman Bernanke:

We are writing to urge the Board of Governors to complete its regulatory review of the credit card disclosure requirements under Regulation Z as soon as possible. For the last 40 years, the Board's Regulation Z has established requirements for credit card disclosures. During that time, credit cards have become more prevalent in our economy, serving as a preferred form of payment in retail transactions while also enabling consumers to undertake big ticket purchases, such as household appliances, without assuming costly and inconvenient retail installment credit. Federal Reserve statistics indicate that Americans now hold almost 600 million credit cards. We are concerned, however, that changes in credit card products make it more difficult for consumers to understand the terms of their credit card accounts and to shop for new accounts. It is our view that Regulation Z has failed to keep pace with these new products and needs to be revised accordingly.

A September 2006 report by the Government Accountability Office, entitled "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures for Consumers," highlighted weaknesses in current credit card disclosures. Over the years, the terms of credit card accounts have become more diverse and sophisticated. For example, many credit card issuers have higher fees, such as over-the-limit fees and late payment fees, instead of charging a simple, all-inclusive annual percentage rate with an attendant annual fee. Other cards use complex balance computation methods, such as two-cycle billing. Card issuers also may offer consumers different rates for different transactions—for example, a low rate for balance transfers, but a higher rate for new purchases. Not only should consumers understand these differing rates, but also the manner in which their payments will be applied to the different balances.

Although overall innovation in the marketplace has benefited consumers by expanding access to credit for some consumers and enabling others to obtain credit at lower rates, we are concerned that the current disclosures with respect to these products may not be sufficient. Consumers who are not adequately apprised of fees or complex balance computation and payment allocation methods may pay higher fees or additional interest, even though they present no increased risk to the card issuer. We firmly believe that consumers should be well-informed

The Honorable Ben S. Bernanke
February 13, 2007
Page 2

with respect to credit card products so that they may decide which product offering is best for them. Regulation Z must be revised in order to achieve this goal.

Although we understand that it is the Board's policy to review each of its regulations every five years, Regulation Z has not been the subject of a comprehensive review since 1982. While the Board began a review of Regulation Z's open-end credit disclosure requirements in December 2004, it is now 2007 and the Board has not issued a proposed revision.

We believe that it is critical that the Board accelerate its efforts to complete the Regulation Z review process. In doing so, the Board must recognize the need for consumers to receive simple, clear disclosures that help them choose credit cards effectively and to understand how to manage the credit card accounts that they have.

Sincerely,

Spencer Bachus
Ranking Member

Paul E. Gillmor
Ranking Member
Subcommittee on Financial Institutions and Consumer Credit

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

BEN S. BERNANKE
CHAIRMAN

February 27, 2007

The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Thank you for your letter dated February 13, 2007, in which you encouraged the Board to accelerate its efforts to complete the review of Regulation Z, which implements the Truth in Lending Act (TILA). In particular, you ask that the Board complete its review of TILA's rules affecting credit cards. You note consumers' increasing use of credit cards to pay for retail transactions, including big-ticket purchases. You express concern that changes in credit card products make it more difficult for consumers to understand the terms of their credit card agreements, and that Regulation Z has not kept pace with these changes.

You refer to the findings of a September 2006 report by the Government Accountability Office (GAO) regarding the effectiveness of credit card disclosures. The report highlighted weaknesses in current disclosures, and discussed that consumers may not understand how card issuers' increasingly complex pricing structures affect the overall cost for a particular credit card account. For example, current credit card pricing may include not only higher rates and fees, but balance computation and payment allocation methods that also affect the overall cost of the card account. You believe current disclosures may not be sufficient to enable consumers to make informed decisions about credit card products, and Regulation Z must be revised to achieve this goal.

In December 2004, the Board announced its plan to review Regulation Z in stages, beginning with a review of open-end credit (primarily credit card) rules, in an advance notice of proposed rulemaking (ANPR).[1] A second ANPR was published in October 2005, in which the Board requested comment on issues relating to amendments to TILA's rules affecting open-end credit contained in the Bankruptcy Abuse Prevention and

[1] The Board has reviewed, revised, and added specific provisions to Regulation Z over the last several years, as discussed more fully in the December 2004 ANPR.

The Honorable Spencer Bachus
Page Two

Consumer Protection Act of 2005, and announced its intention to incorporate implementation of the new amendments with the ongoing review of open-end credit rules. Copies of the ANPRs are enclosed for your information.

A primary goal of the Regulation Z review is to improve the effectiveness and usefulness of the open-end credit disclosures and substantive protections. Specific issues raised for public comment in the Board's ANPRs about how the Board might achieve this goal are consistent with the concerns expressed in the September 2006 GAO report on credit card disclosures and your letter. The Board acknowledged the complexities of credit card products in today's marketplace, and the challenge of explaining complex terms in a way and at a time that is meaningful and useful in making informed decisions about the cost and use of credit. In the ANPRs, the Board also noted consumers' usage of credit cards differs, and thus, that the relative importance of certain cost terms to cardholders may vary, depending on whether, for example, they consistently revolve--or repay in full--their balances each month. The Board sought comment on possible improvements to the timing, formatting, and terminology of required disclosures, among other issues.

During 2006 and continuing into 2007, Board staff has worked with a consultant engaged to conduct consumer research for the Board. The research has been designed to elicit consumers' current understanding and usage of credit card terms in making account-related decisions, and how changes in terminology or format might improve the disclosures' effectiveness. For example, the testing has explored, and continues to explore, the extent to which complex pricing terms, such as balance computation and payment allocation methods, can be explained both sufficiently and succinctly. The testing is expected to be concluded in March.

I understand that Board staff has met with industry and consumer groups, and others on this matter. Board staff is currently developing its recommendations, based in part on testing, and the Board hopes to issue a proposal for public comment in the next several months.

I hope this is helpful.

Sincerely,

Enclosures

Identical letter also sent to:

Ranking Member Paul E. Gillmor, House Subcommittee on Financial Institutions and Consumer Credit

Sandra Braunstein subsequently submitted the following in response to written questions received from Congressman Barrett in connection with the April 17, 2008, hearing before the House Financial Services Committee:

I am curious about the Federal Reserve's work on improving credit card disclosures and ensuring that practices are transparent and reasonable. I am particularly interested in the amount of research that your staff has put into these regulations.

- **What types of unintentional consequences do you consider when crafting your credit card regulations?**
    - **What steps did you take to ensure that your regulations do not lead to unintended consequences for consumers such as the restriction of credit options?**
    - **Does H.R. 5244, the Credit Cardholders' Bill of Rights, contain any provision that you are concerned may lead to unintentional consequences?**

On May 2, 2008, the Board issued proposed rules under the Truth in Lending Act (TILA) and the Federal Trade Commission Act (FTC Act) to address unfair or deceptive practices by banks in connection with credit card accounts. The proposed rules address many of the same practices as H.R 5244. Although the Board's proposal takes a different approach in some cases, both seek to address concerns about interest rate increases on existing balances, two-cycle billing, adequate time to make payments, allocation of payments among multiple balances, and credit cards that have high initial fees that use up a significant amount of the credit limit.

In developing its proposed rules, the Board carefully considered the potential for unintended consequences. The Board recognizes that, if the proposed rules are adopted, consumers may see certain costs decline but, in some cases, there may be higher upfront costs and less available credit. Nevertheless, it appears that the proposed rules would benefit consumers overall by creating a more transparent pricing structure that enables consumers to more accurately assess the cost of using their credit cards at the time they engage in transactions. In addition, credit card issuers would be more likely to offer initial interest rates that realistically reflect risks and market conditions instead of offering low rates at the outset with the expectation of subsequently re-pricing balances.

This increase in transparency and fairness should enhance competition and empower consumers to better manage their accounts and avoid unnecessary costs. The Board's proposal would permit credit card issuers to guard against changes in market conditions by offering credit cards with variable rates tied to an index. The Board's proposal would also permit issuers to price for risk in cases of serious delinquency, by increasing the interest rate on an existing balance after the consumer becomes 30 days delinquent on the account. Creditors would retain the ability to address credit risk by lowering the credit limit or, subject to certain limitations, increasing consumers' minimum payment.

The Board will continue to evaluate the potential unintended consequences of its proposal during the comment period. The Board has solicited information and comment on a number of issues related to possible unintended consequences. For example, with respect to the rules governing rate increases on existing balances, the Board solicited comment on the effect the proposed restrictions would have on outstanding securitizations and card issuers' ability to securitize credit card assets in the future. The Board also sought comment on whether the restrictions in the proposed rules would limit an issuer's ability to effectively manage risk if the default rate on credit cards is greater than anticipated, and whether additional exceptions to the rules are needed to address safety and soundness concerns.

- **Based on your extensive research, are there any aspects of the Credit Cardholders' Bill of Rights that you think would be unhelpful to consumers?**

As noted above, the Board's proposal addresses many of the same practices as H.R. 5244. One provision in H.R. 5244 that is not addressed in the Board's proposal would direct credit card issuers to disclose the amount required to pay off the account in full (the "payoff balance") on each periodic statement and pursuant to a consumer's request by telephone or through the issuer's web site. At the time the payoff balance is disclosed, however, the issuer may not be aware of some transactions that are still being processed and that have not yet been posted to the account. In addition, finance charges can continue to accrue after the payoff balance is disclosed. If a consumer relies on the disclosure to submit a payment for that amount, the account still may not have been paid off in full.

Questions submitted for the record by Rep. Gresham Barrett (R-SC).

Would you lend money that you do not believe can be repaid?

How does it benefit your business to ensure that your customers are able to repay their loans? What are the costs for you if your customers cannot repay their loans? What steps have you taken to make it more likely that your customers will repay their loans in full?

Would any parts of this legislation cause you to no longer serve certain customers that you currently serve? Are there any products that you foresee changing dramatically based on the Credit Card Bill of Rights, and are you concerned about reducing consumers' options?

How might your pricing plans change from this legislation? Do you think any consumers would see a sharp increase in their interest rates or see new fees?

RESPONSE:

We would never lend money out if at the time we make the loan we do not think it can be repaid, and as a federally-insured bank, we are expected to operate in a safe and sound manner, which includes maintaining adequate capital and generating positive earnings without assuming unnecessary risk. An example of the type of steps we may take today to manage risk are reducing credit limits for certain segments of our customers or assessing higher rates at some point during their account relationship. For other customers who may not be able to pay all or part of their debts, we try offer special forbearance programs to reduce the amount of unpaid debt.

We set the price for our loan products based on our assessment of the risk the customer presents. For higher risk customers we will price at a higher rate. If we are unable to reprice commensurate with a customer's risk as it changes during the course of an account relationship, it is likely that initial rates and fees for all customers will need to rise to make up for the inability to reprice the risk that exists in existing balances. It is also likely that certain customers will be denied credit entirely and that the choices given to customers will be reduced in terms of products, promotional offers, rewards and the like.

DISCOVER
FINANCIAL SERVICES

May 15, 2008

The Honorable J. Gresham Barrett
United States House of Representatives
Washington, D.C. 20501

Re: *Hearing on H.R. 5244 "Credit Cardholders' Bill of Rights"*

Dear Mr. Barrett:

These are responses to the questions that you addressed to Discover Financial Services and the other the industry witnesses who appeared at the Financial Institutions Subcommittee's April 17, 2007 hearing.

Q. I am a strong believer in the power of the free markets to price products efficiently, drive innovation, and expand the availability of goods that people want. While I believe that consumers must be protected against fraudulent and misleading activities and that terms should be transparent, I think that people should be given the responsibility to borrow money as they see fit.

- **Would you lend money that you do not believe can be repaid?**

  A. No. Our underwriting process is intended to ensure that credit is extended only to individuals who have the ability and willingness to repay their loans. Bank regulators, whose responsibility is to ensure the safety and soundness of financial institutions, require that we do this, and our shareholders and investors (including purchasers of securities backed by credit card receivables) expect it. We have strong incentives to make loans only when we expect that they will be repaid. Each unpaid loan is a costly experience: revenues from multiple paid-as-agreed loans are required to make up for the losses that result when a single account is charged off.

- **How does it benefit your business to ensure that your customers are able to repay their loans?**

  A. Extending credit only to those able to repay their loans is essential to the viability of our business. When customers default on their payment obligations, we lose not only the profit we *anticipated (in the form of interest) but the loan principal itself. Defaults negatively impact our ability to fund the credit we extend by making securities backed by credit card receivables less marketable. When customers pay on time, we avoid incurring losses that have to be passed on to other (low-risk) customers in the form of higher prices or fees.*

- **What are the costs for you if your customers cannot repay their loans?**

A. Customers who miss loan payments increase our costs in the short term, requiring us to carry the cost of the funds that we borrowed and advanced when the customer used the card, as well as billing, account maintenance and collection expenses. When loans are charged off, we experience substantial losses. We lose some or all of the loan principal, accrued interest and fees, the expenses that we incurred during the account underwriting and acquisition, and expenses of managing the account before the default (e.g. monthly billing, postage, and maintenance expenses). Losses from unpaid loans also increase our borrowing costs, and hamper the ability to extend credit to other consumers. A substantial portion of our funding is derived from sales of credit card receivables to investors. The willingness of investors to purchase those securities and the pricing of securitized receivables is dependent on loan quality. As the recent experience in the home loan sector illustrates, loan defaults impair the attractiveness of asset-backed securities and the ability to market them.

- **What steps have you taken to make it more likely that your customers will repay their loans in full?**

A. The process begins with sound underwriting, to ensure that we offer credit to individuals who can afford to repay it and have a history of responsible credit usage. Credit limits are set initially, and re-evaluated periodically, at levels that are appropriate for each individual borrower. We provide pertinent information about responsible credit usage to our Cardmembers, and tools to assist them in managing their Discover account and other financial commitments.

Throughout the life of an account, we monitor the customer's account usage, as well as the customer's experience with other lenders, for signs of changes in the customer's ability or willingness to repay. When we observe changes in account usage that might signal that the customer is experiencing financial stress, we communicate with the customer through messages in account *statements and, in some cases, telephone calls to offer assistance. Consistent with federal regulatory guidance, customers may be offered hardship programs that provide assistance in the form of fee waivers, interest rate reductions and other concessions. We work directly with Cardmembers or consumer credit counseling agencies in establishing payment plans for customers who need them to manage their debts.*

The use of risk-based pricing and default-based pricing, also affects customers' payment habits. Customers whose interest rates are increased based on a deterioration in their creditworthiness or payment defaults on their Discover accounts frequently change their borrowing and/or payment behavior (i.e., reduced card usage, higher monthly payments) that result in the repayments of the outstanding loan.

Sincerely,

Carlos Minetti
ExecutiveVice President
Cardmember Services and
Banking

cc: Thomas G. Duncan
General Counsel
Committee on Financial Services

Responses to Questions from April 17, 2008
Hearing on the Credit Cardholders' Bill of Rights Act of 2008
Submitted by Larry Shamak
Executive Vice President and General Manager, Consumer Cards
American Express Company

Would you lend money that you do not believe can be repaid?

Answer: American Express has very strict underwriting standards based on a customer's ability to repay. We have developed rigorous credit risk models to ensure we are lending to creditworthy borrowers. We would not lend to customers who we believe could not repay the loan.

How does it benefit your business to ensure that your customers are able to repay their loans?

Answer: American Express operates a business model that is driven by Cardmember spending on our payment network. Our most important metric is the level of Cardmember spending on our network, not the outstanding balances Cardmembers choose to revolve. We want our Cardmembers to use their American Express Cards and to pay us back. If customers are not able to repay their loans, we cannot enable them to use their American Express Cards for purchases.

What are the costs for you if your customers cannot repay their loans?

Answer: The costs to our business when a customer does not repay their loan are significant. We are often forced to write-off the entire unpaid balance for delinquent customers and we experience increased costs of collections as well as increased customer servicing costs on these accounts.

What steps have you taken to make it more likely that your customers will repay their loans in full?

Answer: As the economy has weakened in recent months, we have tightened our underwriting standards for new applicants, and we have reduced lines of credit for those customers who pose a greater risk in order to minimize the likelihood of default. The actions we have taken are very targeted and surgical in nature as to allow all good consumers and small businesses to continue to benefit from our valuable card products while limiting our risk exposure within higher risk customer segments.

Would any parts of this legislation cause you to no longer serve certain customers that you currently serve?

Answer: American Express believes that there are two specific provisions in the legislation that will have a significant impact on our ability to serve certain customer segments. The first deals with how issuers can adjust interest rates in response to changes in a customer's risk profile. The second deals with the "pro-rata" payment allocation provisions in the legislation which would have a significant negative impact on consumers.

American Express believes that H.R. 5244 treats all interest rate increases in a similar fashion, regardless of the reason for the increase. The legislation imposes a 45-day advance notice, followed by an additional period of up to three billing cycles to allow consumers the ability to opt-out of the new rate, before any interest rate increase could go into effect. This broad notice and opt-out applies to all interest rate increases uniformly, whether the rate increase was triggered by a consumer's behavior on the account in question, a missed payment with a third-party, or any other reason not related to that particular account.

As currently written, this provision would reduce incentives for consumers to make timely payments and limit our ability to react to changes in a customer's risk profile in a timely way. For example, consumers could run up a balance on their account, make no subsequent payments, and still avoid a rate increase on the account by exercising their right to opt-out. Under this bill, a consumer would have up to five months to decide whether a rate increase should be applied even if they were in default on their own account. Consumers who pay their bills on time should be protected from arbitrary rate increases. At the same time, consumers who fail to make timely payments on their account should be accountable for their actions.

With respect to payment allocations, we conducted research that found that on average a consumer could reduce their overall effective interest rate by nearly 2.8 percent by taking advantage of a balance transfer offer. This benefit is likely much higher when you take into account that most consumers are transferring balances from higher rate loans with other lenders.

In addition, our data show that consumers who take advantage of promotional or balance transfer offers pay down their accounts at a faster rate and exhibit lower delinquency rates than our average customer. This would lead one to conclude that the vast majority of consumers who take advantage of such offers are exhibiting payment behavior that demonstrates they are aware of the terms of the offer.

If this legislation were to be enacted in its current form, we would no longer be able to make our most advantageous offer to the overwhelming majority of consumers who would receive such an offer currently. We would also likely reduce our marketing of promotional rates in general. For those who would still be eligible to receive such offers, the terms would not be as favorable to consumers as they are today. This is because H.R. 5244 would fundamentally change the economics of such offers, thereby making them far less available to consumers than they are currently.

Are there any products that you foresee changing dramatically based on the Credit Card Bill of Rights, and are you concerned about reducing consumers' options?

Answer: As referenced above, the payment allocation provisions in the legislation will likely have a significant adverse impact on consumers. They will see fewer promotional rate offers in the marketplace and these offers will be available to fewer consumers.

In addition, the legislation would significantly restrict an issuer's ability to price for risk at the time that risk has become readily apparent, thus requiring issuers to account for that risk in other ways, such as by pricing accounts at higher rates.

How might your pricing plans change from this legislation? Do you think that any consumers would see a sharp increase in their interest rates or see new fees?

Answer: If this legislation were adopted in its current form, you would likely see low-risk borrowers being forced to subsidize the costs of high-risk borrowers because the legislation limits the ability of issuers to price accounts according to the risk profile of a customer after an account has been opened. This will likely force issuers to price accounts at higher rates.

2008 U.S. Master Tax Guide®

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Taxpayers requesting an abatement of interest generally must file a separate Form 843 for each tax period for each type of tax with the IRS Service Center where their tax return was filed or, if unknown, with the Service Center where their most recent tax return was filed.

Suspension of Interest. In order to avoid the accrual of underpayment interest, a taxpayer may make a cash deposit with the IRS for future application against an underpayment of income, gift, estate, generation-skipping or certain excise taxes that have not been assessed at the time of the deposit (Code Sec. 6603). To the extent that a deposit is used by the IRS to pay a tax liability, the tax is treated as paid when the deposit is made and no interest underpayment is imposed. Furthermore, if the dispute is resolved in favor of the taxpayer or the taxpayer withdraws the deposited money before resolution of the dispute, interest is payable on the deposit at the federal short-term rate.

2845. Interest on Additions and Penalties. Interest on penalties and additions to tax for failure to file, for failure to pay the stamp tax, and for the accuracy-related and fraud penalties (see ¶ 2854 and ¶ 2866) will be imposed for the period beginning on the due date of the return (including extensions) and ending on the date of payment. However, if payment is made within 21 calendar days after notice and demand is made (10 *business* days if the amount demanded is at least $100,000), then interest will stop running after the date of notice and demand (Code Sec. 6601(e)(3)). For all other penalties, interest will be imposed only if the addition to tax or penalty is not paid within the 21-or 10-day period after notice and demand is made and then only for the period from the date of notice and demand to the date of payment (Code Sec. 6601(e)(2)).[44] For rules governing the allocation of interest on tax liabilities paid pursuant to a compromise or partial payment, see ¶ 2723 and ¶ 2724, respectively.

Underpayments of Tax—Penalties

2854. Accuracy-Related Penalty. The two penalties primarily applicable to underpayments of tax are the accuracy-related penalty (Code Sec. 6662)[45] and the fraud penalty (Code Sec. 6663).[46] See ¶ 2866.

The accuracy-related penalty consolidates all of the penalties relating to the accuracy of tax returns. It is equal to 20% of the portion of the underpayment that is attributable to one or more of the following: (1) negligence or disregard of rules or regulations (¶ 2856), (2) substantial understatement of income tax (¶ 2858), (3) substantial valuation misstatement (¶ 2860), and (4) substantial overstatements of pension liabilities (¶ 2862) (Code Sec. 6662(a) and (b)).[47]

The accuracy-related penalty is entirely separate from the failure to file penalty (¶ 2801) and will not be imposed if no return, other than a return prepared by the IRS when a person fails to make a required return, is filed (Code Sec. 6664(b)).[48] In addition, the accuracy-related penalty will not apply to any portion of a tax underpayment on which the fraud penalty is imposed. Also, no penalty is imposed with respect to any portion of any underpayment if the taxpayer shows that there was reasonable cause for the underpayment and that the taxpayer acted in good faith (Code Sec. 6664(c)).[49]

2856. Negligence or Disregard of Rules and Regulations. If any part of an underpayment of tax is due to negligence or careless, reckless or intentional disregard of rules and regulations, the 20% accuracy-related penalty will be imposed on that portion of the underpayment attributable to the negligence or intentional disregard of rules and regulations (Code Sec. 6662(a) and (c)).[50] Negligence includes the failure to reasonably comply with tax laws, to exercise reasonable care in preparing a tax return, to keep adequate books and records, or to substantiate items properly (Reg. § 1.6662-3(b)(1)).[51] Taxpayers may not avoid the negligence penalty merely by adequately disclosing a return position which is "not frivolous" on Form 8275, Disclosure Statement, or Form

Footnote references are to paragraphs of the 2008 Standard Federal Tax Reports.

[44] ¶ 39,410
[45] ¶ 39,651
[46] ¶ 39,656
[47] ¶ 39,651
[48] ¶ 39,660, ¶ 39,661.03
[49] ¶ 39,660, ¶ 39,661.022
[50] ¶ 39,651, ¶ 39,651G.01
[51] ¶ 39,651D, ¶ 39,651G.01

INDEPENDENT COMMUNITY
BANKERS of AMERICA

Statement for the Record

By the

Independent Community Bankers of America

Before the

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

Hearing on

"The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers"

April 17, 2008
Washington, D.C.

Chairwoman Maloney, Ranking Member Biggert, Members of the Subcommittee, the Independent Community Bankers of America[1] (ICBA) is pleased to submit this statement for the record regarding H.R. 5244, the Credit Cardholders' Bill of Rights Act of 2008. On behalf of ICBA's nearly 5,000 member banks, 70%[2] of which issue credit cards to consumers and small businesses, we believe it is critical for this Committee to consider the unintended consequences additional regulation of the credit card industry would have on community banks and their customers. While we agree that a small number of issuers have engaged in practices that are harmful to consumers, any legislative remedy should more broadly focus on encouraging consumer choice, transparency, and disclosure. This measure, which instead attempts to prohibit specific practices, imposes additional costs and burdens on community bankers who did not contribute to the problems in the industry, and will result in fewer and more expensive sources of credit for all Americans.

Carrot vs. Stick

Deceptive practices and egregious and hidden fees should not be tolerated by consumers. Educating consumers on a card's terms and conditions through appropriate and comprehensible disclosures is the best means of combating unfair practices: the marketplace responds when consumers are able to distinguish a good deal from a bad one

[1] The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than \$908 billion in assets, \$726 billion in deposits, and more than \$619 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

[2] To view an executive summary of the 2007 ICBA Community Bank Payments Survey, please visit http://www.icba.org/publications/2007paymentssurvey.cfm?ItemNumber=38445

and make their choices accordingly. Imposing new rules in an effort to target the practices themselves simply encourages those issuers intent on maximizing profits at all cost to find new ways to do so. Shining a spotlight on a card issuer's practices through proper disclosure will give consumers the knowledge they need to avoid entering into a card contract unsuited or detrimental to their needs.

The Credit Cardholders' Bill of Rights Act, in its attempt to restrict what today are considered to be inappropriate practices, would mandate arbitrary rules and procedures on an entire industry that, in the long term, will make consumers worse off than they are today. ICBA disagrees with this approach, and believes the consequences of these new rules will cause many community bankers to open fewer accounts and to consider exiting the credit card marketplace entirely. Regulatory and paperwork requirements such as those that would be imposed through this bill disproportionately burden community banks, diminishing their profitability and their ability to attract capital, support the credit needs of their consumer and small business customers, serve their communities and contribute to their local economies. No one benefits if community banks exit the marketplace.

Negative Consequences for the Community Bank Business Model

In today's struggling economy, access to credit is vital to many families. Many hard-working households use credit cards to budget their cash and spending as well as to deal with emergency or unexpected expenses. Community bankers, with business models based on establishing long-term relationships through good and bad financial times, have remained a solid and cost-effective option for countless consumers when the alternative is often a payday lender.

Community banks do not issue consumer and corporate credit cards at nearly the volumes of the large, nationwide issuers. Community banks are conservative lenders that have no desire to trap their local customers in never-ending cycles of debt. Frankly, our business model, focused on customer service and finding the right product for each customer, gives us a competitive advantage. For the responsible consumer or small business owner, that means they have more choices: they can choose to do business with the megabank with call centers all over the globe, or they can get that same card product, with local customer service, at competitive and often better rates with their local community banker.

But that competitive advantage we offer our local customers can be quickly erased through a legislative approach such as H.R. 5244. Its restrictions take flexibility away from lenders and make it difficult to adapt to changing markets and new consumer demands. Its variety of new burdens will impact the cost of providing services, how community banks price products, and how they are offered to customers. Less flexibility will likely translate to increased costs for all borrowers, and less credit availability for those at the margin.

Contrary to popular belief, for many community banks, the consumer and business credit cards we offer are rarely sources of tremendous profits. Offering community bank-branded cards creates a stronger relationship with the customer, and encourages loyalty. In other words, many community bankers offer these products as an additional service to customers , not as the bank's main source of revenue. The real value often lies in our basic ability to offer these popular products to consumers and small businesses.

Conclusion

Community banks want to provide their customers with a range of services, not just reap profit off credit cards, working to build a relationship built on trust. As such, ICBA is supportive of pending regulatory efforts that will clarify and improve consumer disclosures in a meaningful way, which will go far to force issuers to abandon unfair practices and fee structures.

However, the Credit Cardholders' Bill of Rights Act, while well-intentioned, approaches the issue in way that will create more difficulties than it cures. The consequences of this bill, if enacted, will mean less choice and more cost for Americans as many community banks realize the added regulatory burden mandated by the legislation outweighs the benefits and exit the market. If Congress legislates on credit card practices, it should do so in a manner that opens the process, making terms easier to understand, so consumers will be properly informed about their credit choices.

Statement of John G. Finneran, Jr. General Counsel, Capital One Financial Corporation
Before the United States House Subcommittee on Financial Institutions
April 17, 2008

Chairwoman Maloney, Ranking Member Biggert, and members of the Committee, my name is John Finneran. I am the General Counsel of Capital One Financial Corporation. I want to thank you for this opportunity to submit a statement for the record in response to the testimony of Mr. Steven Autrey, who is appearing before your committee today.

At Capital One, we strive to make all of our customer relationships positive ones. When customers are not satisfied with their experience with us, we seek to address their issue, determine why the issue occurred, and make any changes to existing policies that we feel are warranted. Throughout its history, Capital One has worked diligently to establish a high standard of customer sensitivity:

- We do not engage in any form of "Universal Default" repricing.
- We have never done 2-cycle billing.
- We have a single, clear penalty repricing policy. We will impose a penalty rate on a customer only if the customer pays late twice by three or more days in a twelve month period with respect to that specific card. We will provide the customer with a prominent warning on the billing statement after the first infraction. In many cases, we choose not to reprice a customer even if the customer pays us late twice in a twelve month period. If a customer is repriced, but pays us on time for 12 consecutive months, we will take the customer back to the prior rate. This "unrepricing" is automatic.

- We provide 45 days advance notice and an opportunity to opt out of any repricing based on changes to the economy or our cost of funding. Our customers are given the opportunity to reject such repricings, close their accounts, and pay down their outstanding balances at their existing rate over time.
- We provide our customers notice and the ability to opt out of overlimit transactions.

Across our entire portfolio of customers – more than 30 million – we work very hard to provide important notices in plain English that capture attention at critical moments. We do so because we believe – as Chairman Bernanke said to this Committee – that card holders must understand the terms under which they are borrowing, and be empowered to manage their credit wisely, as the overwhelming majority of our customers do.

Madame Chairwoman, we regret that Mr. Autrey is dissatisfied with his recent experience with us. We have one of the largest customer franchises in the United States and our relationships with each of them are the lifeblood of our company's success. Consistent with this philosophy, we believe that Mr. Autrey's circumstances demonstrate the clarity and fairness of our policies. As Mr. Autrey states:

- We were able to provide him with a highly competitive, fixed interest rate of 9.9 percent for seven years, an extraordinarily long period of time for an open-ended, unsecured loan of this kind.

- We held firm on this rate despite the fact that the Prime rate more than doubled during this period of time. Our right to change this rate was clearly disclosed in Mr. Autrey's original offer.
- After seven years, when our funding costs no longer permitted us to offer Mr. Autrey his current rate, we sent Mr. Autrey a clear and simple notice indicating that we were increasing his rate to a variable rate of Prime plus 7.65 percent. At the time, this new rate would have been 15.9 percent, still a competitive rate in the current marketplace. Today, given the Federal Reserve's recent actions, his rate would have been 12.9 percent.
- Contrary to Mr. Autrey's testimony, this notice was sent in a separate, full size mailing, not as a statement insert. The envelope was marked "Important Information Regarding Your Account." A copy of the notice is attached for your reference. No other information of any kind was included in the mailing. The notice itself was clear, simple and prominent. We displayed a copy of a similar notice at Senator Levin's hearing last year, and received several acknowledgements from the Subcommittee regarding the quality and clarity of the communication.
- Mr. Autrey was told that he could choose to accept his new rate, or alternatively, he could choose to opt-out of this change and keep his existing rate. In exchange, he would agree to stop using the card for additional purchases or other transactions, close the account and pay off the balance over time. Unlike some companies, we provided an 800 number for those wishing to exercise this right.

- Again, contrary to Mr. Autrey's testimony, the reason for the increase was provided in the notice directly above the disclosure of his new rate. The reason given was the increasing interest rate environment, which impacts our cost of funding Mr. Autrey's loan. Contrary to his implication that his account behavior might have led to this rate increase, Mr. Autrey's increase was part of a larger effort in July 2007 to reprice accounts in our portfolio whose funding had expired. All of these accounts had had their rates in place for a minimum of three years, and in many cases such as Mr. Autrey's, far longer.
- Consistent with our description of our notice, Mr. Autrey clearly understood the nature of the notice and the terms of the opt-out opportunity we provided. His actions confirm this fact. Mr. Autrey was given 45 days in which to opt out, and he did so well before the deadline.
- As a result of his decision, Mr. Autrey was able to retain his existing rate of 9.9 percent and carries that rate today. The new rate was never imposed upon his account. He can choose to take as long as he likes to pay down his balance, so long as he continues to make the minimum payment on time.
- Mr. Autrey's assertion that credit card issuers are in "collusion" with the Fair Isaac Company regarding individual consumers' credit scores is unfounded. Fair Isaac is an independent company with a proprietary risk scoring model, the continued secrecy of which is critical to its business success. No issuer, including Capital One, knows how different attributes are weighted. More importantly, we have no logical business incentive to have Mr. Autrey close his account, or to see

Mr. Autrey's credit score drop, which only serves to limit the range (and profitability) of products we can offer him.

Mr. Autrey acknowledges that his account history with our company included some missteps, including a late payment and an incidence of going over his credit limit in 2007. Our records indicate that Mr. Autrey paid late in March 2007, and exceeded his credit limit in July and August. In August, Mr. Autrey also had two payments returned to his bank for insufficient funds. During this time, Mr. Autrey also maintained a balance just under his credit limit of $22,000 – a utilization rate of nearly 100% of his available credit. Each such behavior is sufficient to trigger a penalty rate under many issuers' policies. Despite these infractions, however, because of our industry-leading default repricing policy, Capital One did not impose a penalty rate on Mr. Autrey.

At a broader level, Mr. Autrey speaks to the "unilateral" nature of credit card agreements, suggesting that issuers may "change the rules" in their favor at any time. In truth, credit card customers possess significant, "unilateral" rights against credit card issuers.

- Customers may choose to transfer an existing balance to another card without notice and without any ability on the part of the issuer to stop the transaction. In doing so, a customer can unilaterally deprive the issuer of any further revenue on his account, notwithstanding the company's significant investment in acquiring that customer.
- A customer can choose to stop using his account or close it entirely at any time, for any reason. Unlike a mortgage or an auto loan, there is no impediment, legal or practical, to doing so.

- Customers may choose to pay any amount of their balance at any time, including the minimum payment or the entire amount due, again with no ability on our part to compel one behavior or the other. A customer who typically pays his balance in full every month can, without notice, suddenly choose to begin carrying a balance, dramatically altering their risk profile.

Madame Chairwoman, the very nature of unsecured, open-ended credit demands flexibility on both sides of the account relationship. There can be no question that customers and issuers each possess significant and unique rights under existing contracts. We share your desire to ensure that the playing field remains level, but we respectfully submit that it is unwise – especially at this time – to enact broad legislation that sets payment formulas in statute, redefines critical product features, and limits the tools of risk management for consumer credit.

Rather than making the case for legislation, we believe that Mr. Autrey's experience demonstrates that Capital One's industry leading policies are working as intended to provide customers with flexible terms and meaningful choices. Without any legislative intervention, Capital One provided Mr. Autrey with a clear, plain English notice and a simple procedure for choosing to decline a new interest rate. The process worked precisely as it should, with Capital One exercising the flexibility it needed to in order to respond to the higher cost of capital, and Mr. Autry exercising his choice to decline the new rate and pay off his balance at the old one. The whole procedure worked within the context of existing market forces and exactly as Capital One has said consumer choice should work in positions we've advocated before this subcommittee and before the relevant regulators.

Capital One must therefore oppose H.R. 5244 and we do so for three fundamental reasons:

1. The legislation sets multiple statutory limits on a lender's ability to price for the cost of credit. For example, under the heading of eliminating "double cycle billing," the bill actually redefines the concept of "grace period" and arbitrarily expands the degree to which all issuers--even those that don't engage in double cycle billing--must extend credit interest-free. Similarly, the bill mandates a formula for allocating a customer's payments for different types of borrowing in a way that will certainly result in reducing the availability of deeply discounted introductory and balance transfer rates. Other provisions also raise the specter of price controls.
2. The consequence of so sweeping a bill would be to force the industry to raise the cost of credit for everyone, including those who present less risk of default to the lender, and reduce the availability of credit for those customers who present a greater risk of default.
3. This result would be exactly the wrong policy prescription, particularly in this economic environment. As the mortgage crisis has unfolded, we've had a progressive tightening in the credit markets and many believe we are near or in a recession. To ease the impact of a slow-down in our economy, the Fed has aggressively lowered the federal funds rate and the Congress has passed a bipartisan stimulus package. H.R. 5244 could significantly counteract the positive effects of both of those policy initiatives.

Madame Chairwoman, that would be especially unfortunate since the regulators – those policy makers uniquely positioned to evaluate the complex and dynamic credit card industry – are poised to address all of the issues targeted by H.R. 5244.

Under its new Reg Z rule, the Fed proposes a 45-day notice period before all types of repricing. The new rule also offers improved disclosure requirements for payment allocation, minimum payment, and "fixed" and introductory interest rates. And that's just a partial list.

Equally important, Chairman Bernanke has confirmed before this Committee that the Fed will soon supplement its Reg Z rule with new credit card rules under its UDAP authority. It seems likely that those rules will go to the core of the Committee's concerns. We believe that such rules may provide the best, safest and most direct road to reform.

Capital One has publicly called for balanced, reasoned change that can be implemented quickly, would improve disclosure and enhance consumer choice. We have also sought to work cooperatively with you and the Committee. Though we must respectfully disagree about the impact of H.R. 5244, I want to thank you for this opportunity to express our views.

# # #

Supplemental Statement
of John G. Finneran, Jr. General Counsel, Capital One Financial Corporation
Before the United States House Subcommittee on Financial Institutions
April 17, 2008

Chairwoman Maloney, Ranking Member Biggert, and members of the Committee, my name is John Finneran. I am the General Counsel of Capital One Financial Corporation. I want to thank you for this opportunity to submit a supplemental statement for the record in response to the testimony of Mr. Steven Autrey, who appeared before your Subcommittee on April 17, 2008.

As I noted in my original statement, at Capital One, we strive to make all of our customer relationships positive ones. When customers are not satisfied with their experience with us, we seek to address their issue, determine why the issue occurred, and make any changes to existing policies that we feel are warranted. Throughout its history, Capital One has worked diligently to establish a high standard of customer sensitivity.

During the question and answer portion of the hearing, Mr. Autrey made an erroneous statement regarding Capital One's policy on credit line reporting, which we would like to correct for the record. Mr. Autrey testified that Capital One does not report credit lines to the credit bureaus and instead reports only credit balances. While Capital One did not report credit limits in the past for competitive reasons, we changed this policy last year. Capital One does report credit limits in addition to credit balances for our customers to the major credit reporting agencies.

Thank you for this opportunity to correct the record on this point. We respectfully request that this supplemental statement be made part of the official hearing record.

The American Financial Services Association (AFSA) appreciates the opportunity to provide testimony to the Members of the Subcommittee on H.R. 5244, the Credit Cardholders' Bill of Rights of 2008.

We believe this bill would impose significant restrictions on card issuers' ability to grant credit to consumers at a time when Congress is doing everything possible to stimulate the economy in the midst of what appears to be the beginning of a "credit crunch." In particular, we are troubled by this bill's restriction of pricing practices that take away issuers' ability to determine the cost of credit based on the borrower's risk of default. If the current pricing structure is dismantled, issuers will be forced to raise interest rates and stop offering products, limiting choice and convenience for U.S. consumers.

Currently, the U.S. economy is reeling from rising unemployment, a housing market downturn, record-high oil prices and 26-year highs in food and energy prices. Many American consumers need their credit cards to get them through times when income is tight and non-budgeted expenditures – like a car repair or medical emergency – may arise. Now is not the time to drastically restrict the means by which card issuers may offer credit, thereby denying many consumers the access and flexibility revolving credit provides.

As Congress evaluates the credit card market and considers possible courses of action, these evaluations must be based upon accurate data. While the consumer debt figures often quoted by third party sources such as CardWeb.com show dramatically high levels, they are based upon research with severely flawed methodology. In comparison, a Federal Reserve analysis on the average non-mortgage debt level held by American households over the last quarter-century shows that the ratio of debt-to-income is not significantly higher now than at any point in that 25-year time span. Whereas in the early 1980s consumers still largely used layaway plans and installment loans to purchase appliances, furniture and other durable goods, now they use credit cards – and not at a more irresponsible pace.

Simply put, a credit card is the riskiest type of loan a financial institution can make—and should be priced accordingly. Credit cards are unsecured, revolving loans, issued without knowing much information beyond a consumer's credit profile. Though consumer credit reports have been shown by the Federal Reserve to be accurate predictors of risk, that risk must be accounted for in price. Nearly half of credit card users pay off their balance every month. For these users, a credit card is an interest-free loan that oftentimes pays the customer back in the form of rewards or rebates. For the other half of credit card users – those that revolve a portion of their balance from month to month – an issuer pays merchants for goods and services either needed or wanted, while assuming all the risk that the cardholder will default on that loan, leaving the issuer with the bill. In addition to the risk of default, card issuers also face robust competition from other issuers willing to let consumers transfer their balances to the new card for a lower rate, leaving the previous issuer with no gain or benefit from the consumer relationship.

Universal Default

In addressing specific prohibitions in H.R. 5244, we begin by discussing universal default. A credit card borrower's likelihood of repaying a card balance (a balance that can grow through additional purchasing) changes over time. Information about the customer's use of credit extended by other lenders, which also changes over time, is demonstrably predictive of payment default. Risk models that use this information are required by law to be "empirically derived and statistically sound." The bill's proposed ban on universal default would lock a lender, for the life of the account, into the underwriting assumptions that were made prior to the opening of the account.

The risk-based pricing method permits price modifications for customers who expose the lender to increased risk, while benefiting other customers with lower credit costs and access to credit. The alternative, which this provision would bring about, is a combination of more stringent up front underwriting standards, a contraction of credit availability, and higher credit costs for all consumers.

While some issuers use universal default to price their loans, many others do not. If consumers find that this pricing method does not best fit their financial situations, they are free to take their business to an issuer that does not use universal default. If the lower *ex ante*, or before the fact, estimate of the borrower's likelihood of default provides them a lower interest rate, they may benefit from this pricing method. As long as the borrower does not have a negative change in his or her credit status, there would be no default to re-price them, universal or direct.

Two-Cycle Billing

Perhaps the most often criticized billing method credit card issuers use is that of "two-cycle billing." The very small number of cardholders affected by a two-cycle balance computation are usually the more affluent users of the card – individuals who normally pay the full balance each month without incurring any interest charges (while receiving a cash-back rebates, reward points or airline miles on their purchases). When these users trigger a two-cycle computation for the first time by paying less than the full balance due, they pay interest on new purchases beginning on the date of the purchase.

The only difference under two-cycle billing is that in the first month a convenience user elects to become a revolving card user (by paying less than the full balance), interest on the new purchase runs from the transaction date without a grace period. Interest is not paid twice or calculated differently. The "two-cycle" name refers to computing interest in the second cycle that was not, and could not be, computed in the prior one (because the date and amount of customers' payments was not known). Payments made on the balance in either billing period always reduce the interest due.

We also point out that this payment computation method does not result in an increase in the interest paid or in higher interest than would be due under the average daily balance computation method used by many issuers that do not use two-cycle billing.

Retroactive Re-pricing

Retroactive re-pricing is another example of where marketplace competition effectively shapes issuers' pricing practices. Credit card issuers have strong incentive to retain their relationships with existing customers, as they lose money when customers choose to transfer their balance after a negative experience with their card.

