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Before the U.S. House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

"Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives"

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Chair Maloney, Ranking Member Gillmor, and members of the Committee, thank you for your continuing attention to the serious issues facing consumers in the credit card marketplace as it functions now. We appreciate the focus you bring today to the regulatory environment that has fostered an unequal playing field between card issuers and card holders, leading to insufficient competition in what really matters to consumers – fair terms and fair pricing, and insufficient accountability.

The Center for Responsible Lending (CRL) is an affiliate of the non-profit community development lender Self-Help, whose mission is to create and protect ownership opportunities for low-wealth families.[1] We understand that the rules in the marketplace for credit cards in turn affect the goals of asset- and wealth-building. For many Americans, it is the entry point into the world of credit. Their experience with credit cards can either expand the boundaries of their life choices or limit their options for years to come.

These cards may set the pace for their long-term debt loads. The credit card experience impacts their credit scores, which in turn affects not only later financial decisions, but also educational and job opportunities.[2] For others, unfortunately, it becomes the mechanism by which needed medicines and medical care is obtained, even as health care and insurance costs rise, making access to care and treatment more difficult to afford. The extraordinary credit card debt among older consumers, at least in part, is likely to be a reflection of this emerging economic reality.[3]

Finally, for millions of homeowners, it is the hook by which debt consolidation mortgage loans are marketed. We do know that for millions of Americans, credit card debt has played a role in the loss of equity in their homes, and, for some, the loss of their homes to foreclosure.[4] In sum, there is a lot riding for American families and the American economy on having fair rules for the credit card marketplace.

My testimony today focuses exclusively on one chapter of the rulebook for this marketplace – the disclosure rules under the Truth in Lending Act's Regulation Z.[5] As the Subcommittee knows, on May 23, the Federal Reserve Board proposed its first major revision of the credit card disclosure rules in nearly forty years – four decades that have seen enormous changes in the credit card industry. We ask three questions about this proposal:

1. How will the disclosures be made? Will they be user-friendly and comprehensible?

2. What information will be required in those disclosures? Will they include the information necessary to assure both informed choice by consumers *and* an honest, competitive industry?

3. Will the proposal adequately deal with the abusive practices that the public – and many in Congress – have identified? Is disclosure enough to curb those practices, or is more needed to assure that they do not turn a valuable and almost necessary financial tool – credit cards -- into "pick-pocket products"?

We believe that as to the first question, the Board's proposal gets high marks. As to the second, we give it a "needs improvement" grade. As to the third, the answer to the question posed, unfortunately, is a simple "No, it does not adequately deal with abusive practices."

Before addressing each of these questions, it is important to remind ourselves what Truth in Lending was – and, more importantly, what it was *not* -- designed or intended to do.

I. THE ROLE OF TRUTH IN LENDING

The Overall Purpose of Truth in Lending:

The Board's proposal cites only two purposes for TIL: 1) meaningful disclosure to facilitate comparison shopping and avoid the uninformed use of credit, and 2) to protect consumers against inaccurate and unfair credit billing and credit card practices, 15 U.S.C. §1601(a). These are critical goals of TIL, but it is an incomplete list. The efficacy of the proposals must be weighed against additional purposes of TIL, as well.

In addition to establishing consumers' "right to be informed" about the true cost of using credit, there are at least three other major goals that focus on providers and on the marketplace: [6]

* to enhance honest competition and protect "*ethical and efficient*" credit-extenders, as well as consumers;

* to protect the integrity of the marketplace from "fraudulent, deceitful, or grossly misleading information,

* to facilitate general economic stabilization: an informed consumer credit market helps "stabilize the economy by encouraging consumer restraint when interest rates increase, and consumer activity when rates drop."

These goals are even more important in today's credit card marketplace than they were forty years ago.

Disclosure in a changed legal context: TIL's disclosure approach was designed as a complement to substantive regulation, not a substitute for it.

When Truth in Lending -- and most of the current credit card disclosure rules -- were written,[7] consumer credit was also subject to substantive regulation by the states. The disclosure system mandated by the Truth in Lending Act was designed and intended as a *complement* to substantive regulation, not a substitute for it. State law interest rate ceilings for consumer credit – both revolving and closed-end -- were the norm at the time.[8] Other types of charges and fees were often limited in amount, or prohibited entirely, as well.

Congress explicitly did not disturb the states' substantive regulation of the "types, amounts or rates of charges, or any element of elements of charges" in enacting TIL.[9] It did not envision disclosure as the sole bulwark in a marketplace stripped of substantive regulation. The first step on the slippery slope to credit card "deregulation by exportation" – the *Marquette* decision – was still 10 years away when the disclosure paradigm under Reg. Z, Part B was designed.[10] In 1980, when Congress enacted a major revision of Truth in Lending, open-end disclosure rules were barely touched. While Congress gave state chartered banks parity with national banks (the beneficiaries of the *Marquette* decision.) at that time,[11] the full implications of *Marquette* for the credit card industry had not then registered to law-makers or the public. It was not until the mid-1980s that this ripple-effect *sub rosa* substantive deregulation of the credit card industry began to become apparent.[12] In sum, disclosure today is being asked by some to carry alone a *legal* burden that it shared with substantive regulation when much of the current open-end disclosure rules were devised.

