Written Testimony

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Introduction

Chairman and members of the Committee:

Thank you for the opportunity to speak about some of the current abuses in the credit card industry and to describe the problems and experiences of the everyday consumers I represent in California and elsewhere. This testimony also is presented on behalf of the National

Association of Consumer Advocates (NACA) of which I am a Board member. [1]

My Professional Background

I began my career in 1973 as an attorney with Tolland-Windham Legal Assistance Program in Willimantic, Connecticut. I worked there from September, 1972, and later at Connecticut Legal Services in Northeastern Connecticut, until May, 1978. I concentrated on class actions representing statewide groups of individuals in litigation involving welfare benefits, food stamps, housing, civil and constitutional rights, and unemployment compensation benefits. I then moved to the Los Angeles area and became director of litigation for San Fernando Valley Neighborhood Legal Services. There, I oversaw a staff of more than 25 lawyers and paralegals representing low income individuals in San Fernando Valley in individual and class action litigation involving benefit rights, employment rights, and discrimination. I entered private practice in my own firm in 1980 in Los Angeles and moved my practice to San Francisco a year later. Since then, I have concentrated my practice on consumer protection; employment discrimination; unlawful, unfair, and fraudulent business acts and practices. Major litigation that I have handled on a class action basis, both statewide in California and nationwide, has involved challenges to major credit card company practices, cases against credit card companies involved in illegal debt collection practices, cases against predatory lenders and national banks for illegal lending and debt collection practices, as well as employment discrimination, disability discrimination, Title IX litigation, and challenges to attempts by corporate entities to impose mandatory pre-dispute arbitration clauses on their customers.

[1] The National Association of Consumer Advocates (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

I have been involved extensively for the past 20 years in legislative work before the California Legislature and Congress involving credit card practices, mandatory pre-dispute arbitration clauses, employment discrimination, National Banking Act practices, and federal preemption.

I am the past president of the Consumer Attorneys of California, the largest state organization of trial lawyers. I serve on the boards of several organizations, including the National Association of Consumer Advocates, the Lawyers' Committee for Civil Rights in San Francisco, Equal Justice Works in Washington D.C. A full and complete summary of my professional experience is contained in my resume, which I have attached to this testimony.

<u>Real World Credit Card Abuses</u>

Penalty Fees/Default Accounts

Daily, consumers throughout America receive collection letters claiming that s/he owes thousands of dollars on a delinquent credit card debt. Time and again, I and my fellow consumer advocates hear from clients who tell stories that mimic the facts described by the Court in *Discover Bank v. Owens*. In that case, an Ohio court found that Ms. Owens, an elderly woman who depended on a monthly Social Security Disability ("SSD") check, had more than repaid the principal balance plus interest that she had borrowed on a Discover credit card. The court rejected Discover's attempt to collect an additional $5000 in late fees, penalty interest and credit protection costs, because those charges were, in the court's view, unconscionable.

Many of the clients who contact me depend on a monthly SSI or SSD check or are on very tight budgets because of rising costs of living and stagnant wages, a recent divorce, or a family catastrophe. These individuals and families live on the economic edge. The recent hemorrhage of jobs in all sectors, the swelling tide of foreclosures, and the abrupt halt to credit, affects my clients directly and capriciously.

In today's economic climate, consumers nationwide have an average household income of $52,000 and their average credit card balance exceeds $8,500. Any change in that family's economic situation directly affects their ability to repay credit card debt. Any missed payment triggers both penalty late fees and interest rate increases. Penalty late fees currently average $39 across the major credit card issuers. Late fee interest increases depend on the type of card, but at least double in the event of default. This happens particularly in cases where customers are marketed based on teaser or below-market initial interest rates. As the amount of debt increases for many Americans, the debt servicing costs (that includes interest and late fees) take a larger and larger toll on the American family. For some of my clients, the burdensome costs of credit make it impossible for them to stretch their income to cover surmounting debt – especially if an unexpected calamity like job loss occurs. In addition, the cost of credit is further exasperated by the fact that more and more Americans are forced to pay for basic living necessities, such as housing, food, education, gasoline, and healthcare, on credit.