When issuers raise an interest rate on a card, it is usually a penalty for delinquency or for a greater demonstrated risk of default. In some cases, issuers will allow a customer to decline his or her interest rate increase and keep their old rate if the customer stops making new purchases on that card. In other instances, the issuer will offer the customer a pathway back to a lower rate, obtained as a result of consecutive on-time payments or bringing a balance below a certain ratio of the credit limit.

At all times, it's the cardholder who determines the future relationship with the card issuer. Cardholders can choose to pay off their old balance at the old rate when they stop using the card, or they can continue using that card for purchases at a new, higher rate. A third option is to transfer the balance to another issuer and discontinue using the account found unfavorable. Ultimately, the issuer has strong incentive to honor the cardholder's request for more convenient and flexible terms to continue the banking relationship. With the heightened awareness of credit card billing practices and consumer education, those card issuers that continue to enforce restrictive terms will lose current and future business and be forced to change their methods or exit the market.

Payment Allocation

Most issuers' default method is to allocate payment to the lower-interest portion first. Some issuers do allocate a payment to the higher-interest portion of a balance first. In most cases where variable interest rates make up the balance, the allocation among the portion made up of purchases, cash advance and balance transfer is clearly stated at the opening of the card agreement.

When payment is allocated to the lower-interest balance portion, the cardholder has the right to request a change. Many issuers will honor that request in the effort to keep the customer happy and retain the relationship. Some issuers will not honor that request. In all cases, the cardholder is free to transfer their balance elsewhere if they do not like the policy in place. Again, it is in the issuer's long-term financial interest to keep current customers by honoring their requests.

AFSA supports the clarification of terms, best embodied in the Federal Reserve's enhanced Regulation Z proposal. When credit card offers more clearly define the allocation of payment, new customers are better empowered to weigh the benefits offered by variable- and fixed-rate cards and choose the product that best suits their financial goals.

Conclusion

While we oppose any market restricting provisions to billing practices that will harm consumers, AFSA strongly supports clarifying disclosures to consumers about the various products they are offered. This bill, however, would not allow the operation of a free market in which a financial institution can price on its independent models and allow consumers to choose an issuer based on clearly disclosed terms.

Often the business model used by issuers is that which allows them to offer lower rates, cash rebates, or rewards. Many credit card users, if given the choice of higher permanent interest rates and decreased rewards in exchange for a ban on some of the billing practices discussed here, would still choose their current product. If a tradeoff is to be made between billing practices and benefits allowed, the choice should be left to the consumer.

We respectfully ask Members of the Financial Services Committee to consider AFSA's concerns when deliberating on H.R. 5244. Thank you.

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May 15, 2008

The Honorable Carolyn Maloney
Chairman, Subcommittee on Financial Institutions
and Consumer Credit
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Maloney:

I am writing on behalf of the members of the American Bankers Association (ABA) and the six member banks that have testified before your Subcommittee on H.R. 5244, the Credit Cardholders Bill of Rights Act of 2008, to reiterate our strong concerns about this legislation.

During the hearing held on April 17, 2008, you asked about the financial services industry's primary concerns with H.R. 5244. Questions also were raised about the profitability of the card industry. To ensure completeness of the hearing record, we have attached to this letter a detailed summary of industry concerns so that you and the Subcommittee may consider the views that the broader industry has with respect to H.R. 5244, as well as an analysis of card industry profitability which dispels the notion that the profitability of credit card lenders is disproportionate to the nature of the business.

We respectfully request that you include this letter and the attachments as part of the hearing record with respect to H.R. 5244.

Sincerely,

Floyd E. Stoner

Floyd E. Stoner

Attachments

Cc. Rep. Judy Biggert

Statement for the Record

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Financial Institutions and Consumer Credit

Committee on Financial Services

United States House of Representatives

April 17, 2008

Statement for the Record
on behalf of the
American Bankers Association
before the
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
United States House of Representatives

April 17, 2008

The American Bankers Association is pleased to submit for the record this statement regarding H.R. 5244, the Credit Cardholder's Bill of Rights of 2008, introduced by the Chairwoman of the Subcommittee, Representative Carolyn Maloney (D-NY). ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $12.7 trillion in assets and employ over 2 million men and women.

Summary

The Credit Card Bill of Rights Act of 2008 (H.R. 5244) would impose significant and far-reaching restrictions on the card industry that could have significant and adverse unintended consequences for consumers, the industry, and the U.S. economy.

The bill would significantly curtail the ability of credit card issuers to accurately price for risk on individual accounts, which would substantially reduce their ability to modify pricing to reflect changes in the creditworthiness of borrowers and changing market conditions.[1] The impact would be drastic:

[1] There are three primary issues that contribute to the pricing of credit card accounts: (1) risk levels of the borrower; (2) cost of funds; and (3) operating costs. Borrower risk levels are significantly heightened with credit cards (as opposed to

- The current risk-based pricing model for credit cards would be restructured to one in which customers with good credit histories who pay their bills on time would subsidize higher risk cardholders. Instead of being rewarded with lower interest rates, those with better credit histories would be likely to face higher interest rates.

- It would also lead to a tightening of credit availability to lower income cardholders, or those in acute financial stress, since many issuers may simply avoid offering credit to this segment of the market rather than increasing costs to other cardholders.

This would reduce the availability of credit at a time when Congress is doing everything possible to increase credit and stimulate the economy.

The bill ignores the essential nature of credit card transactions. Simply put, a credit card transaction is a loan. Unlike other loans, however, credit cards offer an interest free period if the cardholder pays in full each month. In contrast, the bill would require credit card issuers that offer this benefit also to

traditional home or auto loans), as they are made on an unsecured basis with the borrower capable of increasing the amount borrowed at any time (up to a pre-defined credit limit), as well as paying back that balance at a time and in amounts of his/her own choosing. This places a premium on accurate and sophisticated credit models at financial institutions so as to not pose safety and soundness risks. Currently, individual borrowers posing higher risk are priced accordingly, and are subject to higher interest rates. Concomitantly, lower-risk borrowers – the vast majority of Americans – fairly enjoy access to credit at lower rates that are reflective of their risk levels. With respect to cost of funds, card issuers must borrow funds in the marketplace to be used to extend credit to consumers. When card transactions are processed, merchants are paid back using those borrowed funds shortly after the transaction occurs. The card issuer then carries the cost of that borrowing, along with the credit risk, until such time as it receives payments from its cardholders. It is important to note that the cost of funds is not simply tied to an index, such as the prime rate, but may change because of macro economic factors, such as investor confidence, changes in spreads between the Federal Funds rate and LIBOR and the general credit environment. In dynamic markets like those in the U.S., the cost of funds regularly changes and card companies engage in sophisticated modeling to ensure that its borrowings and credit offerings are priced appropriately. Finally, with respect to operating costs, significant costs exist in both creating and maintaining card operations capable of providing consumers with efficient and accurate card processing, managed in a safe and sound manner, consistent with regulatory guidance. Legislative and regulatory changes to card operations will have a corresponding impact on card company costs that could be significant.

offer an interest-free period to those who do not pay on time and in full and to those that take out cash advances. The result may be the elimination or significant curtailment of the availability of interest free periods and other benefits for card holders.

Moreover, the bill ignores the fact that the market for credit cards is both highly competitive and highly regulated. The changes already made by the industry, as well as regulatory changes proposed by the Board of Governors of the Federal Reserve System, address fully all of the issues raised by the bill.

When taken together, the provisions in the bill are very far reaching and would have a significant impact on existing pricing models for a product – credit cards – that has provided unparalleled convenience, security, and access to credit for millions of Americans. Moreover, the unintended consequences of its enactment – namely increases in pricing and reductions in available credit – would likewise negatively impact broader economic conditions at a time when there is a great deal of uncertainty in the marketplace. As described below in greater detail, we have serious concerns about the broad range of the proposed restrictions on the card industry in the bill because they go well beyond any changes in current practices that may be necessary or appropriate to help consumers manage their credit card accounts.

Detailed Discussion

The major provisions of the bill and their potential impact on card issuers and consumers are described below.

Limits on the Ability to Charge Interest on an Existing Loan [Sec. 3(a)]. The bill would prohibit the application of interest to credit card balances that have been paid within the so-called "grace period," if a card company provides such a grace period. In effect, this provision acts to dictate the terms of a grace period, fails to permit lenders to charge interest for monies borrowed, and significantly changes current computations of interest owed (e.g., the use of average daily balance methods).[2] This would have a significantly negative impact on consumers through both higher pricing and reductions in services.

- Concerns have been raised previously regarding the practice of two-cycle billing, which, according to the Government Accountability Office (GAO), "eliminates the interest-free period of a consumer who moves from nonrevolving to revolving status."[3] This situation arises in only a very limited number of circumstances. However, the bill's provisions appear to go well beyond this limited fact pattern by extending grace periods to all revolving credit users and to cash advances. This is an enormous intervention into the pricing models of the credit card industry, which have never provided grace periods for those that remain in revolving status, or for

[2] In a loan, interest rates reflect the time value of money as well as the risk of repayment. In a typical revolving open end line of credit, such as a credit card account, a $1,000 loan accrues interest each day it is unpaid, and payments reduce the balance, and therefore the interest as of the day of payment. In simple terms, a "grace period" is the opportunity that the card issuer, in making a credit card loan, offers to a consumer to avoid all interest on that borrowing where the consumer has paid the entire balance in full. Contrary to most other loans in the marketplace that require interest to be paid from the time the money is borrowed, credit card loans offer the opportunity to avoid that interest should borrowers meet certain conditions, e.g., pay balances on time and in full. In such situations, the card issuer bears the full borrowing cost of the borrowing, and the consumer is provided with an interest free loan.

[3] Government Accountability Office, "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosure to Consumers." (September 2006), p. 27. In essence, this situation occurs only in the limited circumstance when a credit card user goes from paying back his/her balance in full (nonrevolver) to carrying a balance to a subsequent billing cycles (revolver). In such a circumstance, some issuers treat the card loan just like any other loan and charge interest from the time the money is borrowed, i.e., when the charge occurred. Borrowers that continue in revolving status to subsequent billing periods have never been eligible for a grace period and have been subject to interest charges, generally under an average daily balance method, from the time charges occur.

cash advances, and goes well beyond the stated intention to deal with concerns over two-cycle billing.

- Current pricing models rely on the ability to charge interest on borrowed funds that are not paid in full, thus imposing costs on those who choose to maintain an outstanding debt while allowing those who pay on time and in full to avoid such charges. Restricting the ability to assess interest may discourage credit card issuers from providing grace periods for anyone (i.e., eliminate the interest free loan aspect of credit cards even for those that pay on time and in full), or impose higher rates on all accounts if they continue to offer grace periods. This would force those who carry balances to pay more in finance charges.

- By requiring grace periods for cash advances, the bill would limit a card issuer's ability to appropriately price for what has statistically proven to be a higher risk activity. Limitations on the ability to charge interest on these advances would likewise result in higher interest rates on cash advances or elsewhere to address that risk, and possibly the elimination or curtailment of this service.

Notice and Choice to Opt-Out [Sec. 2(c)]. The bill would require 45 days advance notice, and an additional 90 day opt-out period, for any rate increase on a credit card account. If the consumer opts-out, the increase would not apply to the balance at the end of the 45 day period. This provision would apply to all increases for any reason except increases based on an index such as the prime rate, as well as the expiration of promotional rates.[4]

- In general, this would delay card issuers from re-pricing for risk at the time that risk has become readily apparent, thus requiring them to account for that risk in other ways, e.g., by pricing accounts higher at the outset.

- This provision would also provide a cash incentive for consumers to opt-out of an APR increase caused by their own default (i.e., because they can avoid increased interest charges if they opt-out), and thereby reduce incentives for making payments on time. Issuer costs would increase and this would ultimately be borne by other card bolders who make their payments on time.

- The bill would require the opt-out notification to appear in three consecutive billing statements. Additional interest collected during this period on the original balance would have to be rebated to the consumer who opts-out before the end of the third month. Again, this reduces the importance of paying bills when they are due, exposes the issuer to increased risk, and would shift costs from consumers who do not meet their payment obligations to those who do.

[4] Ironically, under the proposal, card issuers could immediately lower interest rates on such accounts to reflect the lower cost of funds – which competitive pressures and customer demand would likely require – but could not likewise re-price that account upwards immediately when such costs increase.

Mandated Minimum Duration of Grace Period [Sec. 3(g)]. The bill would increase the time between when statements are provided to consumers and when payments are due by over sixty percent. This provision would discourage card issuers from offering grace periods or require card issuers to charge higher rates to address the income lost due to the expanded grace period that the bill would require.

- Section 163 of the Truth-In-Lending Act (TILA) currently requires statements to be mailed at least 14 days prior to any date by which payment must be made in order to avoid the imposition of a finance charge. The bill would add a separate provision that would require statements to be sent at least 25 calendar days before the due date. In a billing cycle that includes February, it may be exceedingly difficult to meet this standard.

- Despite anecdotal evidence about mailing delays, there is no basis for assuming that current procedures are not adequate to ensure that statements are mailed promptly and received by the customer in time to make timely payments. In addition, a growing number of cardholders send payments over the Internet, through pre-authorized debits, or via no-cost telephone payment authorization, and are not affected by mail delays.

- This provision would effectively extend any grace period offered by the card issuer, thus increasing carrying costs associated with funding that loan and extending the repayment period risk.

Limitations on General Contractual Provisions [Sec. 2(b)]. The bill would prohibit all changes in terms to cardholders' accounts other than credit line increases that are not specifically provided for in the original agreement. This prohibition would even prohibit many changes in services that are beneficial to the cardholder, since it makes no distinction between changes that may decrease customer costs and those that might increase them. This provision would encourage card issuers to use longer and more detailed agreements in what would ultimately be an unsuccessful attempt to anticipate all possible changes. This would frustrate current efforts to simplify credit card disclosures, including the thrust of the Fed's recent Regulation Z proposals.

- For example, while many changes in terms on credit card accounts relate to rates and fees, others, such as recent efforts to convert account agreements into plain English, do not. The bill would prevent a change to a plain English account agreement from being made unless this change was made for specific reasons and subject to specific limitations in the original account agreement.

- At a time when credit card agreements are being criticized as wordy and difficult to understand, and both regulators and the industry are trying to simplify disclosures, this provision would likely result in card issuers acting to anticipate every potential contract provision that might change during the life of the account, and the possible reasons for such changes, and then list them in the contract. It is questionable whether consumers want or would benefit from such detailed and lengthy disclosures.

Limits on Ability to Consider Underwriting Risk [Sec. 2(a)]. The bill would prohibit the use of credit information about a cardholder to increase the interest rate on an account, other than the cardholder's experience with that particular account. This prohibition would apply even though the information actually reflects an increase in risk to the card issuer, and may include failure to pay other obligations to the card issuer or the card issuer's affiliates. Risk-based pricing permits price modifications for consumers who expose card issuers to increased risk, while providing benefits for low risk consumers, such as lower credit costs and increased access to credit. Card issuers would need to charge higher initial rates and curtail the issuance of cards to some consumers to deal with potential risks instead of the current, and fairer, practice of re-pricing the accounts of riskier borrowers. Even with these precautions, in many cases card issuers will need to close accounts or dramatically reduce credit lines to control unanticipated increased risks if they are unable to address increased risk through pricing.

- For example, under the bill, even if a consumer defaults on a mortgage and a car loan that have been made by the credit card issuer or the credit card issuer's affiliate, the credit card issuer would not be able to take the increased credit risk of the cardholder into account by increasing the interest rate charged on the account. The same would be true for defaults at other creditors that likewise reflect higher default risk.

- Card issuers are unsecured lenders and need to consider a consumer's experience with other lenders since "on us" data (e.g., experience of that issuer with that borrower) may not provide enough information to predict the likelihood of a future payment default. For example, it is not uncommon for a consumer to file for bankruptcy relief without ever having missed a payment to the card issuer.

- The bill ignores the fact that a cardholder is given access to an open-end revolving line of credit that he or she can access at any time, including years after an account has been open or last used. This would lock a lender into the underwriting assumptions that were made prior to the opening of the account for the life of the account. This would force credit card issuers to reduce credit lines or close accounts if a cardholder's credit score deteriorated significantly after the application, which may have been made years earlier.

Limitations on the Ability to Charge Interest on Residual Balances [Sec. 3(b)]. The bill would require card issuers to distinguish between balances that represent principal and those that represent interest, and would also make it more difficult for card issuers to collect amounts that only represent interest charges. This would encourage card issuers to charge higher rates to counteract the losses suffered in foregoing collection of these amounts.

- For example, card issuers often continue to charge interest from the date that a statement is sent until the date that the balance is paid. This is because the card issuer continues to have carrying costs associated with that loan for that period, and the card issuer does not know how promptly the consumer will pay his or her bill.

This process is fair to the consumer, as it rewards prompt payment, and fair to the issuer in that it permits the charging of interest on borrowed funds. The bill would provide that no fee can be imposed for failure to pay these amounts, and that failure to pay these amounts cannot be considered a default on the account. Although these amounts are typically relatively small, this provision would make it harder to collect these amounts, as a consumer may have limited interest in paying back these residual balances, particularly if the consumer refrains from using that account further. Again, this would encourage card issuers to use increased rates to make up for losses suffered due to a write-off of these amounts. In other words, this provision would require consumers who pay promptly to subsidize consumers who wait until the last minute.

Limitations on Over-The-Limit Contract Terms [Sec. 4]. The bill would give consumers the right to opt-out of over-the-limit (OTL) transactions where an over-the-limit fee may be imposed and restrict the imposition of OTL fees even if the consumer has not opted-out. Opting-out of OTL transactions would encourage card issuers to deny transactions that might, but will not necessarily exceed credit limits, making it more difficult for a consumer to rely on the ability to use his or her credit card for emergencies or as he or she may otherwise choose. Compliance with this provision would create significant operational difficulties for issuers and would require consumers to continually monitor their account balances to determine if an anticipated purchase will exceed the limit and be declined.

- At any point in time, credit card account balances are approximations of the card holder's obligation to the card issuer. This is because account balances cannot take into account all types of transactions, both debits and credits, which may be in progress. For example, a consumer who has reached the credit limit but has mailed in a payment for the full balance to the card issuer (or who has returned a large-ticket purchase to the seller for credit) remains over the limit until the payment or credit is posted to the account.

- Currently, credit card issuers will allow some transactions that may cause an account to go over the credit limit to address this uncertainty and to avoid inconveniencing card holders. Card issuers sometimes charge fees for these OTL transactions to discourage excessive use of this privilege, both to encourage cardholders to act within the terms of the credit contract and because going over credit limits may, but not always, reflect a higher risk of default. Current OTL policies reflect a balancing of consumer convenience and issuer risk, and limiting the ability to charge for excessive OTL transactions would encourage credit card issuers to deny transactions that may, but will not necessarily, exceed the credit limit. This would disrupt card holder transactions and, in particular, penalize consumers who closely monitor their balances, and therefore, will expect to have these transactions honored.

- Cardholders who sign up for preauthorized credit card payments (e.g., to pay recurring bills for cell phone service, utilities, parking, highway toll-pass payments, and other services) may have these payments disrupted, which can be especially dangerous in emergency situations.

- Further, in some cases it is simply not possible to prevent transactions that exceed a predetermined limit because the merchant originating the transaction does not obtain an authorization for the transaction. This can happen when, for example, the transaction is a relatively small transaction or the authorization system is down.

Required Pro-Rata Allocation of Payments [Sec. 3(f)]. The bill would require pro-rata allocations of payments where different balances are subject to different rates, e.g., low-rate balance transfers vs. new charges vs. cash advances. This changes pricing models associated with various credit options in the marketplace and would harm consumers. For example, it would discourage offering low promotional rates, since balances subject to these low rates would now be paid back over an extended period of time. Ironically, this would reduce the range of low-cost options available to consumers and reduce competition in the marketplace; as such rate options provide added incentives for consumers to change accounts in response to notices of rate increases or other changes in terms. Instead of restrictions, this is an area that is better addressed through improved disclosures.

Card Activation [Sec. 3(d)]. The bill would prohibit furnishing information about a "newly opened" account to a credit bureau before the card has been activated by the consumer. This would expose issuers to unforeseen risk. Information that an individual has applied for an account, particularly where there are multiple applications, is a factor that bears on that person's creditworthiness and default risk. The bill would deprive issuers of this critical risk assessment information in situations where a consumer obtains new credit lines but does not immediately activate them.

<u>Terms</u> [Sec. 3(e)]. The bill attempts to define several key terms used in the credit card industry, but the definitions actually impose several unnecessary requirements that do not benefit consumers. For example:

- The definition of "prime rate" limits that term to rates published in a specified Federal Reserve statistical lease. Card issuers often use other measures of prime (e.g., rates published in the Wall Street Journal) that are more accessible to consumers.

- The bill would create a presumption that payment was received within seven days of the date shown on a receipt from the U.S. Postal Service or another common carrier. This would require creditors to establish procedures for payments submitted through these channels to ascertain those dates for purposes of computing interest and determining whether late fees may be assessed. This is likely to involve significant operational costs for what may be of limited use to consumers, and which may result in higher costs for consumers generally (particularly when coupled with higher costs resulting from other provisions in the bill).

In addition to the provisions discussed above, the bill would require new disclosures and extensive operational changes. Many of these disclosure and operational changes are unnecessary and would lead to higher operating costs and encourage higher rates for consumers. For example:

- Payoff Balance [Sec. 3(c)]. The bill would mandate furnishing information on how to obtain a loan "payoff balance" on each periodic statement. Credit card accounts are open-ended loans whose balances can change rapidly depending upon additional purchases and the amount and timing of payments. Consumers understand this and already have access to toll-free numbers provided by issuers if they have any questions. Adding information such as this to billing statements that are already being criticized for being too complex will provide little, if any, benefit for consumers.

- Reporting [Sec. 5]. The bill would require extensive reporting of card company revenues and profitability, while mandating Congressional studies of these issues. Congress is clearly empowered to require reporting and studies in areas it deems appropriate. However, we remain very concerned over this provision, as it seems to reflect an intention to micromanage private industry pricing models.

Conclusion

The card industry is working constructively with the regulatory agencies and Congress to improve consumer disclosures and to address other concerns. However, we are concerned that the broad restrictions contained in the bill go well beyond what is needed to address these concerns, and that they would impose significanr and far-reaching restrictions on the card industry that could have significant and adverse unintended consequences for consumers, the industry, and the U.S. economy.

We have outlined our preliminary objections to the bill in this memo, and more may be forthcoming as we study it further. It is clear that the overall effect of the bill would be to significantly curtail the ability of credit card issuers to accurately price for risk on individual accounts. This would substantially reduce the ability of card issuers to modify pricing to reflect changes in the creditworthiness of borrowers and changing market conditions.

The consequences of eliminating risk-based pricing and imposing other restrictions in the bill are hard to predict precisely, especially in today's highly volatile credit markets. However, it is very likely that the impact would be to raise the cost of credit for most borrowers, even those with excellent credit histories, and to tighten credit availability to lower income cardholders, or those in acute financial stress, and this would reduce the availability of credit at a time when Congress is doing everything possible to increase credit and stimulate the economy.

Credit Card Issuing Banks:
Observations on Profitability

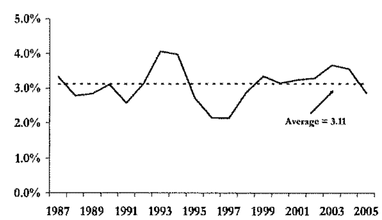
The following observations are intended to dispel the notion that the profitability of credit card lenders is out of line with the nature of the business. There is no question that credit card lending is profitable. It has to be, given that it is the riskiest type of consumer lending. It is also the most expensive consumer lending to deliver, and is more susceptible to fraud than any other type of consumer lending.

As a large part of the broader consumer payment industry – an industry that handles more than 10,000 transactions *every second* and has enough communications lines to encircle the globe nearly 400 times – credit card lending is a highly refined business. Moreover, it is very competitive, requiring hanks to maintain extremely efficient operations in order to ensure a high degree of transaction accuracy and customer support.

Credit Card Lender Profits Have Remained Stable

According to the Federal Reserve, the largest credit card issuing banks have not increased their year-over-year profitability over the last 20 years. In fact, profits remained relatively stable between 1987 and 2005, with an average yearly return on assets (ROA) ratio of 3.11 percent (see chart at right). This means that for every $100 a credit card issuer loans to consumers, that issuer can expect – if all goes well – to receive roughly $103 in return at the end of the year. A 3 percent return is not much when compared to some other well-known industries (see table below).

Return on Assets, Large Credit Card Banks*



Source Federal Reserve

Return on Assets	2005
Mining, Crude-Oil Production	14.9%
Pharmaceuticals	10.5%
Tobacco	8.3%
Computer Services and Software	7.7%
Health Care: Other	6.8%
General Merchandisers	5.6%
Health Care: Insurance & Managed Care	4.5%
Entertainment	3.9%
Food & Drug Stores	3.6%
Motor Vehicles & Parts	3.5%
Large U.S. Credit Card Banks*	2.85%

Source: CNN Money.com, Federal Reserve

Profits are Much Lower than Other Industries

The rate of return for credit card lenders is lower because the credit card lending market is both mature and competitive. The shear number of credit card lenders – more than 6,000 according to a recent report by Government Accountability Office (GAO) – suggests that credit card lending is among the most competitive industries in our economy.

Furthermore, data from the Federal Reserve indicates that the percentage of families with at least one credit card has remained relatively constant since the early 1990s – fluctuating slightly between 72 percent and 76 percent. Simply put, there are few new market opportunities for credit card lenders and potential for further growth is limited. As a result, credit card lenders are forced to compete with one another to attract customers from the existing customer pool. They do so by offering various incentives such as lower interest rates, no annual fees, no balance transfer fees, and enhanced rewards programs. This level of competition brings prices down across the board and affects the bottom line of the entire industry. Moreover, the push to offer more alluring prices ensures that excess profits are wrung out of the market.

But the affect of competition also ensures that customers have the luxury of constantly shopping around for the most attractive offers. Indeed, competition has already led to a decline in average interest rates and a decline in total fee revenue (see table at right). As the GAO concludes in its recent report, issuers generally offered cards with a single, fixed annual percentage rate of around 20 percent prior to the 1990s. However, due in part to the introduction of the Schumer Box, issuers began to compete for consumers by offering lower rates. By 2005, interest rates had fallen to an industry average of roughly 12.5 percent.

Revenues of Credit Card Issuers in Credit Industry Directory per $100 of Credit Card Assets

Revenues	1990	2004
Interest revenues	$16.42	$12.45
Penalty fee revenues	0.69	1.40
Annual fee revenues	1.25	0.42

Source: GAO Analysis of Card Industry Directory Data

Furthermore, up until about 1990, card issuers charged annual fees ranging between $20 and $50, and smaller amounts for penalty fees. By 2005, roughly 75 percent of credit cards no longer carried an annual fee. Finally, credit card issuer revenue from annual and late fees combined fell from $1.94 for every $100 in 1990, to $1.82 for every $100 in 2004.

Credit Card Lending is Risky

Because credir card lending carries more risk than any other type of consumer lending, short-term variation in profit levels can be expected. On most occasions, banks issue credit cards to customers the bank has not formally met. Customers usually mail in completed application forms or contact the bank by phone when opening a credit card account. Moreover, customers can tap into their approved line of credit day or night, over a long period of time. And, unlike loans for a house or a car, which are secured by the value of the purchased item, collateral from a borrower is not required for credit card lending.

Thus, banks that engage in credit card lending are exposed to greater loss potential. This means a greater risk of swings in earnings. For example, average ROA for credit card lending banks has been as high as 4.06 percent and as low as 2.13 percent since 1987, a fluctuation range of almost 2 percentage points. Swings of this degree would be enough to put most other consumer lenders out of business, considering that average returns for all commercial banks has only 1.49 percent since 1987 according to the GAO. Moreover, when a two percentage point variation is considered in light of the 20 year average of just over 3 percent per year, it becomes clear that credit card banks are never assured of a high rate of return.

In fact, ***it is always possible for returns to be much lower – even negative.*** According to a 1994 report by the GAO, between 1977 and 1981, the average pretax earnings for Visa and MasterCard issuers was at or below zero percent, falling to less than negative one percent in 1980 and 1981.

Other risks associated with credit card lending also lead to variability of profit. For example, while all other types of consumer loans rely on fixed repayment schedules, credit card loans have flexible repayment terms that allow borrowers to pay all, or only some of the loan at their convenience. This means that credit card lending banks must bear the uncertainty of highly variable cash flows, and the risk of customer default is always a concern.

Furthermore, credit card lending is more susceptible to fraud than any other type of consumer lending. While banks and credit card networks have spent millions of dollars to prevent and identify illegal credit card transactions, losses from fraud incurred by issuers of Visa, MasterCard, American Express, and Discover reached an all-time high of $1.14 billion in 2005, according to the *Nilson Report*.

Due to the inherent risks associated with credit card loans, credit card lending necessitates a higher rate of return than other forms of consumer lending. Credit card lending banks realize that their potential loss rates are always comparatively high. Thus, they expect returns that can fully absorb these losses but still generate acceptable returns to investors. Along with earnings, capital from investors provides the basis for credit availability. Absent a return that is commensurate with the risks they bear, investors will invest their money elsewhere, and the pool of available credit will shrink. Simply put, credit card lending must be profitable in order for banks to afford taking on the extra risks associated with it.

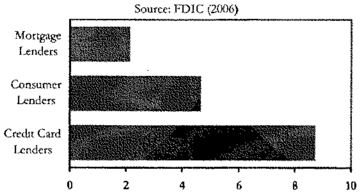
Credit Card Lending is Expensive

Credit card lending is not only very risky it is also very expensive. In order to make consumer loans, banks must obtain funds from various sources, such as deposits, income on investments, or by borrowing from other creditors. The amount of interest banks pay for these funds represents their cost of funds. Cost of funds is the largest expense associated with most consumer loans.

However, the cost of funds for credit card lending is a much lower percentage of the total cost of providing the loan. In fact, data from the *Quarterly Banking Profile* of the Federal Deposit Insurance Corporation (FDIC) indicates that credit card banks spend only about 25 percent of total expenses on obtaining funds, while consumer lenders and mortgage lenders spend 39 percent and 58 percent, respectively.

This is because credit card lenders have much higher operating expenses than other consumer lenders. According to the FDIC, credit card lending banks spent just under 9 percent of their total assets on operating expenses in 2006, compared to an average of roughly 4.5 percent for other consumer lenders, and just over 2 percent for mortgage lenders (see chart below).

Operating Expense as Percentage of Total Assets
Source: FDIC (2006)



Operating expenses are higher for credit card lenders because they must incur greater costs associated with maintaining a large volume of relatively small cardholder accounts. According to a recent report by the GAO, there were almost 700 million credit cards in circulation in 2005, accounting for more than $1.8 trillion in total transactional volume. Furthermore, the Federal Reserve estimated in 2003 that the ***average credit card transaction value was roughly $93.*** Processing each and every one of these small transactions requires a complex and sophisticated infrastructure that is expensive to maintain. This infrastructure includes advanced computer systems, fraud protection programs, and a network of personnel that are available 24 hours a day, 7 days a week to handle customer service issues.

* Credit card banks are commercial banks with average managed assets greater than or equal to 200 million dollars with minimum 50 percent of assets in consumer lending and 90 percent of consumer lending in the form of revolving credit.

Larry Sharnak
EVP/GM Consumer Cards

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April 29, 2008

The Honorable Carolyn B. Maloney
Chairwoman
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
United States House of Representatives
2331 Rayburn House Office Building
Washington, DC 20515

Re: Additional information for the April 17, 2008 hearing record on H.R. 5244, the "Credit Cardholders' Bill of Rights Act of 2008"

Dear Subcommittee Chairwoman Maloney:

Thank you for the opportunity to testify recently before the Financial Institutions and Consumer Credit Subcommittee to share American Express' views on H.R. 5244, the "Credit Cardholders' Bill of Rights Act of 2008." I am writing to provide additional information on two issues that were discussed during the hearing. The first pertains to how the legislation addresses interest rate increases, and the second relates to the impact of mandating that consumer payments be allocated on a "pro-rata" basis. I would respectfully request that this letter be included as part of the formal record from the April 17, 2008 hearing.

Interest rate increases

American Express believes that H.R. 5244 treats all interest rate increases in a similar fashion, regardless of the reason for the increase. We think it is critical to make a distinction between increases that are triggered by the consumer's actions on their specific account and all other rate increases. The only differentiation that the legislation currently makes is for rate increases triggered by "universal default," which would be limited only to future balances. There is no distinction in the advance notice and opt-out that issuers would be required to provide consumers.

The legislation imposes a 45-day advance notice, followed by an additional period of up to three billing cycles to allow consumers the ability to opt-out of the new rate, before any interest rate increase could go into effect. This broad notice and opt-out applies to **all** interest rate increases uniformly, whether the rate increase was triggered by a consumer's behavior on the account in question, a missed payment with a third-party, or any other reason not related to that particular account.

The Honorable Carolyn B. Maloney
April 29, 2008
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As currently written, this provision would reduce incentives for consumers to make timely payments. For example, consumers could run up a balance on their account, make no subsequent payments, and still avoid a rate increase on the account by exercising their right to opt-out. Under this bill, a consumer would have up to five months to decide whether a rate increase should be applied even if they were in default on their own account. Consumers who pay their bills on time should be protected from arbitrary rate increases. At the same time, consumers who fail to make timely payments on their account should be accountable for their actions. Increases triggered by a customer's performance on their account should not be subject to a 45-day advance notice and opt-out.

At American Express, we do not increase an individual customer's interest rate for any reason other than the customer's performance on their particular account. If you are an American Express Cardmember, your interest rate will be increased to a penalty rate **only** if you violate the terms and conditions on that specific American Express account. All of the specific reasons outlining when a penalty rate would apply are clearly disclosed up front to the consumer. We believe that additional notice and opt-out should not be required in these instances.

If a customer doesn't pay on time or bounces a check on the card itself, most consumers believe it is fair to have a consequence. Survey research has consistently shown that most consumers believe that a rate increase caused by their own actions on that particular account should be treated differently than any other rate increase. A recent poll conducted by the Financial Services Roundtable found that 58 percent said it was fair to raise interest rates because of late payments on an account.

The Office of the Comptroller of the Currency testified at the April 17 hearing that "where a customer defaults on his or her obligations under the card itself, the risk to the credit card lender is clear and immediate, and, with appropriate up front notice, the consequence of increased rates on the consumer's existing balance and on future transactions should not come as a surprise to the consumer."[1]

The act of paying late, exceeding one's credit limit multiple times in a 12-month period or submitting a check that is not honored by one's bank are significant indicators of heightened risk. For instance, our data show that a consumer who bounces a check is 20 times more likely to have their balance written off as uncollectible.

At the same time, consumers should be protected from rate increases that are outside of their control and which are not tied to the specific account in question. These would include interest rate increases caused by:

- a consumer's performance on another account with the same lender;
- a consumer's performance with a different lender;
- a deterioration in the consumer's FICO score;

[1] Testimony of Julie L. Williams, Chief Counsel and First Senior Deputy Comptroller, Office of the Comptroller of the Currency, April 17, 2008, p. 5

- an increase in the issuer's cost of funds, and;
- an issuance of a renewal card to the consumer.

In all of these instances, we believe it is appropriate to require an advance notice and opt-out. However, we do not believe such advance notice and opt-out should be required when a customer triggers a higher interest rate because of their actions on the specific account in question.

Payment allocation

During the hearing, there was also discussion about the impact of regulating industry payment allocation methods. American Express believes that requiring a pro-rata approach would result in significant adverse consequences for consumers.

We conducted an extensive analysis to quantify the benefit our consumers receive from taking advantage of low-rate promotional and balance transfer offers. We carefully studied the impact on a consumer's overall interest rate when they took advantage of a balance transfer offer. We found that on average a consumer could reduce their overall effective interest rate by nearly 2.8 percent. This benefit is likely much higher when you take into account that most consumers are transferring balances from higher rate loans with other lenders.

In addition, our data show that consumers who take advantage of promotional or balance transfer offers pay down their accounts at a faster rate and exhibit lower delinquency rates than our average customer. This would lead one to conclude that the vast majority of consumers who take advantage of such offers are exhibiting payment behavior that demonstrates they are aware of the terms of the offer.

We also studied the impact of changing the current payment allocation method used by the industry to the pro-rata approach that would be mandated under the legislation. We found that we would no longer be able to make our most advantageous offer to the overwhelming majority of consumers who would receive such an offer currently. We would also likely reduce our marketing of promotional rates in general. For those who would still be eligible to receive such offers, the terms would not be as favorable to consumers as they are today. This is because H.R. 5244 would fundamentally change the economics of such offers, thereby making them far less available to consumers than they are currently.

We think that imposing a pro-rata payment allocation method would harm the vast majority of consumers who benefit from the availability of promotional offers in the marketplace. This isn't just a theoretical issue. Many issuers have already curtailed balance transfer and other promotional offers in light of the current economic environment, and this legislation would likely accelerate that trend. Ultimately, this will place consumers at a significant disadvantage, by limiting the options of consumers who want to switch among credit card products.

We believe there are other alternatives the Subcommittee should consider to address concerns about payment allocation practices that would also preserve the ability of issuers to continue to

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make low interest promotional and balance transfer offers available to consumers. We would welcome the opportunity to discuss these matters further with you at your convenience.

Again, thank you for the opportunity to testify before your Subcommittee. I hope this additional information is helpful. If I can provide any further information regarding our views on the impact of H.R. 5244 or answer any additional questions you might have, please feel free to call upon me.

Sincerely,

Larry Shanak

Larry Shanak
Executive Vice President and General Manager, U.S. Cards
American Express Company

cc: The Honorable Judy Biggert
United States House of Representatives
1034 Longworth House Office Building
Washington, DC 20515

CHASE

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April 16, 2008

The Honorable Carolyn Maloney
Chairman, Subcommittee on Financial Institutions and Consumer Credit
House Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Judy Biggert
Ranking Member, Subcommittee on Financial Institutions and Consumer Credit
House Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Maloney and Ranking Member Biggert:

Per the Committee's request and with authorization from customer **Ms. Susan Wones**, we respectfully provide the information below relevant to Ms. Wones' accounts with Chase Bank USA, N.A. ("Chase") as background for the April 17, 2008 hearing on H.R. 5244, the Credit Cardholders' Bill of Rights.

Summary
Susan Wones has three accounts with Chase, opened in 2003, 2005 and 2006. Over time, Ms. Wones' credit profile deteriorated due to her high utilization of unsecured credit.

For the past two years her external lines (credit extended by other lenders) have been about $25,000 with actual credit card balances of $20,000, bringing her utilization rate to approximately 80 percent of her available credit. Her utilization on her Chase card has consistently been in the 80% range on a total credit line of $10,000 among her three cards. Generally, Ms. Wones makes minimum or very low payments on her Chase accounts.

Overall, we view Ms. Wones' level of unsecured debt to be extremely high relative to her income. That caused us to propose higher rates due to her increased risk. When we took that step, Ms. Wones rejected the rate increases – we provided her with that option – and her two accounts were closed, allowing her to pay off the balance at the old, lower rate over time.

After we received a complaint from Ms. Wones dated March 28, 2008, we, as we would for any customer, reviewed her accounts and current financial status. We concluded that Ms. Wones was over extended. Her outstanding balances have remained consistently high and her payments relatively low. To assist her, as we would for any customer in similar circumstances, we offered Ms. Wones a payment program that offers substantially reduced rates to enable her to repay her debt. We also offered to refer her to a Consumer Credit Counseling agency in her area if she preferred. I have attached the letter we sent to Ms. Wones that addresses several of her concerns.

As a final point, the rate increases we proposed to Ms. Wones (and she rejected) based on a deteriorating credit score were under a policy no longer in effect at Chase. This year, we eliminated that practice and no longer use information in a credit bureau to initiate an increase to a customer's interest rate. While it is an important element in managing risk, we made the change to better support our objective of building long-term relationships with our customers.

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Account Detail

1. **Account ending 0161**
   - Opened 10/19/03 with a credit line of $6,000, a 0% introductory rate for 6 months and a contract rate of Prime plus 6.9%.
   - Oct. 2003: First transaction on account was a balance transfer of $5,100. Several other transactions were made in first month with statement ending balance of $5,473 on $6,000 credit line.
   - May 2004: Six month 0% introductory rate expired and the APR became 10.90%. (Prime was 4.00%.)
   - Aug. 2005: Credit-based pricing applied due to high balances on multiple credit card accounts, increasing rate to 24.99%. Ms. Wones rejected the change and the account was closed, retaining lower rate and ability to pay off balance over time.
   - Oct. 2006: Credit-based pricing applied due to high balances on multiple credit card accounts, increasing rate to 24.99%. Ms. Wones' APR was 15.15% in November 2006. (Prime was 8.25% at the time.)
   - Jan. 2007: Ms. Wones rejected rate increase and account rate was returned to 15.15%. (Finance charges of $43.06 were reversed.)
   - Account remains closed.

2. **Account ending 9489**
   - Opened 2/16/2005 with a credit line of $2,000, a 0% introductory rate for 15 months and a contract rate of 7.99% fixed. This account was opened prior to increase on account ending 0161 in Aug. 2005.
   - Feb. 2005: Two balance transfers were made in the first month, totaling $1500 on the $2,000 credit line.
   - May 2005: Additional balance transfer of $500. The account has been essentially utilized at 100% since month three.
   - Fixed rate of 7.99% remains.
   - No credit-based pricing action was taken on this account because it had not yet been reviewed. It would have been repriced if the customer's profile remained unchanged.

3. **Account ending 2274**
   - Opened 5/16/2006 with a credit line of $2,000, a 0% introductory rate for 12 months and a contract rate of Prime plus 14.99%. It is important to note that this is a "high risk" APR rate.
   - May. 2005: First transaction was a $1,500 balance transfer on $2,000 credit line.
   - Apr. 2007: Account went overlimit and fee was assessed. No default pricing was applied.
   - Oct. 2007: Credit-based pricing action was taken; Ms. Wones rejected the change and the account was closed, retaining lower rate and ability to pay off balance over time.

Additionally, we would like to respond to several specific points that Ms. Wones made in the testimony that was provided to us on April 14, 2008.

- Ms. Wones stated, "When I signed up, I knew [the card] would go from a 0% introductory rate of 0% to 7.9%. But later I discovered it had gone to 14.9%." The contract rate disclosed on the offer Ms. Wones received was Prime plus 6.99%; this was a variable rate account. In month seven her introductory rate expired as communicated, and the account rate went to 10.99%. As the Prime rate increased, her rate increased to 14.99%.

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- Ms. Wones mentions that her first account had a $6,000 limit and "once I got to around $6,000, though, the rate jumped from 14.9% to 25%." Ms. Wones received a credit-based pricing action notice in August 2005 for a rate of 24.99%. She declined the terms and closed the account. Her original rate remained.
- Ms. Wones stated that during "one billing cycle I went $15 over my limit and they raised my interest rate to 23.24% and charged me a $39 over-the-limit fee-even though my beginning and ending balances for that billing cycle were under my limit." This is not correct. Ms. Wones' terms were prime plus 14.99%. Her 12-month introductory rate coincidentally expired the same month she went overlimit. Her contract rate never changed. Ms. Wones did receive a $39 overlimit fee on April 30, 2007, which is the only fee Ms. Wones has ever received.
- Ms. Wones also states that she felt that, once she reached her credit limit, charges wouldn't be approved. Chase does offer customers the option of having transactions declined that would cause them to exceed their limit so they can avoid fees. Chase does find that most customers prefer not to have their authorizations declined at point of sale, but allows customers to choose.
- Ms. Wones also questions how we could issue her three different cards with different rates. Two of the three accounts are at, or we attempted to take them to, "high risk rates." The third account was not yet reviewed, but would have eventually been moved to a higher rate.
- Ms. Wones also asks "if they think I am overextended, which they stated in a letter sent to me last week-why would they continue to issue me new credit cards?" The second credit card was issued before Chase sent Ms. Wones a credit-based pricing action notice and the third was opened at a "high risk" APR.