Disclosure in a changed economic context:

Just as the legal context has changed drastically since the current regime was designed, so, too, has the economic context. Consumer debt is a more important part of the economy, making it more important than ever to assure a fair marketplace. Revolving debt was $1.5 billion in May, 1968, when TIL was passed; it was $801 billion in January, 2005.[13] In 1977, households charged a little more than $100 a month on credit cards, or 3.4% of average monthly household income. Twenty years later, the average charges for those who have used cards to pay were $830, or 20% of average household monthly income.[14] The revolving debt share of total non-mortgage consumer credit grew from 1.4% in May, 1968 to nearly 38% in January, 2005.[15] In 2001, nearly $1 in $4 of consumer expenditures was paid by a credit card.[16] Today, household spending is 60% of the American economy. It is unlikely a coincidence that household debt as a percentage of disposable income was at a record 108% in 2003.[17]

Even those astonishing figures understate credit card debt. The phenomenal growth in home equity lending is fed by marketing debt consolidation refinancing, so a significant amount of credit card debt has disappeared into mortgage statistics. And, as Attorney General offices and advocates who have worked with consumers in the predatory mortgage lending context can attest, a lot of that begins with the pitch to consolidate credit cards into “one easy monthly payment” and a loan that’s tax-deductible. In fact, even student loans may now disguise consolidated credit card debt.

And a changed market context:

Credit card market changes have undergone several generations of evolution since the fundamental open-end structure was established nearly forty years ago. It is more complex and more highly concentrated.

When TIL rules were originally designed, surveys indicated that consumers getting closed-end loans underestimated the true cost of borrowing – misconceptions that resulted from varying ways of calculating interest, as well as from loading up credit with so-called “non-interest” charges that “rightfully should be included in the percentage rate statement so that any percentage rate quoted is completely meaningless and deceptive.”[18]

In many respects the subsequent evolution of the open-end consumer credit market has brought this segment to the same stage of dysfunction described above by Senator Douglas, the economist and primary champion of Truth In Lending in the 1960s.

> * Opaque and complex accounting methods in open-end credit today distort cost information and competition even more than the varying types of interest calculation used in closed-end credit before 1968.[19]
>
> * Non-interest fee income in the industry was <u>nearly one-third (31.8%)</u> of total revenue by 2005.[20] To generate revenue, the industry has shifted from the upfront, transparent interest rate to back-end fees, along with the accounting tricks, practices that hinder effective price competition. This resurrects Senator Douglas’ criticism of the “camouflaging” of credit costs by the addition of all sorts of fees.
>
> * Individualized pricing and multiple pricing layers have been introduced (e.g. transaction charges for different types of cash advances may vary, the grace period and rates for different types of charges may vary). These changes make pricing information difficult to convey simply and comprehensibly. Flexible pricing, such as penalty rates, also make transaction pricing far more complex and ever-changing. Such industry inventions create higher hurdles to clear in developing useable disclosure rules.
>
> * Finally, the creditors’ extraordinary freedom to unilaterally change contract terms at will subsequent to consummation means even effective disclosure rules for solicitation and initial stages can be pointless.

Thus at the same time that disclosure is being asked to carry a heavier load in the legal context, even some economists have joined consumers in questioning the efficacy of disclosure as a practical matter.[21] It is critically important to understand that increasing complexity has profound implications for a regulatory scheme resting on disclosures.

If increasing complexity (some of it arguably purposefully obfuscatory) creates a hurdle on the provider side, many recognize that inadequate financial literacy on the user side is no less a hurdle.[22] The mismatch between the complex information that consumers need, and the ease with which the intended audience can comprehend and use that information, seems to be getting greater. Disclosure not only is carrying a heavier burden, but it must bridge a greater divide while it does so.

It is against the backdrop of these increased challenges facing consumers in today's marketplace that I evaluate some of the highlights in the current proposal.[23]

II. HOW WILL THE DISCLOSURES BE MADE UNDER THE PROPOSED RULES? *A PASSING GRADE*

Looking to focus groups of consumers to learn how information should be presented to make it used and useful is the single most valuable thing the Board has done in this revision. The improvement in the "account-opening" disclosures (formerly called "initial disclosures") show the most dramatic improvement. Members of this Subcommittee, like every other American who has had a credit card, know that the disclosures and "agreement" that come with opening a credit card account are unreadable. Moreover, they would be virtually incomprehensible to anyone but their authors if they were actually read. We are happy to see that the Board's proposal recognizes that simple, unarguable fact. A review of the sample forms, compared to any current one in your own files, is ample evidence of the improvement.

Utilizing the "Schumer Box" formatting model at all stages is a significant improvement.

The one set of TIL-required disclosures that is currently usable by consumers is the "Schumer Box" – the tabular disclosure of rates and fees now mandated only for the applications and solicitations.[24] Under the proposed rules, there would be a Schumer box of tabular, segregated disclosures for the other stages of the credit card life-cycle: "account-opening," the periodic statement, and change in terms notices.

Creditors would also be required to segregate interest costs and fees from the consumer's purchases and advances on the periodic statement, making those costs more readily visible to the consumer.

