Predatory Credit Card Lending:
Unsafe, Unsound for Consumers *and* Companies

Executive Summary

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CENTER FOR RESPONSIBLE LENDING

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The Center for Responsible Lending (CRL) examined marketing and pricing practices prevalent in the credit card industry before implementation of the Credit Card Accountability, Responsibility and Disclosure Act (CARD Act) of 2009. CRL then examined the connection between these practices and company performance during the recent economic downturn.

For the study, CRL examined 23 marketing and pricing practices that were common among the top 100 credit card issuers during the summer of 2009, when the CARD Act outlawing or curbing many of these practices was passed but not yet implemented. Common practices included imposing high-cost penalty interest rates even when a consumer paid his card on time, using indexes to calculate interest rates to the disadvantage of card holders, and assessing late fees that the Federal Reserve recently ruled were unreasonably high. We then tracked credit losses for these companies from the beginning of 2006 through 2010.

We found that before CARD Act reforms:

- **A credit card issuer that engaged in one unfair, deceptive or abusive tactic tended to engage in many**. In general, smaller banks and credit unions had better practices.
- **Bad practices were a good predictor of complaint levels.** Complaints to the Better Business Bureau correlated with specific practices, regardless of an institution's type or size.
- **The more obscure an issuer's pricing and the more aggressive its marketing, the more its losses jumped during the recession.** In fact, credit card practices were the best predictor of how quickly losses would mount compared to competitors—better than a lender's location, type or size.
- **Credit card issuers' claim that high-cost penalty fees and interest were risk-management tools is false.** Risk-management practices didn't explain the correlation between unfair, deceptive or abusive practices and accompanying increases in losses. That's because these fees and rates didn't mitigate risk, they *were* the risk.

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The research shows that unfair, deceptive or abusive lending practices were clustered within firms as part of an over-all strategy, suggesting that credit card issuers either believed in pricing that was stated clearly up front and with an eye on long-term customer relationships, or in pricing that was purposely complicated, hard to understand and intended to maximize short-term revenue. Banks embracing the latter strategy also tended to be the most aggressive marketers, using high-volume mailings to existing customers to offer high-cost cash advances from a credit card or check. And, the larger the financial institution was that engaged in deceptive or misleading practices, the worse the practices tended to be. In general, regional or smaller banks or credit unions tended to have clearer, fairer pricing.

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The research also shows that a strategy of maximizing short-term revenue by using unfair, deceptive or abusive lending practices led to higher risk and lower profits during the downturn, undermining a bank's safety and soundness. Downturns occur fairly frequently. Since 2000 there have been two recessions, and since 1980 there have been five. A case in point is mortgage lending: Predatory products seemed profitable in the short term and seemed to help fuel economic growth but led to a disproportionate escalation in losses when housing markets slowed and the economy soured. Our new research shows this has also been true in the credit card arena.

Ending practices that undermine market transparency is essential for strong banks and a vibrant economy.

And the report shows credit card issuers' past claim is wrong that consumer protections have the unintended consequence of undermining the safety and soundness of financial institutions. Common sense curbs on abusive lending practices increase market transparency and bolster firms' financial strength. This benefits customers, investors, shareholders and, ultimately, taxpayers, who have had to pay hundreds of billions of dollars to bail out banks after regulators allowed unreasonable mortgage practices to flourish.

Lobbyists repeatedly have used the flawed argument that consumer safeguards undermine financial health. They used it to persuade Congress and regulators to refrain from adopting the common-sense mortgage lending rules that would have prevented the recent recession and continuing downturn. And they are using it now to try to roll back reforms adopted in response to the mortgage meltdown. This study shows that measures to stop deceptive and unfair lending practices promote market transparency and enhance the health of lenders—and the economy—long term.

Finally, the report identifies practices the CARD Act did not eliminate but are potentially unfair, deceptive and overly aggressive. Bank supervisors should further scrutinize these practices.

About the Center for Responsible Lending

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

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