We are happy to answer additional questions related to Ms. Wones' account and the actions we took to manage the risk inherent in making open-ended, unsecured loans.

Thank you for the opportunity to respond.

Respectfully,

David P. Hogan

David P. Hogan
Senior Vice President
Chase Card Services
201 N. Walnut Street
Wilmington, DE 19801
(302) 282-3232

April 8, 2008

Susan Wones
1185 South Monroe Street
Denver, CO 80210-2118

Re: Disney Rewards Platinum Visa Account **** **** **** 0161

Dear Ms. Wones:

Your concerns expressed to Gary Foster, Senior Vice President, Disney Corporate Communications, have been referred to the Card Services Executive Office. Thank you for taking the time to speak with me on April 1, 2008.

I regret to hear that you were not completely satisfied with our January 7, 2007 response provided by Naomi Butinski, Cardmember Advocacy Specialist. As I mentioned last week, I personally review these types of situations so that we can learn how we could have better responded from our Cardmembers' perspective and, therefore, we continuously improve.

Based upon my review of the original information shared with the Office of the Comptroller of the Currency, and the information you shared with me during our conversation, I acknowledge we could have provided a better explanation of our position at that time.

I am pleased to provide the following responses to your specific questions:

1) We initially changed the Annual Percentage Rate (APR) on the Disney account referenced above due to a change-in-terms notice sent August 1, 2005, with an effective date of October 3, 2005. This change notified you that, among other changes, your standard APR for purchases would increase to 24.99% fixed. We made a business decision based on the risk level indicated in part by the information supplied from the credit bureaus, and was not intended to discount the loyalty or tenure of our relationships with you. Our decision was only to appropriately price the account based upon the unique risk factors associated with it At that time, an electronic summary of your Experian credit bureau report primarily indicated that the proportion of bankcard balances was high compared to the assigned credit lines. Please allow me to clarify that our decision does not specifically rely upon an actual FICO score. Given the fact that you rejected the terms, your account was closed on September 29, 2005, as per the instructions provided in the notice.

The second change of terms notification was sent on October 4, 2006, with an effective date of December 1, 2006. This change notified you that, among other changes, your standard APR for purchases would increase to 24.99% fixed.

Our reason for this change was the same as for the August 2005 notice, which was an electronic summary of your Experian credit report primarily indicated that the proportion of bankcard balances was high compared to assigned credit lines. Given the fact that you again rejected the terms, and worked with our Executive Office in January 2007, the changes in terms did not take effect.

Per our discussion, it was noted that you did not dispute the information supplied by the credit bureau. I understand that you disagree with our business decision based, in part, upon this information.

2) Ms. Wones, you asked for an explanation for how you qualified for two new accounts after opening the Disney account referenced at the top of the first page of this letter. Although pricing actions were taken specific to the Disney account ending in 0161 due to concerns with proportion of bankcard balances being high compared to assigned credit lines, you qualified for additional accounts based upon our lending criteria. It may also be helpful to note that the account ending 9489 was opened on February 16, 2005, which was six months prior to the August 5, 2005 change in terms notice. Additionally, the ASPCA account ending 2274, opened on May 16, 2006, carried a variable APR of 23.24%, after the introductory period expired. Lastly, account terms are account specific to, and can vary among, products and portfolios. This can include, among other terms, APR for purchases, APR for cash, annual fees, balance transfer fees, overlimit fees, and late fees.

3) The reason that we required the account to be voluntarily closed, in order to reject the change-in-terms, is due to a business decision to mitigate any further risk to the bank. Your options as outlined in the applicable notices were to:

a) Accept the terms, which may also require additional consideration to pay down the balance.
b) Reject the terms and close the account. I regret to hear that you feel you did not have any other option but to close the account.
c) You had the right to dispute the accuracy or completeness of any item in your consumer report.

4) Please allow me to explain why your non-rewards account may not have been considered for a change in terms notification. The account ending 9489 had not yet reached eligibility for a review of the terms. At such time, under the assumption that no new information would have been presented and the fact that this review would be conducted, this account would have been considered for a change in terms notification.

5) Thank you for advising me that you have not received a response to your November 8, 2007, letter addressed to our Correspondence Department at Post Office Box 15098. Our records indicate that a response was mailed to you on November 19, 2007, acknowledging your request to reject the change-in-terms and hence, close the account. Ms. Wones, I recognize that our response should have addressed your request for an explanation. In addition, I recognize that your recent telephone inquiry of March 20, 2008, again requested an

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Ms. Wones
April 8, 2008

explanation. I sincerely apologize for any inconvenience this may have caused you. The explanation for this change is that an electronic summary of your Experian credit report indicated that the proportion of bankcard balances was high compared to assigned credit lines.

Ms. Wones, it is my conclusion, based upon all of the information available, including the total amount of credit card balances appearing on your credit report, that you may be in need of assistance with the amount of outstanding credit card balances you have with Chase. We offer several payment programs to assist consumers that may be beneficial to you. These programs feature reduced rates and fees, and provide a vehicle for customers to manage and pay down their debt. If you are interested in seeking our assistance, please feel free to contact me. I am available at the address noted on page one of this letter or by telephone number at 847-488-6013. Alternatively, if you prefer to work with an outside agency, we would be happy to refer you to a Consumer Credit Counseling agency in your area.

In closing, based upon the length of time that has passed and the information you have provided to me about our servicing opportunities, I have credited your three accounts for the most current statement finance charge assessments, totaling $79.24 as a gesture of our commitment to you. These credits will be reflected on your next billing statements.

In closing, I anticipate that the above information has met with your satisfaction. I appreciate this opportunity to bring closure to this matter.

Sincerely,

Nancy Stoneman
Card Services Executive Office

cc: Mark Reuling
Senior Vice President

CHASE

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April 16, 2008

The Honorable Carolyn Maloney
Chairman, Subcommittee on Financial Institutions and Consumer Credit
House Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Judy Biggert
Ranking Member, Subcommittee on Financial Institutions and Consumer Credit
House Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Maloney and Ranking Member Biggert:

Per the Committee's request and with authorization from customer **Mr. Stephen Strachan**, we respectfully provide the information below relevant to Mr. Strachan's accounts with Chase Bank USA, N.A. ("Chase") as background for the April 17, 2008, hearing on H.R. 5244, the Credit Cardholders' Bill of Rights.

Summary
Stephen Strachan has three credit card accounts with Chase, opened in 1999, 2000 and 2001. These accounts were issued by various predecessor banks that, due to consolidation, became accounts with the successor bank, Chase. At the time the accounts were issued, Mr. Strachan had an excellent credit profile and an annual income of $300,000 according to information he provided in his application. As a result, his accounts had generous credit lines.

In late 2001, Mr. Strachan's unsecured debt increased sharply while his credit scores decreased. During that timeframe, his total credit card debt increased to approximately $200,000; approximately $150,000 of that unsecured debt was with Chase. To prudently manage the increased risk posed by Mr. Strachan based on his behavior (a combination of his increasing balances, reducing his payments and making multiple late payments), we managed our exposure through rate and credit line adjustments to his three accounts between the period of 2002-2005 as follows:

- Default Pricing Actions: Three (due to delinquency)
- Credit-based Pricing Actions: Six (all adjustments provided the option to reject rate increase)
- Credit Line Decreases: Eight

These changes were made through a combination of systemic reviews and evaluations by lending analysts.

Six of Mr. Strachan's pricing changes were the result of information in his credit bureau that indicated his credit risk was deteriorating. Mr. Strachan's contract provided for that kind of repricing along with the option to decline a proposed rate increase, close the account and pay off the balance at the old rate over time. As you may know, Chase eliminated that practice earlier this year and no longer uses information in a credit bureau to initiate an increase to a customer's interest rate. While it is an important element in managing risk, we made the change to better support our objective of building long-term relationships with our customers.

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As a point of clarification, Mr. Strachan notes additional rate increases in his testimony sent to us on April 14, 2008 – in addition to the rate increases that we have indicated above. Several of these are the result of his holding variable rate accounts that are indexed to the prime rates and can fluctuate based on changes to the prime rate and not because of any specific action by Chase.

While Mr. Strachan asserts that the line reduction and account closure actions by Chase and other banks caused his credit score to fall, subjecting him to rate increases, the actions by Chase were a result of an overall increase in debt and reduced payments.

Account Detail

1. **Account ending 5024**
   - Opened 7/7/99
   - June 2000: Credit line increased to $90,000 to consolidate 3 accounts.
   - Sept. 2002: Account balance was approximately $89,200 on line of $90,000. Payment was not made and the account cycled delinquent.
   - Oct. 2002: A payment was made but the account remained one cycle past due.
   - Nov. 2002: Default pricing action applied, increasing rate from 10.90% to 19.99%
   - May 2003: Credit-based pricing applied due to high balances on multiple credit card accounts and reduced payments, increasing rate from 19.99% to 22.99%. Customer did not opt-out of rate increase. Account Balance was approximately $83,000 on line of $90,000.
   - May 2004: Credit line decreased to $70,600. Credit line was reduced to then current balance plus $1,000 (approximately).
   - July 2004: Credit-based pricing applied due to high balances on multiple credit card accounts, increasing rate from 22.99% to 24.99%. Customer did not opt-out of rate increase. Customer made a $50,000 payment.
   - Sept. 2004: Account balance of $16,000 is paid off.
   - Sept. 2004 to Jan. 2006: No account activity
   - Jan. 2006: Activity resumed on account.
   - Apr. 2008: Currently, there is no balance on account.

   Summary:
   - Default Pricing Actions: One
   - Credit-based Pricing Actions: Two (customer chose not to opt-out of increase)
   - Credit line Decreases: One

2. **Account ending 7434**
   Opened 1/11/2001.
   - Mar. 2002: Balance is $27,838 on a $30,000 line, with most of the balances at 3.99% and 5.99% promotional rates. Contract rate APR is 15.90%.
   - July 2002: Credit line decreased from $30,000 to $18,500.
   - Sept. 2002: Payment not made and account cycled delinquent.
   - Oct: 2002: Payment was made but account remained one cycle past due.
   - Nov. 2002: Default pricing action applied, increasing rate from 15.90% to 19.99%.
   - Apr. 2003: Credit-based pricing applied due to high balances on multiple credit card accounts, increasing rate from 19.99% to 22.99%. Customer did not opt-out of rate increase.

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- Jan. 2004: Credit-based pricing applied due to high balances on multiple credit card accounts, increasing rate from 22.99% to 24.99%. Customer did not opt-out of rate increase.
- May 2004: Credit line decreased to $11,050 from $21,300. Credit line was reduced to the current balance at that time plus $1,000 (approximately).
- Aug. 2004: Credit line decreased to $9,150. Credit line was reduced to the current balance at that time plus $500 (approximately).
- Dec. 2004: Credit-based pricing applied due to high balances on multiple credit card accounts, increasing rate from 24.99% to 29.49%. Customer did not opt-out of rate increase.
- May 2005: APR lowered from 29.49% to 9.99% due to on time payments as part of a test.
- Apr. 2008: Currently, there is no balance on account.

Summary:
- Default Pricing Actions: One
- Credit-based Pricing Actions: Three (customer chose not to opt-out of increase)
- Credit line Decreases: Three

3. **Account ending 1007**

Opened 8/13/2000.
- Mar: 2002: $13,639 balance on a $50,000 line with a contract rate of 14.99%. The majority of balances were at 5.99% and 7.99% promotional rates.
- July 2002: Balance transfer brings balance to $40,094 on line of $50,000. Credit line decreased from $50,000 to $40,200.
- Sept. 2002: Payment not made and account cycled delinquent.
- Oct: 2002: Payment was made but account remained one cycle past due.
- Nov. 2002: Default pricing action applied, increasing rate from 14.99% to 22.99%. Credit line decreased to $39,800.
- Oct. 2003: Payment not made and account cycled delinquent; no default pricing increase applied.
- May 2004: Credit line decreased from $39,800 to $27,250.
- Aug. 2004: Credit line decreased from $27,250 to $26,350.
- Nov. 2004: Payment was not made and account cycled delinquent; no default pricing increase applied.
- Jan. 2005: Credit-based pricing action applied due to high balances on multiple credit card accounts, increasing rate from 23.99% to 28.74%. Customer did not opt-out of rate increase.
- Oct. 2005: No balance on account
- Nov. 2005: Customer transfers balance of $6,000 to Chase card at 4.99% rate.
- Jan. 2006: Customer transfers balance of $10,000 to Chase card at 4.99% rate.
- Apr. 2008: Current balance of $4,599 on credit line of $26,350.

Summary:
- Default Pricing Actions: One
- Credit-based Pricing Actions: One (customer chose not to opt-out of increase)
- Credit line Decreases: Four

CHASE

In addition to these details, we would also like to respond to some specific points that Mr. Strachan made in the testimony that was provided to us on April 14, 2008.

- Mr. Strachan states that he was repriced because we lowered his credit line. This was not the case. He was repriced for being in default when he did not make a payment.
- Mr. Strachan asserts the reductions in his credit lines caused his credit utilization to increase, which in turn caused his FICO score to decline. While it is true that a line reduction can cause a FICO score to fall, what started the credit line reduction/credit-based repricing for Mr. Strachan was a rapid increase in credit card debt, late payments and reduced payments.
- Finally, Mr. Strachan states that we post payments late or not all. That is simply not the case.

We are happy to answer additional questions related to Mr. Strachan's account and the actions we took to manage the risk inherent in making open-ended, unsecured loans.

Thank you for the opportunity to respond.

Respectfully,

David P. Hogan

David P. Hogan
Senior Vice President
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United States Government Accountability Office

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Report to the Ranking Minority Member, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

September 2006

CREDIT CARDS

Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers

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Highlights

Highlights of GAO-06-929, a report to the Ranking Minority Member, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

With credit card penalty rates and fees now common, the Federal Reserve has begun efforts to revise disclosures to better inform consumers of these costs. Questions have also been raised about the relationship among penalty charges, consumer bankruptcies, and issuer profits. GAO examined (1) how card fees and other practices have evolved and how cardholders have been affected, (2) how effectively these pricing practices are disclosed to cardholders, (3) the extent to which penalty charges contribute to cardholder bankruptcies, and (4) card issuers' revenues and profitability. Among other things, GAO analyzed disclosures from popular cards; obtained data on rates and fees paid on cardholder accounts from 6 large issuers; employed a usability consultant to analyze and test disclosures; interviewed a sample of consumers selected to represent a range of education and income levels; and analyzed academic and regulatory studies on bankruptcy and card issuer revenues.

What GAO Recommends

As part of revising card disclosures, the Federal Reserve should ensure that such disclosure materials more clearly emphasize those terms that can significantly affect cardholder costs, such as the actions that can cause default or other penalty pricing rates to be imposed. The Federal Reserve generally concurred with the report.

www.gao.gov/cgi-bin/getrpt?GAO-06-929.

To view the full product, including the scope and methodology, click on the link above. For more information, contact David G. Wood at (202) 512-8678 or woodd@gao.gov.

September 2006

CREDIT CARDS

Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers

What GAO Found

Originally having fixed interest rates around 20 percent and few fees, popular credit cards now feature a variety of interest rates and other fees, including penalties for making late payments that have increased to as high as $39 per occurrence and interest rates of over 30 percent for cardholders who pay late or exceed a credit limit. Issuers explained that these practices represent risk-based pricing that allows them to offer cards with lower costs to less risky cardholders while providing cards to riskier consumers who might otherwise be unable to obtain such credit. Although costs can vary significantly, many cardholders now appear to have cards with lower interest rates than those offered in the past; data from the top six issuers reported to GAO indicate that, in 2005, about 80 percent of their accounts were assessed interest rates of less than 20 percent, with over 40 percent having rates below 15 percent. The issuers also reported that 35 percent of their active U.S. accounts were assessed late fees and 13 percent were assessed over-limit fees in 2005.

Although issuers must disclose information intended to help consumers compare card costs, disclosures by the largest issuers have various weaknesses that reduced consumers' ability to use and understand them. According to a usability expert's review, disclosures from the largest credit card issuers were often written well above the eighth-grade level at which about half of U.S. adults read. Contrary to usability and readability best practices, the disclosures buried important information in text, failed to group and label related material, and used small typefaces. Perhaps as a result, cardholders that the expert tested often had difficulty using the disclosures to find and understand key rates or terms applicable to the cards. Similarly, GAO's interviews with 112 cardholders indicated that many failed to understand key aspects of their cards, including when they would be charged for late payments or what actions could cause issuers to raise rates. These weaknesses may arise from issuers drafting disclosures to avoid lawsuits, and from federal regulations that highlight less relevant information and are not well suited for presenting the complex rates or terms that cards currently feature. Although the Federal Reserve has started to obtain consumer input, its staff recognizes the challenge of designing disclosures that include all key information in a clear manner.

Although penalty charges reduce the funds available to repay cardholders' debts, their role in contributing to bankruptcies was not clear. The six largest issuers reported that unpaid interest and fees represented about 10 percent of the balances owed by bankrupt cardholders, but were unable to provide data on penalty charges these cardholders paid prior to filing for bankruptcy. Although revenues from penalty interest and fees have increased, profits of the largest issuers have been stable in recent years. GAO analysis indicates that while the majority of issuer revenues came from interest charges, the portion attributable to penalty rates has grown.

Contents

Abbreviations

APR	Annual Percentage Rate
FDIC	Federal Deposit Insurance Corporation
OCC	Office of the Comptroller of the Currency
ROA	Return on assets
SEC	Securities and Exchange Commission
TILA	Truth in Lending Act

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United States Government Accountability Office
Washington, D.C. 20548

September 12, 2006

The Honorable Carl Levin
Ranking Minority Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate

Dear Senator Levin:

Over the past 25 years, the prevalence and use of credit cards in the United States has grown dramatically. Between 1980 and 2005, the amount that U.S. consumers charged to their cards grew from an estimated $69 billion per year to more than $1.8 trillion, according to one firm that analyzes the card industry.[1] This firm also reports that the number of U.S. credit cards issued to consumers now exceeds 691 million. The increased use of credit cards has contributed to an expansion in household debt, which grew from $59 billion in 1980 to roughly $830 billion by the end of 2005.[2] The Board of Governors of the Federal Reserve System (Federal Reserve) estimates that in 2004, the average American household owed about $2,200 in credit card debt, up from about $1,000 in 1992.[3]

Generally, a consumer's cost of using a credit card is determined by the terms and conditions applicable to the card—such as the interest rate(s), minimum payment amounts, and payment schedules, which are typically presented in a written cardmember agreement—and how a consumer uses

[1] CardWeb.com, Inc., an online publisher of information about the payment card industry.

[2] Based on data from the Federal Reserve Board's monthly G.19 release on consumer credit. In addition to credit card debt, the Federal Reserve also categorizes overdraft lines of credit as revolving consumer debt (an overdraft line of credit is a loan a consumer obtains from a bank to cover the amount of potential overdrafts or withdrawals from a checking account in amounts greater than the balance available in the account). Mortgage debt is not captured in these data.

[3] B.K. Bucks, A.B. Kennickell, and K.B. Moore, "Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances," *Federal Reserve Bulletin*, March 22, 2006. Also, A.B. Kennickell and M. Starr-McCluer, "Changes in Family Finances from 1989 to 1992: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin*, October 1994. Adjusted for inflation, credit card debt in 1992 was $1,298 for the average American household.

a card.[4] The Federal Reserve, under the Truth in Lending Act (TILA), is responsible for creating and enforcing requirements relating to the disclosure of terms and conditions of consumer credit, including those applicable to credit cards.[5] The regulation that implements TILA's requirements is the Federal Reserve's Regulation Z.[6] As credit card use and debt have grown, representatives of consumer groups and issuers have questioned the extent to which consumers understand their credit card terms and conditions, including issuers' practices that—even if permitted under applicable terms and conditions—could increase consumers' costs of using credit cards. These practices include the application of fees or relatively high penalty interest rates if cardholders pay late or exceed credit limits. Issuers also can allocate customers' payments among different components of their outstanding balances in ways that maximize total interest charges. Although card issuers have argued that these practices are appropriate because they compensate for the greater risks posed by cardholders who make late payments or exhibit other risky behaviors, consumer groups say that the fees and practices are harmful to the financial condition of many cardholders and that card issuers use them to generate profits.

You requested that we review a number of issues related to credit card fees and practices, specifically of the largest issuers of credit cards in the United States. This report discusses (1) how the interest, fees, and other practices that affect the pricing structure of cards from the largest U.S. issuers have evolved and cardholders' experiences under these pricing structures in recent years; (2) how effectively the issuers disclose the pricing structures of cards to their cardholders (3) whether credit card debt and penalty interest and fees contribute to cardholder bankruptcies; and (4) the extent to which penalty interest and fees contribute to the revenues and profitability of issuers' credit card operations.

To identify the pricing structures of cards—including their interest rates, fees, and other practices—we analyzed the cardmember agreements, as

[4]We recently reported on minimum payment disclosure requirements. See GAO, *Credit Cards: Customized Minimum Payment Disclosures Would Provide More Information to Consumers, but Impact Could Vary*, GAO-06-434 (Washington, D.C.: Apr. 21, 2006).

[5]Pub. L. No. 90-321, Title I, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. §§ 1601-1666).

[6]Regulation Z is codified at 12 C.F.R. Part 226.

well as materials used by the six largest issuers as of December 31, 2004, for 28 popular cards used to solicit new credit card customers from 2003 through 2005.[7] To determine the extent to which these issuers' cardholders were assessed interest and fees, we obtained data from each of the six largest issuers about their cardholder accounts and their operations. To protect each issuer's proprietary information, a third-party organization, engaged by counsel to the issuers, aggregated these data and then provided the results to us. Although the six largest issuers whose accounts were included in this survey and whose cards we reviewed may include some subprime accounts, we did not include information in this report relating to cards offered by credit card issuers that engage primarily in subprime lending.[8] To assess the effectiveness of the disclosures that issuers provide to cardholders in terms of their usability or readability, we contracted with a consulting firm that specializes in assessing the readability and usability of written and other materials to analyze a representative selection of the largest issuers' cardmember agreements and solicitation materials, including direct mail applications and letters, used for opening an account (in total, the solicitation materials for four cards and cardmember agreements for the same four cards).[9] The consulting firm compared these materials to recognized industry guidelines for readability and presentation and conducted testing to assess how well cardholders could use the materials to identify and understand information about these credit cards. While the materials used for the readability and usability assessments appeared to be typical of the large issuers' disclosures, the results cannot be generalized to materials that were not reviewed. We also conducted structured interviews to learn about the card-using behavior and knowledge of various credit card terms and conditions of 112 consumers recruited by a market research organization to represent a range of adult income and education levels. However, our sample of cardholders was too

[7]These issuers' accounts constitute almost 80 percent of credit card lending in the United States. Participating issuers were Citibank (South Dakota), N.A.; Chase Bank USA, N.A.; Bank of America; MBNA America Bank, N.A.; Capital One Bank; and Discover Financial Services. In providing us with materials for the most popular credit cards, these issuers determined which of their cards qualified as popular among all cards in their portfolios.

[8]Subprime lending generally refers to extending credit to borrowers who exhibit characteristics indicating a significantly higher risk of default than traditional bank lending customers. Such issuers could have pricing structures and other terms significantly different from those of the popular cards offered by the top issuers.

[9]Regulation Z defines a "solicitation" as an offer (written or oral) by the card issuer to open a credit or charge card account that does not require the consumer to complete an application. 12 C.F.R. § 226.5a(a)(1).

small to be statistically representative of all cardholders, thus the results of our interviews cannot be generalized to the population of all U.S. cardholders. We also reviewed comment letters submitted to the Federal Reserve in response to its comprehensive review of Regulation Z's open-end credit rules, including rules pertaining to credit card disclosures.[10] To determine the extent to which credit card debt and penalty interest and fees contributed to cardholder bankruptcies, we analyzed studies, reports, and bank regulatory data relating to credit card debt and consumer bankruptcies, as well as information reported to us as part of the data request to the six largest issuers. To determine the extent to which penalty interest and fees contributes to card issuers' revenues and profitability, we analyzed publicly available sources of revenue and profitability data for card issuers, including information included in reports filed with the Securities and Exchange Commission and bank regulatory reports, in addition to information reported to us as part of the data request to the six largest issuers.[11] In addition, we spoke with representatives of other U.S. banks that are large credit card issuers, as well as representatives of consumer groups, industry associations, academics, organizations that collect and analyze information on the credit card industry, and federal banking regulators. We also reviewed research reports and academic studies of the credit card industry.

We conducted our work from June 2005 to September 2006 in Boston; Chicago; Charlotte, North Carolina; New York City; San Francisco; Wilmington, Delaware; and Washington, D.C., in accordance with generally accepted government auditing standards. Appendix I describes the objectives, scope, and methodology of our review in more detail.

Results in Brief

Since about 1990, the pricing structures of credit cards have evolved to encompass a greater variety of interest rates and fees that can increase

[10] See Truth in Lending, 69 Fed. Reg. 70925 (advanced notice of proposed rulemaking, published Dec. 8, 2004). "Open-end credit" means consumer credit extended by a creditor under a plan in which: (i) the creditor reasonably contemplates repeated transactions, (ii) the creditor may impose a finance charge from time to time on an outstanding unpaid balance and (iii) the amount of credit that may be extended to the consumer is generally made available to the extent that any outstanding balance is repaid. 12 C.F.R. § 226.2(a)(20).

[11] Although we had previously been provided comprehensive data from Visa International on credit industry revenues and profits for a past report on credit card issues, we were unable to obtain these data for this report.

cardholder's costs; however, cardholders generally are assessed lower interest rates than those that prevailed in the past, and most have not been assessed penalty fees. For many years after being introduced, credit cards generally charged fixed single rates of interest of around 20 percent, had few fees, and were offered only to consumers with high credit standing. After 1990, card issuers began to introduce cards with a greater variety of interest rates and fees, and the amounts that cardholders can be charged have been growing. For example, our analysis of 28 popular cards and other information indicates that cardholders could be charged

- up to three different interest rates for different transactions, such as one rate for purchases and another for cash advances, with rates for purchases that ranged from about 8 percent to about 19 percent;

- penalty fees for certain cardholder actions, such as making a late payment (an average of almost $34 in 2005, up from an average of about $13 in 1995) or exceeding a credit limit (an average of about $31 in 2005, up from about $13 in 1995); and

- a higher interest rate—some charging over 30 percent—as a penalty for exhibiting riskier behavior, such as paying late.

Although cousumer groups and others have criticized these fees and other practices, issuers point out that the costs to use a card can now vary according to the risk posed by the cardholder, which allows issuers to offer credit with lower costs to less-risky cardholders and credit to consumers with lower credit standing, who likely would have not have received a credit card in the past. Although cardholder costs can vary significantly in this new environment, many cardholders now appear to have cards with interest rates less than the 20 percent rate that most cards charged prior to 1990. Data reported by the top six issuers indicate that, in 2005, about 80 percent of their active U.S. accounts were assessed interest rates of less than 20 percent—with more than 40 percent having rates of 15 percent or less.[12] Furthermore, almost half of the active accounts paid little or no interest because the cardholder generally paid the balance in full. The issuers also reported that, in 2005, 35 percent of their active U.S. accounts were assessed late fees and 13 percent were assessed over-limit fees.

[12]For purposes of this report, active accounts refer to accounts of the top six issuers that had had a debit or credit posted to them by December 31 in 2003, 2004, and 2005.

Although credit card issuers are required to provide cardholders with information aimed at facilitating informed use of credit and enhancing consumers' ability to compare the costs and terms of credit, we found that these disclosures have serious weaknesses that likely reduced consumers' ability to understand the costs of using credit cards. Because the pricing of credit cards, including interest rates and fees, is not generally subject to federal regulation, the disclosures required under TILA and Regulation Z are the primary means under federal law for protecting consumers against inaccurate and unfair credit card practices.[13] However, the assessment by our usability consultant found that the disclosures in the customer solicitation materials and cardmember agreements provided by four of the largest credit card issuers were too complicated for many consumers to understand. For example, although about half of adults in the United States read at or below the eighth-grade level, most of the credit card materials were written at a tenth- to twelfth-grade level. In addition, the required disclosures often were poorly organized, burying important information in text or scattering information about a single topic in numerous places. The design of the disclosures often made them hard to read, with large amounts of text in small, condensed typefaces and poor, ineffective headings to distinguish important topics from the surrounding text. Perhaps as a result of these weaknesses, the cardholders tested by the consultant often had difficulty using these disclosures to locate and understand key rates or terms applicable to the cards. Similarly, our interviews with 112 cardholders indicated that many failed to understand key terms or conditions that could affect their costs, including when they would be charged for late payments or what actions could cause issuers to raise rates. The disclosure materials that consumers found so difficult to use resulted from issuers' attempts to reduce regulatory and liability exposure by adhering to the formats and language prescribed by federal law and regulations, which no longer suit the complex features and terms of many cards. For example, current disclosures require that less important terms, such as minimum finance charge or balance computation method, be prominently disclosed, whereas information that could more significantly affect consumers' costs, such as the actions that could raise their interest rate, are not as prominently disclosed. With the goal of improving credit card disclosures, the Federal Reserve has begun obtaining public and industry input as part of a comprehensive review of Regulation Z. Industry participants and others have provided various suggestions to improve

[13]TILA also contains procedural and substantive protections for consumers for credit card transactions.

disclosures, such as placing all key terms in one brief document and other details in a much longer separate document, and both our work and that of others illustrated that involving consultants and consumers can help develop disclosure materials that are more likely to be effective. Federal Reserve staff told us that they have begun to involve consumers in the preparation of potentially new and revised disclosures. Nonetheless, Federal Reserve staff recognize the challenge of presenting the variety of information that consumers may need to understand the costs of their cards in a clear way, given the complexity of credit card products and the different ways in which consumers use credit cards.

Although paying penalty interest and fees can slow cardholders' attempts to reduce their debt, the extent to which credit card penalty fees and interest have contributed to consumer bankruptcies is unclear. The number of consumers filing for bankruptcy has risen more than sixfold over the past 25 years—a period when the nation's population grew by 29 percent—to more than 2 million filings in 2005, but debate continues over the reasons for this increase. Some researchers attribute the rise in bankruptcies to the significant increase in household debt levels that also occurred over this period, including the dramatic increase in outstanding credit card debt. However, others have found that relatively steady household debt burden ratios over the last 15 years indicate that the ability of households to make payments on this expanded indebtedness has kept pace with growth in their incomes. Similarly, the percentage of households that appear to be in financial distress—those with debt payments that exceed 40 percent of their income—did not change much during this period, nor did the proportion of lower-income households with credit card balances. Because debt levels alone did not appear to clearly explain the rise in bankruptcies, some researchers instead cited other explanations, such as a general decline in the stigma associated with bankruptcies or the increased costs of major life events—such as health problems or divorce—to households that increasingly rely on two incomes. Although critics of the credit card industry have cited the emergence of penalty interest rates and growth in fees as leading to increased financial distress, no comprehensive data exist to determine the extent to which these charges contributed to consumer bankruptcies. Any penalty charges that cardholders pay would consume funds that could have been used to repay principal, and we obtained anecdotal information on a few court cases involving consumers who incurred sizable penalty charges that contributed to their financial distress. However, credit card issuers said that they have little incentive to cause their customers to go bankrupt. The six largest issuers reported to us that of their active accounts in 2005 pertaining to cardholders who had filed for bankruptcy before their account became 6 months delinquent, about 10 percent of the outstanding balances on those accounts represented unpaid interest and fees. However, issuers told us that their data system and recordkeeping limitations prevented them from providing us with data that would more completely illustrate a relationship between penalty charges and bankruptcies, such as the amount of penalty charges that bankrupt cardholders paid in the months prior to filing for bankruptcy or the amount of penalty charges owed by cardholders who went bankrupt after their accounts became more than 6 months delinquent.

Although penalty interest and fees have likely increased as a portion of issuer revenues, the largest issuers have not experienced greatly increased profitability over the last 20 years. Determining the extent to which penalty interest charges and fees contribute to issuers' revenues and profits was difficult because issuers' regulatory filings and other public sources do not include such detail. Using data from bank regulators, industry analysts, and information reported by the five largest issuers, we estimate that the majority—about 70 percent in recent years—of issuer revenues came from interest charges, and the portion attributable to penalty rates appears to have been growing. The remaining issuer revenues came from penalty fees—which had generally grown and were estimated to represent around 10 percent of total issuer revenues—as well as fees that issuers receive for processing merchants' card transactions and other sources. The profits of the largest credit-card-issuing banks, which are generally the most profitable group of lenders, have generally been stable over the last 7 years.

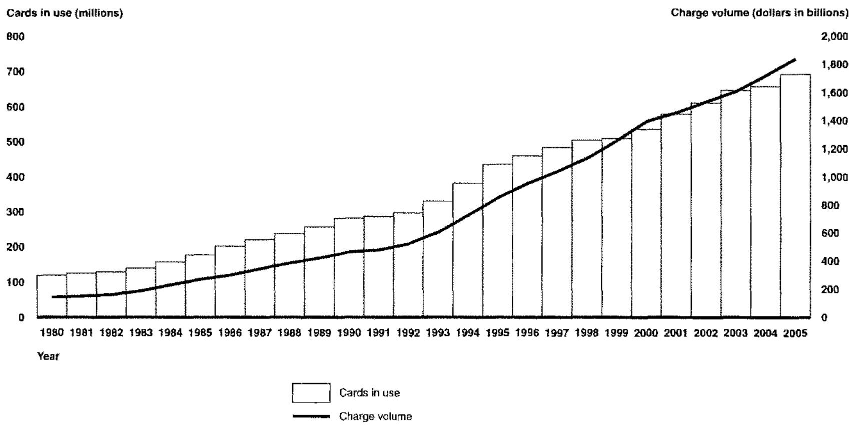
This report recommends that, as part of its effort to increase the effectiveness of disclosure materials, the Federal Reserve should ensure that such disclosures, including model forms and formatting requirements, more clearly emphasize those terms that can significantly affect cardholder costs, such as the actions that can cause default or other penalty pricing rates to be imposed. We provided a draft of this report to the Federal Reserve, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Federal Trade Commission, the National Credit Union Administration, and the Office of Thrift Supervision for comment. In its written comments, the Federal Reserve agreed that curreut credit card pricing structures have added to the complexity of card disclosures and indicated that it is studying alternatives for improving both the content and format of disclosures, including involving consumer testing and design consultants.

Background

Credit card use has grown dramatically since the introduction of cards more than 5 decades ago. Cards were first introduced in 1950, when Diners Club established the first general-purpose charge card that allowed its cardholders to purchase goods and services from many different merchants. In the late 1950s, Bank of America began offering the first widely available general purpose credit card, which, unlike a charge card that requires the balance to be paid in full each month, allows a cardholder to make purchases up to a credit limit and pay the balance off over time. To increase the number of consumers carrying the card and to reach retailers outside of Bank of America's area of operation, other banks were given the opportunity to license Bank of America's credit card. As the network of banks issuing these credit cards expanded internationally, administrative operations were spun off into a separate entity that evolved into the Visa network. In contrast to credit cards, debit cards result in funds being withdrawn almost immediately from consumers' bank accounts (as if they had a written a check instead). According to CardWeb.com, Inc., a firm that collects and analyzes data relating to the credit card industry, the number of times per month that credit or debit cards were used for purchases or other transactions exceeded 2.3 billion in May 2003, the last month for which the firm reported this data.

The number of credit cards in circulation and the extent to which they are used has also grown dramatically. The range of goods and services that can be purchased with credit cards has expanded, with cards now being used to pay for groceries, health care, and federal and state income taxes. As shown in figure 1, in 2005, consumers held more than 691 million credit cards and the total value of transactions for which these cards were used exceeded $1.8 trillion.

Figure 1: Credit Cards in Use and Charge Volume, 1980-2005



Source GAO analysis of CardWeb.com, Inc data

The largest issuers of credit cards in the United States are commercial banks, including many of the largest banks in the country. More than 6,000 depository institutions issue credit cards, but, over the past decade, the majority of accounts have become increasingly concentrated among a small number of large issuers. Figure 2 shows the largest bank issuers of credit cards by their total credit card balances outstanding as of December 31, 2004 (the most recent data available) and the proportion they represent of the overall total of card balances outstanding.

Figure 2: The 10 Largest Credit Card Issuers by Credit Card Balances Outstanding as of December 31, 2004

Card issuer	Outstanding receivables	Percent of total market
Citigroup Inc.	$139,600,000,000	20.2
Chase Card Services	135,370,000,000	19.5
MBNA America	101,900,000,000	14.7
Bank of America	58,629,000,000	8.5
Capital One Financial Corp.	48,609,571,000	7.0
Discover Financial Services, Inc.	48,261,000,000	7.0
American Express Centurion Bank	39,600,000,000	5.7
HSBC Credit Card Services	19,670,000,000	2.8
Providian Financial Corp.	18,100,000,000	2.6
Wells Fargo	13,479,889,059	1.9
	$623,219,460,059	**90.0**

Source: GAO analysis of Card Industry Directory data.

TILA is the primary federal law pertaining to the extension of consumer credit. Congress passed TILA in 1968 to provide for meaningful disclosure of credit terms in order to enable consumers to more easily compare the various credit terms available in the marketplace, to avoid the uninformed use of credit, and to protect themselves against inaccurate and unfair credit billing and credit card practices. The regulation that implements TILA's requirements is Regulation Z, which is administered by the Federal Reserve.

Under Regulation Z, card issuers are required to disclose the terms and conditions to potential and existing cardholders at various times. When first marketing a card directly to prospective cardholders, written or oral applications or solicitations to open credit card accounts must generally disclose key information relevant to the costs of using the card, including the applicable interest rate that will be assessed on any outstanding balances and several key fees or other charges that may apply, such as the fee for making a late payment.[14] In addition, issuers must provide consumers with an initial disclosure statement, which is usually a component of the issuer's cardmember agreement, before the first transaction is made with a card. The cardmember agreement provides more comprehensive information about a card's terms and conditions than would be provided as part of the application or a solicitation letter.

In some cases, the laws of individual states also can affect card issuers' operations. For example, although many credit card agreements permit issuers to make unilateral changes to the agreement's terms and conditions, some state laws require that consumers be given the right to opt out of changes. However, as a result of the National Bank Act, and its interpretation by the U.S. Supreme Court, the interest and fees charged by a national bank on credit card accounts is subject only to the laws of the state in which the bank is chartered, even if its lending activities occur outside of its charter state.[15] As a result, the largest banks have located their credit card operations in states with laws seen as more favorable for the issuer with respect to credit card lending.

Various federal agencies oversee credit card issuers. The Federal Reserve has responsibility for overseeing issuers that are chartered as state banks and are also members of the Federal Reserve System. Many card issuers are chartered as national banks, which OCC supervises. Other regulators of bank issuers are FDIC, which oversees state-chartered banks with federally insured deposits that are not members of the Federal Reserve System; the Office of Thrift Supervision, which oversees federally chartered and state-chartered savings associations with federally insured deposits; or the

[14]Issuers have several disclosure options with respect to applications or solicitations made available to the general public, including those contained in catalogs or magazines. Specifically, on such applications or solicitations issuers may, but are not required to, disclose the same key pricing terms required to be disclosed on direct mail applications and solicitations. Alternatively, issuers may include in a prominent location on the application or solicitation a statement that costs are associated with use of the card and a toll-free telephone number and mailing address where the consumer may contact the issuer to request specific information. 12 C.F.R. § 226.5a(e)(3).

[15]The National Bank Act provision codified at 12 U.S.C. § 85 permits national banks to charge interest at a rate allowed by laws of the jurisdiction in which the bank is located. In *Marquette National Bank v. First of Omaha Service Corp. et al.*, 439 U.S. 299 (1978), the U.S. Supreme Court held that a national bank is deemed to be "located" in the state in which it is chartered. *See also Smiley v. Citibank (South Dakota)*, N.A., 517 U.S. 735 (1996) (holding that "interest" under 12 U.S.C. § 85 includes any charges attendant to credit card usage).

National Credit Union Administration, which oversees federally-chartered and state-chartered credit unions whose member accounts are federally insured. As part of their oversight, these regulators review card issuers' compliance with TILA and ensure that an institution's credit card operations do not pose a threat to the institutions' safety and soundness. The Federal Trade Commission generally has responsibility for enforcing TILA and other consumer protection laws for credit card issuers that are not depository institutions.

Credit Card Fees and Issuer Practices That Can Increase Cardholder Costs Have Expanded, but a Minority of Cardholders Appear to Be Affected

Prior to about 1990, card issuers offered credit cards that featured an annual fee, a relatively high, fixed interest rate, and low penalty fees, compared with average rates and fees assessed in 2005. Over the past 15 years, typical credit cards offered by the largest U.S. issuers evolved to feature more complex pricing structures, including multiple interest rates that vary with market fluctuations. The largest issuers also increased the number, and in some cases substantially increased the amounts, of fees assessed on cardholders for violations of the terms of their credit agreement, such as making a late payment. Issuers said that these changes have benefited a greater number of cardholders, whereas critics contended that some practices unfairly increased cardholder costs. The largest six issuers provided data indicating that most of their cardholders had interest rates on their cards that were lower than the single fixed rates that prevailed on cards prior to the 1990s and that a small proportion of cardholders paid high penalty interest rates in 2005. In addition, although most cardholders did not appear to be paying penalty fees, about one-third of the accounts with these largest issuers paid at least one late fee in 2005.

Issuers Have Developed More Complex Credit Card Pricing Structures

The interest rates, fees, and other practices that represent the pricing structure for credit cards have become more complex since the early 1990s. After first being introduced in the 1950s, for the next several decades, credit cards commonly charged a single fixed interest rate around 20 percent—as the annual percentage rate (APR)—which covered most of an issuer's expenses associated with card use.[16] Issuers also charged cardholders an annual fee, which was typically between $20 and $50

[16]Unless otherwise noted, in this report we will use the term "interest rate" to describe annual percentage rates, which represent the rates expressed on an annual basis even though interest may be assessed more frequently.

beginning in about 1980, according to a senior economist at the Federal Reserve Board. Card issuers generally offered these credit cards only to the most creditworthy U.S. consumers. According to a study of credit card pricing done by a member of the staff of one of the Federal Reserve Banks, few issuers in the late 1980s and early 1990s charged cardholders fees as penalties if they made late payments or exceeded the credit limit set by the issuer.[17] Furthermore, these fees, when they were assessed, were relatively small. For example, the Federal Reserve Bank staff member's paper notes that the typical late fee charged on cards in the 1980s ranged from $5 to $10.