Increased Advance Notice for Change in Terms, and Added Advance Notice for the Triggering of Penalty Rates are Significant Improvements, Although Substantive Limitations are Still Needed

Increased advanced notice of change in terms from 15 days to 45 days: Currently, issuers unilaterally may change any term in a credit card contract -- a rare gift in contract law. Truth in Lending currently requires only 15-days advance notice, a hopelessly inadequate time to permit most cardholders to avoid disadvantageous new terms.[25] While we believe that the ability to unilaterally change contract terms is a practice that should be the subject of more substantive restriction, as we discuss below, the Board has nonetheless recognized that the 15-days currently required is so short as to be meaningless, and has proposed to extend it to 45 days. This is a significant improvement, which we urge the Board to retain in the final rule.

Advanced notice would be required when penalty rates are triggered – increased from 0 to 45 days: Currently, if a penalty rate provided for in the contract is triggered, arguably **no** advance notice is required. The Board's recommendation would, for the first time, specify that advance notice is required, subjecting this re-pricing to a 45-day notice.

We are encouraged by the recognition that advance notice is necessary. The consumer may not even know the penalty rate had been triggered until after the fact, when their next periodic statement comes. This is obviously inadequate for a consumer to take action to avoid it. It may have been months – or even years – since the consumer received notice of the existence of the penalty rate and what events trigger it. Even then, that notice may not have been noticeable or informative.

More critically, the consumer may not even be aware that a trigger event has occurred. Payments may be "late" because of the creditor's posting practices, not the consumer's mailing schedule; trigger events that are external, including drops in a FICO score, may occur without the consumer even knowing they happened. To then be faced with a potential 10% rate hike when they receive their statement is a huge challenge. Simply paying it off during the grace period may work for people with ample resources or small balances, but for most revolvers – the average balance is reported to be over $5,000[26] -- that may well not be possible. Searching out other cards for transfers takes time, and there is typically an exit fee, in the form of a balance transfer fee.

We hope that the Board will stand firm on the 45-day notice for both actions, as that is a minimal time necessary for consumers to avoid the harsh results that come from re-pricing or other adverse actions.

III. WHAT MUST BE DISCLOSED?
NEEDS IMPROVEMENT

The proposal includes revisions as to the content of the disclosures. Some proposals would bring genuine improvements to the disclosures. Others represent a step forward, but more could and should be done about the underlying practices. Unfortunately, some also threaten a step backward for consumers.

Highlights of the Improvements Proposed in the Content of the Disclosures

* All transaction fees will be included in the finance charge: Transaction fees, including ATM cash advance and foreign currency conversion fees will be included in the finance charge. (However, the beneficial impact of this change may be offset by other proposed changes, discussed below.)

* Subprime credit cards: For low-limit, high-fee cards, the proposal would add a new requirement that the amount of available credit must be disclosed on the application/solicitation and account-opening disclosures.

Subprime cards function more as "pick pocket products" than as credit cards. With very low credit limits, and very high fees to open and participate in the account, the consumer can find more than half of the credit line filled up with fees before the cardholder ever uses the card. Furthermore, manipulative accounting tricks make the imposition of over-the-limit charges more likely, or even almost impossible to avoid.

These cards claim to offer a way to repair credit, more than a payment mechanism. (Google "First Premier Bank credit card" and the sponsored link site for the bank that pops up first says, "Rebuild your **credit** with a **First Premier Bank Credit Card.**" How does that work? Pay a lot of money in fees for the privilege of – paying fees, and little else.)

One customer's experience with such a card was detailed in CRL's Comments filed in response to the Board's Advance Notice of Proposed Rule-Making. It had a "low" 9.9%" rate for purchases. It also had a $250 credit limit; a $29 set up fee, a $95 program fee, a $48 annual fee, and a $6 monthly participation fee.[27] That added up to $178 in creditor charges posted on the account immediately upon opening, leaving just $72 for actual purchases. But account manipulation then set up a series of cascading over-the-limit fees that made it impossible for her to get ahead, even when she paid timely and as directed.

For the first time, the Board proposes rules aimed squarely at these products. While more could, and should, be done, the Board is recommending the addition of an important new disclosure especially for these products. Where the fees imposed for issuing or making the account available compose 25% or more of the minimum credit limit, the card issuer must disclose the amount of the available credit left open after the fees are charged against the limit. This disclosure must be made at both application / solicitation stages and the account opening stages.[28]

The proposal would also amend the Official Staff Commentary to provide that a consumer is not considered to have "accepted" the card when the only activity on the account is the creditor's imposition of the charges, until the consumer has been sent a billing statement and made a payment.[29]

* Improvements in advertising requirements: The proposals include two changes to the advertising requirements that may prove helpful to consumers.

- Prohibiting advertising "fixed" rates, unless they are fixed, at least for a certain time, which must be specified.

- The minimum payment would be a trigger term on advertisements for credit purchases of specific goods or services. If a minimum payment is mentioned, the advertisement must also state the total of payments and the time period necessary to repay the obligation.

This is in response to a problem that a number of state attorneys general brought to the attention of the Board nearly ten years ago, regarding "spurious open-end credit," in which door-to-door sellers of expensive items, including home repairs, air conditioning, satellite dishes, etc., would finance through special "credit cards" issued by partnering banks. These accounts were unlikely to be used again, but the virtually worthless open-end disclosures were given, so that consumers had no idea of the full cost of the purchase they were about to make.[30] Here, too, although more could be, and should be done, to curb this problem, this is a welcome step forward.

