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Statement of

Dolores S. Smith

Director, Division of Consumer and Community Affairs

Board of Governors of the Federal Reserve System

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of the

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of the

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Thank you for inviting me to appear before this subcommittee. I am the director of the Federal Reserve Board's Division of Consumer and Community Affairs, which carries out the Board's responsibilities for administering a number of the consumer protection laws that make up the Consumer Credit Protection Act, including the Truth in Lending Act. As the subcommittee focuses on how the credit card industry is treating its customers, I would like first to provide some background information that might be useful to the subcommittee.

The Truth in Lending Act ("TILA") is the primary federal law that governs credit cards. It requires that consumers be provided with disclosures about the costs and terms of a credit card on or with a solicitation or application, at account opening before the first transaction, and with each periodic billing statement. TILA also requires creditors to credit accounts on the date the consumer's payment is received, it limits consumers' liability for unauthorized use of a credit card, and it provides procedures for resolving billing disputes. In addition to TILA, credit cards are also subject to various state laws that may regulate the terms of the accounts.

As part of the bank examination process, the Federal Reserve enforces the federal banking laws, including the Truth in Lending rules, with respect to the approximately 980 state-chartered banks that are members of the Federal Reserve System. Other regulators enforce these rules with respect to other institutions. The Board also investigates consumer complaints against state member banks, and forwards complaints involving other creditors to the appropriate enforcement agencies. In addition, the Federal Reserve's Division of Research and Statistics monitors certain trends in the credit card industry. I will share some observations with the committee based on the information that we have gathered in carrying out these functions.

Growth in the Credit Card Industry

Among the notable changes in consumer financial services over the past few decades has been the growth in the use of credit cards. Credit cards are used both as a means of payment and as a ready source of credit. Recent estimates suggest that in 2000, consumers used about 1.4 billion credit cards (or roughly 9 cards per holder) to purchase nearly 1.5 trillion dollars in goods and services in more than 20 billion individual transactions. It is estimated that at year-end 2000, consumers in the U.S. owed nearly $675 billion on general purpose credit cards.

In the Fair Credit and Charge Card Disclosure Act of 1988, the Congress directed the Federal Reserve Board to transmit annually to the Congress a report about the profitability of credit card operations of depository institutions, a copy of which is attached to my testimony. In 2000, credit card banks--those banks established primarily to issue and service credit card accounts--reported net earnings before taxes of about 3.14 percent of outstanding balances adjusted for credit card-backed securitization. This was slightly lower than in 1999. Recent earnings on credit card operations compare favorably with returns during the mid-1990s, but they remain below their high point attained in 1993.

The Federal Reserve has for many years sponsored surveys of consumers to gather information on their financial circumstances including their use of different forms of credit. The most recent Survey of Consumer Finances shows that in 1998 almost three-fourths of American families had one or more general purpose or retail store credit cards. General-purpose cards that have a revolving feature, often referred to as "bank-type" cards, show the most notable increase, rising from 16 percent of families in 1970 to 68 percent in 1998. Moreover, the survey shows that the holding of bank-type credit cards has become more widespread across all income groups over this period. For example, among families in the lower income quintiles, holdings of bank credit cards increased from two percent in 1970 to 28 percent in 1998.

Over the past several years, competition has led to substantial shifts in market shares among the industry's largest issuers of credit cards. Most of the larger issuers have grown by acquisition of credit card portfolios or by mergers. But several of the more rapidly growing firms have recently attracted market share by offering comparatively low-rate cards and attractive balance transfer programs. Others have gained market share through co-branding and offering rebates or annual fee waivers. The large number of direct mail solicitations of credit cards, some 3.5 billion in 2000, attests to the continuing desire of card issuers to expand and retain their cardholder base. The response rate on credit card solicitations in 2000 was estimated at .6 percent

Recent Trends in Credit Card Pricing

Over the past several years, pricing practices in the credit card market have changed significantly. Prior to the early 1990s, card issuers competed primarily by waiving annual fees and providing credit card program enhancements. Since then, however, interest-rate competition has played a much more prominent role. Many card issuers now offer a broad range of plans with differing rates depending on credit risk and consumer usage patterns. Risk-based pricing makes credit cards available to consumers with less-than-perfect credit histories, but also makes the credit more expensive for some consumers. Many issuers have also moved to variable-rate pricing, with rates that automatically adjust with changes in the market. A general decline in credit card interest rates from mid-1991 is the result of many factors, including a sharp drop in card issuers' cost of funds and greater competition on this aspect of credit card pricing. Today, credit card interest rates average about 14.6 percent. Apart from the information we have about interest rates, we have little systematic information about other aspects of credit card pricing.

Consumers' Attitudes Toward Credit Cards

The Federal Reserve has sponsored or participated in surveys of consumers' attitudes toward, and their understanding of, credit cards. The results of some of these surveys were published in an article in the Federal Reserve Bulletin for September 2000, a copy of which is attached.

Overall, consumers' opinions about the use of credit cards are somewhat more negative in 2000 than they were a generation ago, but those who actually hold bank-type cards are more favorable in their views than the general population. A survey in January 2000 reveals a divergence of views, and suggests that consumers who currently have negative views may have developed these in part based on their perceptions of <u>other</u> consumers' difficulties, rather than from the individual's own experiences. Ninety-one percent of the surveyed consumers with bank-type cards agreed that they were generally satisfied in their dealings with their own credit card companies. Ninety percent agreed that their credit card company treats them fairly, and 86 percent agreed that they could easily get a card from another company if they were not treated well. And yet, about 40 percent of those surveyed said that credit card use is “bad” and that consumers would be better off if there were no credit cards.