Multiple Interest Rates May Apply to a Single Account and May Change Based on Market Fluctuations

After generally charging just a single fixed interest rate before 1990, the largest issuers now apply multiple interest rates to a single card account balance and the level of these rates can vary depending on the type of transaction in which a cardholder engages. To identify recent pricing trends for credit cards, we analyzed the disclosures made to prospective and existing cardholders for 28 popular credit cards offered during 2003, 2004, and 2005 by the six largest issuers (based on credit card balances outstanding at the end of 2004).[18] At that time, these issuers held almost 80 percent of consumer debt owed to credit card issuers and as much as 61 percent of total U.S. credit card accounts. As a result, our analysis of these 28 cards likely describes the card pricing structure and terms that apply to the majority of U.S. cardholders. However, our sample of cards did not include subprime cards, which typically have higher cost structures to compensate for the higher risks posed by subprime borrowers.

We found that all but one of these popular cards assessed up to three different interest rates on a cardholder's balance. For example, cards assessed separate rates on

- balances that resulted from the purchase or lease of goods and services, such as food, clothing, and home appliances;

[17] M. Furletti, "Credit Card Pricing Developments and Their Disclosure," Federal Reserve Bank of Philadelphia's Payment Cards Center, January 2003. In preparing this paper, the author relied on public data, proprietary issuer data, and data from a review of more than 150 cardmember agreements from 15 of the largest issuers in the United States for the 5-year period spanning 1997 to 2002.

[18] See *Card Industry Directory: The Blue Book of the Credit and Debit Card Industry in North America*, 17th Edition, (Chicago, IL: 2005). These issuers were Bank of America, Capital One Bank; Chase Bank USA: Citibank (South Dakota), N.A.; Discover Financial Services; and MBNA America Bank.

- balances that were transferred from another credit card, which cardholders may do to consolidate balances across cards to take advantage of lower interest rates; and

- balances that resulted from using the card to obtain cash, such as a withdrawal from a bank automated teller machine.

In addition to having separate rates for different transactions, popular credit cards increasingly have interest rates that vary periodically as market interest rates change. Almost all of the cards we analyzed charged variable rates, with the number of cards assessing these rates having increased over the most recent 3-year period. More specifically, about 84 percent of cards we reviewed (16 of 19 cards) assessed a variable interest rate in 2003, 91 percent (21 of 23 cards) in 2004, and 93 percent (25 of 27 cards) in 2005.[19] Issuers typically determine these variable rates by taking the prevailing level of a base rate, such as the prime rate, and adding a fixed percentage amount.[20] In addition, the issuers usually reset the interest rates on a monthly basis.

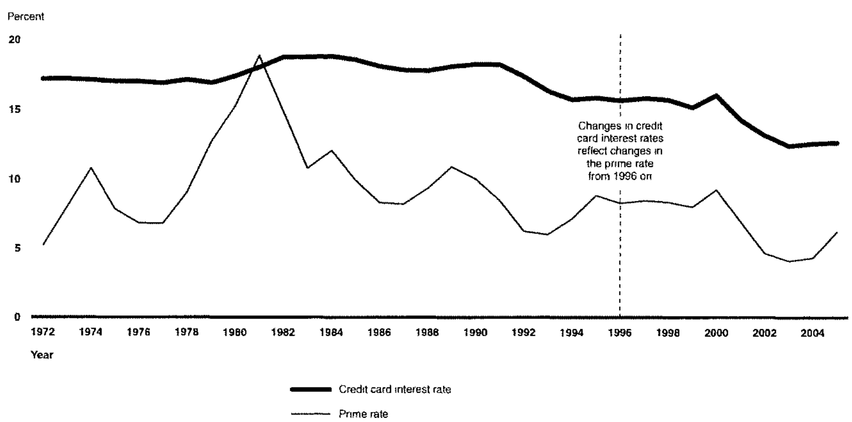
Issuers appear to have assessed lower interest rates in recent years than they did prior to about 1990. Issuer representatives noted that issuers used to generally offer cards with a single rate of around 20 percent to their cardholders, and the average credit card rates reported by the Federal Reserve were generally around 18 percent between 1972 and 1990. According to the survey of credit card plans, conducted every 6 months by the Federal Reserve, more than 100 card issuers indicated that these issuers charged interest rates between 12 and 15 percent on average from 2001 to 2005. For the 28 popular cards we reviewed, the average interest rate that would be assessed for purchases was 12.3 percent in 2005, almost 6 percentage points lower than the average rates that prevailed until about 1990. We found that the range of rates charged on these cards was between about 8 and 19 percent in 2005. The average rate on these cards climbed slightly during this period, having averaged about 11.5 percent in 2003 and about 12 percent in 2004, largely reflecting the general upward movement

[19]Although we reviewed a total of 28 card products for 2003 to 2005, we did not obtain disclosure documents for all card products for every year.

[20]The prime rate is the rate that commercial banks charge to the most creditworthy borrowers, such as large corporations for short-term loans. The prime rate reported by *The Wall Street Journal* is often used as a benchmark for credit card loans made in the United States.

in prime rates. Figure 3 shows the general decline in credit card interest rates, as reported by the Federal Reserve, between about 1991 and 2005 compared with the prime rate over this time. As these data show, credit card interest rates generally were stable regardless of the level of market interest rates until around 1996, at which time changes in credit card rates approximated changes in market interest rates. In addition, the spread between the prime rate and credit card rates was generally wider in the period before the 1980s than it has been since 1990, which indicates that since then cardholders are paying lower rates in terms of other market rates.

Figure 3: Credit Card Interest Rates, 1972-2005



Source: GAO analysis of Federal Reserve data

Recently, many issuers have attempted to obtain new customers by offering low, even zero, introductory interest rates for limited periods. According to an issuer representative and industry analyst we interviewed, low introductory interest rates have been necessary to attract cardholders in the current competitive environment where most consumers who qualify for a credit card already have at least one. Of the 28 popular cards that we analyzed, 7 cards (37 percent) offered prospective cardholders a low introductory rate in 2003, but 20 (74 percent) did so in 2005—with most rates set at zero for about 8 months. According to an analyst who studies the credit card industry for large investors, approximately 25 percent of all purchases are made with cards offering a zero percent interest rate.

Increased competition among issuers, which can be attributed to several factors, likely caused the reductions in credit card interest rates. In the early 1990s, new banks whose operations were solely focused on credit cards entered the market, according to issuer representatives. Known as monoline banks, issuer representatives told us these institutions competed for cardholders by offering lower interest rates and rewards, and expanded the availability of credit to a much larger segment of the population. Also, in 1988, new requirements were implemented for credit card disclosures that were intended to help consumers better compare pricing information on credit cards. These new requirements mandated that card issuers use a tabular format to provide information to consumers about interest rates and some fees on solicitations and applications mailed to consumers. According to issuers, consumer groups, and others, this format, which is popularly known as the Schumer box, has helped to significantly increase consumer awareness of credit card costs.[21] According to a study authored by a staff member of a Federal Reserve Bank, consumer awareness of credit card interest rates has prompted more cardholders to transfer card balances from one issuer to another, further increasing competition among issuers.[22] However, another study prepared by the Federal Reserve Board also attributes declines in credit card interest rates to a sharp drop in issuers' cost of funds, which is the price issuers pay other lenders to obtain the funds that are then lent to cardholders.[23] (We discuss issuers' cost of funds later in this report.)

[21]The Schumer box is the result of the Fair Credit and Charge Card Disclosure Act, Pub. L. No. 100-583, 102 Stat. 2960 (1988), which amended TILA to provide for more detailed and uniform disclosures of rates and other cost information in applications and solicitations to open credit and charge card accounts. The act also required issuers to disclose pricing information, to the extent practicable as determined by the Federal Reserve, in a tabular format. This table is also known as the Schumer box, named for the Congressman that introduced the provision requiring this disclosure into the legislation.

[22]Furletti, "Credit Card Pricing Developments and Their Disclosure."

[23]Board of Governors of the Federal Reserve System, *The Profitability of Credit Card Operations of Depository Institutions*, (Washington, D.C.: June 2005).

Our analysis of disclosures also found that the rates applicable to balance transfers were generally the same as those assessed for purchases, but the rates for cash advances were often higher. Of the popular cards offered by the largest issuers, nearly all featured rates for balance transfers that were substantially similar to their purchase rates, with many also offering low introductory rates on balance transfers for about 8 months. However, the rates these cards assessed for obtaining a cash advance were around 20 percent on average. Similarly to rates for purchases, the rates for cash advances on most cards were also variable rates that would change periodically with market interest rates.

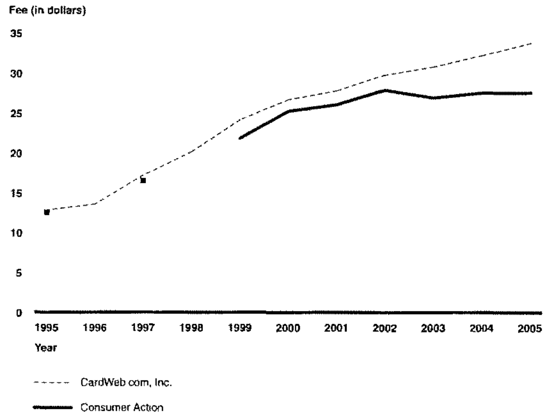
Credit Cards Increasingly Have Assessed Higher Penalty Fees

Although featuring lower interest rates than in earlier decades, 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. One penalty fee, commonly included as part of credit card terms, is the late fee, which issuers assess when they do not receive at least the minimum required payment by the due date indicated in a cardholder's monthly billing statement. As noted earlier, prior to 1990, the level of late fees on cards generally ranged from \$5 to \$10. However, late fees have risen significantly. According to data reported by CardWeb.com, Inc., credit card late fees rose from an average of \$12.83 in 1995 to \$33.64 in 2005, an increase of over 160 percent. Adjusted for inflation, these fees increased about 115 percent on average, from \$15.61 in 1995 to \$33.64 in 2005.[24] Similarly, Consumer Action, a consumer interest group that conducts an annual survey of credit card costs, found late fees rose from an average of \$12.53 in 1995 to \$27.46 in 2005, a 119 percent increase (or 80 percent after adjusting for inflation).[25] Figure 4 shows trends in average late fee assessments reported by these two groups.

[24]Dollar values adjusted using the Gross Domestic Product (GDP) deflator, with 2005 as the base year.

[25]Consumer Action analyzed more than 100 card products offered by more than 40 issuers in each year they conducted the survey, except in 1995, when 71 card products were included.

Figure 4: Average Annual Late Fees Reported from Issuer Surveys, 1995-2005 (unadjusted for inflation)



Source: GAO analysis of Consumer Action Credit Card Survey, CardWeb.com, Inc

Notes: Consumer Action data did not report values for 1996 and 1998.

CardWeb.com, Inc. data are for financial institutions with more than $100 million in outstanding receivables.

In addition to increased fees a cardholder may be charged per occurrence, many cards created tiered pricing that depends on the balance held by the cardholder.[26] Between 2003 and 2005, all but 4 of the 28 popular cards that we analyzed used a tiered fee structure. Generally, these cards included three tiers, with the following range of fees for each tier:

- $15 to $19 on accounts with balances of $100 or $250;
- $25 to $29 on accounts with balances up to about $1,000; and

[26]Based on our analysis of the Consumer Action survey data, issuers likely began introducing tiered late fees in 2002.

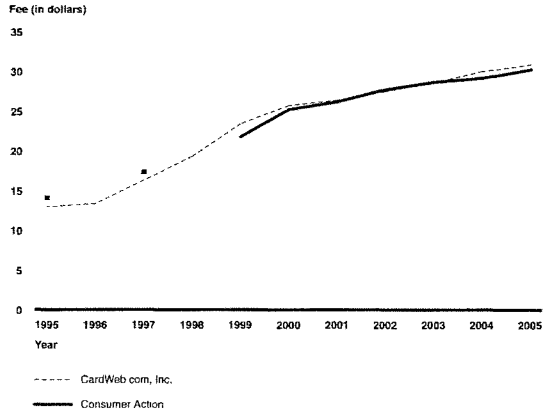
- $34 to $39 on accounts with balances of about $1,000 or more.

Tiered pricing can prevent issuers from assessing high fees to cardholders with comparatively small balances. However, data from the Federal Reserve's Survey of Consumer Finances, which is conducted every 3 years, show that the median total household outstanding balance on U.S. credit cards was about $2,200 in 2004 among those that carried balances. When we calculated the late fees that would be assessed on holders of the 28 cards if they had the entire median balance on one card, the average late fee increased from $34 in 2003 to $37 in 2005, with 18 of the cards assessing the highest fee of $39 in 2005.

Issuers also assess cardholders a penalty fee for exceeding the credit limit set by the issuer. In general, issuers assess over-limit fees when a cardholder exceeds the credit limit set by the card issuer. Similar to late fees, over-limit fees also have been rising and increasingly involve a tiered structure. According to data reported by CardWeb.com, Inc., the average over-limit fees that issuers assessed increased 138 percent from $12.95 in 1995 to $30.81 in 2005. Adjusted for inflation, average over-limit fees reported by CardWeb.com increased from $15.77 in 1995 to $30.81 in 2005, representing about a 95 percent increase.[27] Similarly, Consumer Action found a 114 percent increase in this period (or 76 percent, after adjusting for inflation). Figure 5 illustrates the trend in average over-limit fees over the past 10 years from these two surveys.

[27]Dollar values adjusted using the Gross Domestic Product (GDP) deflator, with 2005 as the base year.

Figure 5: Average Annual Over-limit fees Reported from Issuer Surveys, 1995-2005 (unadjusted for inflation)



Source: GAO analysis of Consumer Action Credit Card Survey, CardWeb.com, Inc.

Notes: Consumer Action did not report values for 1996 and 1998.

CardWeb.com, Inc. data are for financial institutions with more than $100 million in outstanding receivables.

The cards we analyzed also increasingly featured tiered structures for over-limit fees, with 29 percent (5 of 17 cards) having such structures in 2003, and 53 percent (10 of 19 cards) in 2005. Most cards that featured tiered over-limit fees assessed the highest fee on accounts with balances greater than $1,000. But not all over-limit tiers were based on the amount of the cardholder's outstanding balance. Some cards based the amount of the over-limit fee on other indicators, such as the amount of the cardholder's credit limit or card type. For the six largest issuers' popular cards with over-limit fees, the average fee that would be assessed on accounts that carried the median U.S. household credit card balance of $2,200 rose from $32 in 2003 to $34 in 2005. Among cards that assessed over-limit fees in 2005, most charged an amount between $35 and $39.

Not all of the 28 popular large-issuer cards included over-limit fees and the prevalence of such fees may be declining. In 2003, 85 percent, or 17 of 20 cards, had such fees, but only 73 percent, or 19 of 26 cards, did in 2005. According to issuer representatives, they are increasingly emphasizing competitive strategies that seek to increase the amount of spending that their existing cardholders do on their cards as a way to generate revenue. This could explain a movement away from assessing over-limit fees, which likely discourage cardholders who are near their credit limit from spending.

Cards also varied in when an over-limit fee would be assessed. For example, our analysis of the 28 popular large-issuer cards showed that, of the 22 cards that assessed over-limit fees, about two-thirds (14 of 22) would assess an over-limit fee if the cardholder's balance exceeded the credit limit within a billing cycle, whereas the other cards (8 of 22) would assess the fee only if a cardholder's balance exceeded the limit at the end of the billing cycle. In addition, within the overall limit, some of the cards had separate credit limits on the card for how much a cardholder could obtain in cash or transfer from other cards or creditors, before similarly triggering an over-limit fee.

Finally, issuers typically assess fees on cardholders for submitting a payment that is not honored by the issuer or the cardholder's paying bank. Returned payments can occur when cardholders submit a personal check that is written for an amount greater than the amount in their checking account or submit payments that cannot be processed. In our analysis of 28 popular cards offered by the six largest issuers, we found the average fee charged for such returned payments remained steady between 2003 and 2005 at about $30.

Cards Now Frequently Include a Range of Other Fees

Since 1990, issuers have appended more fees to credit cards. In addition to penalties for the cardholder actions discussed above, the 28 popular cards now often include fees for other types of transactions or for providing various services to cardholders. As shown in table 1, issuers assess fees for such services as providing cash advances or for making a payment by telephone. According to our analysis, not all of these fees were disclosed in the materials that issuers generally provide to prospective or existing cardholders. Instead, card issuers told us that they notified their customers of these fees by other means, such as telephone conversations.

Table 1: Various Fees for Services and Transactions, Charged in 2005 on Popular Large-Issuer Cards

Fee type	Assessed for:	Number of cards that assessed fee in 2005	Average or range of amounts generally assessed (if charged)
Cash advance	Obtaining cash or cash equivalent item using credit card or convenience checks	26 of 27	3% of cash advance amount or $5 minimum
Balance transfer	Transferring all or part of a balance from another creditor	15 of 27	3% of transfer amount or $5 to $10 minimum
Foreign transaction	Making purchases in a foreign country or currency	19 of 27	3% of transaction amount (in U.S. dollars)
Returned convenience check	Using a convenience check that the issuer declines to honor	20 of 27	$31
Stop payment	Requesting to stop payment on a convenience check written against the account	20 of 27	$26
Telephone payment	Arranging a single payment through a customer service agent	N/A[a]	$5-$15
Duplicate copy of account records	Obtaining a copy of a billing statement or other record	N/A[a]	$2-$13 per item
Rush delivery of credit card	Requesting that a card be sent by overnight delivery	N/A[a]	$10-$20

Source GAO

Note: Cash equivalent transactions include the purchase of items such as money orders, lottery tickets and casino chips. Convenience checks are personalized blank checks that issuers provide cardholders that can be written against the available credit limit of a credit card account.

[a]We were unable to determine the number of cards that assessed telephone payment, duplicate copy, or rush delivery fees in 2005 because these fees are not required by regulation to be disclosed with either mailed solicitation letters or initial disclosure statements. We obtained information about the level of these fees from a survey of the six largest U.S. issuers.

While issuers generally have been including more kinds of fees on credit cards, one category has decreased: most cards offered by the largest issuers do not require cardholders to pay an annual fee. An annual fee is a fixed fee that issuers charge cardholders each year they continue to own that card. Almost 75 percent of cards we reviewed charged no annual fee in 2005 (among those that did, the range was from $30 to $90). Also, an industry group representative told us that approximately 2 percent of cards featured annual fee requirements. Some types of cards we reviewed were more likely to apply an annual fee than others. For example, cards that offered airline tickets in exchange for points that accrue to a cardholder for using the card were likely to apply an annual fee. However, among the 28 popular cards that we reviewed, not all of the cards that offered rewards charged annual fees.

Recently, some issuers have introduced cards without certain penalty fees. For example, one of the top six issuers has introduced a card that does not charge a late fee, over-limit fee, cash-advance fee, returned payment fee, or an annual fee. Another top-six issuer's card does not charge the cardholder a late fee as long as one purchase is made during the billing cycle. However, the issuer of this card may impose higher interest rates, including above 30 percent, if the cardholder pays late or otherwise defaults on the terms of the card.

Issuers Have Introduced Various Practices that Can Significantly Affect Cardholder Costs

Popular credit cards offered by the six largest issuers involve various issuer practices that can significantly affect the costs of using a credit card for a cardholder. These included practices such as raising a card's interest rates in response to cardholder behaviors and how payments are allocated across balances.

Interest Rate Changes

One of the practices that can significantly increase the costs of using typical credit cards is penalty pricing. Under this practice, the interest rate applied to the balances on a card automatically can be increased in response to behavior of the cardholder that appears to indicate that the cardholder presents greater risk of loss to the issuer. For example, representatives for one large issuer told us they automatically increase a cardholder's interest rate if a cardholder makes a late payment or exceeds the credit limit. Card disclosure documents now typically include information about default rates, which represent the maximum penalty rate that issuers can assess in response to cardholders' violations of the terms of the card. According to an industry specialist at the Federal Reserve, issuers first began the practice of assessing default interest rates as a penalty for term violations in the late 1990s. As of 2005, all but one of the cards we reviewed included default rates. The default rates were generally much higher than rates that otherwise applied to purchases, cash advances, or balance transfers. For example, the average default rate across the 28 cards was 27.3 percent in 2005—up from the average of 23.8 percent in 2003—with as many as 7 cards charging rates over 30 percent. Like many of the other rates assessed on these cards in 2005, default rates generally were variable rates. Increases in average default rates between 2003 and 2005 resulted from increases both in the prime rate, which rose about 2 percentage points during this time, and the average fixed amount that issuers added. On average, the fixed amount that issuers added to the index rate in setting default rate levels increased from about 19 percent in 2003 to 22 percent in 2005.

Four of the six largest issuers typically included conditions in their disclosure documents that could allow the cardholder's interest rate to be reduced from a higher penalty rate. For example some issuers would lower a cardholders' rate for not paying late and otherwise abiding by the terms of the card for a period of 6 or 12 consecutive months after the default rate was imposed. However, at least one issuer indicated that higher penalty rates would be charged on existing balances even after six months of good behavior. This issuer assessed lower nonpenalty rates only on new purchases or other new balances, while continuing to assess higher penalty rates on the balance that existed when the cardholder was initially assessed a higher penalty rate. This practice may significantly increase costs to cardholders even after they've met the terms of their card agreement for at least six months.

The specific conditions under which the largest issuers could raise a cardholder's rate to the default level on tbe popular cards that we analyzed varied. The disclosures for 26 of the 27 cards that included default rates in 2005 stated that default rates could be assessed if the cardholders made late payments. However, some cards would apply such default rates only after multiple violations of card terms. For example, issuers of 9 of the cards automatically would increase a cardholder's rates in response to two late payments. Additionally, for 18 of the 28 cards, default rates could apply for exceeding the credit limit on the card, and 10 cards could also impose such rates for returned payments. Disclosure documents for 26 of the 27 cards that included default rates also indicated that in response to these violations of terms, the interest rate applicable to purchases could be increased to the default rate. In addition, such violations would also cause issuers to increase the rates applicable to cash advances on 16 of the cards, as well as increase rates applicable to balance transfers on 24 of the cards.

According to a paper by a Federal Reserve Bank researcher, some issuers began to increase cardholders' interest rates in the early 2000s for actions they took with other creditors.[28] According to this paper, these issuers would increase rates when cardholders failed to make timely payments to other creditors, such as other credit card issuers, utility companies, and mortgage lenders. Becoming generally known as "universal default," consumer groups criticized these practices. In 2004, OCC issued guidance to the banks that it oversees, which include many of the largest card

[28]Furletti, "Credit Card Pricing Developments and Their Disclosure."

issuers, which addressed such practices.[29] While OCC noted that the repricing might be an appropriate way for banks to manage their credit risk, they also noted that such practices could heighten a bank's compliance and reputation risks. As a result, OCC urged national banks to fully and prominently disclose in promotional materials the circumstances under which a cardholder's interest rates, fees, or other terms could be changed and whether the bank reserved the right to change these unilaterally. Around the time of this guidance, issuers generally ceased automatically repricing cardholders to default interest rates for risky behavior exhibited with other creditors. Of the 28 popular large issuer cards that we reviewed, three cards in 2005 included terms that would allow the issuer to automatically raise a cardholder's rate to the default rate if they made a late payment to another creditor.

Although the six largest U.S. issuers appear to have generally ceased making automatic increases to a default rate for behavior with other creditors, some continue to employ practices that allow them to seek to raise a cardholder's interest rates in response to behaviors with other creditors. During our review, representatives of four of these issuers told us that they may seek to impose higher rates on a cardholder in response to behaviors related to other creditors but that such increases would be done as a change-in-terms, which can require prior notification, rather than automatically.[30] Regulation Z requires that the affected cardholders be notified in writing of any such proposed changes in rate terms at least 15 days before such change becomes effective.[31] In addition, under the laws of the states in which four of the six largest issuers are chartered, cardholders would have to be given the right to opt out of the change.[32] However, issuer representatives told us that few cardholders exercise this right. The ability of cardholders to opt out of such increases also has been questioned. For example, one legal essay noted that some cardholders may not be able to reject the changed terms of their cards if the result would be a requirement

[29]Credit Card Practices, OCC Advisory Letter AL 2004-10 (Sept. 14, 2004).

[30]At least one of the six largest issuers may automatically increase a cardholder's rates for violations of terms on any loan the cardholder held with the issuer or bank with which it was affiliated.

[31]12 C.F.R. § 226.9(c).

[32]States in which issuers have a statutory obligation to afford cardholders an opportunity to opt-out or reject a change-in-terms to increase the interest rate on their credit card account include Delaware, South Dakota, New Hampshire, Florida and Georgia.

to pay off the balance immediately.[33] In addition, an association for community banks that provided comments to the Federal Reserve as part of the ongoing review of card disclosures noted that 15 days does not provide consumers sufficient time to make other credit arrangements if the new terms were undesirable.

Payment Allocation Method

The way that issuers allocate payments across balances also can increase the costs of using the popular cards we reviewed. In this new credit environment where different balances on a single account may be assessed different interest rates, issuers have developed practices for allocating the payments cardholders make to pay down their balance. For 23 of the 28 popular larger-issuer cards that we reviewed, cardholder payments would be allocated first to the balance that is assessed the lowest rate of interest.[34] As a result, the low interest balance would have to be fully paid before any of the cardholder's payment would pay down balances assessed higher rates of interest. This practice can prolong the length of time that issuers collect finance charges on the balances assessed higher rates of interest.

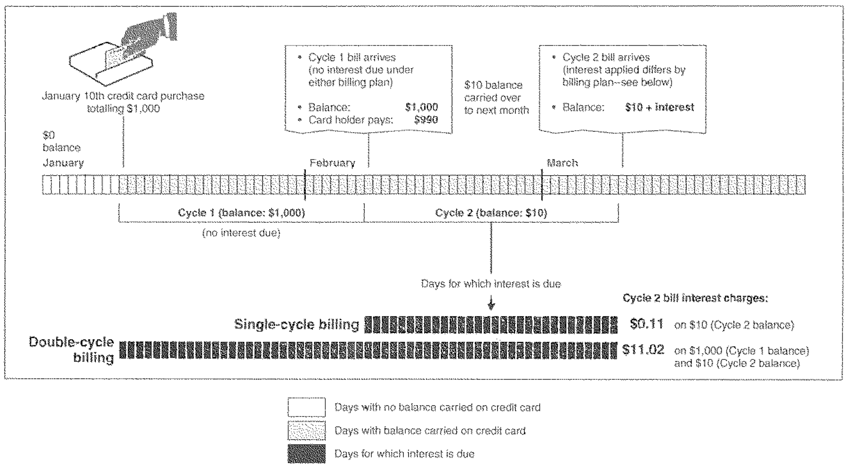
Balance Computation Method

Additionally, some of the cards we reviewed use a balance computation method that can increase cardholder costs. On some cards, issuers have used a double-cycle billing method, which eliminates the interest-free period of a consumer who moves from nonrevolving to revolving status, according to Federal Reserve staff. In other words, in cases where a cardholder, with no previous balance, fails to pay the entire balance of new purchases by the payment due date, issuers compute interest on the original balance that previously had been subject to an interest-free period. This method is illustrated in figure 6.

[33]Samuel Issacharoff and Erin F. Delaney, "Symposium: Homo Economicus, Homo Myopicus, and the Law and Economics of Consumer Choice," *University of Chicago Law Review* 73 (Winter: 2006).

[34]Issuers of the remaining five cards would apply cardholder payments in a manner subject to their discretion.

Figure 6: How the Double-Cycle Billing Method Works



Sources: GAO analysis of Federal Reserve Bank data; Art Explosion (images).

Note: We calculated finance charges assuming a 13.2 percent APR, 30-day billing cycle, and that the cardholder's payment is credited on the first day of cycle 2. We based our calculations on an average daily balance method and daily compounding of finance charges.

In our review of 28 popular cards from the six largest issuers, we found that two of the six issuers used the double-cycle billing method on one or more popular cards between 2003 and 2005. The other four issuers indicated they would only go back one cycle to impose finance charges.

New Practices Appear to Affect a Minority of Cardholders

Representatives of issuers, consumer groups, and others we interviewed generally disagreed over whether the evolution of credit card pricing and other practices has been beneficial to consumers. However, data provided by the six largest issuers show that many of their active accounts did not pay finance charges and that a minority of their cardholders were affected by penalty charges in 2005.

Issuers Say Practices Benefit More Cardholders, but Critics Say Some Practices Harm Consumers

The movement towards risk-based pricing for cards has allowed issuers to offer better terms to some cardholders and more credit cards to others. Spurred by increased competition, many issuers have adopted risk-based pricing structures in which they assess different rates on cards depending on the credit quality of the borrower. Under this pricing structure, issuers have offered cards with lower rates to more creditworthy borrowers, but also have offered credit to consumers who previously would not have been considered sufficiently creditworthy. For example, about 70 percent of families held a credit card in 1989, but almost 75 percent held a card by 2004, according to the Federal Reserve Board's Survey of Consumer Finances. Cards for these less creditworthy consumers have featured higher rates to reflect the higher repayment risk that such consumers represented. For example, the initial purchase rates on the 28 popular cards offered by the six largest issuers ranged from about 8 percent to 19 percent in 2005.

According to card issuers, credit cards offer many more benefits to users than they did in the past. For example, according to the six largest issuers, credit cards are an increasingly convenient and secure form of payment. These issuers told us credit cards are accepted at more than 23 million merchants worldwide, can be used to make purchases or obtain cash, and are the predominant form of payment for purchases made on the Internet. They also told us that rewards, such as cash-back and airline travel, as well as other benefits, such as rental car insurance or lost luggage protection, also have become standard. Issuers additionally noted that credit cards are reducing the need for cash. Finally, they noted that cardholders typically are not responsible for loss, theft, fraud, or misuse of their credit cards by unauthorized users, and issuers often assist cardholders that are victims of identity theft.

In contrast, according to some consumer groups and others, the newer pricing structures have resulted in many negative outcomes for some consumers. Some consumer advocates noted adverse consequences of offering credit, especially at higher interest rates, to less creditworthy consumers. For example, lower-income or young consumers, who do not have the financial means to carry credit card debt, could worsen their financial condition.[35] In addition, consumer groups and academics said that

[35]We previously reported on the marketing of credit cards to students and student experiences with credit cards. See GAO *Consumer Finance: College Students and Credit Cards*, GAO-01-773, (Washington, D.C.: June 20, 2001).

various penalty fees could increase significantly the costs of using cards for some consumers. Some also argued that card issuers were overly aggressive in their assessment of penalty fees. For instance, a representative of a consumer group noted that issuers do not reject cardholders' purchases during the sale authorization, even if the transaction would put the cardholder over the card's credit limit, and yet will likely later assess that cardholder an over-limit fee and also may penalize them with a higher interest rate. Furthermore, staff for one banking regulator told us that they have received complaints from consumers who were assessed over-limit fees that resulted from the balance on their accounts going over their credit limit because their card issuer assessed them a late fee. At the same time, credit card issuers have incentives not to be overly aggressive with their assessment of penalty charges. For example, Federal Reserve representatives told us that major card issuers with long-term franchise value are concerned that their banks not be perceived as engaging in predatory lending because this could pose a serious risk to their brand reputation. As a result, they explained that issuers may be wary of charging fees that could be considered excessive or imposing interest rates that might be viewed as potentially abusive. In contrast, these officials noted that some issuers, such as those that focus on lending to consumers with lower credit quality, may be less concerned about their firm's reputation and, therefore, more likely to charge higher fees.

Controversy also surrounds whether higher fees and other charges were commensurate with the risks that issuers faced. Consumer groups and others questioned whether the penalty interest rates and fees were justifiable. For example, one consumer group questioned whether submitting a credit card payment one day late made a cardholder so risky that it justified doubling or tripling the interest rate assessed on that account. Also, as the result of concerns over the level of penalty fees being assessed by banks in the United Kingdom, a regulator there has recently announced that penalty fees greater than 12 pounds (about $23) may be challenged as unfair unless they can be justified by exceptional factors.[36] Representatives of several of the issuers with whom we spoke told us that the levels of the penalty fees they assess generally were set by considering various factors. For example, they noted that higher fees help to offset the increased risk of loss posed by cardholders who pay late or engage in other

[36]Office of Fair Trading, *Calculating Fair Default Charges in Credit Card Contracts: A Statement of the OFT's Position*, OFT842 (April 2006).

negative behaviors. Additionally, they noted a 2006 study, which compared the assessment of penalty fees that credit card banks charged to bankruptcy rates in the states in which their cards were marketed, and found that late fee assessments were correlated with bankruptcy rates.[37] Some also noted that increased fee levels reflected increased operating costs; for example, not receiving payments when due can cause the issuer to incur increased costs, such as those incurred by having to call cardholders to request payment. Representatives for four of the largest issuers also told us that their fee levels were influenced by what others in the marketplace were charging.

Concerns also have been expressed about whether consumers adequately consider the potential effect of penalty interest rates and fees when they use their cards. For example, one academic researcher, who has written several papers about the credit card industry, told us that many consumers do not consider the effect of the costs that can accrue to them after they begin using a credit card. According to this researcher, many consumers focus primarily on the amount of the interest rate for purchases when deciding to obtain a new credit card and give less consideration to the level of penalty charges and rates that could apply if they were to miss a payment or violate some other term of their card agreement. An analyst that studies the credit card industry for large investors said that consumers can obtain low introductory rates but can lose them very easily before the introductory period expires.

Most Active Accounts Are Assessed Lower Rates Than in the Past

As noted previously, the average credit card interest rate assessed for purchases has declined from almost 20 percent, that prevailed until the late 1980s, to around 12 percent, as of 2005. In addition, the six largest issuers—whose accounts represent 61 percent of all U.S. accounts—reported to us that the majority of their cardholders in 2005 had cards with interest rates lower than the rate that generally applied to all cardholders prior to about 1990. According to these issuers, about 80 percent of active accounts were assessed interest rates below 20 percent as of December 31, 2005, with

[37]Massoud, N., Saunders A., and Scholnick B., "The Cost of Being Late: The Case of Credit Card Penalty Fees," January 2006. Published with financial assistance from the Social Sciences Research Council of Canada and the National Research Program on Financial Services and Public Policy at the Schulich School of Business, York University in Toronto, Ontario (Canada). This study examined data from the Federal Reserve's survey of U.S. credit card rates and fees and compared them to bankruptcy rates across states.

more than 40 percent having rates below 15 percent.[38] However, the proportion of active accounts assessed rates below 15 percent declined since 2003, when 71 percent received such rates. According to issuer representatives, a greater number of active accounts were assessed higher interest rates in 2004 and 2005 primarily because of changes in the prime rate to which many cards' variable rates are indexed. Nevertheless, cardholders today have much greater access to cards with lower interest rates than existed when all cards charged a single fixed rate.

A large number of cardholders appear to avoid paying any significant interest charges. Many cardholders do not revolve a balance from month to month, but instead pay off the balance owed in full at the end of each month. Such cardholders are often referred to as convenience users. According to one estimate, about 42 percent of cardholders are convenience users.[39] As a result, many of these cardholders availed themselves of the benefits of their cards without incurring any direct expenses. Similarly, the six largest issuers reported to us that almost half, or 48 percent, of their active accounts did not pay a finance charge in at least 10 months in 2005, similar to the 47 percent that did so in 2003 and 2004.

Minority of Cardholders Appear to Be Affected by Penalty Charges Assessed by the Largest U.S. Issuers

Penalty interest rates and fees appear to affect a minority of the largest six issuers' cardholders.[40] No comprehensive sources existed to show the extent to which U.S. cardholders were paying penalty interest rates, but, according to data provided by the six largest issuers, a small proportion of their active accounts were being assessed interest rates above 25 percent—which we determined were likely to represent penalty rates. However, this proportion had more than doubled over a two-year period by having increased from 5 percent at the end of 2003 to 10 percent in 2004 and 11 percent in 2005.

[38]For purposes of this report, active accounts refer to accounts of the top six issuers that had had a debit or credit posted to them by December 31 in 2003, 2004, and 2005.

[39]CardWeb.com, Inc.

[40]Our data likely undercounted the cards and cardholders that were affected by these charges because our data was comprised of active accounts for the six largest U.S. issuers. Although these issuers have some subprime accounts (accounts held by less-creditworthy borrowers), we did not include issuers in our sample that predominantly market to subprime borrowers.

Although still representing a minority of cardholders, cardholders paying at least one type of penalty fee were a significant proportion of all cardholders. According to the six largest issuers, 35 percent of their active accounts had been assessed at least one late fee in 2005. These issuers reported that their late fee assessments averaged $30.92 per active account. Additionally, these issuers reported that they assessed over-limit fees on 13 percent of active accounts in 2005, with an average over-limit fee of $9.49 per active account.

Weaknesses in Credit Card Disclosures Appear to Hinder Cardholder Understanding of Fees and Other Practices That Can Affect Their Costs

The disclosures that issuers representing the majority of credit card accounts use to provide information about the costs and terms of using credit cards had serious weaknesses that likely reduce their usefulness to consumers. These disclosures are the primary means under federal law for protecting consumers against inaccurate and unfair credit card practices. The disclosures we analyzed had weaknesses, such as presenting information written at a level too difficult for the average consumer to understand, and design features, such as text placement and font sizes, that did not conform to guidance for creating easily readable documents. When attempting to use these disclosures, cardholders were often unable to identify key rates or terms and often failed to understand the information in these documents. Several factors help explain these weaknesses, including outdated regulations and guidance. With the intention of improving the information that consumers receive, the Federal Reserve has initiated a comprehensive review of the regulations that govern credit card disclosures. Various suggestions have been made to improve disclosures, including testing them with consumers. While Federal Reserve staff have begun to involve consumers in their efforts, they are still attempting to determine the best form and content of any revised disclosures. Without clear, understandable information, consumers risk making poor choices about using credit cards, which could unnecessarily result in higher costs to use them.

Mandatory Disclosure of Credit Card Terms and Conditions Is the Primary Means Regulators Use for Ensuring Competitive Credit Card Pricing

Having adequately informed consumers that spur competition among issuers is the primary way that credit card pricing is regulated in the United States. Under federal law, a national bank may charge interest on any loan at a rate permitted by the law of the state in which the bank is located.[41] In 1978, the U.S. Supreme Court ruled that a national bank is "located" in the state in which it is chartered, and, therefore, the amount of the interest rates charged by a national bank are subject only to the laws of the state in which it is chartered, even if its lending activities occur elsewhere.[42] As a result, the largest credit card issuing banks are chartered in states that either lacked interest rate caps or had very high caps from which they would offer credit cards to customers in other states. This ability to "export" their chartered states' interest rates effectively removed any caps applicable to interest rates on the cards from these banks. In 1996, the U.S. Supreme Court determined that fees charged on credit extended by national banks are a form of interest, allowing issuers to also export the level of fees allowable in their state of charter to their customers nationwide, which effectively removed any caps on the level of fees that these banks could charge.[43]

In the absence of federal regulatory limitations on the rates and fees that card issuers can assess, the primary means that U.S. banking regulators have for influencing the level of such charges is by facilitating competition among issuers, which, in turn, is highly dependent on informed consumers. The Truth in Lending Act of 1968 (TILA) mandates certain disclosures aimed at informing consumers about the cost of credit. In approving TILA, Congress intended that the required disclosures would foster price competition among card issuers by enabling consumers to discern differences among cards while shopping for credit. TILA also states that its purpose is to assure that the consumer will be able to compare more readily the various credit terms available to him or her and avoid the uninformed use of credit. As authorized under TILA, the Federal Reserve has promulgated Regulation Z to carry out the purposes of TILA. The Federal Reserve, along with the other federal banking agencies, enforces compliance with Regulation Z with respect to the depository institutions under their respective supervision.

In general, TILA and the accompanying provisions of Regulation Z require credit card issuers to inform potential and existing customers about specific pricing terms at specific times. For example, card issuers are

[41] 12 U.S.C. § 85.

[42] *Marquette National Bank v First of Omaha Service Corp. et. al*, 439 U.S. 299 (1978).

[43] *Smiley v. Citibank*, 517 U.S. 735 (1996).

required to make various disclosures when soliciting potential customers, as well as on the actual applications for credit. On or with card applications and solicitations, issuers generally are required to present pricing terms, including the interest rates and various fees that apply to a card, as well as information about how finance charges are calculated, among other things. Issuers also are required to provide cardholders with specified disclosures prior to the cardholder's first transaction, periodically in billing statements, upon changes to terms and conditions pertaining to the account, and upon account renewal. For example, in periodic statements, which issuers typically provide monthly to active cardholders, issuers are required to provide detailed information about the transactions on the account during the billing cycle, including purchases and payments, and are to disclose the amount of finance charges that accrued on the cardholder's outstanding balance and detail the type and amount of fees assessed on the account, among other things.

In addition to the required timing and content of disclosures, issuers also must adhere to various formatting requirements. For example, since 1989, certain pricing terms must be disclosed in direct mail, telephone, and other applications and solicitations and presented in a tabular format on mailed applications or solicitations.[44] This table, generally referred to as the Schumer box, must contain information about the interest rates and fees that could be assessed to the cardholder, as well as information about how finance charges are calculated, among other things.[45] According to a Federal Reserve representative, the Schumer box is designed to be easy for consumers to read and use for comparing credit cards. According to a consumer group representative, an effective regulatory disclosure is one that stimulates competition among issuers; the introduction of the Schumer box in the late 1980s preceded the increased price competition in the credit card market in the early 1990s and the movement away from uniform credit card products.

Not all fees that are charged by card issuers must be disclosed in the Schumer box. Regulation Z does not require that issuers disclose fees unrelated to the opening of an account. For example, according to the Official Staff Interpretations of Regulation Z (staff interpretations), nonperiodic fees, such as fees charged for reproducing billing statements

[44]See generally 12 C.F.R. § 226.5a.

[45]See supra note 21.

or reissuing a lost or stolen card, are not required to be disclosed. Staff interpretations, which are compiled and published in a supplement to Regulation Z, are a means of guiding issuers on the requirements of Regulation Z.[46] Staff interpretations also explain that various fees are not required in initial disclosure statements, such as a fee to expedite the delivery of a credit card or, under certain circumstances, a fee for arranging a single payment by telephone. However, issuers we surveyed told us they inform cardholders about these other fees at the time the cardholders request the service, rather than in a disclosure document.

Although Congress authorized solely the Federal Reserve to adopt regulations to implement the purposes of TILA, other federal banking regulators, under their authority to ensure the safety and soundness of depository institutions, have undertaken initiatives to improve the credit card disclosures made by the institutions under their supervision. For example, the regulator of national banks, OCC, issued an advisory letter in 2004 alerting banks of its concerns regarding certain credit card marketing and account management practices that may expose a bank to compliance and reputation risks. One such practice involved the marketing of promotional interest rates and conditions under which issuers reprice accounts to higher interest rates.[47] In its advisory letter, OCC recommended that issuers disclose any limits on the applicability of promotional interest rates, such as the duration of the rates and the circumstances that could shorten the promotional rate period or cause rates to increase. Additionally, OCC advised issuers to disclose the circumstances under which they could increase a consumer's interest rate or fees, such as for failure to make timely payments to another creditor.

Credit Card Disclosures Typically Provided to Many Consumers Have Various Weaknesses

The disclosures that credit card issuers typically provide to potential and new cardholders had various weaknesses that reduced their usefulness to consumers. These weaknesses affecting the disclosure materials included the typical grade level required to comprehend them, their poor organization and formatting of information, and their excessive detail and length.