Improvements to the advertising rules, however, must be viewed in light of the weak enforcement available for TIL advertising. There is no private right of action for violations of the TIL advertising provisions, so only public enforcement is a possibility. Given the regulatory efforts to restrict the right of state attorneys general to enforce even non-preempted state laws – such as state laws against deceptive practices in sales and advertising – it is unclear whether even the attorneys general who brought the problem to the Board's attention today would be able to act against card issuers who teamed up with such sellers.[31]

Areas of Serious Concern that Reduce Consumer Protections

* Limiting fees required to be disclosed on applications/solicitations, at account opening, and in change in terms to an exclusive list.

Experience has shown that where there are loopholes in TIL's disclosure and computational rules, they will be exploited. Charges that need not be included in the "price tag" finance charge and APR disclosures become more common and inflated. It is predictable, then, that mandating the disclosure of an *exclusive* list of fees and charges will lead to another generation of imaginative new fees. Given the fee inflation that has occurred in the decades since *Marquette*, it can hardly be said that the marketplace is in need of further incentives in that regard.

According to the Board, this proposal aims to ease creditor uncertainty about how to disclose new fees, and reduce litigation risks. However, there is another way to accomplish the same end – one that does not run the risk of increasing "off-the-chart" fees and doing harm to the letter and spirit of the Act. The definition of "finance charge" in the statute is very broad, and the exceptions from that broad definition in the statute are very few. The definition is

> "the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit." 15 USC § 1605(a).

If the Board were to require that creditors simply use the statute itself as the touchstone, there should be very little doubt as to how new fees should be treated. But unfortunately, that is a path not taken.

The charges to be disclosed are ones that indeed may cover most of the typical charges in today's market. The concern, however, is that many of the charges in today's marketplace were unheard of in yesterday's marketplace, and so tomorrow's marketplace may look more fee-intensive yet. (Who would have thought we might one day have to pay to make our payments?)

* <u>The Board proposes two alternatives for the disclosure of the "fully-loaded" APR price tag – the "effective APR" – on the periodic statement. One is to improve it, but the other is to **eliminate it entirely.**</u>

The industry's shift to complex fee-based pricing makes comparison shopping difficult.[32] However, an "all-inclusive" APR on the periodic statement that reflects both rate-based costs and fees costs helps consumers focus on the real price tag and should foster a competitive marketplace.

The Board advances the alternative of eliminating the disclosure because consumers did not understand the term. But that should have been no surprise. Indeed, in our comments to the Board's 2005 ANPRM, we noted the confusion generated by inconsistent terminology around the rate-only APR (the "corresponding" or "nominal APR or "corresponding nominal APR") and the fee + rate APR, which also can be labeled with different adjectives, such as "effective APR" or "historic APR" or "actual APR." The existing rules permit this semantic anarchy, contributing to consumer confusion. The simple solution, of course, is to improve the price tag, not tear it off. Mandating consistent terminology, with a simple descriptive phrase such as has been the standard in closed-end credit for decades, would advance understanding significantly.[33]

The Board's experience with the focus groups appears to have borne out this approach. As it improved the sample disclosure of this term given the participants in the focus groups, their comprehension grew. The final form, with the descriptive term "***fee-inclusive APR"*** and a short explanatory phrase noting that it represented fees as well as interest resulted in a majority of the participants understanding the information.

We strongly urge keeping the fee-inclusive APR. It is the closest a credit card customer gets to a "fully-loaded" price tag.[34] Eliminating it not only would *hamper* consumer appreciation of the full cost of credit, its elimination would also contribute to a shift to more fees, a fact that even an industry trade group admitted: "[a] trade association commenter concedes a policy argument for retaining the effective APR as a hedge against creditors shifting their pricing from periodic rates to transaction-triggered fees and charges." (Proposed Rule, Reg. Z, Docket No R-1286, page 114 (May 23, 2007).

* *If retained, the "fee-inclusive" or effective APR may allow some fees to be excluded from its calculation – again encouraging a shift to the "outside-the-rate" fees.*

The proposed rules for calculating the "fee-inclusive" APR again refer to an exclusive list of fees, leaving others outside the calculation.

To illustrate: "participation fees" that are imposed annually are not included, while participation fees imposed more frequently than annually would be included.

Thus Advance America's $149.95 <u>monthly</u> participation fee on its $500-credit limit line of credit – quite properly – would have to be added to the finance charges resulting from the reasonable 5.98% interest-rate to disclose an eye-popping 600+% APR on a $300 draw.

On the other hand, neither the $150 annual fee nor the $29 "activation" fee imposed upon opening the $300 credit-limit account reportedly charged for a credit card issued by Compu Credit would be captured by the "fee-inclusive" APR on the first periodic statement. [35] It also has a $6.50 monthly maintenance fee. But since that fee is not applied to a balance, this would, apparently, be a "0%" effective APR.[36]

We do appreciate the Board's recognition that such fees like Advance America's outrageous $150 monthly "participation fee" on a $500 limit account, or Capital One's relatively reasonable fee of $6 / $1,000, may be imposed "as a substitute for interest or in addition to interest" and therefore should be captured.[37]

But here, too, the use of an exclusive list of captured fees has the likely result that some creditors will be encouraged to develop new "off the list" fees. The Board mentions here, as well, its concern with providing certainty to creditors – a goal that could just as well be achieved by an "all-in" rule, but which would serve to encourage transparent pricing and discourage fee-proliferation.