The credit card industry's practice of charging high interest rates and burdensome fees weighs most heavily on Americans of modest means. These customers, like checking account customers on fixed incomes, are particularly at risk of being caught in a bottomless debt trap. For example, in *Miller v. Bank of America*, a case I tried in January/February 2004, in San Francisco Superior Court, involving the seizure by Bank of America of exempt funds from deposit accounts of elderly and disabled customers, the undisputed testimony was that the bank receives 85 percent of its bounced check or NSF fee income throughout California and throughout the nation from customers with average account balances of $1,000 or less. The same is true in the credit card context. Credit card companies derive the great majority of their fee income from the most vulnerable customers who are the least able to pay them.

Universal Default Clauses

The universal default provision is routinely buried in credit card agreements, whose average length today exceeds 30 pages. The agreement itself is not provided to the consumer until after the application is submitted, approved, and the card has been mailed to the consumer.

The universal default provisions that are hidden in credit card contracts provide that if the customer is in default on any obligation owed to *any entity or individual anywhere* and the credit issuer discovers this fact, the interest rate originally offered and provided to the customer skyrockets. Credit card customers assume reasonably that they may be subject to penalty fees or an increase in their credit card rate of interest if they default on the obligation with the credit card issuer itself. They do not understand that if they default on an obligation with an unrelated entity or individual, that they will be subjected to these punitive repercussions by the company with whom they have the credit card.

Universal default provisions have been roundly condemned by some individual credit card issuers, members of this committee and other members of Congress, consumer advocates, and the Federal Reserve. However, to date, this unconscionable practice continues unabated. Yes, the Federal Reserve's regulations address universal default, but they do not take effect until July 2010. The American consumer cannot wait that long for this unfair practice to be addressed.

Balance Transfers

Other customers are frequently and routinely marketed and solicited to transfer credit card balances to a different credit card company. Shortly after the transfer occurs, it is the common practice of the new issuer to increase the card's APR to a rate more than twice the one that was offered. This occurs without any notice. I have seen it happen to customers who unfortunately transferred their balances to credit cards provided by Providian and MBNA (now owned by Bank of America). These customers were deceived by Providian and MBNA's balance transfer offers that conveniently failed to disclose material information about the terms and conditions before the credit was transferred.

For many customers, balance transfers amount to a classic unfair and deceptive practice, because the credit card issuers renege on the very promises and commitments they made when the consumers agreed to accept the card or transfer the balance.

Timing of Payments

Many customers have been sandbagged by both the "timing" or date of payment and the hour of the due date when the payment is *received* and posted. For example, one of my clients, Steve M. of Oakland, California complained to me in April 2007, that the interest rate on his Bank of America credit card had unfairly been raised from 21.24% to 32.24%. Apparently, when Mr. M. asked Bank of America for an explanation of this 50% interest rate increase, he was surprised to find out that it was because (unbeknownst to him) he had gone over his credit limit and paid $1.50 of his debt late. He also learned for the first time that his payments were due at a Bank of America branch by 2:30 p.m. EST or they would be deemed paid the next day. Because of this, Mr. M. always made sure his payment was paid on the due date by 2:30 pm. Nonetheless, this apparently wasn't good enough for Bank of America when on February 24, 2007 (his due date) Mr. M. made a monthly payment prior to 2:30 p.m. EST. Somehow, despite the timeliness of his payment, Bank of America posted his payment on February 26, claiming that their timing rule didn't include a payment made on a Saturday, thus making his payment late. While Mr. M.'s complaints about this late fee ultimately led to its removal, it did not stop the bank from substantially increasing his interest rate because of this "late payment."