[46]Compliance with these official staff interpretations afford issuers protection from liability under Section 130(f) of TILA, which protects issuers from civil liability for any act done or omitted in good faith compliance with any official staff interpretation. 12 C.F.R. Part 226, Supp. I.

[47]Credit Card Practices, OCC Advisory Letter AL 2004-10 (Sept. 14, 2004).

Disclosures Written at Too High a Level

The typical credit card disclosure documents contained content that was written at a level above that likely to be understandable by many consumers. To assess the readability of typical credit card disclosures, we contracted with a private usability consultant to evaluate the two primary disclosure documents for four popular, widely-held cards (one each from four large credit card issuers). The two documents were (1) a direct mail solicitation letter and application, which must include information about the costs and fees associated with the card; and (2) the cardmember agreement that contains the full range of terms and conditions applicable to the card.[48] Through visual inspection, we determined that this set of disclosures appeared representative of the disclosures for the 28 cards we reviewed from the six largest issuers that accounted for the majority of cardholders in the United States. To determine the level of education likely needed for someone to understand these disclosures, the usability consultant used computer software programs that applied three widely used readability formulas to the entire text of the disclosures. These formulas determined the readability of written material based on quantitative measures, such as average number of syllables in words or numbers of words in sentences. For more information about the usability consultant's analyses, see appendix I.

On the basis of the usability consultant's analysis, the disclosure documents provided to many cardholders likely were written at a level too high for the average individual to understand. The consultant found that the disclosures on average were written at a reading level commensurate with about a tenth- to twelfth-grade education. According to the consultant's analysis, understanding the disclosures in the solicitation letters would require an eleventh-grade level of reading comprehension, while understanding the cardmember agreements would require about a twelfth-grade education. A consumer advocacy group that tested the reading level needed to understand credit card disclosures arrived at a similar conclusion. In a comment letter to the Federal Reserve, this consumer group noted it had measured a typical passage from a change-in-terms notice on how issuers calculate finance charges using one of the readability formulas and that this passage required a twelfth-grade reading level.

[48]We did not evaluate disclosures that issuers are required to provide at other times—such as in periodic billing statements or change in terms notices.

These disclosure documents were written such that understanding them required a higher reading level than that attained by many U.S. cardholders. For example, a nationwide assessment of the reading level of the U.S. population cited by the usability consultant indicated that nearly half of the adult population in the United States reads at or below the eighth-grade level.[49] Similarly, to ensure that the information that public companies are required to disclose to prospective investors is adequately understandable, the Securities and Exchange Commission (SEC) recommends that such disclosure materials be written at a sixth- to eighth-grade level.[50]

In addition to the average reading level, certain portions of the typical disclosure documents provided by the large issuers required even higher reading levels to be understandable. For example, the information that appeared in cardmember agreements about annual percentage rates, grace periods, balance computation, and payment allocation methods required a minimum of a fifteenth-grade education, which is the equivalent of 3 years of college education. Similarly, text in the documents describing the interest rates applicable to one issuer's card were written at a twenty-seventh-grade level. However, not all text in the disclosures required such high levels. For example, the consultant found that the information about fees that generally appeared in solicitation letters required only a seventh- and eighth-grade reading level to be understandable. Solicitation letters likely required lower reading levels to be understandable because they generally included more information in a tabular format than cardmember agreements.

Poor Organization and Formatting

The disclosure documents the consultant evaluated did not use designs, including effective organizational structures and formatting, that would have made them more useful to consumers. To assess the adequacy of the design of the typical large issuer credit card solicitation letters and cardmember agreements, the consultant evaluated the extent to which these disclosures adhered to generally accepted industry standards for

[49]1992 National Adult Literacy Survey. The 2003 National Assessment of Adult Literacy (renamed from 1992) found that reading comprehension levels did not significantly change between 1992 and 2003 and that there was little change in adults' ability to read and understand sentences and paragraphs.

[50]U.S. Securities and Exchange Commission, *Plain English Handbook: How to Create Clear SEC Disclosure Documents* (Washington, D.C.: 1998). The Securities and Exchange Commission regulates the issuance of securities to the public, including the information that companies provide to their investors.

effective organizational structures and designs intended to make documents easy to read. In the absence of best practices and guidelines specifically for credit card disclosures, the consultant used knowledge of plain language, publications design guidelines, and industry best practices and also compared the credit card disclosure documents to the guidelines in the Securities and Exchange Commission's plain English handbook. The usability consultant used these standards to identify aspects of the design of the typical card disclosure documents that could cause consumers using them to encounter problems.

On the basis of this analysis, the usability consultant concluded that the typical credit card disclosures lacked effective organization. For example, the disclosure documents frequently placed pertinent information toward the end of sentences. Figure 7 illustrates an example taken from the cardmember agreement of one of the large issuers that shows that a consumer would need to read through considerable amounts of text before reaching the important information, in this case the amount of the annual percentage rate (APR) for purchases. Best practices would dictate that important information—the amount of the APR—be presented first, with the less important information—the explanation of how the APR is determined—placed last.

Figure 7: Example of Important Information Not Prominently Presented in Typical Credit Card Disclosure Documents

Usability consultant's comments: Placing pertinent information, in this case the APR for purchases, near the end of sentences requires readers to wade through considerable amounts of text before reaching important information.

3.3.1.a: Purchases. The Annual Percentage Rate for Purchases, a variable rate, is the Index plus a Margin of 4 99% Based on this formula, the APR as of May 4, 2005 is 10 99% (0 03011% corresponding Daily Periodic Rate)

Sources: UserWorks, Inc , Information International Associates

In addition, the disclosure documents often failed to group relevant information together. Although one of the disclosure formats mandated by law—the Schumer box—has been praised as having simplified the presentation of complex information, our consultant observed that the amount of information that issuers typically presented in the box compromised the benefits of using a tabular format. Specifically, the typical credit card solicitation letter, which includes a Schumer box, may be causing difficulties for consumers because related information generally is not grouped appropriately, as shown in figure 8.

Figure 8: Example of How Related Information Was Not Being Grouped Together in Typical Credit Card Disclosure Documents

Annual Percentage Rate (APR) for Purchases[3]	0.0% fixed introductory rate until October 1, 2006;[1] thereafter, a variable APR, currently 13.49%.
Other APRs[3]	**Non-Check Balance Transfers:** 0.0% fixed introductory APR until October 1, 2006;[1] thereafter, together with all other Balance Transfers, a variable APR, currently 13.49%. **Cash Advances and Convenience Checks:** A variable APR, currently 22.49%. **Penalty APR:** A variable APR, currently up to 30.49%.[3]
Variable Rate Information[2]	All APRs (other than your introductory APRs) may vary. They are determined by adding the following margin to the Prime Rate: 6.99% for Purchases and Non-Check Balance Transfers; 15.99% for Cash Advances and Convenience Checks; and up to 23.99% for Penalty APRs.
Balance Calculation Method for Purchases	Average Daily Balance (including new purchases)
Annual Fee	None
Grace Period for Purchases	At least 20 days
Minimum Finance Charge for Purchases	$1.50 (unless purchase Average Daily Balance is zero)

Current rate for purchases

How the rate is determined

†The terms of your Account, including any APR (or how an APR is Calculated) are subject to change. Any changes will be made in accordance with the Cardholder Agreement.

[1]If an introductory rate is applicable to this product and we do not receive at least the Minimum Payment Due during any billing cycle, you exceed your credit limit or you close your account, any introductory rate on Purchases and Balance Transfers will terminate.

[2]The Prime Rate used in your APR calculations is determined on the last day of each month by taking the highest prime rate published in the Money Rates section of The Wall Street Journal in effect within the prior three months (the "Index Date(s)"). All Prime Rate changes will take effect on the first day of your Billing Cycle that ends in the calendar month following the Index Date. All variable rate disclosures are based on the Prime Rate of 6.50% in effect on August 10, 2005.

How the prime rate is determined

Usability consultant's comments:
Related information, in this case the APR for purchases, is not grouped together, potentially causing difficulties for readers.

Sources: GAO analysis of data from UserWorks, Inc.; Information International Associates.

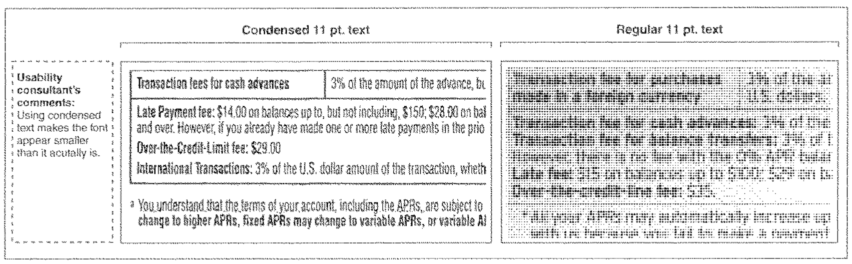
As shown in figure 8, information about the APR that would apply to purchases made with the card appeared in three different locations. The first row includes the current prevailing rate of the purchase APR; text that describes how the level of the purchase APR could vary according to an underlying rate, such as the prime rate, is included in the third row; and text describing how the issuer determines the level of this underlying rate is included in the footnotes. According to the consultant, grouping such related information together likely would help readers to more easily understand the material.

In addition, of the four issuers whose materials were analyzed, three provided a single document with all relevant information in a single cardmember agreement, but one issuer provided the information in separate documents. For example, this issuer disclosed specific information about the actual amount of rates and fees in one document and presented information about how such rates were determined in another document. According to the readability consultant, disclosures in multiple documents can be more difficult for the reader to use because they may require more work to find information.

Formatting weaknesses also likely reduced the usefulness of typical credit card disclosure documents. The specific formatting issues were as follows:

- *Font sizes.* According to the usability consultant's analysis, many of the disclosure documents used font sizes that were difficult to read and could hinder cousumers' ability to find information. For example, the consultant found extensive use of small and condensed typeface in cardmember agreements and in footnotes in solicitation materials when best practices would suggest using a larger, more legible font size. Figure 9 contains an illustration of how the disclosures used condensed text that makes the font appear smaller than it actually is. Multiple consumers and consumer groups who provided comments to the Federal Reserve noted that credit card disclosures were written in a small print that reduces a consumer's ability to read or understand the document. For example, a consumer who provided comments to the Federal Reserve referred to the text in card disclosures as "mice type." This example also illustrates how notes to the text, which should be less important, were the same size and thus given the same visual emphasis as the text inside the box. Consumers attempting to read such disclosures may have difficulty determining which information is more important.

Figure 9: Example of How Use of Small Font Sizes Reduces Readability in Typical Credit Card Disclosure Documents



Sources: UserWorks, Inc.; Information International Associates.

Note: Graphic shown is the actual size it appears in issuer disclosure documents. Graphic is intentionally portioned off to focus attention to headings.

- *Ineffective font placements.* According to the usability consultant, some issuers' efforts to distinguish text using different font types sometimes had the opposite effect. The consultant found that the disclosures from all four issuers emphasized large amounts of text with all capital letters and sometimes boldface. According to the consultant, formatting large blocks of text in capitals makes it harder to read because the shapes of the words disappear, forcing the reader to slow down and study each letter (see figure 10). In a comment letter to the Federal Reserve, an industry group recommended that boldfaced or capitalized text should be used discriminately, because in its experience, excessive use of such font types caused disclosures to lose all effectiveness. SEC's guidelines for producing clear disclosures contain similar suggestions.

Figure 10: Example of How Use of Ineffective Font Types Reduces Readability in Typical Credit Card Disclosure Documents

Usability consultant's comments:
By emphasizing all the text in a paragraph, nothing is emphasized.

7.14: AMENDMENT OF THIS AGREEMENT. WE MAY AMEND THIS AGREEMENT BY CHANGING, ADDING OR DELETING ANY TERM, CONDITION, SERVICE OR FEATURE ("NEW TERM") OF YOUR ACCOUNT OR OF THIS AGREEMENT AT ANY TIME. WE WILL PROVIDE YOU WITH NOTICE OF THE AMENDMENT TO THE EXTENT REQUIRED BY LAW. UNLESS WE STATE OTHERWISE, ANY NEW TERM WILL APPLY TO YOUR

ARBITRATION: PLEASE READ THIS PROVISION CAREFULLY. IT PROVIDES THAT ANY DISPUTE MAY BE RESOLVED BY BINDING ARBITRATION. ARBITRATION REPLACES THE RIGHT TO GO TO COURT. YOU WILL NOT BE ABLE TO BRING A CLASS ACTION OR SIMILAR PROCEEDING IN COURT, NOR WILL YOU BE ABLE TO BRING ANY CLAIM IN

Sources: UserWorks, Inc.; Information International Associates.

- *Selecting text for emphasis.* According to the usability consultant, most of the disclosure documents unnecessarily emphasized specific terms. Inappropriate emphasis of such material could distract readers from more important messages. Figure 11 contains a passage from one cardmember agreement that the readability consultant singled out for its emphasis of the term "periodic finance charge," which is repeated six times in this example. According to the consultant, the use of boldface and capitalized text calls attention to the word, potentially requiring readers to work harder to understand the entire passage's message.

Figure 11: Example of How Use of Inappropriate Emphasis Reduces Readability in Typical Credit Card Disclosure Documents

Usability consultant's comments:
Repeated use of boldface and caps calls attention to a word, potentially requiring readers to work harder to understand the passage's message.

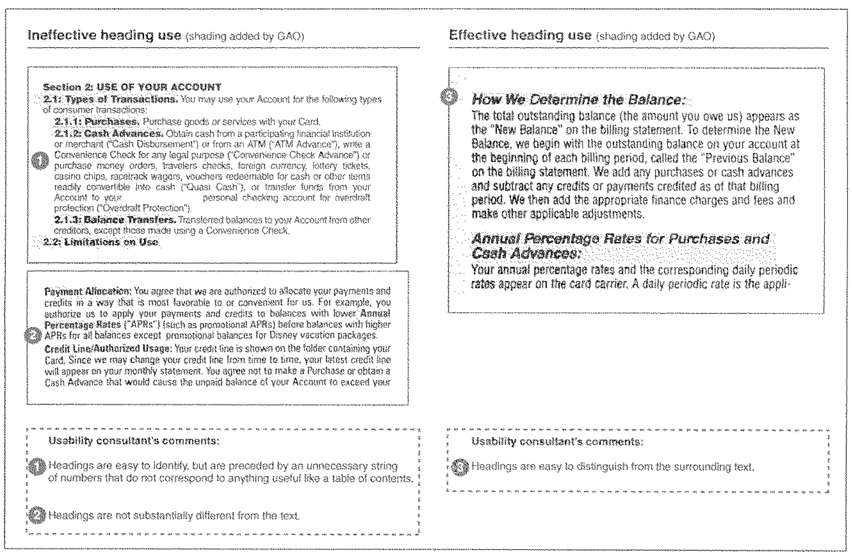
zero. We multiply the daily balance by the applicable Daily Periodic Rate, as stated in the Table of Interest Charges, to get your **Periodic FINANCE CHARGES** for that day. We then add these **Periodic FINANCE CHARGES** to your daily balance to get the beginning balance for the next day. For Purchases, we do the same thing for each day of the previous cycle to get the daily balance of Purchases for the previous billing cycle. However, the daily balance for previous billing cycle Purchases is considered to be zero for each day of the previous billing cycle if a **Periodic FINANCE CHARGE** was already imposed on Purchases itemized on your previous statement or you paid your New Balance on your previous statement in full by the payment due date.

To get your total **Periodic FINANCE CHARGE** for a billing cycle, we add all of the daily **Periodic FINANCE CHARGES** for all features. If you multiply the Average Daily Balance for each feature by the applicable Daily Periodic Rate and the number of days in the applicable billing cycle(s) and add the results together, the total will equal the **Periodic FINANCE CHARGES** for the billing cycle, except for minor variations due to rounding. To determine an Average Daily Balance, we add your daily balances and divide by the number of the days in the applicable billing cycle(s).

Sources: UserWorks, Inc.; Information International Associates.

- *Use of headings.* According to the usability consultant, disclosure documents from three of the four issuers analyzed contained headings that were difficult to distinguish from surrounding text. Headings, according to the consultant, provide a visual hierarchy to help readers quickly identify information in a lengthy document. Good headers are easy to identify and use meaningful labels. Figure 12 illustrates two examples of how the credit card disclosure documents failed to use headings effectively.

Figure 12: Example of Ineffective and Effective Use of Headings in Typical Credit Card Disclosure Documents



Sources: UserWorks, Inc.; Information International Associates.

In the first example, the headings contained an unnecessary string of numbers that the consultant found would make locating a specific topic in the text more difficult. As a result, readers would need to actively ignore the string of numbers until the middle of the line to find what they wanted. The consultant noted that such numbers might be useful if this document had a table of contents that referred to the numbers, but it did not. In the second example, the consultant noted that a reader's ability to locate information using the headings in this document was hindered because the headings were not made more visually distinct, but instead were aligned with other text and printed in the same type size as the text that followed. As a result, these headings blended in with the text. Furthermore, the consultant noted that because the term "Annual Percentage Rates" was given the same visual treatment as the two headings in the example, finding headings quickly was made even more difficult. In contrast, figure 12 also shows an example that the consultant identified in one of the disclosure documents that was an effective use of headings.

- *Presentation techniques.* According to the usability consultant, the disclosure documents analyzed did not use presentation techniques, such as tables, bulleted lists, and graphics, that could help to simplify the presentation of complicated concepts, especially in the cardmember agreements. Best practices for document design suggest using tables and bulleted lists to simplify the presentation of complex information. Instead, the usability consultant noted that all the cardmember agreements reviewed almost exclusively employed undifferentiated blocks of text, potentially hindering clear communication of complex information, such as the multiple-step procedures issuers use for calculating a cardholder's minimum required payment. Figure 13 below presents two samples of text from different cardmember agreements describing how minimum payments are calculated. According to the consultant, the sample that used a bulleted list was easier to read than the one formatted as a paragraph. Also, an issuer stated in a letter to the Federal Reserve that their consumers have welcomed the issuer's use of bullets to format information, emphasizing the concept that the visual layout of information either facilitates or hinders consumer understanding.

Figure 13: Example of How Presentation Techniques Can Affect Readability in Typical Credit Card Disclosure Documents

MINIMUM MONTHLY PAYMENT. The Minimum Payment Due each month will be the sum of any amount past due and the minimum monthly payment. The minimum monthly payment each month will be the greater of $10 or 1/50th of the New Balance, rounded to the next higher whole dollar amount. If any ANNUAL PERCENTAGE RATE applicable to your Account is greater than 22.99%, but less than 26.00%, your minimum monthly payment will be the greater of $10 or 1/45th of the New Balance, rounded to the next higher whole dollar amount. If any ANNUAL PERCENTAGE RATE applicable to your Account is 26.00% or greater, your minimum monthly payment will be the greater of $10 or 1/40th of the New Balance. Regardless of the Annual Percentage Rates on your Account, if the New Balance is less than $10.00, the minimum monthly payment will be the amount of the New Balance. We may also include in your minimum monthly payment all or a portion of the amount by which your outstanding balance exceeds your Account credit limit as of the last day of the billing period. Paying the Minimum Payment Due may be insufficient to bring

Usability consultant's comments:
Expressing a complicated, multistep process as prose makes it difficult to understand the relationships between steps

Minimum Amount Due:
Each month you must pay a minimum amount that is calculated as follows. First, we begin with any amount that is past due and add to it any amount in excess of your credit line. Second, we add the largest of the following:

- The New Balance on the billing statement if it is less than $20;
- $20 if the New Balance is at least $20;
- 1% of the New Balance (which calculation is rounded down to the nearest dollar) plus the amount of your billed finance charges and any applicable late fee; or
- 1.5% of the New Balance (which calculation is rounded down to the nearest dollar).

However, the Minimum Amount Due will never exceed your New Balance. In calculating the Minimum Amount Due, we may subtract from the New Balance certain fees added to your account during the billing period.

Usability consultant's comments:
By using bullet points, it is much easier to see multiple steps broken out into individual steps and when they are applied

Sources UserWorks, Inc , Information International Associates

Excessive Complexity and Volume of Information

The content of typical credit card disclosure documents generally was overly complex and presented in too much detail, such as by using unfamiliar or complex terms to describe simple concepts. For example, the usability consultant identified one cardmember agreement that used the term "rolling consecutive twelve billing cycle period" instead of saying "over the course of the next 12 billing statements" or "next 12 months"—if that was appropriate. Further, a number of consumers, consumer advocacy groups, and government and private entities that have provided comments to the Federal Reserve agreed that typical credit card disclosures are written in complex language that hinders consumers' understanding. For example, a consumer wrote that disclosure documents were "loaded with booby traps designed to trip consumers, and written in intentionally impenetrable and confusing language." One of the consumer advocacy groups stated the disclosures were "full of dense, impenetrable legal jargon that even lawyers and seasoned consumer advocates have difficulty understanding." In addition, the consultant noted that many of the disclosures, including solicitation letters and cardmember agreements, contained overly long and complex sentences that increase the effort a reader must devote to understanding the text. Figure 14 contains two examples of instances in which the disclosure documents used uncommon words and phrases to express simple concepts.

Figure 14: Examples of How Removing Overly Complex Language Can Improve Readability in Typical Credit Card Disclosure Documents

101 words

"If at any time during any rolling consecutive twelve billing cycle period you fail to make two Minimum Payments on a timely basis or exceed your Credit Limit twice we may elect to increase your Purchase, Cash Advance and/or Balance Transfer APRs to the Penalty APRs. All Penalty APRs will remain in effect until, in a subsequent rolling consecutive six billing cycle period, you do not exceed your Credit Limit at any time and you make all of your required Minimum Payments on a timely basis when, in your next billing cycle, all Penalty APRs will no longer apply.

50 words

Usability consultant's rewrite:
If you pay late or go over your credit limit twice in a year, the interest rate you pay on most things goes up to the default rate, currently 30.49%. It will go back down when you pay on time and do not go over your credit limit for six months.

69 words

Using Your Account: You may use your Card or Account to purchase or lease goods or services, or pay amounts you owe, wherever the Card is honored, transfer balances from other accounts or, if applicable, to obtain advances to cover an overdraft on your checking account with a affiliate under the terms of this Agreement and your Overdraft Protection Agreement, ("Overdraft Advances"), (Purchases, Balence Transfers and Overdraft Advances are collectively called "Purchases").

20 words

Usability consultant's rewrite:
You can use this card to buy things, pay off other accounts, transfer balances, or keep from bouncing a check.

Sources UserWorks, Inc., Information International Associates

In addition, the disclosure documents regularly presented too much or irrelevant detail. According to the usability consultant's analysis, the credit card disclosures often contained superfluous information. For example, figure 15 presents an example of text from one cardmember agreement that described the actions the issuer would take if its normal source for the rate information used to set its variable rates—*The Wall Street Journal*—were to cease publication. Including such an arguably unimportant detail lengthens and makes this disclosure more complex. According to SEC best practices for creating clear disclosures, disclosure documents are more effective when they adhere to the rule that less is more. By omitting unnecessary details from disclosure documents, the usability consultant indicated that consumers would be more likely to read and understand the information they contain.

Figure 15: Example of Superfluous Detail in Typical Credit Card Disclosure Documents

Usability consultant's comments: This section provides superfluous information on how the prime rate is determined. For example, the explanation of the actions if the Wall Street Journal was to cease publication.

If any annual percentage rate is based on the U.S. *Prime* Rate plus a margin, we will calculate the rate for each billing period by adding the applicable margin that appears on the card carrier to the U.S. Prime Rate. For each billing period we will use the U.S. Prime Rate published in *The Wall Street Journal* two business days prior to your Statement/Closing Date for that billing period. Any increase or decrease in a variable annual percentage rate due to a change in the U.S. Prime Rate takes effect as of the first day of the billing period for which we calculate the variable annual percentage rate. If more than one U.S. Prime Rate is published, we may choose the highest rate. If *The Wall Street Journal* ceases publication or to publish the U.S. Prime Rate, we may use the U.S. Prime Rate published in any other newspaper of general circulation, or we may substitute a similar reference rate at our sole discretion. When a change in an applicable variable annual percentage rate takes effect we will apply it to any existing balances, subject to any promotional rate that may apply.

Sources UserWorks, Inc., Information International Associates

Consumer Confusion Indicated That Disclosures Were Not Communicating Credit Card Cost Information Clearly

Many of the credit cardholders that were tested and interviewed as part of our review exhibited confusion over various fees, practices, and other terms that could affect the cost of using their credit cards. To understand how well consumers could use typical credit card disclosure documents to locate and understand information about card fees and other practices, the usability consultant with whom we contracted used a sample of cardholders to perform a usability assessment of the disclosure documents from the four large issuers. As part of this assessment, the consultant conducted one-on-one sessions with a total of 12 cardholders so that each set of disclosures, which included a solicitation letter and a cardmember agreement, was reviewed by 3 cardholders.[51] Each of these cardholders were asked to locate information about fee levels and rates, the circumstances in which they would be imposed, and information about changes in card terms. The consultant also tested the cardholders' ability to explain various practices used by the issuer, such as the process for determining the amount of the minimum monthly payment, by reading the disclosure documents. Although the results of the usability testing cannot

[51] According to the consultant, testing with small numbers of individuals can generally identify many of the problems that can affect the readability and usability of materials.

be used to make generalizations about all cardholders, the consultant selected cardholders based on the demographics of the U.S. adult population, according to age, education level, and income, to ensure that the cardholders tested were representative of the general population. In addition, as part of this review, we conducted one-on-one interviews with 112 cardholders to learn about consumer behavior and knowledge about various credit card terms and practices.[52] Although we also selected these cardholders to reflect the demographics of the U.S. adult population, with respect to age, education level, and income, the results of these interviews cannot be generalized to the population of all U.S. cardholders.[53]

Based on the work with consumers, specific aspects of credit card terms that apparently were not well understood included:

- *Default interest rates.* Although issuers can penalize cardholders for violating the terms of the card, such as by making late payments or by increasing the interest rates in effect on the cardholder's account to rates as high as 30 percent or more, only about half of the cardholders that the usability consultant tested were able to use the typical credit card disclosure documents to successfully identify the default rate and the circumstances that would trigger rate increases for these cards. In addition, the usability consultant observed the cardholders could not identify this information easily. Many also were unsure of their answers, especially when rates were expressed as a "prime plus" number, indicating the rate varied based on the prime rate. Locating information in the typical cardmember agreement was especially difficult for cardholders, as only 3 of 12 cardholders were able to use such documents to identify the default interest rate applicable to the card. More importantly, only about half of the cardholders tested using solicitation letters were able to accurately determine what actions could potentially cause the default rate to be imposed on these cards.
- *Other penalty rate increases.* Although card issuers generally reserve the right to seek to raise a cardholder's rate in other situations, such as when a cardholder makes a late payment to another issuer's credit card, (even if the cardholder has not defaulted on the cardmember

[52]We also used this data in a previous report to show cardholder preferences for customized information in their monthly billing statements about the consequences of making minimum payments on their outstanding balance. GAO-06-434.

[53]For more information about our scope and methodology, see appendix I.

agreement), about 71 percent of the 112 cardholders we interviewed were unsure or did not believe that issuers could increase their rates in such a case. In addition, about two-thirds of cardholders we interviewed were unaware or did not believe that a drop in their credit score could cause an issuer to seek to assess higher interest rates on their account.[54]

- *Late payment fees.* According to the usability assessment, many of the cardholders had trouble using the disclosure documents to correctly identify what would occur if a payment were to be received after the due date printed in the billing statement. For example, nearly half of the cardholders were unable to use the cardmember agreement to determine whetber a payment would be considered late based on the date the issuer receives the payment or the date the payment was mailed or postmarked. Additionally, the majority of the 112 cardholders we interviewed also exhibited confusion over late fees: 52 percent indicated that they have been surprised when their card company applied a fee or penalty to their account.

- *Using a credit card to obtain cash.* Although the cardholders tested by the consultant generally were able to use the disclosures to identify how a transaction fee for a cash advance would be calculated, most were unable to accurately use this information to determine the transaction fee for withdrawing funds, usually because they neglected to consider the minimum dollar amount, such as $5 or $10, that would be assessed.

- *Grace periods.* Almost all 12 cardholders in the usability assessment had trouble using the solicitation letters to locate and define the grace period, the period during which the a cardholder is not charged interest on a balance. Instead, many cardholders incorrectly indicated that the grace period was instead when their lower, promotional interest rates would expire. Others incorrectly indicated that it was the amount of time after the monthly bill's due date that a cardholder could submit a payment without being charged a late fee.

- *Balance computation method.* Issuers use various methods to calculate interest charges on outstanding balances, but only 1 of the 12 cardholders the usability consnltant tested correctly described average

[54]A credit score is a number, roughly between 300 and 800, that reflects the credit history detailed by a person's credit report. Lenders use borrowers' credit scores in the process of assigning rates and terms to the loans they make.

daily balance, and none of the cardholders were able to describe two-cycle average daily balance accurately. At least nine letters submitted to the Federal Reserve in connection with its review of credit card disclosures noted that few consumers understand balance computation methods as stated in disclosure documents.

Perhaps as a result of weaknesses previously described, cardholders generally avoid using the documents issuers provide with a new card to improve their understanding of fees and practices. For example, many of the cardholders interviewed as part of this report noted that the length, format, and complexity of disclosures led them to generally disregard the information contained in them. More than half (54 percent) of the 112 cardholders we interviewed indicated they read the disclosures provided with a new card either not very closely or not at all. Instead, many cardholders said they would call the issuer's customer service representatives for information about their card's terms and conditions. Cardholders also noted that the ability of issuers to change the terms and conditions of a card at any time led them to generally disregard the information contained in card disclosures. Regulation Z allows card issuers to change the terms of credit cards provided that issuers notify cardholders in writing within 15 days of the change. As a result, the usability consultant observed some participants were dismissive of the information in the disclosure documents because they were aware that issuers could change anything.

Federal Reserve Effort to Revise Regulations Presents Opportunity to Improve Disclosures

With liability concerns and outdated regulatory requirements seemingly explaining the weaknesses in card disclosures, the Federal Reserve has begun efforts to review its requirements for credit card disclosures. Industry participants have advocated various ways in which the Federal Reserve can act to improve these disclosures and otherwise assist cardholders.

Regulations and Guidance May Contribute to Weaknesses in Current Disclosures

Several factors may help explain why typical credit card disclosures exhibit weaknesses that reduce their usefulness to cardholders. First, issuers make decisious about the content and format of their disclosures to limit potential legal liability. Issuer representatives told us that the disclosures made in credit card solicitations and cardmember agreements are written for legal purposes and in language that consumers generally could not understand. For example, representatives for one large issuer told us they cannot always state information in disclosures clearly because the increased potential that simpler statements would be misinterpreted would expose them to litigation. Similarly, a participant of a symposium on credit card disclosures said that disclosures typically became lengthier after the issuance of court rulings on consumer credit issues. Issuers can attempt to reduce the risk of civil liability based on their disclosures by closely following the formats that the Federal Reserve has provided in its model forms and other guidance. According to the regulations that govern card disclosures, issuers acting in good faith compliance with any interpretation issued by a duly authorized official or employee of the Federal Reserve are afforded protection from liability.[55]

Second, the regulations governing credit card disclosures have become outdated. As noted earlier in this report, TILA and Regulation Z that implements the act's provisions are intended to ensure that consumers have adequate information about potential costs and other applicable terms and conditions to make appropriate choices among competing credit cards. The most recent comprehensive revisions to Regulation Z's open-end credit rules occurred in 1989 to implement the provisions of the Fair Credit and Charge Card Act. As we have found, the features and cost structures of credit cards have changed considerably since then. An issuer representative told us that current Schumer box requirements are not as useful in presenting the more complicated structures of many current cards. For example, they noted that it does not easily accommodate information about the various cardholder actions that could trigger rate increases, which they argued is now important information for consumers to know when shopping for credit. As a result, some of the specific requirements of Regulation Z that are intended to ensure that consumers have accurate information instead may be diminishing the usefulness of these disclosures.

Third, the guidance that the Federal Reserve provides issuers may not be consistent with guidelines for producing clear, written documents. Based on our analysis, many issuers appear to adhere to the formats and model forms that the Federal Reserve staff included in the Official Staff Interpretations of Regulation Z, which are prepared to help issuers comply with the regulations. For example, the model forms present text about how rates are determined in footnotes. However, as discussed previously, not grouping related information undermines the usability of documents. The

[55]Under Section 130(f) of the TILA, creditors are protected from civil liability for any act done or omitted in good faith in conformity with any interpretation issued by a duly authorized official or employee of the Federal Reserve System. 15 U.S.C. § 1640.

Schumer box format requires a cardholder to look in several places, such as in multiple rows in the table and in notes to the table, for information about related aspects of the card. Similarly, the Federal Reserve's model form for the Schumer box recommends that the information about the transaction fee and interest rate for cash advances be disclosed in different areas.

Finally, the way that issuers have implemented regulatory guidance may have contributed to the weaknesses typical disclosure materials exhibited. For example, in certain required disclosures, the terms "annual percentage rate" and "finance charge," when used with a corresponding amount or percentage rate, are required to be more conspicuous than any other required disclosures.[56] Staff guidance suggests that such terms may be made more conspicuous by, for example, capitalizing these terms when other disclosures are printed in lower case or by displaying these terms in larger type relative to other disclosures, putting them in boldface print or underlining them.[57] Our usability consultant's analysis found that card disclosure documents that followed this guidance were less effective because they placed an inappropriate emphasis on terms. As shown previously in figure 11, the use of bold and capital letters to emphasize the term "finance charge" in the paragraph unnecessarily calls attention to that term, potentially distracting readers from information that is more important. The excerpt shown in figure 11 is from an initial disclosure document which, according to Regulation Z, is subject to the "more conspicuous" rule requiring emphasis of the terms "finance charge" and "annual percentage rate."

Suggestions for Improving Disclosures Included Obtaining Input from Consumers

With the intention of improving credit card disclosures, the Federal Reserve has begun efforts to develop new regulations. According to its 2004 notice seeking public comments on Regulation Z, the Federal Reserve hopes to address the length, complexity, and superfluous information of disclosures and produce new disclosures that will be more useful in helping consumers compare credit products.[58] After the passage of the

[56]See generally 12 C.F.R. 225.5(a)(3) and the corresponding staff commentary.

[57]Notwithstanding the more conspicuous rule, Regulation Z expressly provides that the annual percentage rate for purchases required to be disclosed in the Schumer box must be in at least 18-point type. 12 C.F.R. § 226.5a(b)(1).

[58]Truth in Lending, 69 Fed. Reg. 70925 (advanced notice of proposed rulemaking, published Dec. 8, 2004).

Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (Bankruptcy Act) in October of that year, which included amendments to TILA, the Federal Reserve sought additional comments from the public to prepare to implement new disclosure requirements including disclosures intended to advise consumers of the consequences of making only minimum payments on credit cards.[59] According to Federal Reserve staff, new credit card disclosure regulations may not be in effect until sometime in 2007 or 2008 because of the time required to conduct consumer testing, modify the existing regulations, and then seek comment on the revised regulation.

Industry participants and others have provided input to assist the Federal Reserve in this effort. Based on the interviews we conducted, documents we reviewed, and our analysis of the more than 280 comment letters submitted to the Federal Reserve, issuers, consumer groups, and others provided various suggestions to improve the content and format of credit card disclosures, including:

- *Reduce the amount of information disclosed.* Some industry participants said that some of the information currently presented in the Schumer box could be removed because it is too complicated to disclose meaningfully or otherwise lacks importance compared to other credit terms that are arguably more important when choosing among cards. Such information included the method for computing balances and the amount of the minimum finance charge (the latter because it is typically so small, about 50 cents in 2005).
- *Provide a shorter document that summarizes key information.* Some industry participants advocated that all key information that could significantly affect a cardholder's costs be presented in a short document that consumers could use to readily compare across cards, with all other details included in a longer document. For example, although the Schumer box includes several key pieces of information, it does not include other information that could be as important for consumer decisions, such as what actions could cause the issuer to raise the interest rate to the default rate.

[59] Truth in Lending, 70 Fed. Reg. 60235 (request for comments; extension of comment period, published October 17, 2005).

- *Revise disclosure formats to improve readability.* Various suggestions were made to improve the readability of card disclosures, including making more use of tables of contents, making labels and headings more prominent, and presenting more information in tables instead of in text. Disclosure documents also could use consistent wording that could allow for better comparison of terms across cards.

Some issuers and others also told us that the new regulations should allow for more flexibility in card disclosure formats. Regulations mandating formats and font sizes were seen as precluding issuers from presenting information in more effective ways. For example, one issuer already has conducted market research and developed new formats for the Schumer box that it says are more readable and contain new information important to choosing cards in today's credit card environment, such as cardholder actions that would trigger late fees or penalty interest rate increases.

In addition to suggestions about content, obtaining the input of consumers, and possibly other professionals, was also seen as an important way to make any new disclosures more useful. For example, participants in a Federal Reserve Bank symposium on credit card disclosures recommended that the Federal Reserve obtain the input of marketers, researchers, and consumers as part of developing new disclosures. OCC staff suggested that the Federal Reserve also employ qualitative research methods such as in-depth interviews with consumers and others and that it conduct usability testing.

Consumer testing can validate the effectiveness or measure the comprehension of messages and information, and detect document design problems. Many issuers are using some form of market research to test their disclosure materials and have advocated improving disclosures by seeking the input of marketers, researchers, and consumers.[60] SEC also has recently used consumer focus groups to test the format of new disclosures related to mutual funds. According to an SEC staff member who participated in this effort, their testing provided them with valuable information on what consumers liked and disliked about some of the initial forms that the regulator had drafted. In some cases, they learned that

[60]Consumer testing can be conducted in several ways, such as focus groups, where consumers analyze products in a group setting, and conjoint analysis, which helps companies understand the extent to which consumers prefer certain product attributes over others.

information that SEC staff had considered necessary to include was not seen as important by consumers. As a result, they revised the formats for these disclosures substantially to make them simpler and may use graphics to present more information rather than text.[61] According to Federal Reserve staff, they have begun to involve consumers in the development of new credit card disclosures. According to Federal Reserve staff, they have already conducted some consumer focus groups. In addition, they have contracted with a design consultant and a market research firm to help them develop some disclosure formats that they can then use in one-on-one testing with consumers. However, the Federal Reserve staff told us they recognize the challenge of designing disclosures that include all key information in a clear manner, given the complexity of credit card products and the different ways in which consumers use credit cards.

Although Credit Card Penalty Fees and Interest Could Increase Indebtedness, the Extent to Which They Have Contributed to Bankruptcies Was Unclear

The number of consumers filing for bankruptcy has risen more than six-fold over the past 25 years, and various factors have been cited as possible explanations. While some researchers have pointed to increases in total debt or credit card debt in particular, others found that debt burdens and other measures of financial distress had not increased and thus cite other factors, such as a general decline in the stigma of going bankrupt or the potentially increased costs of major life events such as health problems or divorce. Some critics of the credit card industry have cited penalty interest and fees as leading to increased financial distress; however, no comprehensive data existed to determine the extent to which these charges were contributing to consumer bankruptcies. Data provided by the six largest card issuers indicated that unpaid interest and fees represented a small portion of the amounts owed by cardholders that filed for bankruptcy; however, these data alone were uot sufficient to determine any relationship between the charges and bankruptcies filed by cardholders.

Researchers Cited Various Factors as Explanations for Rise in Consumer Bankruptcies

According to U.S. Department of Justice statistics, consumer bankruptcy filings generally rose steadily from about 287,000 in 1980 to more than 2 million as of December 31, 2005, which represents about a 609 percent

[61]Securities Exchange Act Release No. 33-8544 (Feb. 28, 2005).

increase over the last 25 years.[62] Researchers have cited a number of factors as possible explanations for the long-term trend.

Increase in Household Indebtedness

The total debt of American households is composed of mortgages on real estate, which accounts for about 80 percent of the total, and consumer credit debt, which includes revolving credit, such as balances owed on credit cards, and nonrevolving credit, primarily consisting of auto loans. According to Federal Reserve statistics, consumers' use of debt has expanded over the last 25 years, increasing more than sevenfold from $1.4 trillion in 1980 to about $11.5 trillion in 2005. Some researchers pointed to this rise in overall indebtedness as contributing to the rise in bankruptcies. For example, a 2000 Congressional Budget Office summary of bankruptcy research noted that various academic studies have argued that consumer bankruptcies are either directly or indirectly caused by heavy consumer indebtedness.

Rather than total debt, some researchers and others argue that the rise in bankruptcies is related to the rise in credit card debt in particular. According to the Federal Reserve's survey of consumer debt, the amount of credit card debt reported as outstanding rose from about $237 billion to more than $802 billion—a 238 percent increase between 1990 and 2005.[63] One academic researcher noted that the rise in bankruptcies and charge-offs by banks in credit card accounts grew along with the increase in credit card debt during the 1973 to 1996 period he examined.[64] According to some consumer groups, the growth of credit card debt is one of the primary explanations of the increased prevalence of bankruptcies in the United States. For example, one group noted in a 2005 testimony before Congress that growth of credit card debt—particularly among lower and moderate income households, consumers with poor credit scores, college students,

[62]Bankruptcy filings sharply increased recently, with filings in 2005 30 percent higher than in 2004. This increase likely resulted from the accelerated rate of filing that occurred in the months before the new Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which tightened eligibility for filing, became effective on October 17, 2005.

[63]In addition to capturing amounts outstanding on credit cards, the number reported in the Federal Reserve's survey of consumer debt for revolving debt also includes other types of revolving debt. However, Federal Reserve staff familiar with the survey's results indicated that the vast majority of the amount reported as revolving debt is from credit cards.

[64]L. Ausubel, "Credit Card Defaults, Credit Card Profits, and Bankruptcy," *The American Bankruptcy Law Journal*, 71 (Spring 1997).

older Americans, and minorities—was contributing to the rise in bankruptcies.[65]

However, other evidence indicates that increased indebtedness has not severely affected the financial condition of U.S. households in general. For example:

- Some researchers note that the ability of households to make payments on debt appears to be keeping pace. For example, total household debt levels as a percentage of income has remained relatively constant since the 1980s. According to the Federal Reserve, the aggregate debt burden ratio—which covers monthly aggregate required payments of all households on mortgage debt and both revolving and non-revolving consumer loans relative to the aggregate monthly disposable income of all households—for U.S. households has been above 13 percent in the last few years but generally fluctuated between 11 percent and 14 percent from 1990 to 2005, similar to the levels observed during the 1980s. According to one researcher, although the debt burden ratio has risen since the 1980s, the increase has been gradual and therefore cannot explain the six-fold increase in consumer bankruptcy filings over the same period.
- Credit card debt remains a small portion of overall household debt, even among households with the lowest income levels. According to the Federal Reserve, credit card balances as a percentage of total household debt have declined from 3.9 percent of total household debt in 1995 to just 3.0 percent as of 2004.
- The proportion of households that could be considered to be in financial distress does not appear to be increasing significantly. According to the Federal Reserve Board's Survey of Consumer Finances, the proportion of households that could be considered to be in financial distress—those that report debt-to-income ratios exceeding 40 percent and that have had at least one delinquent payment within the last 60 days—was relatively stable between 1995 and 2004. Further, the proportion of the

[65]Consumer Federation of America testimony before the Committee on Banking, Housing, and Urban Affairs of the United States Senate, "*Examining the Current Legal and Regulatory Requirements and Industry Practices for Credit Card Issuers with Respect to Consumer Disclosures and Marketing Efforts,*" 109th Congress, 2nd sess., May 17, 2005. We reported on issues relating to college students and credits in 2001. See GAO, *Consumer Finance: College Students and Credit Cards*, GAO-01-773 (Washington, D.C.; June 20, 2001).

lowest-income households exhibiting greater levels of distress was lower in 2004 than it was in the 1990s.