* <u>Account-specific minimum payment disclosures are encouraged, but not mandated by the proposal: Congress should reconsider the bankruptcy act amendments</u>

The Board strongly encourages creditors to make the disclosure of the amount of time it would take to repay a balance at the minimum payment based on the consumers' own account, rather than a hypothetical account. It offers some modest incentives to do so, but does not mandate account-specific minimum payment disclosures.[38]

The alternatives to account-specific disclosures are cumbersome, and their usefulness may range from not very helpful to possibly misleading. However, in this respect, the Board clearly felt constrained by the minimum payment disclosure scheme enacted by Congress. Those alternatives are laid out in the statute, as amended by the 2005 Bankruptcy amendments.[39] We urge Congress to revisit the issue, and mandate what the Board clearly understands is both feasible for the industry and preferable for consumers – account-specific disclosures of the time it would take to pay off their account at the minimum payment.

IV: BEYOND DISCLOSURE: CONGRESS MUST ACT TO CURB THE ABUSES IN THE CREDIT CARD MARKETPLACE

In many previous hearings in both the House and the Senate, a number of clear abuses in the marketplace have been repeatedly documented. Several proposals have been introduced in both the House and Senate to stop these abuses.

While the Congressional proposals would ban, or otherwise substantively regulate them, the Board does not propose to do so. We believe the Board does have authority to declare them to be "unfair" or "deceptive practices" under 12 U.S.C. § 57a(f). In fact, in 2002, then Congressman John LaFalce asked the Board to use that authority to address some credit card abuses.[40] (While any such rules would apply to banks, the overwhelming majority of credit cards are issued by banks, so most of the market would be subject to a Fed-promulgated rule.[41])

Many, if not most, of these practices would qualify for such a characterization. The test for an "unfair" practice under the FTC Act is a three-pronged test: a) it causes a substantial injury to consumers; b) the injury is not outweighed by countervailing benefits to consumers or competition, and c) consumers cannot reasonably avoid the injury.[42]

These practices have been described by several witnesses in an earlier hearing before this Subcommitee, and will be discussed today by another witness, Ed Mierswinski. I will not repeat their explanations of the practices that give us most concern: universal default; re-pricing based on other information, such as FICO scores, etc; unilateral change in terms, any time, for any reason; retroactive application of higher rates to pre-existing balances; double-cycle billing; unfair balance allocation methods; delayed posting of payments to generate fees; and failure to assess repayment capacity. (Appendix A is a chart comparing the approaches taken with respect to these terms in various Congressional proposals from the 109th and 110th Congresses with the Board's proposals.)

The Board's proposal rejects the recommendations to ban the dubious practices, instead relying exclusively on disclosure. (The exception is the addition of a 45-day advance notice requirement prior to the invocation of a penalty rate, and the extension of the current 15-day advance notice for unilateral change in terms to 45 days. These are important, and welcome improvements.)

Yet the limits of disclosure are evidenced in the Board's own actions. Take, for example, the double-cycle billing method. It easily meets the unfairness test: There is consumer injury. It is the most expensive of the balance calculation methods for consumers. One sample account analysis calculated a $28.50 finance charge calculated under an average daily balance method compared to a $44.90 finance charge under the two-cycle billing method. Furthermore, it effectively, but surreptiously, eliminates the grace period for many consumers. There is no "countervailing benefit to consumers or competition" whatsoever. As for the third prong? Perhaps this is the best example of disclosure is simply not the answer to all market abuses. The Board proposes to simply give up on disclosures of the balance computation method, because it is simply too complex.[43] That makes it hard to argue that consumers can realistically "avoid" that injury. A similar analysis leads to the same conclusion for most, if not all, of the above practices. If it is too complex to explain, and it adversely affects consumers, then there is little reason to believe that market forces can effectively deal with an abusive practice.

While we recognize and applaud the issuers, like Citi, who have voluntarily stopped doing universal default and "any time, any reason" re-pricing, many other issuers have not. We know well from past experience across many segments of the financial services industry that "best practices" adopted when the spotlight is on, can slip away when that spotlight moves on. And, more to the point, "best practices" are not enforceable.

In both the last Congress and this one, strong legislation has been proposed. Though we welcome the progress in the Board's proposals, we urge Congress to proceed to act where the Board will not.

Notwithstanding our disagreement and disappointment in some of the Board's proposals, we greatly appreciate the care, the thoughtfulness, and the effort of Board and Board staff. While we believe there is much more reform needed, these proposals do reflect progress, for which we thank the Board.

We also thank you for this opportunity to explain our views on this regulatory effort.

ENDNOTES

[1] CRL is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL began as a coalition of groups in North Carolina that shared a concern about the rise of predatory lending in the late 1990s.