There has been significant litigation in California and elsewhere concerning when payments are considered timely and when payments that are made timely and posted later makes payments late under the credit card issuer's systems. Lawsuits have been filed and settled against Citibank and Bank of America to name just two. Recently, an Appellate Court in California held the California law prohibiting payment due dates on weekends and holidays was preempted under federal law, thus, knocking out reasonable consumer protections put in place by the California legislature to protect its citizens from that type of credit card abuse. *Miller v. Bank of Am., N.A.*, --- Cal. Rptr. 3d ----, 2009 WL 189969 (Jan. 28, 2009).

I am very thankful and glad to see that Senator Dodd's Credit Card Accountability, Responsibility and Reform Act would prohibit this type of abusive behavior that Mr. M. and countless consumers like him have suffered at the hands of the credit card companies

SKYROCKETING CREDIT CARD DEBT

The Industry and its Abuses Keep Escalating

As the above examples of credit card industry-wide abuse demonstrate and as I have seen first-and during my years of representing consumers, a significant amount of the debt of American households is caused not by consumer borrowing as such, but by the punitive – and exorbitantly expensive – tactics and practices of the credit card industry. A significant contributor to the snowballing credit card debt of American consumers is the enormous increase in both the *number* and *amount* of non-periodic interest fees charged and collected by credit card issuers. These "junk" fees include both fees considered to be finance charges (cash advance, balance transfer, wire transfer fees) and non-finance charge or "other" fees. Most widely known among the latter are late payment and over-limit fees. Other abuses include penalty interest rates (situations in which rate increases are triggered automatically by late payments or transactions which the issuer *authorizes* exceeding credit limits on the card, deceptive marketing and arbitrary cut-off times for payment postings that cause borrowers to be charged a late fee even if the payment arrives on its due date (for example, by posting all payments at 11 a.m. so that any payment received or "posted" an hour late is deemed late).

From 1978 to 1995, credit card debt increased six-fold to $378 billion.[2] In 1996, the Supreme Court paved the way for credit card banks to increase their income stream even more dramatically. In *Smiley v. Citibank (South Dakota), N.A.*, the Court approved the Office of Comptroller of Currency's definition of interest that included a number of credit card penalty fees (imposed only in the event of default), such as late payment, over-limit, cash advance, returned check, annual, and membership fees.[3] As a result, national banks and other credit card issuers are permitted to charge and collect fees in any amount to their customers as long as their home-state laws permit the fees and so long as the fees are "interest" under the Office of the Comptroller of the Currency ("OCC") definition. Avoiding the reasonable control of many fees under state law on the amount and number of fees that credit card banks can charge nationwide has resulted in the exponential growth of and reliance on fee income by credit card issuers.

After *Smiley*, banks rushed to increase late charges, over-limit fees, and other charges. The average late payment fee soared from $14 in 1996 to over $32 in 2004.[4] Over-limit fees similarly have nearly tripled from $14 in 1996 to over $30 in 2004[5] and now routinely equal or

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[2] *See* Fed. Res. Bull., available at http://www.federalreserve.gov/releases/g19/hist/cc_hist_mt.txt.

[3] *Smiley v. Citibank (S.D.), Nat'l Assn.*, 517 U.S. 735, 116 S. Ct. 1730, 135 L. Ed. 2d 25 (1996). The OCC definition of interest is found in 12 C.F.R. § 7.4001(a).

[4] Cardweb.com, Late Fees (Jan. 28, 2005), at http://www.cardweb.com/cardtrak/news/2005/january/28a.html.

[5] Cardweb.com, Late Fees (Jan. 28, 2005), at http://www.cardweb.com/cardtrak/news/2005/january/28a.html.

exceed $39.[6]

Banks impose these fees, not as a way to curb undesirable behavior from consumers – which used to be the stated justification for imposing high penalties – but as a significant source of revenue for the bank. Since *Smiley*, penalty fee revenue has increased nearly nine-fold from $1.7 billion in 1996 to $14.8 billion in 2004[7] alone. The income from just three fees – penalty fees, cash advance fees and annual fees – reached $24.4 billion in 2004.[8] Fee income topped $30 billion if balance transfer fees, foreign exchange, and other fees are added to this total.[9] Concurrently, card issuer profits, though declining somewhat between 1995 to 1998; have steadily increased between 1999 and 2004. These profits rose from 3.1% in 1999 to 4.5% in 2004.[10]