Other Explanations

With the effect of increased debt unclear, some researchers say that other factors may better explain the surge in consumer bankruptcy filings over the past 25 years. For example, the psychological stigma of declaring bankruptcy may have lessened. One academic study examined a range of variables that measured the credit risk (risk of default) of several hundred thousand credit card accounts and found that because the bankruptcy rate for the accounts was higher than the credit-risk variables could explain, the higher rate must be the result of a reduced level of stigma associated with filing.[66] However, others have noted that reliably measuring stigma is difficult. Some credit card issuers and other industry associations also have argued that the pre-2005 bankruptcy code was too debtor-friendly and created an incentive for consumers to borrow beyond the ability to repay and file for bankruptcy.

In addition to the possibly reduced stigma, some academics, consumer advocacy groups, and others noted that the normal life events that reduce incomes or increase expenses for households may have a more serious effect today. Events that can reduce household incomes include job losses, pay cuts, or having a full-time position converted to part-time work. With increasing health care costs, medical emergencies can affect household expenses and debts more significantly than in the past, and, with more families relying on two incomes, so can divorces. As a result, one researcher explains that while these risks have always faced households, their effect today may be more severe, which could explain higher bankruptcy rates.[67]

Researchers who assert that life events are the primary explanation for bankruptcy filings say that the role played by credit cards can vary. They acknowledged that credit card debt can be a contributing factor to a bankruptcy filing if a person's income is insufficient to meet all financial obligations, including payments to credit card issuers. For example, some individuals experiencing an adverse life event use credit cards to provide

[66] David B. Gross and Nicholas S. Souleles, "Explaining the Increase in Bankruptcy and Delinquency: Stigma Versus Risk-Composition." Mimeo, University of Chicago, (August 28, 1998).

[67] Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School, "The Growing Threat to Middle Class Families," *Brooklyn Law Review*, (April 2003).

additional funds to satisfy their financial obligations temporarily but ultimately exhaust their ability to meet all obligations. However, because the number of people that experience financially troublesome life events likely exceeds the number of people who file for bankruptcy, credit cards in other cases may serve as a critical temporary source of funding they needed to avert a filing until that person's income recovers or expenses diminish. (Appendix II provides additional detail about the factors that may have affected the rise in consumer bankruptcy filings and its relationship with credit card debt.)

The Extent to Which Credit Card Penalty Interest and Fees Contribute to Consumer Bankruptcies Remains Controversial in the Absence of Comprehensive Data

With very little information available on the financial condition of individuals filing for bankruptcy, assessing the role played by credit card debt, including penalty interest and fees, is difficult. According to Department of Justice officials who oversee bankruptcy trustees in most bankruptcy courts, the documents submitted as part of a bankruptcy filing show the total debt owed to each card issuer but not how much of this total consists of unpaid principal, interest, or fees. Similarly, these Justice officials told us that the information that credit card issuers submit when their customers reaffirm the debts owed to them—known as proofs of claim—also indicate only the total amount owed. Likewise, the amount of any penalty interest or fees owed as part of an outstanding credit card balance is generally not required to be specified when a credit card issuer seeks to obtain a court judgment that would require payment from a customer as part of a collection case.

Opinions on the Link between Credit Card Practices and Bankruptcies Vary

Although little comprehensive data exist, some consumer groups and others have argued that penalty interest and fees materially harm the financial condition of some cardholders, including those that later file for bankruptcy. Some researchers who study credit card issues argue that high interest rates (applicable to standard purchases) for higher risk cardholders, who are also frequently lower-income households, along with penalty and default interest rates and fees, contribute to more consumer bankruptcy filings. Another researcher who has studied issues relating to credit cards and bankruptcy asserted that consumers focus too much on the introductory purchase interest rates when shopping for credit cards and, as a result, fail to pay close attention to penalty interest rates, default clauses, and other fees that may significantly increase their costs later. According to this researcher, it is doubtful that penalty fees (such as late fees and over-limit fees) significantly affect cardholders' debt levels, but accrued interest charges—particularly if a cardholder is being assessed a high penalty interest rate—can significantly worsen a cardholder's financial distress.

Some consumer advocacy groups and academics say that the credit card industry practice of raising cardholder interest rates for default or increased risky behavior likely has contributed to some consumer bankruptcy filings. According to these groups, cardholders whose rates are raised under such practices can find it more difficult to reduce their credit card debt and experience more rapid declines in their overall financial conditions as they struggle to make the higher payments that such interest rates may entail. As noted earlier in this report, card issuers have generally ceased practicing universal default, although representatives for four of the six issuers told us that they might increase their cardholder's rates if they saw indications that the cardholder's risk has increased, such as how well they were making payments to other creditors. In such cases, the card issuers said they notify the cardholders in advance, by sending a change in terms notice, and provide an option to cancel the account but keep the original terms and conditions while paying off the balance.

Some organizations also have criticized the credit card industry for targeting lower-income households that they believe may be more likely to experience financial distress or file for bankruptcy. One of the criticisms these organizations have made is that credit card companies have been engaging in bottom-fishing by providing increasing amounts of credit to riskier lower-income households that, as a result, may incur greater levels of indebtedness than appropriate. For example, an official from one consumer advocacy group testified in 2005 that card issuers target lower-income and minority households and that this democratization of credit has had serious negative consequences for these households, placing them one financial emergency away from having to file for bankruptcy.[68] Some consumer advocacy group officials and academics noted that card issuers market high-cost cards, with higher interest rates and fees, to customers with poor credit histories—called subprime customers—including some just coming out of bankruptcy. However, as noted earlier, Federal Reserve survey data indicate that the proportion of lower-income households—those with incomes below the fortieth percentile—exhibiting financial distress has not increased since 1995. In addition, in a June 2006 report that the Federal Reserve Board prepared for Congress on the relationship

[68]See above: Consumer Federation of America testimony before the Committee on Banking, Housing, and Urban Affairs of the United States Senate on May 17, 2005.

between credit cards and bankruptcy, it stated that credit card issuers do not solicit customers or extend credit to them indiscriminately or without assessing their ability to repay debt as issuers review all received applications for risk factors.[69]

In addition, representatives of credit card issuers argued that they do not offer credit to those likely to become financially bankrupt because they do not want to experience larger losses from higher-risk borrowers. Because card accounts belonging to cardholders that filed for bankruptcy account for a sizeable portion of issuers' charge-offs, card issuers do not want to acquire new customers with high credit risk who may subsequently file for bankruptcy. However, one academic researcher noted that, if card issuers could increase their revenue and profits by offering cards to more customers, including those with lower creditworthiness, they could reasonably be expected to do so until the amount of expected losses from bankruptcies becomes larger than the expected additional revenues from the new customers.

In examining the relationship between the consumer credit industry and bankruptcy, the Federal Reserve Board's 2006 report comes to many of the same couclusions as the studies of other researchers we reviewed. The Federal Reserve Board's report notes that despite large growth in the proportion of households with credit cards and the rise in overall credit card debt in recent decades, the debt-burden ratio and other potential measures of financial distress have not significantly changed over this period. The report also found that, while data on bankruptcy filings indicate that most filers have accumulated consumer debt and the proportion of filings and rise in revolving consumer debt have risen in tandem, the decision to file for bankruptcy is complex and tends to be driven by distress arising from life events such as job loss, divorce, or uninsured illness.

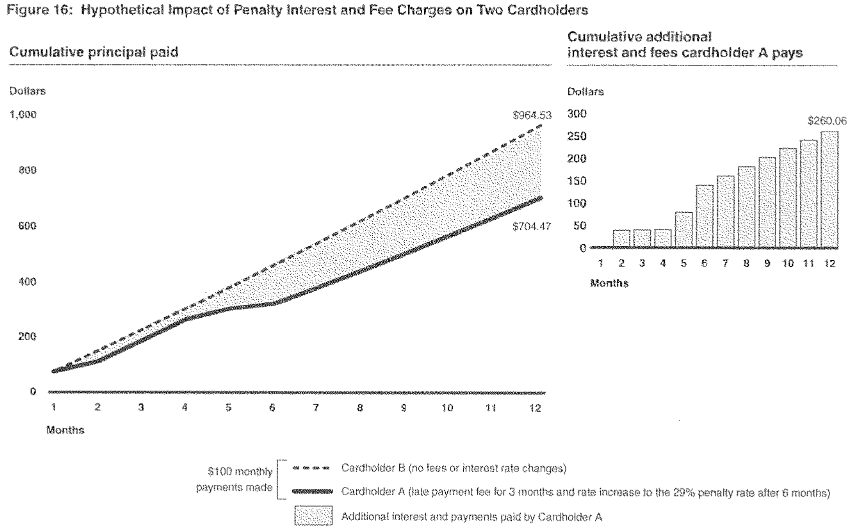
Penalty Interest and Fees Can Affect Cardholders' Ability to Reduce Outstanding Balances

While the effect of credit card penalty interest charges and fees on consumer bankruptcies was unclear, such charges do reduce the ability of cardholders to reduce their overall indebtedness. Generally, any penalty charges that cardholders pay would consume funds that could have been used to repay principal. Figure 16 below, compares two hypothetical

[69]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* (Washington, D.C.: June 2006).

cardholders with identical initial outstanding balances of $2,000 that each make monthly payments of $100. The figure shows how the total amounts of principal are paid down by each of these two cardholders over the course of 12 months, if penalty interest and fees apply. Specifically, cardholder A (1) is assessed a late payment fee in three of those months and (2) has his interest rate increased to a penalty rate of 29 percent after 6 months, while cardholder B does not experience any fees or penalty interest charges. At the end of 12 months, the penalty and fees results in cardholder A paying down $260 or 27 percent less of the total balance owed than does cardholder B who makes on-time payments for the entire period.

Figure 16: Hypothetical Impact of Penalty Interest and Fee Charges on Two Cardholders



Source: GAO.

In Some Court Cases, Cardholders Paid Significant Amounts of Penalty Interest and Fees

In reviewing academic literature, hearings, and comment letters to the Federal Reserve, we identified some court cases, including some involving the top six issuers, that indicated that cardholders paid large amounts of penalty interest and fees. For example:

- In a collections case in Ohio, the $1,963 balance on one cardholder's credit card grew by 183 percent to $5,564 over 6 years, despite the cardholder making few new purchases. According to the court's records, although the cardholder made payments totaling $3,492 over this period, the holder's balance grew as the result of fees and interest charges. According to the court's determinations, between 1997 and 2003, the cardholder was assessed a total of $9,056, including $1,518 in over-limit fees, $1,160 in late fees, $369 in credit insurance, and $6,009 in interest charges and other fees. Although the card issuer had sued to collect, the judge rejected the issuer's collection demand, noting that the cardholder was the victim of unreasonable, unconscionable practices.[70]

- In a June 2004 bankruptcy case filed in the U.S. Bankruptcy Court for the Eastern District of Virginia, the debtor objected to the proofs of claim filed by two companies that had been assigned the debt outstanding on two of the debtor's credit cards. One of the assignees submitted monthly statements for the credit card account it had assumed. The court noted that over a two-year period (during which balance on the account increased from $4,888 to $5,499), the debtor made only $236 in purchases on the account, while making $3,058 in payments, all of which had gone to pay finance charges, late charges, over-limit fees, bad check fees and phone payment fees.[71]

- In a bankruptcy court case filed in July 2003 in North Carolina, 18 debtors filed objections to the claims by one card issuer of the amounts owed on their credit cards.[72] In response to an inquiry by the judge, the card issuer provided data for these accounts that showed that, in the

[70] "Comments of the National Consumer Law Center et al. regarding Advance Notice of Proposed Rulemaking Review of the Revolving Credit Rules of Regulation Z," p. 7-9.

[71] *McCarthy vs. eCast Settlement Corporation et al.*, No.04-10493-SSM (Bankr. E.D. Va. filed June 9, 2004).

[72] *See Blair v. Capital One Bank*, No. 02-11400, *Amended Order Overruling Objection to Claim(s)s* (Bankr. W.D. NC filed Feb. 10, 2004) (disposing of, on a consolidated basis, similar objections filed in 18 separate Chapter 13 cases against a common creditor) (Additional docket numbers omitted.).

aggregate, 57 percent of the amounts owed by these 18 accounts at time of their bankruptcy filings represented interest charges and fees. However, the high percentage of interest and fees on these accounts may stem from the size of these principal balances, as some were as low as $95 and none was larger than $1,200.

Regulatory interagency guidance published in 2003 for all depository institutions that issue credit cards may have reduced the potential for cardholders who continue to make minimum payments to experience increasing balances.[73] In this guidance, regulators suggested that card issuers require minimum repayment amounts so that cardholders' current balance would be paid off–amortized–over a reasonable amount of time. In the past, some issuers' minimum monthly payment formulas were such that a full payment may have resulted in little or no principal being paid down, particularly if the cardholder also was assessed any fees during a billing cycle. In such cases, these cardholders' outstanding balances would increase (or negatively amortize). In response to this guidance, some card issuers we interviewed indicated that they have been changing their minimum monthly payment formulas to ensure that credit card balances will be paid off over a reasonable period by including at least some amount of principal in each payment due.

Representatives of card issuers also told us that the regulatory guidance, issued in 2003, addressing credit card workout programs—which allow a distressed cardholder's account to be closed and repaid on a fixed repayment schedule—and other forbearance practices, may help cardholders experiencing financial distress avoid fees. In this guidance, the regulators stated that (1) any workout program offered by an issuer should be designed to have cardholders repay credit card debt within 60 months and (2) to meet this time frame, interest rates and penalty fees may have to be substantially reduced or eliminated so that principal can be repaid. As a result, card issuers are expected to stop imposing penalty fees and interest charges on delinquent card accounts or hardship card accounts enrolled in repayment workout programs. According to this guidance, issuers also can negotiate settlement agreements with cardholders by forgiving a portion of

[73] *Credit Card Lending: Account Management and Loss Allowance Guidance* (January 2003), joint guidance issued under the auspices of the Federal Financial Institutions Examination Council by the Office of the Comptroller of the Currency (OCC Bulletin 2003-1), Federal Reserve (Supervisory Letter SR-03-1), Federal Deposit Insurance Corporation (Financial Institution Letter, FIL-2-2003), and Office of Thrift Supervision (OTS Release 03-01).

the amount owed. In exchange, a cardholder can be expected to pay the remaining balance either in a lump-sum payment or by amortizing the balance over a several month period. Staff from OCC and an association of credit counselors told us that, since the issuance of this guidance, they have noticed that card issuers are increasingly both reducing and waiving fees for cardholders who get into financial difficulty. OCC officials also indicated that issuers prefer to facilitate repayment of principal when borrowers adopt debt management plans and tend to reduce or waive fees so the accounts can be amortized. On the other hand, FDIC staff indicated that criteria for waiving fees and penalties are not publicly disclosed to cardholders. These staff noted that most fee waivers occurs after cardholders call and complain to the issuer and are handled on a case-by-case basis.

Data for Some Bankrupt Cardholders Shows Little in Interest and Fees Owed, but Comprehensive Data Were Not Available

Card issuers generally charge-off credit card loans that are no longer collectible because they are in default for either missing a series of payments or filing for bankruptcy. According to the data provided by the six largest issuers, the number of accounts that these issuers collectively had to charge off as a result of the cardholders filing for bankruptcy ranged from about 1.3 million to 1.6 million annually between 2003 and 2005. Collectively, these represented about 1 percent of the six issuers' active accounts during this period. Also, about 60 percent of the accounts were 2 or more months delinquent at the time of the charge-off. Most of the cardholders whose accounts were charged off as the result of a bankruptcy owed small amounts of fees and interest charges at the time of their bankruptcy filing. According to the data the six issuers provided, the average account that they charged off in 2005 owed approximately $6,200 at the time that bankruptcy was filed. Of this amount, the issuers reported that on average 8 percent represented unpaid interest charges; 2 percent unpaid fees, including any unpaid penalty charges; and about 90 percent principal.

However, these data do not provide complete information about the extent to which the financial condition of the cardholders may have been affected by penalty interest and fee charges. First, the amounts that these issuers reported to us as interest and fees due represent only the unpaid amounts that were owed at the time of bankruptcy. According to representatives of the issuers we contacted, each of their firms allocates the amount of any payment received from their customers first to any outstanding interest charges and fees, then allocates any remainder to the principal balance. As a result, the amounts owed at the time of bankruptcy would not reflect any previously paid fees or interest charges. According to representatives of these issuers, data system and recordkeeping limitations prevented them from providing us the amounts of penalty interest and fees assessed on these accounts in the months prior to the bankruptcy filings.

Furthermore, the data do not include information on all of the issuers' cardholders who went bankrupt, but only those whose accounts the issuers charged off as the result of a bankruptcy filing. The issuers also charge off the amounts owed by customers who are delinquent on their payments by more than 180 days, and some of those cardholders may subsequently file for bankruptcy. Such accounts may have accrued larger amounts of unpaid penalty interest and fees than the accounts that were charged off for bankruptcy after being delinquent for less than 180 days, because they would have had more time to be assessed such charges. Representatives of the six issuers told us that they do not maintain records on these customers after they are charged off, and, in many cases, they sell the accounts to collection firms.

Although Penalty Interest and Fees Likely Have Grown as a Share of Credit Card Revenues, Large Card Issuers' Profitability Has Been Stable

Determining the extent to which penalty interest charges and fees contribute to issuers' revenues and profits was difficult because issuers' regulatory filings and other public sources do not include such detail. According to bank regulators, industry analysts, and information reported by the five largest issuers, we estimate that the majority of issuer revenues—around 70 percent in recent years—came from interest charges, and the portion attributable to penalty rates appears to be growing. Of the remaining issuer revenues, penalty fees had increased and were estimated to represent around 10 percent of total issuer revenues. The remainder of issuer revenues came from fees that issuers receive for processing merchants' card transactions and other types of consumer fees. 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.

Publicly Disclosed Data on Revenues and Profits from Penalty Interest and Fees Are Limited

Determining the extent to which penalty interest and fee charges are contributing to card issuer revenues and profits is difficult because limited information is available from publicly disclosed financial information. Credit card-issuing banks are subject to various regulations that require them to publicly disclose information about their revenues and expenses. As insured commercial banks, these institutions must file reports of their financial condition, known as call reports, each quarter with their respective federal regulatory agency. In call reports, the banks provide comprehensive balance sheets and income statements disclosing their earnings, including those from their credit card operations. Although the call reports include separate lines for interest income earned, this amount is not further segregated to show, for example, income from the application of penalty interest rates. Similarly, banks report their fee income on the call reports, but this amount includes income from all types of fees, including those related to fiduciary activities, and trading assets and liabilities and is not further segregated to show how much a particular bank has earned from credit card late fees, over-limit fees, or insufficient payment fees.

Another limitation of using call reports to assess the effect of penalty charges on bank revenues is that these reports do not include detailed information on credit card balances that a bank may have sold to other investors through a securitization. As a way of raising additional funds to lend to cardholders, many issuers combine the balances owed on large groups of their accounts and sell these receivables as part of pools of securitized assets to investors. In their call reports, the banks do not report revenue received from cardholders whose balances have been sold into credit card interest and fee income categories.[74] The banks report any gains or losses incurred from the sale of these pooled credit card balances on their call reports as part of noninterest income. Credit card issuing banks generally securitize more than 50 percent of their credit card balances.

Although many card issuers, including most of the top 10 banks, are public companies that must file various publicly available financial disclosures on an ongoing basis with securities regulators, these filings also do not disclose detailed information about penalty interest and fees. We reviewed the public filings by the top five issuers and found that none of the financial statements disaggregated interest income into standard interest and penalty interest charges. In addition, we found that the five banks' public financial statements also had not disaggregated their fee income into penalty fees, service fees, and interchange fees. Instead, most of these card issuers disaggregated their sources of revenue into two broad categories—interest and noninterest income.

[74]In accordance with generally accepted accounting principles (Standards of Financial Accounting Statement 140), when card issuers sell any of their credit card receivables as part of a securitization, they subtract the amount of these receivables from the assets shown on their balance sheets.

Majority of Card Issuer Revenues Came from Interest Charges

Although limited information is publicly disclosed, the majority of credit card revenue appears to have come from interest charges. According to regulators, information collected by firms that analyze the credit card industry, and data reported to us by the five of the six largest issuers, the proportion of net interest revenues to card issuers' total revenues is as much as 71 percent. For example, five of the six largest issuers that provided data to us reported that the proportion of their total U.S. card operations income derived from interest charges ranged from 69 to 71 percent between 2003 and 2005.[75]

[75] One of the top six largest issuers, Discover, Inc., operates its own transaction processing network; the other issuers process card transactions through the networks operated by Visa International or Mastercard. Because this difference could have reduced the comparability of the data we obtained from these issuers, the information on revenue and profitability aggregated by the third party in response to our data request excludes Discover, Inc.

Credit card bank revenue sources

The sources of revenues for credit card banks are different than those of nonfinancial businesses. For example, the profits of a manufacturing business are determined by subtracting its production costs and the other expenses it incurs from the revenues it earns from selling the goods it produces. In contrast, banks' profits are generally derived by subtracting the interest expenses they incur on the sources of funds—such as savings deposits—that they use to make loans from the interest revenues they earn on those loans. The difference between banks' interest revenues and their interest expenses represents their net interest income. To determine the total net income from a bank's operations, any revenues from noninterest sources, such as fees, are added to its net interest income, and then all other expenses, including amounts owed on loans that now appear uncollectible—loan losses—and the expenses of operating the bank, including staff salaries and marketing expenses, are subtracted. Figure 17 shows a simplified example of a typical bank's income statement.

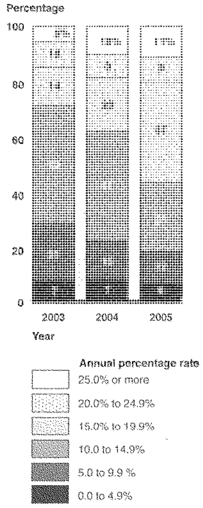
Figure 17: Example of a Typical Bank's Income Statement

Revenue/expense category	Description
Interest charges ($)/yield (%)	Received from loans to corporate and consumer borrowers, credit card holders carrying balances, etc.
- Cost of funds	Paid on deposits or borrowings from other banks
Net interest income	
+ Noninterest income	From fees or other charges for services paid by borrowers or other customers
Total revenue from operations	
- Credit losses	From the writeoff of amounts of loans or card balances that will not be paid by borrowers who have defaulted
Net risk-adjusted revenue	
- Noninterest expenses	Operating expenses such as postage, utilities, etc., for staff and other noninterest expenses
- Fraud losses	
Noninterest expense + fraud losses	
+ Pre-tax income	
- Taxes	
Net income	

Source: GAO analysis of data reported by the six largest credit card issuers.

We could not precisely determine the extent to which penalty interest charges contribute to this revenue, although the amount of penalty interest that issuers have been assessing has increased. In response to our request, the six largest issuers reported the proportions of their total cardholder accounts that were assessed various rates of interest for 2003 to 2005. On the basis of our analysis of the popular cards issued by these largest issuers, all were charging, on average, default interest rates of around 27 percent. According to the data these issuers provided, the majority of cardholders paid interest rates below 20 percent, but the proportion of their cardholders that paid interest rates at or above 25 percent—which likely represent default rates—has risen from 5 percent in 2003 to 11 percent in 2005. As shown in Figure 18, the proportion of cardholders paying between 15 and 20 percent has also increased, but an issuer representative told us that this likely was due to variable interest rates on cards rising as a result of increases in U.S. market interest rates over the last 3 years.

Figure 18: Proportion of Active Accounts of the Six Largest Card Issuers with Various Interest Rates for Purchases, 2003 to 2005



Source: GAO analysis of data reported by the six largest credit card issuers.

Although we could not determine the amounts of penalty interest the card issuers received, the increasing proportion of accounts assessed rates of 25 percent suggests a significant increase in interest revenues. For example, a cardholder carrying a stable balance of $1,000 and paying 10 percent interest would pay approximately $100 annually, while a cardholder carrying the same stable balance but paying 25 percent would pay $250 to the card issuer annually. Although we did not obtain any information on the size of balances owed by the cardholders of the largest issuers, the proportion of the revenues these issuers received from cardholders paying penalty interest rates may also be greater than 11 percent because such cardholders may have balances larger than the $2,500 average for 2005 that the issuers reported to us.

Fees Represented the Remainder of Issuer Revenues

The remaining card issuer revenues largely come from noninterest sources, including merchant and consumer fees. Among these are penalty fees and other consumer fees, as well as fees that issuers receive as part of processing card transactions for merchants.

Penalty Fees Had Increased

Although no comprehensive data exist publicly, various sources we identified indicated that penalty fees represent around 10 percent of issuers' total revenues and had generally increased. We identified various sources that gave estimates of penalty fee income as a percentage of card issuers' total revenues that ranged from 9 to 13 percent:

- Analysis of the data the top six issuers provided to us indicated that each of these issuers assessed an average of about $1.2 billion in penalty fees for cardholders that made late payments or exceeded their credit limit in 2005. In total, these six issuers reported assessing $7.4 billion for these two penalty fees that year, about 12 percent of the $60.3 billion in total interest and consumer fees (penalty fees and fees for other cardholder services).[76]
- According to a private firm that assists credit card banks with buying and selling portfolios of credit card balance receivables, penalty fees likely represented about 13 percent of total card issuer revenues. According to an official with this firm, it calculated this estimate by using information from 15 of the top 20 issuers, as well as many smaller banks, that together represent up to 80 percent of the total credit card industry.[77]

[76]We were not provided information on the portion of revenues these issuers earned from these penalty fees and consumer fees.

[77]Although we were not able to completely assess the reliability of this organization's data and its methods for making its estimates of industry revenue components, we present this information because it appeared to be similar to the proportions reported by the top six issuers that provided us data.

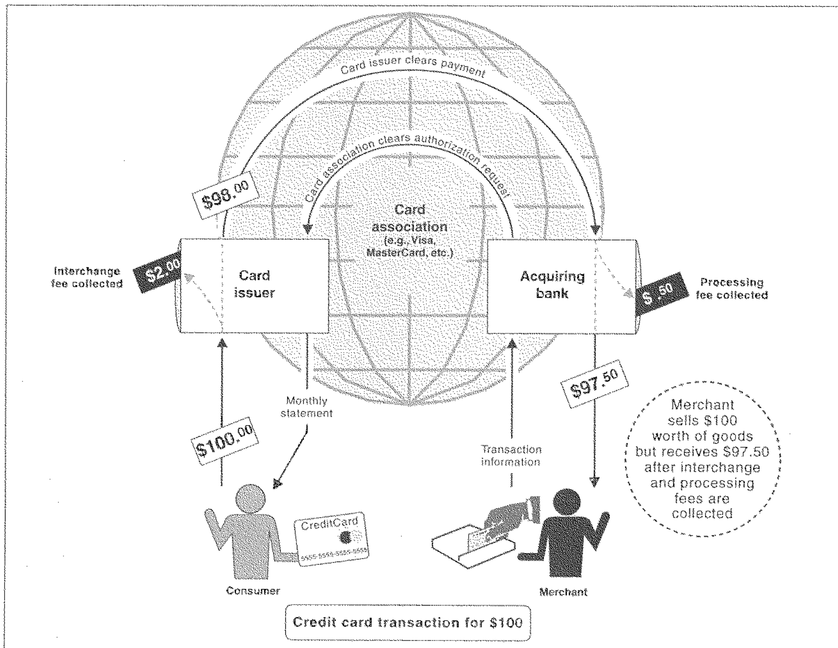
- An estimate from an industry research firm that publishes data on credit card issuer activities indicated that penalty fees represented about 9 percent of issuer total revenues.

Issuers Also Collect Revenues from Processing Merchant Card Transactions

When a consumer makes a purchase with a credit card, the merchant selling the goods does not receive the full purchase price. When the cardholder presents the credit card to make a purchase, the merchant transmits the cardholder's account number and the amount of the transaction to the merchant's bank.[78] The merchant's bank forwards this information to the card association, such as Visa or Mastercard, requesting authorization for the transaction. The card association forwards the authorization request to the bank that issued the card to the cardholder. The issuing bank then responds with its authorization or denial to the merchant's bank and then to the merchant. After the transaction is approved, the issuing bank will send the purchase amount, less an interchange fee, to the merchant's bank. The interchange fee is established by the card association. Before crediting the merchant's account, the merchant's bank will subtract a servicing fee. These transaction fees—called interchange fees—are commonly about 2 percent of the total purchase price. As shown in figure 19, the issuing banks generally earn about $2.00 for every $100 purchased as interchange fee revenue. In addition, the card association receives a transaction processing fee. The card associations, such as Visa or Mastercard, assess the amount of these fees and also conduct other important activities, including imposing rules for issuing cards, authorizing, clearing and settling transactions, advertising and promoting the network brand, and allocating revenues among the merchants, merchant's bank, and card issuer.

[78]The bank that a merchant uses to process its credit card transactions is known as the acquiring bank.

Figure 19: Example of a Typical Credit Card Purchase Transaction Showing How Interchange Fees Paid by Merchants Are Allocated



Sources: GAO (analysis); Art Explosion (images).

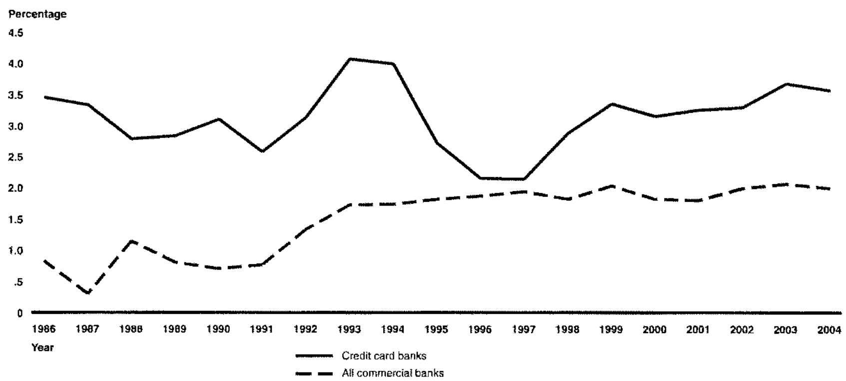
In addition to penalty fees and interchange fees, the remaining noninterest revenues for card issuers include other consumer fees or other fees. Card issuers collect annual fees, cash advance fees, balance transfer fees, and other fees from their cardholders. In addition, card issuers collect other revenues, such as from credit insurance. According to estimates by industry analyst firms, such revenues likely represented about 8 to 9 percent of total issuer revenues.

Large Credit Card Issuer Profitability Has Been Stable

The profits of credit card-issuing banks, which are generally the most profitable group of lenders, have been stable over the last 7 years. A commonly used indicator of profitability is the return on assets ratio (ROA). This ratio, which is calculated by dividing a company's income by its total assets, shows how effectively a business uses its assets to generate profits. In annual reports to Congress, the Federal Reserve provides data on the profitability of larger credit card issuers—which included 17 banks in 2004.[79] Figure 20 shows the average ROA using pretax income for these large credit card issuers compared with pretax ROA of all commercial banks during the period 1986 to 2004. In general, the large credit card issuers earned an average return of 3.12 percent over this period, which was more than twice as much as the 1.49 percent average returns earned by all commercial banks.

[79]See Federal Reserve System, *Profitability of Credit Card Operations*, June 2005. The data included in these reports are for all commercial banks with at least $200 million in yearly average assets (loans to individuals plus securitizations) and at least 50 percent of assets in consumer lending, of which 90 percent must be in the form of revolving credit.

Figure 20: Average Pretax Return on Assets for Large Credit Card Banks and All Commercial Banks, 1986 to 2004



Source: Federal Reserve Board.

As shown in the figure above, the ROA for larger credit card banks, although fluctuating more widely during the 1990s, has generally been stable since 1999, with returns in the 3.0 to 3.5 percent range. The return on assets for the large card issuers peaked in 1993 at 4.1 percent and has declined to 3.55 percent in 2004. In contrast, the profitability of all commercial banks has been generally increasing over this period, rising more than 140 percent between 1986 and 2004. Similar to the data for all larger credit card issuers, data that five of the six largest issuers provided to us indicated that their profitability also has been stable in the 3 years between 2003 and 2005. These five issuers reported that the return on their pretax earnings over their credit card balances over this 3-year period ranged from about 3.6 percent to 4.1 percent.

Because of the high interest rates that issuers charge and variable rate pricing, credit card lending generally is the most profitable type of consumer lending, despite the higher rate of loan losses that issuers incur on cards. Rates charged on credit cards generally are the highest of any consumer lending category because they are extensions of credit that are not secured by any collateral from the borrower. In contrast, other common types of consumer lending, such as automobile loans or home mortgages, involve the extension of a fixed amount of credit under fixed terms of repayment that are secured by the underlying asset—the car or the house—which the lender can repossess in the event of nonpayment by the borrower. Collateral and fixed repayment terms reduce the risk of loss to the lender, enabling them to charge lower interest rates on such loans. In contrast, credit card loans, which are unsecured, available to large and heterogeneous populations, and repayable on flexible terms at the cardholders' convenience, present greater risks and have commensurately higher interest rates. For example, according to Federal Reserve statistics, the interest rate charged on cards by lenders generally has averaged above 16 percent since 1980, while the average rate charged on car loans since then has averaged around 10 percent. Borrowers may be more likely to cease making payments on their credit cards if they become financially distressed than they would on other loans that are secured by an asset they could lose. For example, the percentage of credit card loans that banks have had to charge off averaged above 4 percent between 2003 and 2005; in contrast, charge-offs for other types of consumer loans average about 2 percent, with charge-offs for mortgage loans averaging less than 1 percent, during those 3 years. (App. III provides additional detail about the factors that affect the profitability of credit card issuers.)

Conclusions

Credit cards provide various benefits to their cardholders, including serving as a convenient way to pay for goods and services and providing additional funds at rates of interest generally lower than those consumers would have paid to borrow on cards in the past. However, the penalties for late payments or other behaviors involving card use have risen significantly in recent years. Card issuers note that their use of risk-based pricing structures with multiple interest rates and fees has allowed them to offer credit cards to cardholders at costs that are commensurate with the risks presented by different types of customers, including those who previously might not have been able to obtain credit cards. On the whole, a large number of cardholders experience greater benefits—either by using their cards for transactions without incurring any direct expense or by enjoying generally lower costs for borrowing than prevailed in the past—from using credit cards than was previously possible, but the habits or financial circumstances of other cardholders also could result in these consumers facing greater costs than they did in the past.

The expansion and increased complexity of card rates, fees, and issuer practices has heightened the need for consumers to receive clear disclosures that allow them to more easily understand the costs of using cards. In the absence of any regulatory or legal limits on the interest or fees that cards can impose, providing consumers with adequate information on credit card costs and practices is critical to ensuring that vigorous competition among card issuers produces a market that provides the best possible rates and terms for U.S. consumers. Our work indicates that the disclosure materials that the largest card issuers typically provided under the existing regulations governing credit cards had many serious weaknesses that reduced their usefulness to the consumers they are intended to help. Although these regulations likely were adequate when card rates and terms were less complex, the disclosure materials they produce for cards today, which have a multitude of terms and conditions that can affect cardholders' costs, have proven difficult for consumers to use in finding and understanding important information about their cards. Although providing some key information, current disclosures also give prominence to terms, such as minimum finance charge or balance computation method, that are less significant to consumers' costs and do not adequately emphasize terms such as those cardholder actions that could cause their card issuer to raise their interest rate to a high default rate. Because part of the reason that current disclosure materials may be less effective is that they were designed in an era when card rates and terms were less complex, the Federal Reserve also faces the challenge of creating disclosure requirements that are more flexible to allow them to be adjusted more quickly as new card features are introduced and others become less common.

The Federal Reserve, which has adopted these regulations, has recognized these problems, and its current review of the open-end credit rules of Regulation Z presents an opportunity to improve the disclosures applicable to credit cards. Based on our work, we believe that disclosures that are simpler, better organized, and use designs and formats that comply with best practices and industry standards for readability and usability would be more effective. Our work and the experiences of other regulators also confirmed that involving experts in readability and testing documents with actual consumers can further improve any resulting disclosures. The Federal Reserve has indicated that it has begun to involve consumers in the design of new model disclosures, but it has not completed these efforts to date, and new model disclosures are not expected to be issued until 2007 or 2008. Federal Reserve staff noted that they recognize the challenge of how best to incorporate the variety of information that consumers may need to understand the costs of their cards in clear and concise disclosure materials. Until such efforts are complete, consumers will continue to face difficulties in using disclosure materials to better understand and compare costs of credit cards. In addition, until more understandable disclosures are issued, the ability of well-informed consumers to spur additional competition among issuers in credit card pricing is hampered.

Definitively determining the extent to which credit card penalty interest and fees contribute to personal bankruptcies and the profits and revenues of card issuers is difficult given the lack of comprehensive, publicly available data. Penalty interest and fees can contribute to the total debt owed by cardholders and decrease the funds that a cardholder could have used to reduce debt and possibly avoid bankruptcy. However, many consumers file for bankruptcy as the result of significant negative life events, such as divorces, job losses, or health problems, and the role that credit cards play in avoiding or accelerating such filings is not known. Similarly, the limited available information on card issuer operations indicates that penalty fees and interest are a small but growing part of such firms' revenues. With the profitability of the largest card issuers generally being stable over recent years, the increased revenues gained from penalty interest and fees may be offsetting the generally lower amounts of interest that card issuers collect from the majority of their cardholders. These results appear to indicate that while most cardholders likely are better off, a smaller number of cardholders paying penalty interest and fees are accounting for more of issuer revenues than they did in the past. This further emphasizes the importance of taking steps to ensure that all cardholders receive disclosures that help them clearly understand their card costs and how their own behavior can affect those costs.

Recommendation for Executive Action

As part of its effort to increase the effectiveness of disclosure materials used to inform consumers of rates, fees, and other terms that affect the costs of using credit cards, the Chairman, Federal Reserve should ensure that such disclosures, including model forms and formatting requirements, more clearly emphasize those terms that can significantly affect cardholder costs, such as the actions that can cause default or other penalty pricing rates to be imposed.

Agency Comments and Our Evaluation

We provided a draft of this report to the Federal Reserve, OCC, FDIC, the Federal Trade Commission, the National Credit Union Administration, and the Office of Thrift Supervision for their review and comment. In a letter from the Federal Reserve, the Director of the Division of Consumer and

Community Affairs agreed with the findings of our report that credit card pricing has become more complex and that the disclosures required under Regulation Z could be improved with the input of consumers. To this end, the Director stated that the Board is conducting extensive consumer testing to identify the most important information to consumers and how disclosures can be simplified to reduce current complexity. Using this information, the Director said that the Board would develop new model disclosure forms with the assistance of design consultants. If appropriate, the Director said the Board may develop suggestions for statutory changes for congressional consideration.

We also received technical comments from the Federal Reserve and OCC, which we have incorporated in this report as appropriate. FDIC, the Federal Trade Commission, the National Credit Union Administration, and the Office of Thrift Supervision did not provide comments.

As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this report. At that time, we will send copies of this report to the Chairman, Permanent Subcommittee on Investigations, Senate Committee on Homeland Security and Governmental Affairs; the Chairman, FDIC; the Chairman, Federal Reserve; the Chairman, Federal Trade Commission; the Chairman, National Credit Union Administration; the Comptroller of the Currency; and the Director, Office of Thrift Supervision and to interested congressional committees. We will also make copies available to others upon request. The report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions regarding this report, please contact me at (202) 512-8678 or woodd@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix IV.

Sincerely yours,

David G. Wood

David G. Wood
Director, Financial Markets
and Community Investment

Objectives, Scope and Methodology

Our objectives were to determine (1) how the interest, fees, and other practices that affect the pricing structure of cards from the largest U.S. issuers have evolved, and cardholders' experiences under these pricing structures in recent years; (2) how effectively the issuers disclose the pricing structures of cards to their cardholders; (3) whether credit card debt and penalty interest and fees contribute to cardholder bankruptcies; and (4) the extent to which penalty interest and fees contribute to the revenues and profitability of issuers' credit card operations.

Methodology for Identifying the Evolution of Pricing Structures

To identify how the pricing structure of cards from the largest U.S. issuers has evolved, we analyzed disclosure documents from 2003 to 2005 for 28 popular cards that were issued by the six largest U.S. card issuers, as measured by total outstanding receivables as of December 31, 2004 (see fig. 2 in the body of this report). These issuers were Bank of America; Capital One Bank; Chase Bank USA, N.A.; Citibank (South Dakota), N.A.; Discover Financial Services; and MBNA America Bank, N.A. Representatives for these six issuers identified up to five of their most popular cards and provided us actual disclosure materials, including cardmember agreements and direct mail applications and solicitations used for opening an account for each card. We calculated descriptive statistics for various interest rates and fees and the frequency with which cards featured other practices, such as methods for calculating finance charges. We determined that these cards likely represented the pricing and terms that applied to the majority of U.S. cardholders because the top six issuers held almost 80 percent of consumer credit card debt and as much as 61 percent of total U.S. credit card accounts.

We did not include in our analysis of popular cards any cards offered by credit card issuers that engage primarily in subprime lending. Subprime lending generally refers to extending credit to borrowers who exhibit characteristics indicating a significantly higher risk of default than traditional bank lending customers. Such issuers could have pricing structures and other terms significantly different to those of the popular cards offered by the top issuers. As a result, our analysis may underestimate the range of interest rate and fee levels charged on the entire universe of cards. To identify historical rate and fee levels, we primarily evaluated the Federal Reserve Board's G.19 Consumer Credit statistical release for 1972 to 2005 and a paper written by a Federal Reserve Bank staff, which included more than 150 cardmember agreements from 15 of the largest U.S. issuers in 1997 to 2002.[1]

To evaluate cardholders' experiences with credit card pricing structures in recent years, we obtained proprietary data on the extent to which issuers assessed various interest rate levels and fees for active accounts from the six largest U.S. issuers listed above for 2003, 2004, and 2005. We obtained data directly from issuers because no comprehensive sources existed to show the extent to which U.S. cardholders were paying penalty interest rates. Combined, these issuers reported more than 180 million active accounts, or about 60 percent of total active accounts reported by CardWeb.com, Inc. These accounts also represented almost $900 billion in credit card purchases in 2005, according to these issuers. To preserve the anonymity of the data, these issuers engaged legal counsel at the law firm Latham & Watkins, LLP, to which they provided their data on interest rate and fee assessments, which then engaged Argus Information and Advisory Services, LLC, a third-party analytics firm, to aggregate the data, and then supplied it to us. Although we originally provided a more comprehensive data request to these issuers, we agreed to a more limited request with issuer representatives as a result of these firms' data availability and processing limitations. We discussed steps that were taken to attempt to ensure that the data provided to us were complete and accurate with representatives of these issuers and the third party analytics firm. We also shared a draft of this report with the supervisory agencies of these issuers. However, we did not have access to the issuers' data systems to fully assess the reliability of the data or the systems that housed them. Therefore, we present these data in our report only as representations made to us by the six largest issuers.