CRL is an affiliate of Self Help (www.self-help.org), which consists of a credit union and a non-profit loan fund. For the past 26 years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans. Self-Help has provided over $5 billion of financing to over 50,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across the country, with an annual loan loss rate of under one percent.

[2] For data on the rise in credit card debt among young people, see Tamara Draut and Javier Silva, *Generation Broke: The Growth of Debt Among Young Americans* (Demos, October 2004), www.demos-usa.org. Three in four cardholders between 18 – 24 carried a balance, and the 2001 average credit card balance for that group was $2,985. The study reports that college seniors graduating in 2001 were carrying an average $3,262 in credit card debt.

[3] See, e.g. Cindy Zeldin and Mark Rukavina, *Borrowing to Stay Healthy: How Credit Card Debt is Related to Medical Expenses* (Demos 2007), www.demos-usa.org; David U. Himmelstein, Elizabeth Warren, Deborah Thorne, and Steffie Woolhandler, *Illness and Injury as Contributors to Bankruptcy*, Health Affairs (February 2005); Tamara Draut and Javier Silva, *Borrowing to Make Ends Meet: The Growth of Credit Card Debt in the '90s* (Demos, 2003), www.demos-usa.org

[4] *See, e.g.* Tamara Draut, *The Plastic Safety Net* , 14-17 (Demos and Center for Responsible Lending 2005). A recent report co-authored by former FRB Chairman Alan Greenspan estimates that home "equity extraction" repaid "an average of about $50 billion of non-mortgage consumer debt per year from 1991 to 2005." Alan Greenspan and James Kennedy, *Sources and Uses of Equity Extracted From Homes* p. 9, (Federal Reserve Board 2007-20)

[5] The portions of Regulation Z relevant to credit card disclosures are 12 C.F.R. § 226.4 (rules for determining the *finance charge* – the credit price tag as a dollar amount – for both open- and closed-end credit, and Subpart B, §§ 226.5 – 16. (The proposed revision generally does not address the special rules for Home Equity Lines of Credit, § 226.5b, which will be the subject of a later stage of the review process.)

[6] 15 U.S.C. 1601(a); 109 Cong. Red. 2029 (1963) (remarks of Sen. Douglas), quoted in National Consumer Law Center, *Truth In Lending*, § 1.1.1 (5th Ed. 2003). See also *Mills v. Home Equity Group*, 871 F.Supp. 1482 (D.D.C. 1994) (citing both the public and private purposes of TIL).

Indeed, at the time of the last major overhaul of Reg. Z, following the 1980 Truth in Lending Simplification Act, the FRB staff listed 39 possible goals, in 9 separate categories, against which the effectiveness of TIL could be measured. See 46 Fed. Reg. 20848, 20945-48 (April 7, 1981).

[7] Little has changed about the rules governing the account-opening (or "initial") disclosures, or the periodic statements since they were originally promulgated pursuant to the original 1968 TILA enactment. Though there was a major revision of Regulation Z in 1980 - 81, implementing the Truth in Lending Simplification Act, that focused almost exclusively on the closed-end rules. In 1988, Congress added the requirements for the credit card application and solicitation stage, including the "Schumer Box" tabular disclosures, the rules for which were updated in 2000.

[8] For example, revolving credit caps in California and Nebraska were 18% on the first $1000, and 12% on the balances above $1000. See, e.g. Barbara A. Curran, *Trends in Consumer Credit Legislation* , p. 102

(Univ. of Chicago Press 1966); *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299 (1978).

[9] 15 U.S.C. § 1610(b). For example, one congressman noted that the TIL bill "does not give protection similar to that of some State laws which protect the consumer by limiting rates charged on consumer credit." Congressional Daily Edition, Jan. 30, 1968 (Statement of Rep. Eilberg). Indeed, when first introduced, eight years earlier, the proposal was called simply the "Consumer Credit <u>Labeling</u> Bill." S. 2755, 86th Cong., 2d Sess. 1960.) (emphasis added)

[10] *Marquette National Bank of Minneapolis v. First of Omaha Service Corp*., 439 U.S. 299 (1978).

[11] Ralph J. Rohner and Fred H. Miller, *Truth in Lending*, p. 17 (American Bar Association 2000). Both TIL Simplification and the parity provision were part the Depository Institutions Deregulation and Monetary Control Act of 1980, P.L. 96-221; Title V, Part C (parity), Title VI (TIL Simplification).

[12] See, e.g. Robert A. Burgess and Monica A. Ciolfi, *Exportation or Exploitation? A State Regulators' View of Interestate Credit Card Transactions*, 42 Bus. Law. 929 (1987). See also the court's discussion in *Greenwood Trust Co. v. Commonwealth of Mass.*, 776 F. Supp. 21 (D. Mass. 1991), *rev'd* 971 F.2d 818 (1st Cir.1992).

[13] Federal Reserve Statistical Release G.19, http://www.federalreserve.gov/releases/g19/hist/cc_hist_mt.html (visited March 23, 2005).

[14] David S. Evans and Richard Schmalensee, Paying with Plastic: The Digital Revolution in Buying and Borrowing, p. 2 (MIT Press 1999).

[15] Federal Reserve Statistical Release G.19, http://www.federalreserve.gov/releases/g19/hist/cc_hist_mt.html (visited March 23, 2005).