Consumers’ views about their personal experiences with credit cards and their relations with their current card issuers are more favorable than their opinions of the relations of consumers in general. For example, 88 percent of surveyed consumers agreed with the statement that “credit card companies make too much credit available to most people.” In contrast, about 90 percent of the holders of bank-type credit cards said that credit cards provide a useful service to consumers, and about 70 percent said that most people are satisfied in their dealings with card companies. About 60 percent disagreed with the statement that consumers would be better off without cards.

Consumer Complaints

As I noted earlier, the Board investigates consumer complaints against state member banks, and forwards complaints received about other creditors to the appropriate enforcement agency. The annual volume of complaints received by the Board has been increasing since 1997. Complaints about credit cards have similarly increased, rising by 58 percent over the same period.

In the year 2000, the Board received approximately 2,400 complaints about state member banks; a like number of complaints about other institutions were referred to other enforcement agencies. About 1,000 of the 2,400 complaints processed by the Board, or about 40 percent, were complaints about credit cards. These complaints are divided into a number of categories, but our review of the complaint data shows that about 60 percent of the credit card complaints fall into three categories: disputes about billing errors; concerns about penalty charges and other fees (such as late fees, over-the-limit fees, and annual fees); and disputes involving alleged errors in reporting consumers' payment history and the denial of requests for credit cards due to erroneous credit reports.

Information About Credit Terms

The Board has also participated in surveys that looked at consumers' knowledge of credit terms and their views concerning the availability of information about account terms. It appears that consumer awareness of APRs on bank-type credit cards has continued to rise, and was measured by the survey at 85 percent of bank-type card holders.

The survey also gathered information on consumers' perception about the ease of obtaining information about credit terms. About two-thirds of consumers in the 2000 survey who had bank-type credit cards said that obtaining information on credit terms is easy; only 7 percent of holders of bank-type cards believed that obtaining information on credit terms is "very difficult." The percentages of consumers holding these views about credit cards are similar to earlier surveys about credit generally. However, about 60 percent of the respondents did state that they found solicitations offering a low introductory rate to be confusing.

Disclosures for Credit Card Solicitations and Applications

The Fair Credit and Charge Card Disclosure Act of 1988 amended the Truth in Lending Act to require that the annual percentage rate (APR) for credit card purchases and certain other costs be disclosed in direct mail and other solicitations and applications to open credit and charge card accounts. Prior to that, consumers generally were not required to be provided with cost information until account opening. The purpose of the 1988 Act was to ensure that consumers receive key cost information about credit and charge cards early enough to have the opportunity to comparison shop. The act requires that the disclosures be given in the form of a table, with headings. The table is required to be in a prominent location on or with the solicitation or application.

Over the years, as the pricing of credit card programs has become more complex, the cost disclosures accompanying credit card solicitations have also become more complex. Multiple APRs may apply to a single program. For example, there may be a temporary introductory rate that applies to purchases and balance transfers, a fixed or variable rate that applies after the temporary introductory period, a separate rate for cash advances, and one or more "penalty rates" that apply if the consumer makes late payments.

As interest rates and other account features became more complex, and the cost disclosures became longer, some card issuers have chosen to use reduced type sizes instead of allocating additional space for the disclosures. In some cases it became difficult for consumers to use the disclosure table to readily identify key costs and terms for comparison shopping. In contrast, the promotional materials that accompany a credit card application or solicitation may highlight a low introductory APR in a large, easy to read type size. The rate that will apply after the introductory period may appear much less prominently in the promotional material, or it may appear only in the disclosure table. The disclosure table itself may be in a location that is less likely to capture the consumer's attention--for example, on the reverse side of an application or on the last page of a multi-page solicitation.

Last year, the Board made changes in the regulatory scheme to help ensure that consumers receive meaningful disclosures on a more consistent basis. The Board revised its rules for credit card solicitations and applications to make the required disclosure table more noticeable, simpler, and easier to use. These changes became effective on a mandatory basis on October 1, 2001, and consumers should now be seeing improved disclosures with the credit card offers they receive.

One of the key changes requires card issuers to disclose the regular APR for purchases in at least 18-point type, under a separate heading in the disclosure table, so that it is more prominent than any temporary introductory rate. The requirement that the disclosures be "clear and conspicuous" was also strengthened, to clarify that they must be readily noticeable. Disclosures automatically meet this standard if they are in at least 12-point type. Cash advance and balance transfer APRs must also be included in the table under the revised rules.

Although the Truth in Lending rules require that a cost disclosure table be included with credit card solicitations, the rules generally do not regulate the manner in which the account terms and features are presented in a card issuer's promotional materials. Often the promotional materials highlight a low introductory rate, while the higher rate that will apply when the introductory rate expires is more difficult to locate. Sometimes it appears only on the disclosure table as a separate insert. We note that the bankruptcy reform legislation currently pending in the Congress contains a provision to address this concern, and would require card issuers to list the permanent rate more prominently in promotional materials.

Enforcement

As I mentioned earlier, the Federal Reserve conducts compliance examinations of about 980 state member banks. In terms of size, 72 percent of the banks examined have total assets of $250 million or less. For the vast majority, credit card lending is not a significant activity. In fact, of the banks supervised by the Federal Reserve, only three banks are identified as having substantial credit card portfolios representing 50 percent or more of the banks' total loans.

In our examination of state member banks that are involved in credit card lending, we have not found any widespread practices that violate applicable laws or regulations. Violations have been found in only a small number of banks and, even in those cases, the violations generally have been isolated in scope.

Attachments