Methodology for Assessing Effectiveness of Disclosures

To determine how effectively card issuers disclose to cardholders the rates, fees, and other terms related to their credit cards, we contracted with UserWorks, Inc., a private usability consulting firm, which conducted three separate evaluations of a sample of disclosure materials. We provided the usability consultant with a cardmember agreement and solicitation letter for one card from four representative credit card issuers—a total of four cards and eight disclosure documents. The first evaluation, a readability assessment, used computer-facilitated formulas to predict the grade level

[1]M. Furletti, "Credit Card Pricing Developments and Their Disclosure," Federal Reserve Bank of Philadelphia's Payment Cards Center, January 2003.

required to understand the materials. Readability formulas measure the elements of writing that can be subjected to mathematical calculation, such as average number of syllables in words or numbers of words in sentences in the text. The consultant applied the following industry-standard formulas to the documents: Flesch Grade Level, Frequency of Gobbledygook (FOG), and the Simplified Measure of Gobbledygook (SMOG). Using these formulas, the consultant measured the grade levels at which the disclosure documents were written overall, as well as for selected sections. Secondly, the usability consultant conducted an heuristic evaluation that assessed how well these card disclosure documents adhered to a recognized set of principles or industry best practices. In the absence of best practices specifically applicable to credit card disclosures, the consultant used guidelines from the U.S. Securities and Exchange Commission's 1998 guidebook *Plain English Handbook: How to Create Clear SEC Disclosure Documents*.

Finally, the usability consultant tested how well actual consumers were able to use the documents to identify and understand information about card fees and other practices and used tbe results to identify problem areas. The consultant conducted these tests with 12 consumers.[2] To ensure sample diversity, the participants were selected to represent the demographics of the U.S. adult population in terms of education, income, and age. While the materials used for the readability and usability assessments appeared to be typical of the large issuers' disclosures, the results cannot be generalized to materials that were not reviewed.

To obtain additional information on consumers' level of awareness and understanding of their key credit card terms, we also conducted in-depth, structured interviews in December 2005 with a total of 112 adult cardholders in three locations: Boston, Chicago, and San Francisco.[3] We contracted with OneWorld Communications, Inc., a market research organization, to recruit a sample of cardholders that generally resembled the demographic makeup of the U.S. population in terms of age, education levels, and income. However, the cardholders recruited for the interviews did not form a random, statistically representative sample of the U.S.

[2]According to the consultant, testing with small numbers of individuals can generally identify many of the problems that can affect the readability and usability of materials.

[3]We conducted these interviews when preparing our report on the feasibility and usefulness of requiring additional disclosures to cardholders on the consequences of making only the minimum payment on their cards.

population and therefore cannot be generalized to the population of all U.S. cardholders. Cardholders had to speak English, have owned at least one general-purpose credit card for a minimum of 12 months, and have not participated in more than one focus group or similar in-person study in the 12 months prior to the interview. We gathered information about the cardholders' knowledge of credit card terms and conditions, and assessed cardholders' use of card disclosure materials by asking them a number of open- and closed-ended questions.

Methodology for Determining How Penalty Charges Contribute to Bankruptcy

To determine whether credit card debt and penalty interest and fees contribute to cardholder bankruptcies, we interviewed Department of Justice staff responsible for overseeing bankruptcy courts and trustees about the availability of data on credit card penalty charges in materials submitted by consumers or issuers as part of bankruptcy filings or collections cases. We also interviewed two attorneys that assist consumers with bankruptcy filings. In addition, we reviewed studies that analyzed credit card and bankruptcy issues published by various academic researchers, the Congressional Research Service, and the Congressional Budget Office. We did not attempt to assess the reliability of all of these studies to the same, full extent. However, because of the prominence of some of these data sources, and frequency of use of this data by other researchers, as well as the fact that much of the evidence is corroborated by other evidence, we determined that citing these studies was appropriate.

We also analyzed aggregated card account data provided by the six largest issuers (as previously discussed) to measure the amount of credit card interest charges and fees owed at the time these accounts were charged off as a result of becoming subject to bankruptcy filing. We also spoke with representatives of the largest U.S. credit card issuers, as well as representatives of consumer groups and industry associations, and with academic researchers that conduct analysis on the credit card industry.

Methodology for Determining How Penalty Charges Contribute to Issuer Revenues

To determine the extent to which penalty interest and fees contributed to the revenues and profitability of issuers' credit card operations, we reviewed the extent to which penalty charges are disclosed in bank regulatory reports—the call reports—and in public disclosures—such as annual reports (10-Ks) and quarterly reports (10-Qs) made by publicly traded card issuers. We analyzed data reported by the Federal Reserve on the profitability of commercial bank card issuers with at least $200 million in yearly average assets (loans to individuals plus securitizations) and at least 50 percent of assets in consumer lending, of which 90 percent must be in the form of revolving credit. In 2004, the Federal Reserve reported that 17 banks had card operations with at least this level of activity in 2004. We also analyzed information from the Federal Deposit Insurance Corporation, which analyzes data for all federally insured banks and savings institutions and publishes aggregated data on those with various lending activity concentrations, including a group of 33 banks that, as of December 2005, had credit card operations that exceeded 50 percent of their total assets and securitized receivables.

We also analyzed data reported to us by the six largest card issuers on their revenues and profitability of their credit card operations for 2003, 2004, and 2005. We also reviewed data on revenues compiled by industry analysis firms, including *Card Industry Directory* published by Sourcemedia, and R.K. Hammer. Because of the proprietary nature of their data, representatives for Sourcemedia and R.K. Hammer were not able to provide us with information sufficient for us to assess the reliability of their data. However, we analyzed and presented some information from these sources because we were able to corroborate their information with each other and with data from sources of known reliability, such as regulatory data, and we attribute their data to them.

We also interviewed broker-dealer financial analysts who monitor activities by credit card issuers to identify the extent to which various sources of income contribute to card issuers' revenues and profitability. We attempted to obtain the latest in a series of studies of card issuer profitability that Visa, Inc. traditionally has compiled. However, staff from this organization said that this report is no longer being made publicly available.

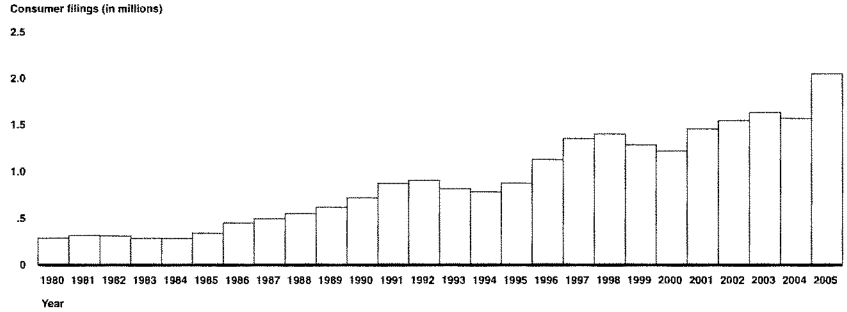
We discussed issues relevant to this report with various organizations, including representatives of 13 U.S. credit card issuers and card networks, 2 trade associations, 4 academics, 4 federal bank agencies, 4 national consumer interest groups, 2 broker dealer analysts that study credit card issuers for large investors, and a commercial credit-rating agency. We also obtained technical comments on a draft of this report from representatives of the issuers that supplied data for this study.

Appendix II

Consumer Bankruptcies Have Risen Along with Debt

Consumer bankruptcies have increased significantly over the past 25 years. As shown in figure 21 below, consumer bankruptcy filings rose from about 287,000 in 1980 to more than 2 million as of December 31, 2005, about a 609 percent increase over the last 25 years.[1]

Figure 21: U.S. Consumer Bankruptcy Filings, 1980-2005



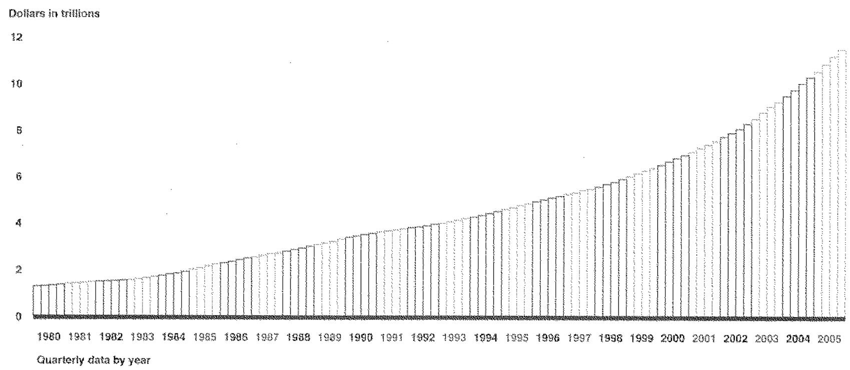
Source: GAO analysis of Congressional Research Service report and Administrative Office of the United States Courts data.

Debt Levels Have Also Risen

The expansion of consumers' overall indebtedness is one of the explanations cited for the significant increase in bankruptcy filings. As shown in figure 22, consumers' use of debt has expanded over the last 25 years, increasing more than 720 percent from about \$1.4 trillion in 1980 to about \$11.5 trillion in 2005.

[1]Of the filings in 2005, approximately 80 percent were Chapter 7 cases and the other 20 percent were Chapter 13 cases.

Figure 22: U.S. Household Debt, 1980-2005



Source: Board of Governors of the Federal Reserve System.

Some researchers have been commenting on the rise in overall indebtedness as a contributor to the rise in bankruptcies for some time. For example, in a 1997 congressional testimony, a Congressional Budget Office official noted that the increase in consumer bankruptcy filings and the increase in household indebtedness appeared to be correlated.[2] Also, an academic paper that summarized existing literature on bankruptcy found that some consumer bankruptcies were either directly or indirectly caused by heavy consumer indebtedness, specifically pointing to the high correlation between consumer bankruptcies and consumer debt-to-income ratios.[3]

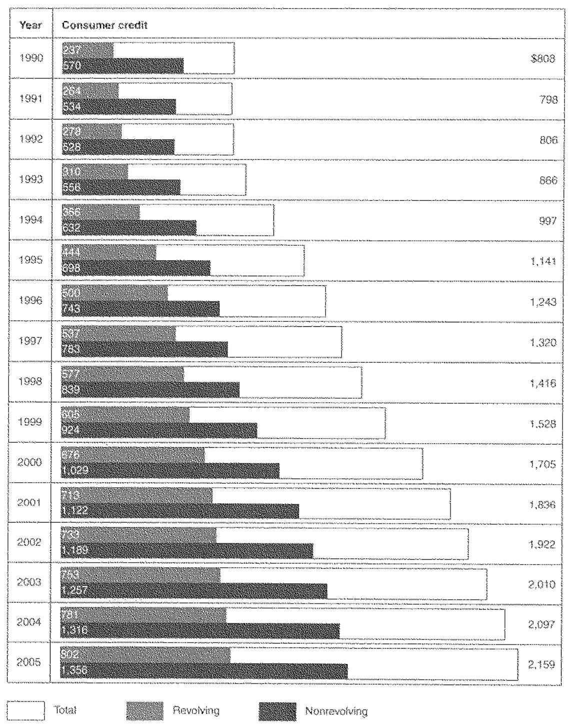
[2]Kim Kowalewski, "Consumer Debt and Bankruptcy," Congressional Budget Office testimony before the United States Senate Subcommittee on Administrative Oversight and the Courts, Committee on the Judiciary, 105th Congress, 1st sess., Apr. 11, 1997.

[3]Todd J. Zywicki, "An Economic Analysis of the Consumer Bankruptcy Crisis," *Northwestern University Law Review*, 99, no.4, (2005).

Beyond total debt, some researchers and others argue that the rise in bankruptcies also was related to the rise in credit debt, in particular. As shown in figure 23, the amount of credit card debt reported also has risen from $237 billion to about $802 billion—a 238 percent increase between 1990 and 2005.[4]

[4]In addition to capturing amounts outstanding on credit cards, the number reported in the Federal Reserve's survey of consumer debt for revolving debt also includes other types of revolving debt. However, Congressional Research Service staff familiar with the survey's results indicated that the vast majority of the amount reported as revolving debt is from credit cards.

Figure 23: Credit Card and Other Revolving and Nonrevolving Debt Outstanding, 1990 to 2005



Source: GAO analysis of Congressional Research Service report data.

Increased Access to Credit Cards by Lower-income Households Raised Concerns

Rather than total credit card debt alone, some researchers argued that growth in credit card use and indebtedness by lower-income households has contributed to the rise in bankruptcies. In the survey of consumer finances conducted every 3 years, the Federal Reserve reports on the use and indebtedness on credit cards by households overall and also by income percentiles. As shown in figure 24 below, the latest Federal Reserve survey results indicated the greatest increase of families reporting credit card debt occurred among those in the lowest 20 percent of household income between 1998 and 2001.

Figure 24: Percent of Households Holding Credit Card Debt by Household Income, 1998, 2001, and 2004

Percentile of income	1998	2001	2004
Less than 20	24.5	30.3	28.8
20-39.9	40.9	44.5	42.9
40-59.9	50.1	52.8	55.1
60-79.9	57.4	52.6	56.0
80-89.9	53.1	50.3	57.6
90-100	42.1	33.1	38.5
All	44.1	44.4	46.2

Source: Federal Reserve Board's Survey of Consumer Finances.

In the last 15 years, credit card companies have greatly expanded the marketing of credit cards, including to households with lower incomes than previously had been offered cards. An effort by credit card issuers to expand its customer base in an increasingly competitive market dramatically increased credit card solicitations. According to one study, more than half of credit cards held by consumers are the result of receiving mail solicitations.[5] According to another academic research paper, credit card issuers have increased the number of mail solicitations they send to consumers by more than five times since 1990, from 1.1 billion to 5.23 billion in 2004, or a little over 47 solicitations per household. The research paper also found that wealthier families receive the highest number of solicitations but that low-income families were more likely to open them.[6] As shown in figure 25 above, the Federal Reserve's survey results indicated that the number of lower income households with credit cards has also grown the most during 1998 to 2001, reflecting issuers' willingness to grant greater access to credit cards to such households than in the past.

Levels of Financial Distress Have Remained Stable among Households

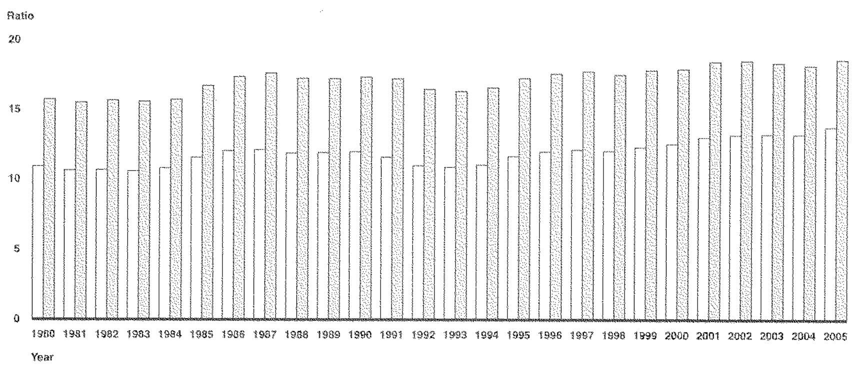
The ability of households to make the payments on their debt appeared to be keeping pace with their incomes as their total household debt burden levels—which measure their payments required on their debts as percentage of household incomes—have remained relatively constant since the 1980s. As shown below in figure 25, Federal Reserve statistics show that the aggregate debt burden ratio for U.S. households has generally fluctuated between 10.77 percent to 13.89 percent between 1990 to 2005, which are similar to the levels for this ratio that were observed during the 1980s. Also shown in figure 25 are the Federal Reserve's statistics on the household financial obligations ratio, which compares the total payments that a household must make for mortgages, consumer debt, auto leases, rent, homeowners insurance, and real estate taxes to its after-tax income. Although this ratio has risen from around 16 percent in 1980 to over 18 percent in 2005—representing an approximately 13 percent increase—Federal Reserve staff researchers indicated that it does not necessarily indicate an increase in household financial stress because

[5] Vertis, "*Financial Direct Mail Readers Interested in Credit Card Offers,*" (Jan. 25, 2005), cited in the Consumer Federation of America testimony before the Committee on Banking, Housing, and Urban Affairs of the United States Senate, "*Examining the Current Legal and Regulatory Requirements and Industry Practices for Credit Card Issuers with Respect to Consumer Disclosures and Marketing Efforts,*" 109th Congress, 2nd sess., May, 17, 2005.

[6] Amdetsion Kidane and Sandip Mukerji, "Characteristics of Consumers Targeted and Neglected by Credit Card Companies," *Financial Services Review*, 13, no. 3, (2004), cited in the Consumer Federation of America testimony before the Committee on Banking, Housing, and Urban Affairs of the United States Senate, "*Examining the Current Legal and Regulatory Requirements and Industry Practices for Credit Card Issuers with Respect to Consumer Disclosures and Marketing Efforts,*" 109th Congress, 2nd sess., May 17, 2005.

much of this increase appeared to be the result of increased use of credit cards for transactions and more households with cards.[7]

Figure 25: U.S. Household Debt Burden and Financial Obligations Ratios, 1980 to 2005



Debt service ratio (ratio of debt payments to disposable personal income)

Financial obligations ratio (debt service ratio plus automobile lease, rental on tenant-occupied property, homeowners insurance, and property tax payments)

Source: Federal Reserve.

In addition, credit card debt remains a small portion of overall household debt, including those with the lowest income levels. As shown in table 2, credit card balances as a percentage of total household debt actually have been declining since the 1990s.

[7] 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* (Washington, D.C.: June 2006).

Table 2: Portion of Credit Card Debt Held by Households

Type of debt	1995	1998	2001	2004
Amount of debt of all families, distributed by type of debt				
Secured home loan	80.7	78.9	81.4	83.7
Lines of credit not secured by residential property	0.6	0.3	0.5	0.7
Installment loans	12.0	13.1	12.3	11.0
Credit card balances	3.9	3.9	3.4	3.0
Other	2.9	3.7	2.3	1.6
Total	**100**	**100**	**100**	**100**

Source: Federal Reserve.

Also, as shown in table 3, median credit card balances for the lowest-income households has remained stable from 1998 through 2004.

Table 3: Credit Card Debt Balances Held by Household Income[8]

	1998	2001	2004
Median value of holdings for families holding credit card debt			
All families	$1,900	$2,000	$2,200
Percentile of income			
Less than 20	$1,000	$1,100	$1,000
20-39.9	$1,300	$1,300	$1,900
40-59.9	$2,100	$2,100	$2,200
60-79.9	$2,400	$2,400	$3,000
80-89.9	$2,200	$4,000	$2,700
90-100	$3,300	$3,000	$4,000

Source: Federal Reserve.

As shown in figure 26 below, the number of households in the twentieth percentile of income or less that reportedly were in financial distress has remained relatively stable.

[8]The 1998 median credit card balance in 2001 dollars; 2001 and 2004 median credit card balances in 2004 dollars.

Figure 26: Households Reporting Financial Distress by Household Income, 1995 through 2004

Percentile of income	1995	1998	2001	2004
All	11.7	13.6	11.8	12.2
Less than 20	27.5	29.9	29.3	27.0
20-39.9	18.0	18.3	16.6	18.6
40-59.9	9.9	15.8	12.3	13.7
60-79.9	7.7	9.8	6.5	7.10
80-89.9	4.7	3.5	3.5	2.4
90-100	2.3	2.8	2.0	1.8

Source: Federal Reserve Survey of Consumer Finances.

As shown in figure 26 above, more lower-income households generally reported being in financial distress than did other households in most of the other higher-income groups. In addition, the lowest-income households in the aggregate generally did not exhibit greater levels of distress over the last 20 years, as the proportion of households that reported distress was higher in the 1990s than in 2004.

Some Researchers Find Other Factors May Trigger Consumer Bankruptcies and that Credit Cards Role Varied

Some academics, consumer advocacy groups, and others have indicated that the rise in consumer bankruptcy filings has occurred because the normal life events that reduce incomes or increase expenses for households have more serious effects today. Events that can reduce household incomes include job losses, pay cuts, or conversion of full-time positions to part-time work. Medical emergencies can result in increased household expenses and debts. Divorces can both reduce income and increase expenses. One researcher explained that, while households have faced the same kinds of risks for generations, the likelihood of these types of life events occurring has increased. This researcher's studies noted that the likelihood of job loss or financial distress arising from medical problems and the risk of divorce have all increased. Furthermore, more households send all adults into the workforce, and, while this increases their income, it also doubles their total risk exposure, which increases their likelihood of having to file for bankruptcy. According to this researcher, about 94 percent of families who filed for bankruptcy would qualify as middle class.[9]

Although many of the people who file for bankruptcy have considerable credit card debt, those researchers that asserted that life events were the primary explanation for filings noted that the role played by credit cards varied. According to one of these researchers, individuals who have filed for bankruptcy with outstanding credit card debt could be classified into three groups:

- Those who had built up household debts, including substantial credit card balances, but filed for bankruptcy after experiencing a life event that adversely affected their expenses or incomes such that they could not meet their obligations.
- Those who experienced a life event that adversely affected their expenses or incomes, and increased their usage of credit cards to avoid falling behind on other secured debt payments (such as mortgage debt), but who ultimately failed to recover and filed for bankruptcy.
- Those with very little credit card debt who filed for bankruptcy when they could no longer make payments on their secured debt. This represented the smallest category of people filing for bankruptcy.

[9]Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School, "The Growing Threat to Middle Class Families," *Brooklyn Law Review*, (April 2003).

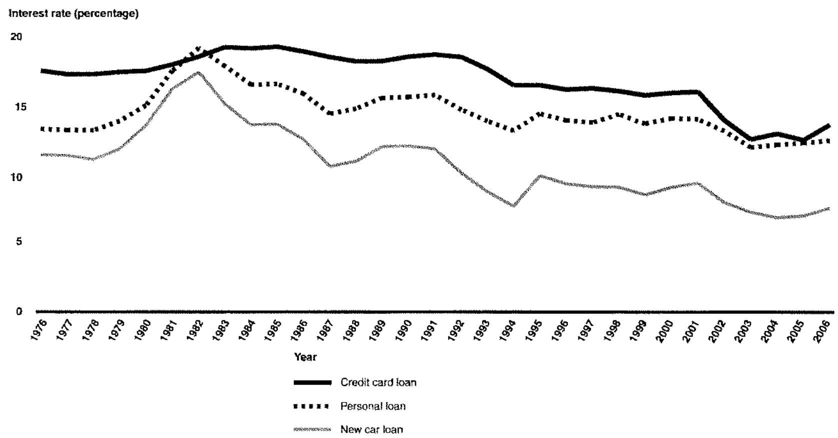
Appendix III

Factors Contributing to the Profitability of Credit Card Issuers

Various factors help to explain why banks that focus on credit card lending generally have higher profitability than other lenders. The major source of income for credit card issuers comes from interest they earn from their cardholders who carry balances—that is, do not payoff the entire outstanding balance when due. One factor that contributes to the high profitability of credit card operations is that the average interest rates charged on credit cards are generally higher than rates charged on other types of lending. Rates charged on credit cards are generally the highest because they are extensions of credit that are not secured by any collateral from the borrower. Unlike credit cards, most other types of consumer lending involve the extension of a fixed amount of credit under fixed terms of repayment (i.e., the borrower must repay an established amount of principal, plus interest each month) and are collateralized—such as loans for cars, under which the lender can repossess the car in the event the borrower does not make the scheduled loan payments. Similarly, mortgage loans that allow borrowers to purchase homes are secured by the underlying house. Loans with collateral and fixed repayment terms pose less risk of loss, and thus lenders can charge less interest on such loans. In contrast, credit card loans, which are unsecured, available to large and heterogeneous populations, and can be repaid on flexible terms at the cardholders' convenience, present greater risks and have commensurately higher interest rates.

As shown in figure 27, data from the Federal Reserve shows that average interest rates charged on credit cards were generally higher than interest rates charged on car loans and personal loans. Similarly, average interest rates charged on corporate loans are also generally lower than credit cards, with the best business customers often paying the prime rate, which averaged 6.19 percent during 2005.

Figure 27: Average Credit Card, Car Loans and Personal Loan Interest Rates

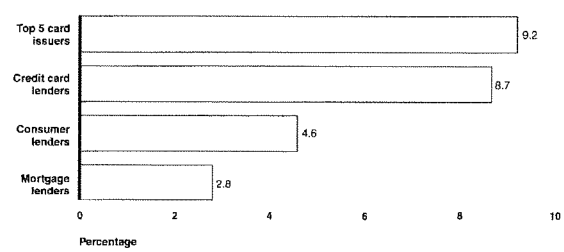


Source: Federal Reserve.

Moreover, many card issuers have increasingly begun setting the interest rates they charge their cardholders using variable rates that change as a specified market index rate, such as the prime rate, changes. This allows credit card issuers' interest revenues to rise as their cost of funding rises during times when market interest rates are increasing. Of the most popular cards issued by the largest card issuers between 2004 and 2005 that we analyzed, more than 90 percent had variable rates that changed according to an index rate. For example, the rate that the cardholder would pay on these large issuer cards was determined by adding between 6 and 8 percent to the current prime rate, with a new rate being calculated monthly.

As a result of the higher interest charges assessed on cards and variable rate pricing, banks that focus on credit card lending had the highest net interest margin compared with other types of lenders. The net interest income of a bank is the difference between what it has earned on its interest-bearing assets, including the balances on credit cards it has issued and the amounts loaned out as part of any other lending activities, and its interest expenses. To compare across banks, analysts calculate net interest margins, which express each banks' net interest income as a percentage of interest-bearing assets. The Federal Deposit Insurance Corporation (FDIC) aggregates data for a group of all federally insured banks that focus on credit card lending, which it defines as those with more than 50 percent of managed assets engaged in credit card operations; in 2005, FDIC identified 33 banks with at least this much credit card lending activity. As shown in figure 28, the net interest margin of all credit card banks, which averaged more than 8 percent, was about two to three times as high as other consumer and mortgage lending activities in 2005. Five of the six largest issuers reported to us that their average net interest margin in 2005 was even higher, at 9 percent.

Figure 28: Net Interest Margin for Credit Card Issuers and Other Consumer Lenders in 2005

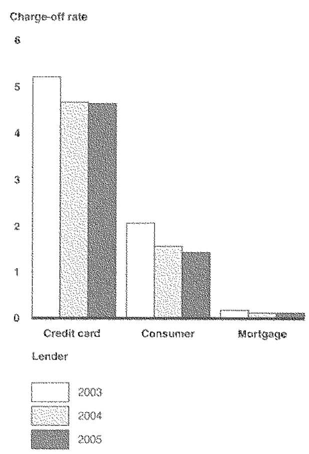


Source: GAO analysis of public financial statements of the five largest credit card issuers.

Credit Card Operations Also Have Higher Rates of Loan Losses and Operating Expenses

Although profitable, credit card operations generally experience higher charge-off rates and operating expenses than those of other types of lending. Because these loans are generally unsecured, meaning the borrower will not generally immediately lose an asset—such as a car or house—if payments are not made, borrowers may be more likely to cease making payments on their credit cards if they become financially distressed than they would for other types of credit. As a result, the rate of losses that credit card issuers experience on credit cards is higher than that incurred on other types of credit. Under bank regulatory accounting practices, banks must write off the principal balance outstanding on any loan when it is determined that the bank is unlikely to collect on the debt. For credit cards, this means that banks must deduct, as a loan loss from their income, the amount of balance outstanding on any credit card accounts for which either no payments have been made within the last 180 days or the bank has received notice that the cardholder has filed for bankruptcy. This procedure is called charging the debt off. Card issuers have much higher charge-off rates compared to other consumer lending businesses as shown in figure 29.

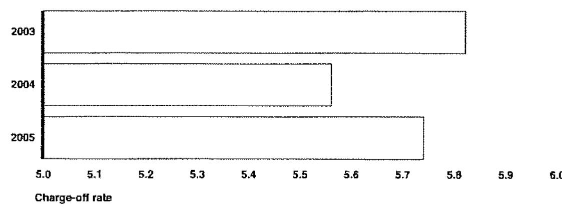
Figure 29: Charge-off Rates for Credit Card and Other Consumer Lenders, 2004 to 2005



Source: FDIC.

The largest credit card issuers also reported similarly high charge-off rates for their credit card operations. As shown in figure 30, five of the top six credit card issuers that we obtained data from reported that their average charge-off rate was higher than 5.5 percent between 2003 and 2005, well above other consumer lenders' average net charge-off rate of 1.44 percent.

Figure 30: Charge-off Rates for the Top 5 Credit Card Issuers, 2003 to 2005

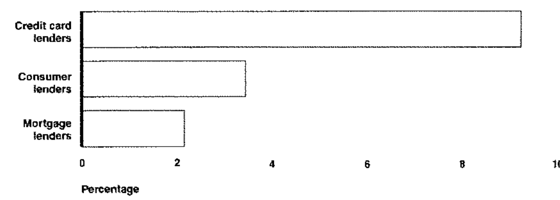


Source: GAO analysis of public financial statements of the five largest credit card issuers

Credit card issuers also incur higher operating expenses compared with other consumer lenders. Operating expense is another one of the largest cost items for card issuers and, according to a credit card industry research firm, accounts for approximately 37 percent of total expenses in 2005. The operating expenses of a credit card issuer include staffing and the information technology costs that are incurred to maintain cardholders' accounts. Operating expense as a proportion of total assets for credit card lending is higher because offering credit cards often involves various activities that other lending activities do not. For example, issuers often incur significant expenses in postage and other marketing costs as part of soliciting new customers. In addition, some credit cards now provide rewards and loyalty programs that allow cardholders to earn rewards such as free airline tickets, discounts on merchandise, or cash back on their accounts, which are not generally expenses associated with other types of lending. Credit card operating expense burden also may be higher because issuers must service a large number of relatively small accounts. For example, the six large card issuers that we surveyed reported that they each had an average of 30 million credit card accounts, the average outstanding balance on these accounts was about $2,500, and 48 percent of accounts did not revolve balances in 2005.

As a result, the average operating expense, as a percentage of total assets for banks, that focus on credit card lending averaged over 9 percent in 2005, as shown in figure 31, which was well above the 3.44 percent average for other consumer lenders. The largest issuers operating expenses may not be as high as all banks that focus on credit card lending because their larger operations give them some cost advantages from economies of scale. For example, they may be able to pay lower postage rates by being able to segregate the mailings of account statements to their cardholders by zip code, thus qualifying for bulk-rate discounts.

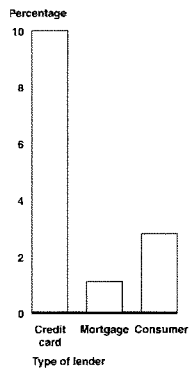
Figure 31: Operating Expense as Percentage of Total Assets for Various Types of Lenders in 2005



Source FDIC

Another reason that the banks that issue credit cards are more profitable than other types of lenders is that they earn greater percentage of revenues from noninterest sources, including fees, than lenders that focus more on other types of consumer lending. As shown in figure 32, FDIC data indicates that the ratio of noninterest revenues to assets—an indicator of noninterest income generated from outstanding credit loans—is about 10 percent for the banks that focus on credit card lending, compared with less than 2.8 percent for other lenders.

Figure 32: Non-Interest Revenue as Percentage of Their Assets for Card Lenders and Other Consumer Lenders



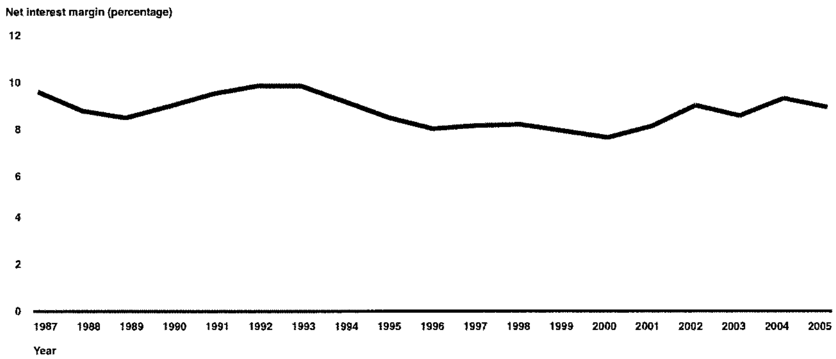
Source: GAO analysis of FDIC data

Effect of Penalty Interest and Fees on Credit Card Issuer Profitability

Although penalty interest and fees apparently have increased, their effect on issuer profitability may not be as great as other factors. For example, while more cardholders appeared to be paying default rates of interest on their cards, issuers have not been experiencing greater profitability from interest revenues. According to our analysis of FDIC Quarterly Banking Profile data, the revenues that credit card issuers earn from interest generally have been stable over the last 18 years.[1] As shown in figure 33, net interest margin for all banks that focused on credit card lending has ranged between 7.4 percent and 9.6 percent since 1987. Similarly, according to the data that five of the top six issuers provided to us, their net interest margins have been relatively stable between 2003 and 2005, ranging from 9.2 percent to 9.6 percent during this period.

[1]The Quarterly Banking Profile is issued by the FDIC and provides a comprehensive summary of financial results for all FDIC-insured institutions. This report card on industry status and performance includes written analyses, graphs, and statistical tables.

Figure 33: Net Interest Margin for All Banks Focusing on Credit Card Lending, 1987-2005



Source FDIC

These data suggest that increases in penalty interest assessments could be offsetting decreases in interest revenues from other cardholders. During the last few years, card issuers have competed vigorously for market share. In doing so, they frequently have offered cards to new cardholders that feature low interest rates—including zero percent for temporary introductory periods, usually 8 months—either for purchases or sometimes for balances transferred from other cards. The extent to which cardholders now are paying such rates is not known, but the six largest issuers reported to us that the proportion of their cardholders paying interest rates below 5 percent—which could be cardholders enjoying temporarily low introductory rates—represented about 7 percent of their cardholders between 2003 and 2005. To the extent that card issuers have been receiving lower interest as the result of these marketing efforts, such declines could be masking the effect of increasing amounts of penalty interest on their overall interest revenues.

Although revenues from penalty fees have grown, their effect on overall issuer profitability is less than the effect of income from interest or other factors. For example, we obtained information from a Federal Reserve

Bank researcher with data from one of the credit card industry surveys that illustrated that the issuers' cost of funds may be a more significant factor for their profitability lately. Banks generally obtain the funds they use to lend to others through their operations from various sources, such as checking or savings deposits, income on other investments, or borrowing from other banks or creditors. The average rate of interest they pay on these funding sources represents their cost of funds. As shown in table 4 below, the total cost of funds (for $100 in credit card balances outstanding) for the credit card banks included in this survey declined from $8.98 in 1990 to a low of $2.00 in 2004—a decrease of 78 percent. Because card issuers' net interest income generally represents a much higher percentage of revenues than does income from penalty fees, its impact on issuers' overall profitability is greater; thus the reduction in the cost of funds likely contributed significantly to the general rise in credit card banks' profitability over this time.

Table 4: Revenues and Profits of Credit Card Issuers in Card Industry Directory per $100 of Credit Card Assets

Revenues and profits	1990	2004	Percent change
Interest revenues	$16.42	$12.45	-24%
Cost of funds	8.98	2.00	-78
Net interest income	7.44	10.45	40
Interchange fee revenues	2.15	2.87	33
Penalty fee revenues	0.69	1.40	103
Annual fee revenues	1.25	0.42	-66
Other revenues	0.18	0.87	383
Total revenue from operations	11.71	16.01	37
Other expenses	8.17	10.41	27
Taxes	1.23	1.99	62
Net income	2.30	3.61	57

Source: GAO Analysis of Card Industry Directory data.

Although card issuer revenues from penalty fees have been increasing since the 1980s, they remain a small portion of overall revenues. As shown in table 4 above, our analysis of the card issuer data obtained from the Federal Reserve indicated that the amount of revenues that issuers collected from penalty fees for every $100 in credit card balances outstanding climbed from 69 cents to $1.40 between 1990 and 2004—an increase of 103 percent. During this same period, net interest income collected per $100 in card balances outstanding grew from $7.44 to $10.45—an increase of about 41 percent. However, the relative size of each of these two sources of income indicates that interest income is between 7 to 8 times more important to issuer revenues than penalty fee income is in 2004. Furthermore, during this same time, collections of annual fees from cardholders declined from $1.25 to 42 cents per every $100 in card balances—which means that the total of annual and penalty fees in 2004 is about the same as in 1990 and that this decline may also be offsetting the increased revenues from penalty fees.

Comments from the Federal Reserve Board

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

SANDRA F. BRAUNSTEIN
DIRECTOR
DIVISION OF CONSUMER
AND COMMUNITY AFFAIRS

August 23, 2006

Mr. David G. Wood
Director, Financial Markets and Community
Investment
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Wood:

Thank you for the opportunity to comment on the GAO's draft report entitled Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers. As the report notes, the Federal Reserve Board has commenced a comprehensive rulemaking to review the Truth in Lending Act (TILA) rules for open-end (revolving) credit, including credit card accounts. The primary goal of the review is to improve the effectiveness and usefulness of consumer disclosures and the substantive protections provided under the Board's Regulation Z, which implements TILA. To ensure that consumers get timely information in a readable form, the Board is studying alternatives for improving both the content and format of disclosures, including revising the model forms published by the Board.

The draft GAO report specifically recommends that the Board revise credit card disclosures to emphasize more clearly the account terms that can significantly affect cardholder costs, such as default or other penalty pricing rates. We agree that increased complexity in credit card pricing has added to the complexity of the disclosures. To help address this, the Board has invited public comment on ways in which the disclosures required under Regulation Z can be made more meaningful to consumers. The Board is conducting extensive consumer testing to determine what information is most important to consumers, when that information is most useful, what language and formats work best, and how disclosures can be simplified, prioritized, and organized to reduce complexity and information overload. To that end, the Board has hired design consultants to assist in developing model disclosures that are most likely to be effective in communicating information to consumers. Importantly, the Board also plans to use consumer testing to assist in developing model disclosure forms. Based on this review and testing, the Board will revise Regulation Z and, if appropriate, develop suggested statutory changes for congressional consideration.

Mr. David G. Wood
Page 2

The Board's staff has provided technical comments on the draft GAO report separately. We appreciate the efforts of your staff to respond to our comments.

Sincerely,

c: Cody Goebel, Assistant Director, GAO

GAO Contact and Staff Acknowledgments

GAO Contact

Dave Wood (202) 512-8678

Staff Acknowledgments

In addition to those named above, Cody Goebel, Assistant Director; Jon Altshul; Rachel DeMarcus; Kate Magdelena Gonzalez; Christine Houle; Christine Kuduk; Marc Molino; Akiko Ohnuma; Carl Ramirez; Omyra Ramsingh; Barbara Roesmann; Kathryn Supinski; Richard Vagnoni; Anita Visser; and Monica Wolford made key contributions to this report.

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Washington, DC 20548

February 28, 2008

The Honorable Carolyn Maloney
Chairwoman, Subcommittee on Financial Institutions
and Consumer Credit
Committee on Financial Services
House of Representatives

Subject: *Credit Cards: How the Two-Cycle Billing Method Works*

Dear Madam Chairwoman:

In accordance with a discussion with your staff, this letter provides certain information supplementing our September 2006 report, *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers* (GAO-06-929, September 12, 2006). In that report, we discussed, among other things, billing practices of credit card issuers that could affect cardholders' costs. One such practice concerned the balance computation method—that is, the method used by issuers to compute a cardholder's unpaid balance for the purpose of assessing finance charges (interest). Our report contrasted two methods: the "single-cycle" billing method, and the "two-cycle" billing method.[1] As we noted in the report, on some cards issuers used a two-cycle billing method. In such cases, if a cardholder with no previous balance fails to pay the entire balance of new purchases by the payment due date, then—on the next periodic billing statement—issuers compute interest on the original balance that had been subject to an interest-free period.

To understand the distinction between these two methods, some general background may be helpful. Issuers generally establish billing "cycles," consisting of a certain number of days (sometimes, a calendar month) and after each billing cycle ends, send the cardholder a statement. The statement shows the outstanding balance, purchases and other transactions made on the account during the cycle, and a payment amount. The cardholder generally has the option of paying the entire amount owed on the account (the total outstanding balance), the specified minimum payment, or any

[1] The "two-cycle" billing method is also called "double-cycle" billing, which is the term used in our September 2006 report (GAO-06-929).

amount in between.[2] If the cardholder pays the total outstanding balance by the payment due date, the issuer "waives" the interest on purchases made in the previous cycle and identified on the statement. In effect, this treats the period between the date(s) of the purchase(s) and the date payment is credited to the account as an interest-free period.

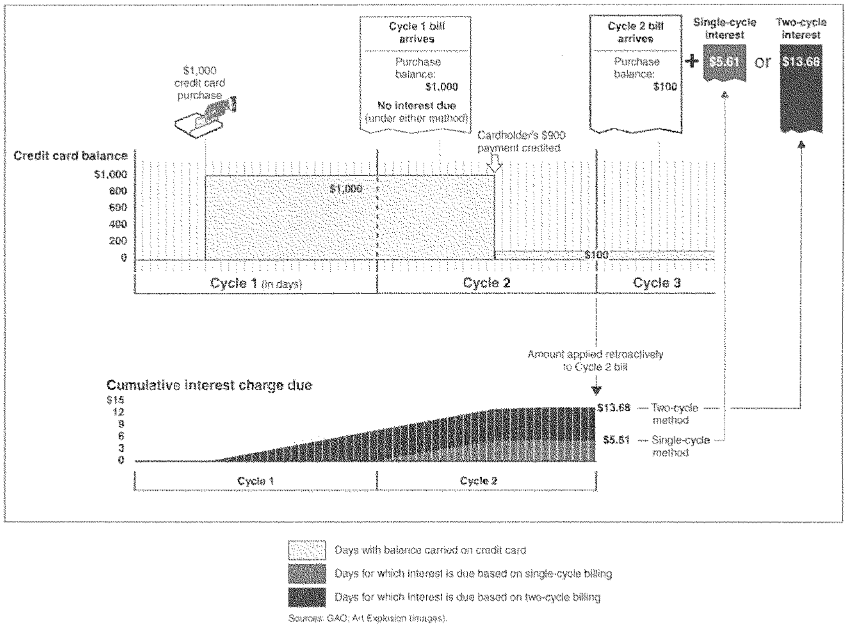
However, if a cardholder—who previously had no outstanding balance—does not pay off the entire outstanding balance, then the following periodic billing statement generally will include finance charges on purchases made in the previous cycle. Issuers compute the finance charge differently depending on the length of time for which they assess interest, as determined by whether the issuer uses the "single-cycle" or "two-cycle" method. The difference in finance charges is illustrated in figure 1 below for a cardholder that makes a $1,000 purchase in one period and then pays off most but not all of the balance in the next period.

- As shown in figure 1, under the "single-cycle" method, the card issuer computes interest on the outstanding balance from the beginning of Cycle 2. So, for example, if the cardholder's billing statement for Cycle 1 had shown a total outstanding balance of $1,000 in purchases, and the cardholder paid $900, then—for the following billing statement—the issuer would assess (1) daily interest on the $1,000 for those days in Cycle 2 before the cardholder's payment is credited to the account, and (2) daily interest on $100 for the rest of the days in Cycle 2. Under this method, the $1,000 balance is subject to an interest-free period between the purchase date and the end of the billing cycle in which the purchase occurred (Cycle 1).