[16] David S. Evans, *The Growth and Diffusion of Credit Cards in Society*, 2 The Payment Card Economics Review, 59, 63 (Winter, 2004).

[17] See, e.g. Dean Baker, *Dangerous Trends: The Growth of Debt in the U.S. Economy* (Center for Economic and Policy Research (Sept., 2004), www. cepr.net.; Financial Markets Center, *Flow of Funds Brief* : June 10, 2004 (household debt as share of disposable income rose by 15.8% between 2001 and 2004, to "cross the 110% threshold in final quarter of 2003.)

[18] See National Consumer Law Center, <u>Truth in Lending</u> §1.1.1 (5th Ed. 2003)

[19] This has been successfully addressed by the standardized APR calculation rules for closed-end credit. To the extent that the closed-end APR remains subject to manipulation, it is primarily because of the laundry list of excludable charges in §226.4, rather than the actuarial accounting component of the APR rules.

On the difficulty that increased complexity presents to the disclosure paradigm, see Mark Furletti, *Credit Card Pricing Developments and Their Disclosure*, (Payment Cards Center, The Federal Reserve Bank of Philadelphia, January, 2003); William R. Emmons, *Consumer Finance Myths and Other Obstacles to Financial Literacy,* December 8, 2004, conference paper "Consequences of the Consumer Lending Revolution, (St. Louis Univ. School of Law, Dec. 8, 2004) *See also Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*, GAO –06-929 (September, 2006), *available at* http://www.gao.gov/new.items/d06929.pdf.

[20] In 1999, it was 26.2%. Mark Furletti, *Credit Card Pricing Developments and Their Disclosure*, p 32. (Payment Cards Center, The Federal Reserve Bank of Philadelphia, January, 2003). Mr. Furletti updated the information through 2005 at CRL request. (E-mail from Mark Furletti, March 5, 2005, on file with

CRL.) *See also* Patrick McGeehan, "Mountains of Interest Add to Pain of Credit Cards," New York Times, p. 1 (Nov. 21, 2004) (fee revenue rose from $6.2 billion in 1990 to $21.5 billion in 2003).

[21] See, e.g. Mark Furletti, *Credit Card Pricing Developments and Their Disclosure*, (Payment Cards Center, The Federal Reserve Bank of Philadelphia, January, 2003); William R. Emmons, *Consumer Finance Myths and Other Obstacles to Financial Literacy*, note 19, *supra*, at 23-26. ("But would consumers not be better off if financial-services providers reduced fees and loan rates rather than spending on financial-literacy that, by all accounts, have minimal impact? The point is, of course, that profit-maximizing financial-services providers really do not want to 'give back' any of their profit margin. Nor do they necessarily desire more financially savvy customers who might shop around more actively or bargain down the terms on the products and services they sell." p. 25-26.)

[22] E.g. *Alan M. White and Cathy Lesser Mansfield, Literacy and Contract* 13.2 Stanford Law & Policy *Re*view 233 (2002); *Re-Examining Truth in Lending: Do Borrowers Actually Use Consumer Disclosures?* 52 Consumer Fin. L. Qtrly Rep. 3 (1998). *See also* Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price*, 65 Maryland L. Rev. 707 (2006); Matthew A. Edwards, *Empirical and Behavioral Critiques of Mandatory Disclosure: Socio-Economics and the Quest for Truth i Lending*, 14 Cornell J. Law & Pub. Pol'y 199 (2005).

[23] The proposal, released just two weeks ago, is approximately 400 pages long. Due to both time constraints and space limitations, this testimony addresses only a few highlights gleaned from our preliminary review.

[24] 15 U.S.C. § 1637(c); Reg. Z, § 226.5a.

[25] Reg. Z, § 226.9(c).

[26] *See, e.g.* Testimony of Cindy Zeldin, p. 3, Hearing before the US House of Representatives Committee on Financial Services, Subc. on Financial Institutions and Consumer Credit, <u>Credit Card Practices: Current Consumer and Regulatory Issues."</u> (April 26, 2007)

[27] The operation of one such card, offered by First Premier Bank, is detailed in Comments of the Center for Responsible Lending to the Federal Reserve Board Advance Notice of Proposed Rule-Making, Regulation Z Open-end Review, Docket No. R-1217, pp. 33-36 and Attachment C-1 through C-6.

[28] Proposed 226.5a(b)(16), 226.6(b)(4)(vii).

[29] Proposed OSC 226.5(b)(1)(i)-1(i).

[30] *See generally* Comments to FRB Open-End ANPRM, note 27, *supra* at pp.24-29, Attachment B.

[31] The OCC's rule asserting exclusive enforcement authority even for non-preempted state law was promulgated in 2004. A challenge to the rule is currently pending in the Second Circuit, *OCC v. Spitzer*, 396 F. Supp. 2d 383 (S.D.N.Y. 2005), *appeal docketed*, No. 05-5996cv (2d Cir. 2005). The OCC did bring one such enforcement action against a national bank issuing such a special financing card, but only after two state attorneys general had commenced investigations.

[32] *See, e.g.* notes and text accompanying notes 19-22, *supra*.

[33] *See*, Reg. Z, § 226.18(d), (e), which prescribe a simple descriptive phrase for the finance charge and APR.

