

Smoke and Mirrors

*The need to protect consumers from the
deceptive practices of the credit card industry*

Testimony of

Consumer Action

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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*

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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 Action¹ 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 reports² 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 existing 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.

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

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 America⁷ 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.*

Chase⁸ 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***

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.

Citi⁹ 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 Express¹⁰ 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 One¹¹ 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.

⁹ Citicards web site:

https://www.accountonline.com/ACQ/DisplayTerms?sc=4DNZ18A7300000000W&app=UNSOL&siteId=cb&langId=en&BUS_TYP_CD=CONSUMER&DOWNSSELL_LEVEL=2&BALCON_SC=&B=M&DO_WNSSELL_BRANDS=M,M,&DownsellSourceCode1=4DNZ28E7300000000W&B1=M&DownsellSourceCode2=4DNZ38C7300000000W&B2=M&t=t&uc=2J9&productConId=BM4DNZ1

¹⁰ American Express web site, April 11, 2008

<https://www201.americanexpress.com/cards/Applyfervlet?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.

Ausubel¹² 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.)

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 commentary¹³ 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 argument¹⁴ in his critique¹⁵ 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.

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 110th 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.

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