- Under the "two-cycle" method, the card issuer computes interest on the $1,000 balance, not from the beginning of Cycle 2, but rather from the date of the purchase, which occurred during Cycle 1. So, in this example, the issuer assesses interest for all days for which there was an outstanding balance of $1,000 in Cycle 1, which would not be assessed under a "single-cycle" method. In addition, the issuer assesses interest for all days in Cycle 2 for which the outstanding balance is $1,000, as well as the days in this cycle after the $900 payment is credited to the account.

[2] Specific practices may vary according to the terms and conditions applicable to specific cards. Under regulations implementing the federal Truth in Lending Act, issuers are generally required to disclose key information relevant to the costs of using the card, including the applicable interest rate that will be assessed on any outstanding balances.

Figure 1: How the Two-Cycle Billing Method Works



Note: We calculated finance charges assuming a daily periodic rate of 0.03616438 percent (13.2 percent APR), compounded daily.

In this hypothetical example, the cardholder's Cycle 1 bill arrives 8 days into Cycle 2, and the cardholder's payment is credited 7 days later (or 15 days into Cycle 2). In this scenario, the cardholder would be assessed a finance charge of $5.61 under the single-cycle billing method, or a finance charge of $13.68 under the two-cycle method. However, the difference in interest would also be affected by the date on which the cardholder makes the payment—or more precisely, the number of days into Cycle 2 that elapse before the cardholder's payment is credited to the account. If the cardholder paid the same amount, for example, but the payment was credited 25 days into Cycle 2, then—all else being equal—the cardholder would be assessed a finance charge of $8.87 under the single-cycle billing method, or a finance charge of $16.94 under the two-cycle method.

I hope this information is helpful. If you have questions, please contact me at (202) 512-8678 or woodd@gao.gov.

Sincerely,

David G. Wood

David G. Wood
Director, Financial Markets
and Community Investment

Congress of the United States
Washington, DC 20515

February 1, 2008

Mr. John C. Dugan
Comptroller of the Currency
Office of the Comptroller of the Currency
250 E. Street, SW
Washington, DC 20219

Dear Comptroller Dugan:

As you know, both Congress and the bank regulators have been looking closely at current credit card industry business practices, the overall costs borne by consumers for card products, and the potential need for further legislative and/or regulatory action to address concerns raised in the credit card marketplace. We have heard concerns from many consumers about, among other things, a lack of clarity from credit card issuers in explaining account features, terms, and pricing and we remain concerned about consumers who become trapped in a cycle of debt as a result of unexpected fees or rate increases. Your office has previously taken action to address concerns over certain industry practices. Current Federal Reserve Board (Fed) rulemaking, some three years in the making and now winding down to final action, likewise appears to be focused on resolving much of what remains in controversy. Such scrutiny has led to much debate and various changes in industry practices aimed at addressing legitimate problems faced by consumers in the marketplace.

Yet the question still remains as to whether more needs to be done. While we recognize that it may be premature to make such judgments given the pending nature of the Fed's rulemaking, we ask for your guidance on some of the more complicated aspects of the credit card debate. As the federal regulator with the expertise and regulatory authority over the vast majority of our nation's credit card institutions, your office is well positioned to give us the necessary insights into the various issues at hand.

A number of proposals to address these concerns have been discussed by policymakers, such as:

- Prohibitions on considering accurate but negative information on a consumer's creditworthiness, such as their performance on other credits both at other lenders or with the institution itself, in determining the pricing of a credit card loan;
- Prohibitions on maximum interest rates applicable to credit card loans;
- Prohibitions on the ability to charge interest on outstanding credit card balances;
- Limitations on how finance charges are assessed;
- Requirements to allocate payments to highest rate balances first, or to apply payments on a pro-rata basis to outstanding balances subject to differing interest rates (e.g., promotional rate balances vs. new balances vs. cash advances); and,
- Improvements in the timing and adequacy of credit card disclosures.

We ask for your analysis of the broader impact of these proposals, in particular the impact that restrictions on credit card practices may have on consumer access to credit, the pricing of credit card products, the availability of low-cost alternatives for consumers in the marketplace and the impact on institution safety and soundness. Likewise, we would like to better understand the macroeconomic impact of such proposals in the context of current federal efforts to make credit more widely available.

We would welcome your views on all of these issues as well as on the extent to which the OCC and other bank regulators have sufficient authority to take action to address the concerns that have been raised about certain card industry practices, and to what extent you believe further authority is necessary.

While we believe a number of current credit card practices could be held up for scrutiny, we understand that roughly 6,000 banks issue credit cards in this country, and around 2.5 billion cards are presently in circulation worldwide. Given the ongoing and growing concerns we have about the state of our nation's economy, we believe these issues are too important to consumers and financial institutions alike to act imprudently. Our primary goal is to ensure that legitimate consumer concerns are aggressively addressed while minimizing the potential negative unintended consequences that may arise through overly-broad legislative solutions.

Therefore, we ask that your office carefully consider these questions and the issues they raise and return to us your views at your earliest convenience.

Sincerely,

Michael N. Castle

Nydia Velázquez

Ed Perlmutter

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

April 15, 2008

The Honorable Dennis Moore
United States House of Representatives
Washington, D.C. 20515

Dear Congressman Moore:

Thank you for your recent letter to me about the regulation of credit cards. In your letter, you described several proposals intended to address concerns that have been raised recently about a variety of credit card practices. These proposals have included:

- Prohibitions on considering accurate but negative information on a consumer's creditworthiness, such as their performance on other credits both at other lenders or with the institution itself, in determining the pricing of a credit card loan;
- Prohibitions on maximum interest rates applicable to credit card loans;
- Prohibitions on the ability to charge interest on outstanding credit card balances;
- Limitations on how finance charges are assessed;
- Requirements to allocate payments to the highest rate balances first, or to apply payments on a pro-rata basis to outstanding balances subject to differing interest rates (e.g., promotional rate balances vs. new balances vs. cash advances); and
- Improvements in the timing and adequacy of credit card disclosures.

You asked for the OCC's views about proposed restrictions on the terms and pricing of credit cards. In particular, you asked for our assessment of the impact of such proposals on the availability of credit, on the safety and soundness of lending institutions, and on the economy. I will be happy to provide you with my perspectives on credit card regulation generally, as well as on some of the proposals you have identified – imposing limitations on risk-based pricing, "universal default," allocation of payments, and certain methods of assessing finance charges, and making improvements to the timing and adequacy of consumer disclosures for credit cards.[1]

The regulation of credit cards presents several unique challenges. As an initial matter, it is important to recognize that credit cards are fundamentally different from other common consumer credit products like closed-end home mortgage loans – not only in the structure of the product, but also in the credit risks inherent in the product. Unlike a mortgage loan, each credit

[1] Some of the proposals you describe are similar to what is contained in legislation that has been introduced in the Congress and my letter is not intended as a comment on specific legislative proposals.

card transaction is a new extension of unsecured credit that is not separately underwritten at the time of the transaction. Instead, the consumer has been qualified for revolving transactions up to a specified credit limit at the time the account is approved. Moreover, in contrast to closed-end home mortgage loans, the individual consumer, not the lender, generally determines the amount of credit that is revolved, the amount of payment above the minimum required payment, and the length of repayment. In these respects, credit cards provide convenient and immediate access to credit throughout the account relationship without consumers having to apply, and be approved for separate new loans. Because of these features, however, the credit risk for credit cards can vary throughout the account relationship based on fluctuations in rates, market developments, and changes in a borrower's creditworthiness. These conditions can increase the credit risk presented not only by new transactions, but also by account balances that may have accrued when credit risk was low. Banks manage such changes in credit risk through practices such as closing accounts, shortening account expiration dates, and/or limiting future credit advances. Risk-based *pricing* also can be an effective tool for managing credit risk.

The OCC expects national banks to engage in ongoing and prudent risk management with respect to their credit card accounts, and they need to be able to use all the tools that are available to do this. Thus, we would generally be opposed to restrictions that could unnecessarily impede banks' ability to monitor and contain credit risk.

For the most part, there has been little substantive regulation of the terms of credit card products, such as interest rates, fees, and grace periods. Instead, the primary focus of regulation of credit cards by Congress has been on providing consumers, through mandated disclosures, with notice of the costs and terms of a credit card. Although a bill passed the Senate in 1991 that would have imposed a cap on credit card interest rates, it was not passed by the full Congress after critics argued that such a law would cause significant market disruptions and reduce the availability of credit. Under our predominantly disclosure-based system of credit card regulation, consumers receive disclosures of the material terms, fees, and other costs of a credit card product before entering into the contract and in periodic statements.

As I explain below, however, for this system to work well, I believe that disclosure should be designed not only to convey information effectively, but also to create an opportunity for consumers to make an informed and meaningful choice about particular product terms and credit practices.[2] Consumers need this opportunity for meaningful choice before they commit to a particular credit card as well as at key decision points throughout the account relationship when terms change.

Disclosure has been the cornerstone of federal consumer protection regulation for credit card users, and there would be costs associated with going beyond disclosure to regulate credit card practices. For example, proposals to restrict creditors' ability to monitor and manage risk, including through risk-based pricing, could have unintended consequences to the cost, supply,

---

[2] For a more comprehensive discussion of credit card regulation, see my Congressional testimony on these issues. *Testimony of John C. Dugan, Comptroller of the Currency, Before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services of the U.S. House of Representatives* (June 7, 2007). http:/www.occ.gov/ftp/release/2007-54b.pdf.

and availability of credit cards. In other words, we should expect that creditors will react to such restrictions by increasing the price of credit cards for some or all consumers and reducing the type and amount of credit that is available. Credit cards are a substantial segment of the consumer credit market as they have been used for more than $1 trillion in transactions over time. Consequently, a severe reaction by card issuers to market restrictions has the potential to add stress to general economic conditions. Thus, the issues you raise in your letter are complex ones that merit a careful assessment of the benefits and consequences of particular responses.

Nevertheless, it is clear that we are seeing a backlash against certain credit card practices. The intensity of this concern is apparent from the sheer number and types of proposals that have been made in reaction to these practices.. As you know, the Federal Reserve Board published an extensive proposal to revise the Regulation Z open-end credit disclosure rules and to bring them current with market developments. We strongly support the Board's actions in this regard, and their proposal, if adopted, would bring much-needed improvements to credit card disclosure rules.

Other proposals, however, have not been limited to addressing the content or adequacy of disclosures, but instead have called into question the underlying practices themselves. So-called "universal default" provisions are one example. Universal default provisions allow card issuers to increase interest rates on new transactions, as well as on existing balances, where a customer has failed to make required payments on another account or obligation. Concerns about universal default involve the fairness of applying a penalty rate to existing balances based on risk indicators not directly related to repayment on the account itself -- even though those factors can indicate a customer's increased credit risk. In contrast, when a customer defaults on his or her obligations under the terms of the credit card, the heightened credit risk is clear, direct, and immediate and, assuming there is meaningful notice, the customer is not surprised that there is a consequence.

While a prohibition on universal default would certainly eliminate the source of these complaints, that restriction could also deprive creditors of the ability to adjust rates to reflect increased levels of credit risk. I believe there are other ways to address concerns about universal default penalty pricing that would not adversely affect a creditor's ability to monitor and control credit risk in these circumstances. In a comment letter I sent to the Federal Reserve Board on its proposal to revise the Truth in Lending Act regulations governing credit cards, I offered one such alternative. I recommended that the Board amend Regulation Z to provide that, before a credit card issuer may increase the interest rate on an account pursuant to a universal default or unilateral change in terms provision, the issuer should be required to provide the consumer with a reasonable opportunity to opt out of the change. Thus, for example, when a creditor seeks to impose a penalty rate on an account because of deterioration in a consumer's credit score or default on an account with another creditor, the opt-out right would enable the consumer to pay down the outstanding card balance in accordance with the existing terms. If the consumer opted out of the rate increase, the creditor would be permitted to close the account to new transactions or the consumer could be permitted to keep the account open on the existing terms for a period of time, perhaps until the card expiration date. Structured in this manner, such an opt-out would preserve the creditor's ability to monitor and respond to changes in a borrower's creditworthiness using all relevant information and to control for any changes in credit risk.[3] This is important for the safety and soundness of credit card issuers.

In my comment letter, I also noted that some issuer practices may be so adverse to consumers or generally so difficult to understand that they may require an alternative disclosure approach that would warn consumers about the result of the practice, rather than simply describe its mechanics. A different form of disclosure could provide consumers with the type of information that would be more useful in helping them to make informed and meaningful choices. Short of imposing a ban, it could nevertheless serve as a potent check on these more aggressive practices.

We gave two examples of practices that should be strong candidates for additional warning-type disclosures – if such practices continue to be lawful. The first is commonly referred to as "two-cycle billing." Consumer testing indicates that most consumers do not understand that two-cycle billing can result in the retroactive elimination of grace periods in certain circumstances. Therefore, we recommended that the Federal Reserve prohibit the use of two-cycle billing, <u>unless</u> the consumer receives a prominent warning that the consumer's failure to pay off the entire balance due will result in interest charges on the entire amount of the balances for two billing cycles.

The second practice relates to the assessment of penalty fees without any affirmative act by the consumer that would trigger the penalty. Some issuers may charge overlimit fees at the end of a billing cycle when the assessment of periodic interest for that cycle causes the entire balance due to exceed the credit limit established for the account. Similarly, when a customer fails to pay the amount due on time in one billing cycle, and the assessment of a late fee causes the account to become overlimit, some issuers may assess not only the late fee but also an overlimit fee in the next billing cycle. Some issuers also may impose penalty fees in consecutive billing cycles based on a single prior breach by the consumer. Such practices of imposing "fees-on-fees" may surprise and impose significant costs on consumers, though neither the practice nor these costs may be readily apparent from the disclosures currently required to be provided to consumers. We recommended that the Federal Reserve require special warning disclosures in such instances as well.

As you know, the Federal Reserve Board's proposal also would do a number of things to improve the content and timing of disclosures for credit cards, and we strongly endorse their use of consumer testing to improve the effectiveness of consumer disclosures. In my comment letter, we also specifically supported the Board's proposal to enhance disclosures about the allocation of payments to balances subject to different interest rates, such as a lower promotional rate for balance transfers. In our experience, many consumers do not understand that payment allocation methods can vary and that a creditor's payment allocation practices may increase the relative cost of using the account when it includes features with different APRs. The Federal Reserve

[3] As noted above, when a consumer defaults on his or her obligations under the terms of the credit card, the credit risk consequences are more direct and immediate. Assuming there is meaningful notice, the consumer is not surprised when the creditor takes appropriate action to address this risk. Consequently, we do not favor providing consumers the right to opt out of an increased interest rate based on risk factors related to the consumer's repayment performance on his or her card account with that creditor.

did not propose restrictions on how creditors must apply payments among balances subject to different interest rates, however, and such restrictions would not appear to be necessary – *provided* that creditors clearly disclose the payment allocation method to consumers before consumers enter into the credit contract. As you know, credit card companies compete for new customers by offering temporarily low interest rates on balance transfers, and many consumers can benefit by lowering their borrowing costs when they transfer credit balances to a lower-cost account. If payment allocation rules were imposed, however, the result might well be fewer low-rate promotional programs that benefit customers, and changes to the way credit cards are priced.

Ultimately, it is a matter for the Congress to decide when disclosures alone may be inadequate to address consumer protection concerns about credit cards. As I noted above, this decision will involve weighing the benefits and consequences, or "trade-offs," of particular responses. And the Congress may well conclude that, with respect to certain practices, it is appropriate to intervene in the market. However, as you point out in your letter, the glare of recent scrutiny of credit cards itself has had the positive effect of causing many issuers to change their offending practices without the need for changes to the law.

Finally, let me respond to your question about whether the OCC and the other bank regulators have sufficient authority to take action to address concerns about certain credit card practices and whether we believe additional authority is necessary. The OCC has taken a number of steps to address issues relating to inadequate and ineffective disclosure of credit card practices, practices that pose safety and soundness concerns, and practices that may be characterized as unfair and deceptive. For example, we have taken a number of enforcement actions to address credit card practices that we found to be unfair or deceptive, particularly involving subprime credit card issuers. The OCC has sufficient authority to supervise the credit card operations of national banks, and to take enforcement actions as necessary to address violations of law.

However, given our substantial supervisory authority over many major credit card issuers, it is anomalous that the OCC does not have any formal role -- either through consultation or direct rule-writing authority -- in the implementation of either of the two major consumer protection laws that affect the credit card operations of national banks. Therefore, I believe that the OCC should be provided joint rulemaking authority with the Federal Reserve Board and the other federal banking agencies under the Federal Trade Commission Act relating to unfair or deceptive practices. I am pleased to note that legislation has been introduced in the Congress that would provide us with that authority. I also believe that, at a minimum, the Federal Reserve Board should be explicitly required to consult with the OCC (and the other federal banking agencies) in its rulemakings affecting credit cards under the Truth in Lending Act.

I hope that this has been responsive to your inquiry. If you have any further questions, please do not hesitate to contact me.

Sincerely,

John C. Dugan
Comptroller of the Currency

DISCOVER
FINANCIAL SERVICES

Rep. Mike Castle
United States House of Representatives
Washington, D.C. 20515

Dear Congressman Castle;

I am responding to your request for clarification of an answer I gave at last week's hearing on the "Credit Cardholder's Bill of Rights", H.R. 5422.

At the hearing, Chairwoman Maloney asked whether I agreed that the bill did not impose price controls or set fees on credit cards. Her question followed up on a comment I made about the negative consumer impact of a statutory late fee ceiling that was imposed in the United Kingdom where we formerly issued a credit card.

H.R. 5422 does not contain provisions that mirror the U.K. late fee ceiling or set fee levels. But we think that some of the bill's provisions are likely to have the same effect: increased prices, reduced consumer choice and curtailed credit availability. For example:

> prohibiting the adjustment of interest rates when there are changes in the original underwriting assumptions about the borrower's ability or willingness to repay, effectively "caps" the APR on these accounts for the life of the account. This requires that costs of extending credit to these riskier borrowers to be covered through higher prices (initial APR, fees) or by tightening qualification standards, lowering credit lines, etc.
>
> prohibiting banks from using a particular balance computation method reduces the interest that is derived from that method. The shortfall must be made up though additional or higher fees or APRs, shorter grace periods, or other changes.
>
> limiting over limit fees to once monthly and three times consecutively is a fee cap that reduces borrowers' incentive to keep spending below their credit

Whether or not any of the provisions of H.R.5244 constitute price controls should not be a determinative issue. What is important is to ensure that nothing in the bill would have the unintended consequence, like UK's legislated ceiling on fees, of driving up consumer costs or impairing consumers' ability to obtain credit from regulated financial institutions. As both my hearing statement and written submission indicate, we are concerned that H.R. 5422 might do that.

Sincerely,

C. Nicetti

Discover Financial Services 2500 Lake Cook Road Riverwoods, IL 60015

Please include the following testimony supplement to the record relevant to HR-5244. 05/16/08

A detailed review of Mr. David P. Hogan's Chase Bank rebuttal of my written testimony reflects predictable and selectively comprehensive denials of material fact and omissions of convenience. In addition, facts briefly outlined below also serve to refute 04/17/08 testimony of Ms. Julie Williams of the OCC. Ms. Williams' testimony contains leaps of faith and jumps to conclusions not supported by practical application or realistic results. These reflect idealistic and industry-protective implementation goals maintaining the status quo support of recommendations that serve to further the current state of Revolving Credit lending policy at the expense of American consumers, in the same way as has already been witnessed since the late 1990s. Neither Mr. Hogan nor Ms. Williams address "lender error". In repudiation of Mr. Hogan's rebuttal and Ms. Williams' testimony, I add the following to my testimony:

My payments are normally made by check using the bank's own bar-coded mailing envelopes in the traditional manner, as well as interim payments made in standard envelopes as may occur due to a missing statement in which no bar-coded envelope would be received. Briefly, starting from late-2001, several instances of consecutive, repeated late- and non-receipt of monthly statements, and late- and non-posting of payment occurred. A literal following of pre-disclosed "rules" resulted in opportunistic predatory marketing policies designed to induce lower credit scores via additional debt, recurring APR increases, "Universal Default", and resultant usurious finance charges. The nature of these practices is reminiscent of classic deception in advertising. These predatory tactics are clearly evident in all four Revolving Charge accounts with FirstUSA/BankOne/Chase Bank, while ~130+ other vendors showed no such degree of practice, 10+ also being unsecured Revolving Charge accounts. Traditional loans were very expensive post 9-11, and it was not disclosed that under-limit utilization of available, assigned credit lines would be arbitrarily penalized by reduced credit and applications of Universal Default.

In the wake of 9-11 and biochemical threats to the US Postal Service, service delays necessitated policies of disclaimer, such as continue in Washington to this day. But frequent Chase Bank errors (or USPS failures) were made accountable to me, producing excessive finance charges, then accompanied by continual offerings of low-priced "Siren Song" promotions designed to exacerbate a situation I was already being penalized for. Apparently, either wide chasms exist between bureaucratic departmental communications, or these unethical practices are engineered. As time went on, I came to realize that perceived "communication breakdowns" were coordinated efforts to enhance furthering spirals of debt. It no longer appears that "one hand does not know what the other is doing", but that concerted efforts are made to induce maximum penalties and finance charges by lowering FICO and raising APRs.

For example, as balances were paid down, Chase Bank would "follow" my balances down by lowering the credit limits to within a razor's edge of newly-lowered balances, contrary to Mr. Hogan's assertion. This tactic ensured full utilization of my credit limits by keeping my usage artificially high, thereby manipulating reports of full utilization to credit bureaus, negatively impacting credit scores, and paving the way to continually raise APRs rather than freezing accounts, had Chase felt so inclined. I turned down dozens of low-APR promotional offers as obvious, recognized marketing ploys designed to renew increased levels of recently paid-off debt. Mr. Hogan's rebuttal recap indicates numerous and severe inaccuracies produced as a result of Chase's own incomplete records and ignored material facts. My experience reflects that of many other Chase customers. Personal experiences abound, for instance:

Hogan: "...Mr. Strachan was repriced for being in default when he did not make a payment."

Strachan: Payments were made and some posted late, thus appearing to have cycled into following months. Errors in billing and posting were generally discovered with receipt of following monthly statements. Additionally, numerous consecutive statements were not received due to Chase admitted repeat computer errors with my address. After several complaints, a Chase Bank representative stated that "(We) are not required to send out statements." Chase's report of late payment to a credit bureau had to be reversed and was documented back to me. Some late fees and multiplied finance charges were reversed due to bank error, but APRs continued to rise and Universal default applications ensued with other lenders. In each case of delay, without regard to cause or fault, payments were made immediately upon discovery, or when a requested duplicate statement was received via USPS, as fax requests were not granted. APRs were not only raised contractually along with increases in the prime rate, but also independently of prime, contrary to assertion.

Hogan: "While it is true that a line reduction can cause a FICO score to fall, what started the (line reduction/repricing) was a rapid increase in (debt), (late and reduced) payments."

Strachan: Mr. Hogan fails to acknowledge that a major contributing factor to debt increase was the very application of "Universal Default", constantly rising APRs, and continual lowering of credit limits (absent any new charges), thus creating vicious cycles of cause and effect. Resultant "Universal Default" occurred after Chase continually raised my APRs while "chasing" my credit limits down to levels dangerously close to new lower balances. This Chase tactic of lowering credit limits to razor-thin margins of lowered balances ensured an appearance of full utilization, despite continually falling balances. My FICO score fell 47 points when added finance charges exceeded a newly unilaterally-lowered credit limit.

Chase then had to reverse a resultant negative report made to a credit bureau by raising the credit limit a few hundred dollars, lowering it again, and documented the situation back to me. APRs still continued to rise even though the bank documented errors and reversed the Bureau report. By raising APR and finance charge by as much as 300%, a triple-sized payment would then be construed as "minimum". ~$100,000 in payments to Chase, not reported to credit bureaus, ensured artificially high levels of outstanding debt. Mr. Hogan's rebuttal fails to acknowledge these and other salient facts. Specific details and particular effects of many other key events can be made available to qualified parties.

Hogan: States that Chase late-posting or non-posting of payments is "simply not the case".

Strachan: My records clearly indicate numerous instances of practices in which the departmental bureaucracy of FirstUSA/BankOne/Chase Bank displayed either a dysfunctional and uncoordinated hierarchy, or was engineered by design in order to squeeze every possible dollar of profit from proven responsible borrowers. Mr. Hogan's information evidently is exclusive of obvious facts aside from information supplied in his rebuttal of 04/16/08. My records include very specific details and backup documents, factual data apparently not made available to Mr. Hogan at the time of his rebuttal. Elements of this wide array of predatory lending practices are still obvious in my paid off Chase accounts, even today.

The information in Mr. Hogan's rebuttal is likely to have been imputed to him by Chase Bank's computer summary as he conveys no instances of any documented non-receipt of statement (continued and consecutive), late-posting and non-posting of payment, blatantly inaccurate statements made by Chase Customer Service representatives, and highly unprofessional personal innuendo and clearly false statements made by more than one Chase representative. Errors and practices accountable to specific bank supervisors are either not made part of Chase's record, or simply omitted from his rebuttal. Three currently existing accounts with Chase Bank were mentioned by Mr. Hogan in a 350+ page rebuttal received during the late night hours prior to the day of my scheduled verbal testimony. A fourth, now closed account is not addressed in his rebuttal at all. All four accounts with Chase Bank exhibit clear, documented, and unconscionable displays of practices ultimately leading to applications of Universal Default and thence, perceived violations of traditional default that Chase attributes to me. Regardless of cause, the effects of these practices have been the same, and are still evident and clear in Chase and other credit accounts to this day. In each instance of irregularity, expedited payment and/or EFT was made immediately upon discovery with no regard given to which party may or may not have been accountable, discoveries generally made upon receipt of a following statement ~30+ days later.

I experienced no such situation with my Chase Auto Installment accounts, past or present. Similarly, multiple Revolving Charge accounts with CitiBank, Capital One, Discover, Advanta, MBNA, American Express, NextCard, and even US Bank did not witness FirstUSA/Bank One/Chase degrees of egregious extortive and predatory practices as outlined in my testimony, and either unacknowledged or flatly denied in Mr. Hogan's rebuttal, let alone any of another ~130 vendors of other goods/services.

In April, 2008, a review of my Equifax report reflected a Chase account's entire ($ amount) credit line as $0. I then contacted both Equifax and Chase Bank so as to have the error corrected. I received a letter from Chase explaining that my ($ amount) credit line is actually a "credit access line" with "no preset spending limit", and thus somehow exempt from certain accepted standards of reporting. This report was finally revised in May, 2008 after a failure to accurately report for a very long time. Similarly, just prior to 04/17 testimony, US Bank's claim that my ($ amount) account was a "credit line" rather than a "credit card" led to removal of highly relevant testimony, contradicting a commonly accepted definition of instruments utilized to access unsecured "revolving charge" accounts. Twice in one week witnessed instances in which lenders "blurring the lines" of commonly used terminologies has been aimed at exempting some common unsecured Revolving Charge instruments from relevant, needed oversight legislation. The adage "if it walks like a duck and quacks like a duck, it's a duck" is truly pertinent, and must be applicable to all aspects of these murky waters of credit lending practices, not just selectively as would serve the lender alone. Within unsecured Revolving Charge accounts, various instruments and forms of access to credit available in that account are considered by consumers to be "inclusive", for all intents and purposes. Whether "credit line", "credit limit", "credit card" or "credit convenience check", etc., terminologies have been, and still are, used interchangeably by consumers, government, and even the banking industry itself. However, selective exclusion by making distinctions without making a difference serves to exempt the inclusion of normal Revolving Charge products from required oversight and legislative controls. Lender attempts to <u>exclude</u> transactions implemented by "non-plastic card" product instruments, such as <u>Balance</u> <u>Transfer</u> or <u>Cash</u> <u>Advance</u> "Access" <u>Checks</u>, Telephone- and Electronic Funds Transfers, etc. further obfuscate and exempt those transactions from effective controls. These are <u>all</u> instruments utilized to access unsecured, Revolving Charge accounts, and comprise a growing portion of unsecured, outstanding Revolving Charge debt. Definitions and valuations considered during the drafting of TILA 30-40 years ago are now grossly insufficient. Hence, now-common, widely-promoted products are not amply considered. Exemptions viewed as reasonable under TILA and FCRA do not recognize modern instruments of access and higher credit limits, giving some overzealous lenders a basis for abusive practice. Initial account limits and widely used products are thus assigned at levels with definitions exempted by TILA, and therefore ripe for coercive abuse.

From the period of the mid-to-late 1990s, credit lines of $25,000+ have been more prevalent than the period in which TILA was drafted and have grown to become a profitable "feeding ground" for the predatory practices of some overzealous lenders. Consequently, such accounts must not be exempted from the Truth in Lending Act and other relevant legislation, and thus be afforded similar protection. "Opting out" or "lowering limits" have severe repercussions for risk metrics reflected as FICO scoring.

I do not wish to bring harm to either Chase, their customers, or myself. I do, however, wish to correct wrongs that some lenders have done, bring clarity and fairness to these examples of disparate influence and power, and will continue to seek redress through all available forums, whether public or private. Lax regulation and dubious oversight have shown that "The fox cannot watch the hen house". Implied admission by banks of discontinued applications of some predatory policies, including Chase, do nothing to address injuries already experienced, nor have attempts been made by lenders to return these predatory, extortive, and ill-gotten gains, roll back terms on a retroactive or going forward basis, or exhibit any true, meaningful intention to obviate the need for effective, modernized legislation.

When lender errors occur, they tend to be compounded by the time they are discovered. This has been made painfully evident in the actions of Chase Bank relevant to the four accounts mentioned above. On occasion, penalty fees were waived, all the while the bank continuing to raise my APRs and finance charges mercilessly by as much as 300%-400%. As a result, my payments were then reflected as "minimum" amounts rather than multiple and larger in size, thus appearing "risky" or "deteriorating". The negative effects of instances of late-posting, non-posting, non-receipt of statement, and inaccurate information given by Chase representatives in numerous documented cases were then ascribed to me. Mr. Hogan's rebuttal makes no mention of, nor gives validity to any of these corporate mistakes, but implies that my account activity was somehow devoid of my many documented attempts to address those errors, even when instigated by these clearly discernable Chase actions. In his recap of rebuttal, Mr. Hogan infers that Chase Bank was somehow "unerring" in execution, despite documented records of this "comedy of errors". Chase Bank's errors are, and have been, prevalent, very expensive, and have made a material impact on my personal and financial well-being since late-2001. The consequences of these errors truly stretch the imagination, but are very real, nonetheless. My commitment as a borrower and a strong resolute refusal to capitulate were primarily responsible for preventing any of my accounts from becoming delinquent, and high balances were paid off years ahead of term regardless of Chase Bank's apparent efforts to take advantage of my responsible repayment history. TILA and FCRA, as "doctrines of fairness", have been run over roughshod in my and millions of other cases. I maintain a 788 FICO score to this day, yet the pernicious effects of Chase's predatory policies continue to persist.

May 12, 2008

House of Financial Services Committee
US House of Representatives
Washington, DC 20515

Dear Committee:

I first wish to say Thank You for allowing me to testify this time. It was a very scary experience, but I feel a very worthwhile one to talk about why we need HR5244.

I found it interesting that the letter Chase sent to the Committee to rebuttal my testimony, Chase had asked that it not be made part of the public record yet they were quick to hand out themselves. They followed me outside the courtroom and jumped on any reporter I talked to. They then said it was not the same letter but it was very close to the same letter just not addressed to the committee and few things left out which point out the fairness issues (I was given a copy from one of the reporters). To me this shows that Chase does not want my story told because they know it represents the average American who plays by the rules but is not treated fairly. When reading the letter, I personally would be embarrassed to hand it out or even give it to the committee. It again, only confirms, that I have not been treated fairly and (does not clarify or justify) why I have different interest rates on three different Chase Credit Cards. If you just glance at the letter without really reading it and/or knowing what to look at and the story of looking for fairness for the three different interest rates, you would buy the story Chase wants you to believe. There is only one of me so there should be only one risk

According to Chase if you use the limit that they have set, you are considered over extended.
In addition, they determine the minimum payment but if that is what is paid, you are considered over extended. The way the agreement reads you only need to stay under your limit and make at least the minimum payment. Where in the agreement does it state that if you use your limit or make minimum payment they will consider you over extended and can reprice you? Perhaps I am unable to see in the agreement where it states this because the agreement is so long and ambiguous. Why issue those limits if you cannot use them?

In a complaint that Chase received from me they state in their response and the letter to the subcommittee that they reviewed my accounts and current financial status when they received the complaint 4/2008. How can they review my current financial status without asking me if I still am in the same position as the last time (which I am not) and what my current salary is? They never asked me anything but yet reviewed my current financial status, which would mean my salary compared to debit. HHHMMM, would Love to know how they did this.

They state that I use 80% of my credit line with all three Chase Credit Cards. They also state that the lower interest rate credit card 7.9% is used at 100% of the credit line, which would mean the higher interest rate credit cards balances are used up to 75 % of the limit. They said that this caused my cards to go thru re-pricing because of high balances but according to their letter, the credit card with the highest balance percentage is the lowest interest rate. Like I have been saying from day one where is the fairness in this?

On my Disney card (0161) they re-priced it the 1st time within 2 years and then a 2nd time less than a year later so twice in a 3-year period. In addition, I stated that it was 7.9%, I rounded up instead of down, I knew it was around 7%. I just got a notice in this month's bill that they are changing the rules again. They have changed my contract 3 times in 5 years, where is the fairness in this when like I continue to say I play by the rules, never exceeded my limit and pay at least the minimum payment if not more. Two of the changes to the contract have been since the credit card was closed, why are they re-pricing/changing the terms on a closed account. It is my fault for not realizing that it was a variable rate instead of fixed

On the American Society For The Prevention of Cruelty To Animals (ASPCA Card -2274) they re-priced the interest rate within 16 months of this card being open; this was just 4 months after the 0% introductory offer. The card I applied for was a 7% rate; I was not made aware that this is not what was issued.

Therefore, the card I use 100% of the available credit has yet to come up for re-pricing and has been open over 3 years. It has been open longer than the Disney card was when it was being re-priced for the 2nd time. The ASPCA card was repriced within 16 months of the first usage or 4 months after the introductory period. Yet according to Chase, the reason the other two were re-priced was the usage or could part of it be that they are rewards cards and Chase does not want to pay the rewards?

Chase has also admitted that I adhered to their rules of paying on time and paying at least the minimum payment if not more. I have not gone over the limit except once in the middle of the month on the ASPCA Card. Yet they continue to state they feel I am over extended and need credit help. If I were able to make my payments on time and make the minimum payment why would I need help? For example, on the ASPCA Card (2274) when they asked for a minimum payment of $36.00 the interest was $35.85 so **$0.15 would go to the principle**. If I am so over extended as Chase would have you believe that I can only afford to make the minimum payment or close, how come then since January (08) to current I was able to pay $939.12 toward the principle on this card card. I will attach January and current balance from Chase as proof. Yet Chase, also notes that if I am willing to state I am over extended they can lower the interest rate? Why can't Chase just lower the interest rate if they feel I am over extended, why does it first require an admission to something I do not believe to be true? So Chase feels that I deserve interest rates from the lowest credit card is at 7.9% and the highest is currently at 20.24%. Again let me state where is the fairness in this?

Chase talks about my continued decline in my credit score (which I was told they do not use) but if it has declined and is still considered Great at 726 what was it when they decided to re-price me? It seems that one's credit score would only have to decline a point for Chase to use it as an excuse to reprice someone's interest rate. They also stated that they reviewed my current financial status last month and feel that I am still over extended with a very good credit score. Yet I am told that this is a very good credit score and that there is very little chance I will not repay my debit. I will enclose a copy from my bank for the record. I also want to state for the records in my almost 30 years of credit history I have never defaulted on my bills and all three credit reports show excellent payment history and never being late.

I also would like to state for the record that I authorized Chase to talk about my debt with the three cards with Chase; however, they talked about my debit outside Chase. This means they violated my privacy in my opinion, not that I have anything to hide. Before signing the waiver, I asked if my personal information would be on it (like credit card number, ssn, etc) and the committee checked and was told they would redact these documents. Do you think they did this, so know my numbers are available for all. I have had to put a fraud alert on my credit report for safety. I have talk with several people at large organizations and when they get a legal request for information the personal information is redacted, this is a common practice. Chase would know this practice as big as the organization is. I am sorry because of what has happened in my history with Chase I do not buy that this was an oversight like they are saying. They also stated to reporters it was only one person at the committee that had seen it and that they would apologize for This Mistake. In a letter from Mr. Hogan, Senior Vice President of Chase Card Services, he states four members. So for the media Chase down plays it and states one thing but to me they give me a story closer to the truth. This continues to show how Chase is trying every way possible to contradict the fact they do not practice fair and are afraid of the truth.

In addition, they keep making it sound like they are willing to help me. Why do they just not give me the lower interest rate if I deserve it? I would like to play the devil's advocate here and look at this in two ways from a company standpoint.

> 1st scenario, looking at it from a Customer Service Standpoint. Hey, look this person might be over extended. Why don't we lower her limit, not charge her the over the limit fee since we have lowered it, keep her at the lower interest rate and help her pay off the debit.
>
> 2nd scenario from a profit margin. Hey, looks like this person might be over extended. Let's raise the interest rate and make some more money because they will not be able to pay it off.

The Credit Cardholders Bill of Rights would have protected me for the following:

Protects cardholders against arbitrary interest rate increases
Prevents cardholders who pay on time from being unfairly penalized
Protects cardholders from due date gimmicks
Shields cardholders from misleading terms
Empowers cardholders to set limits on their credit

What is disappointing to me is that Chase has caused me to lose my Disney Rewards which was important to me, as I'm a big Disney Fan. They also have caused the ASPCA to lose the rewards they would have received to help animals in need. It is sad when a large corporation like Chase can treat regular consumers like me so poorly. It is amazing that Chase can promote themselves as a company working to better support their objectives of building long term relationships with customers. I have yet to see an example of this.

I can only hope that my story will help Congress realize that this bill is needed and we need to help the Individual Americans out there from being treated unfairly by bad credit card companies.

Sincerely,

Susan Wones

Susan Wones

Bill Pay | Order Checks | Rates | eLerts | Total View | Apply for a Loan | Contact

March 04, 2008

- Accounts
  - View Balances
  - eStatements
  - Open Account
  - Tax Info
  - View Checks
- Transfers
- Preferences
- Credit Cards
- Online Tools
- Other Services
- Loan Application

BELLCOnline

Credit Score

All Accounts Credit Score Checking Savings

Susan Wones, your credit score is 726. Last updated: 01-15-200

200

How Does Your Score Rate?

Poor	Low	Fair	Average	Good	Very Good	Grea
Below 599	600-639	640-659	660-679	680-699	700-719	720-7

- For more information on what your credit score means to you, click l
- To receive your free annual credit report, click here.
- Do you need help improving your credit score? click here.

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Bellco - Credit Score

Poor	Low	Fair	Average	Good	Very Good	Great	Exceptional
Below 599	600-639	640-659	660-679	680-699	700-719	720-739	740+

Statement for account number [redacted] 2274

New Balance	Payment Due Date	Past Due Amount	Minimum Payment
$1,485.85	02/04/08	$0.00	$36.00

CHASE

Amount Enclosed $.

Make your check payable to Chase Card Services.
New address or e-mail? Print on back.

[redacted]

41801 BEX Z 01508 C
MRS SUSAN WONES
[redacted]

CARDMEMBER SERVICE
PO BOX 94014
PALATINE IL 60094-4014

[redacted]

CHASE

Opening/Closing Date: 12/16/07 - 01/15/08
Payment Due Date: 02/04/08
Minimum Payment Due: $36.00

CUSTOMER SERVICE
In U.S. 1-888-305-4016
Español 1-888-446-3308
TDD 1-800-955-8060
Pay by phone 1-800-436-7958
Outside U.S. call collect
1-302-594-8200

ACCOUNT INQUIRIES
P.O. Box 15298
Wilmington, DE 19850-5298

PAYMENT ADDRESS
P.O. Box 94014
Palatine, IL 60094-4014

VISIT US AT:
www.chase.com/creditcards

VISA ACCOUNT SUMMARY Account Number: [redacted] 2274

Previous Balance	$1,892.21	Total Credit Line	$2,000
Payment, Credits	-$542.21	Available Credit	$514
Finance Charges	+$35.85	Cash Access Line	$400
New Balance	$1,485.85	Available for Cash	$400

Your account is closed. Please continue to make monthly payments by the due date until your balance is paid in full.

FLEXIBLE REWARDS SUMMARY

Previous points balance	0
Points earned on purchases this period	0
New total points balance	0
Total points unavailable for redemption	1,167

429 Points to expire on statement on or after JUNE, 2011

To redeem your Flexible Rewards points, call 1-800-603-2285, or log on to www.chase.com/creditcards for 24-hour access to your rewards program.

TRANSACTIONS

Trans Date	Reference Number	Merchant Name or Transaction Description	Amount Credit	Amount Debit
12/31	[redacted]	Payment Thank You Electronic Chk	$38.00	
01/0[redacted]	[redacted]	Payment - Thank You	150.00	
01/08	[redacted]	Payment - Thank You	103.21	
01/15	[redacted]	Payment - Thank You	250.00	

FINANCE CHARGES

Category	Daily Periodic Rate 31 days in cycle	Corresp. APR	Average Daily Balance	Finance Charge Due To Periodic Rate	Transaction Fee	Accumulated Fin Charge	FINANCE CHARGES
Purchases	V .06093%	22.24%	$371.36	$7.02	$0.00	$0.00	$7.02
Cash advances	V .06367%	23.24%	$0.00	$0.00	$0.00	$0.00	$0.00
Balance transfer	V .06093%	22.24%	$1,525.92	$28.83	$0.00	$0.00	$28.83
Total finance charges							$35.85

Effective Annual Percentage Rate (APR): 22.24%

Please see Information About Your Account section for balance computation method, grace period, and other important information.

The Corresponding APR is the rate of interest you pay when you carry a balance on any transaction category.
The Effective APR represents your total finance charges - including transaction fees such as cash advance and balance transfer fees - expressed as a percentage.

IMPORTANT NEWS

Do you know about the ASPCA Guardian monthly giving program? Guardians are dedicated friends like you whose monthly credit card donations are changing the lives of America's needy animals. To become an ASPCA Guardian please visit www.aspca.org/guard & the animals say thanks!

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CREDIT CARD (...2274)

ASPCA

Account Summary

Outstanding balance†	$1,053.02	See activity
Payment due date	05/05/2008	See statement
Minimum payment due	$0.00	Pay credit card
Balance last statement	$1,153.02	
Available credit†	$946.00	Transfer balances
Total credit limit†	$2,000.00	
Chase Flexible Rewards^{SM}		See rewards details

See more information

Payments &
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† **Credit Card**
"Outstanding Balance" may not reflect most recent transactions or pending authorizations. If your account currently has No Pre-Set Spe
"Available Credit" is the amount of your "Credit Access Line" currently available for use, and your "Total Credit Limit" is the total amount
Access Line" as defined within your Cardmember Agreement. All APRs, including balance transfer APRs, may not be displayed. Please
statement for additional APR information.