[34] The "effective" APR is closer to a "fully-loaded" price tag than any other, but, because the Regulation excludes some important charges from the definition of the "finance charge," such as participation fees, §

226.4(c)(4), OTL fees, and "actual, unanticipated" late fees (§226.4(c)(2) and therefore from the calculation of the effective APR, it may still understate the costs. For that reason, consumer groups had recommended that the Board have an "all-inclusive" APR.

[35] § 226.14(e) excludes charges relating to account-opening and participation fees imposed no more than annually. Though "participation fees" are not finance charges, 226.4(c), the Board would include the monthly participation fees in the computation despite that. *See* proposed OSC § 226.14(e)(2)-1,2.

[36] *See* proposed Alternative 1: 226.14(d)(2)(ii) Information on this card's terms is based on information given potential investors, rather than advertisements or disclosures.

[37] Proposal, p. 163, citing the unnamed example of Capital One's "Clarity" card, which has a single charge of $6/$1000 and is currently advertised as a "no interest, 0% APR".

[38] See, e.g. Proposed Rule, pg. 22

[39] 15 U.S.C. § 1637(11) (2005)

[40] *See,* Julie L. Williams and Michael S. Bylsma, *On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks*, 58 Bus. Law. 1243, 1250 note 41.

[41] There are two sources of statutory authority for the Board to regulate unfair or deceptive practices. As to mortgages, it was granted additional authority as part of the Home Ownership Equity Protection Act of 1994, 15 U.S.C. § 1639*l*. However, it also has the authority to issue rules regarding unfair and deceptive practices by banks under the FTC Improvement Act of 1975. Since credit cards are overwhelmingly issued by banks, exercising this rule-making authority would have a tremendous impact on the credit card market.

[42] 15 U.S.C. § 45(n)

[43] *See, e.g.* Proposed Rule, p. 78.

UNFAIR CREDIT CARD INDUSTRY PRACTICES:
Congressional Proposals and FRB Proposed Revision to Regulation Z

Practice / Terms	Congressional Proposals – 110th Congress *109th Congress*	FRB Proposed Relevant Changes [Notes: "AS" denotes application & solicitation disclosures; "AO" denotes "account opening disclosures; "PS" denotes periodic statements; and "CT" denotes change in terms notice
Universal Default	- Ban on universal default trigger --H.R. 1461, H.R. 2146 , S. 1309, *S.2655* - Limit penalty rate to 7% above pre-penalty rate – S. 1395 - Adv. Notice on penalty rate/rate hikes & right to cancel, *S. 499*	- *Mandate 45- day advance notice (up from none)* - Mandate use of term "penalty rate" - Disclose on separate row in table, not combined with "other APRs" on AS & AO - Include brief description of triggering events in the table with the rate - Disclose the balance to which the penalty rate will apply (i.e. retrospective application) - Disclose how long the penalty rate will apply
any time/ any reason or other "risk-related" trigger for penalty rate	-same as above	see above
retrospective application of increased rate to pre-existing balances	Ban -- S. 1395, *S.2655* Right to cancel & freeze old terms on existing balance, H.R. 1461, *S.499.*	-specify the balance to which the penalty rate will apply on AS & AO
unilateral change in terms	*S.2655*	- *Increase advance notice from 15 days to 45 days*
double cycle billing	Ban – S. 1395, H.R. 1461, *S. 499*	- N/A
(un) prompt posting	Mandate date of postmark H.R. 1461, *S. 499*, *S. 2*	**-** disclose payment cut-off time on the front of the periodic statement near the due date, if the cut off time is before 5:00 PM (PS)
payment allocation	Apply payment to high-rate balance first – S. 1395	- if an lower introductory rate applies to balance transfer or cash advance and not purchases, there is a grace period on purchases, and the creditor applies payments to the low rate first, this must be disclosed (AS & AO)

OTL fees	Ban if creditor approves – H.R. 1461, *S.499* Ban if limit exceeded do to penalty fee; only once per billing cycle; none in subsequent cycle without additional purchase; offer opt-out of OTL transactions – S.1395	- Disclose in Schumer Box (AS & AO) - Segregated fee disclosure on periodic statement - Year-to-date disclosure of fees on PS
excessive fees / other fee issues	Cap penalty rates at 7% above pre-penalty rate; S. 1395; - Prohibit fees relating to payment (other than late payment) – H.R. 873, 1461, S. 1395 - no compounding interest on fees, S. 1395 - residual interest – S. 1395 -reasonable currency fees, S. 1395 - fees must be limited to amount reasonably related to costs, *S. 2655*	- All transaction fees are finance charges - Exclusive list of charges that must be disclosed on AS & AO; that exclusive list triggers advance change in notice requirements; ; others, including newly invented charges, cannot be disclosed on AS & AO -- disclose at time they may be incurred. - Suggests option to *eliminate* disclosure of the APR that includes fees and rate charges on periodic statements / alternative option is to use more comprehensible explanation , e.g. "fee-inclusive APR" - Year-to-date disclosure of fees and interest on PS
ability to pay / underwriting	Limitations on cards to consumers under 18 – H.R. 1461 - Verification of ability to pay, *S. 2655*	NA