During my thirty plus years of representing consumers I have seen the number and types of fees mushroom as well. The Federal Reserve Board provides a list of fees to consumers in a brochure titled “Choosing a Credit Card.”[11] The most common fees incurred in credit card transactions include:

NAME OF FEE	DESCRIPTION OF FEE
Annual fee (sometimes billed monthly)	Charged for having the card. Fees range from zero to $130.

[6] Cardweb.com, Fees & Recession (Dec. 17, 2008), at http://www.cardtrak.com/news/2008/12/17/fees___recession.
[7] Cardweb.com, Fee Party (Jan. 13, 2005), at http://www.cardweb.com/cardtrak/news/2005/january/13a.html.
[8] *Id.*
[9] *Id.* If merchant-paid fees are combined with consumer-paid fees, the total fee income is estimated at $50.8 billion.
[10] Cardweb.com, Card Profits 04, (Jan. 24, 2005), at http://www.cardweb.com/cardtrak/news/2005/january/24a.html.
[11] Federal Reserve Board, Choosing a Credit Card, at http://www.federalreserve.gov/pubs/shop.

Cash advance fee	Charged when the card is used to obtain a cash advance; the fee is usually 3% of the advance, with a minimum of $5 and no maximum.
Balance-transfer fee	Charged when the consumer transfers a balance from another credit card. Fees range from 2% to 3% of the amount transferred, with a minimum.
Late-payment fee	Charged if the consumer's payment is received after the due date. Fees range from $10 to $49.
Over-the-credit-limit fee	Charged if the consumer goes over the credit limit. Fees range from $10 to $39.
Credit-limit-increase fee	Charged if the consumer asks for an increase in her/his credit limit.
Set-up fee	One-time fee, charged when a new credit card account is opened.
Return-item fee	Charged if the consumer pays the bill by check and the check is returned for nonsufficient funds.
Expedited payment fee	Charged when the consumer makes a payment over the phone. Fees range from $10 to $14.95.
Expedited delivery fee	Charged when the consumer requests an additional credit card and requests that it be delivered in an expedited way.
Replacement card fee	Charged when the consumer's credit card is lost, stolen, damaged, or otherwise needs to be replaced.
Additional card fee	Charged when the consumer requests a card for a family member or otherwise wishes an additional card.
Other fees	Some credit card companies charge a fee to cover the costs of reporting to credit bureaus, reviewing the consumer's account, or providing other customer services.

The problem with these punitive charges, especially in combination with constantly increasing penalty interest rates, is that they exacerbate the economic problems for consumers caught up in the current economic crisis. Too often these charges have driven my clients and other consumers into bankruptcy, resulting in cascading personal losses as well as losses to their families and neighborhoods – of lost savings, lost homes, forced moves, with all of the consequential financial and emotional tolls.

The top six credit card issuers engage in these abusive practices.[12] It is this pattern of heavy-handed and manipulative conduct by an entire industry that shows that credit card issuers have altered their fundamental treatment of consumers from a fair, respectful business relationship to an abusive, exploitative one.

Credit card companies were not always so free to engage in predatory, unfair, and fraudulent (if not unlawful) conduct. Credit card deregulation, and the concomitant spiraling credit card debt of Americans, began in 1978, with the Supreme Court's decision in *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*[13] *Marquette* gave national banks the green light to take the most favored lender status from their home state and "export" it across state lines, thereby preempting the law of the borrower's home state. As a result, national banks and other credit card issuers established their headquarters in states that eliminated or raised their usury limits, giving them free rein to charge whatever interest rate they wanted.[14] Therein lies the reason why so many of those credit card solicitations sent by mail every week come from Delaware or South Dakota: credit card issuers moved there to export those unregulated states' lack of consumer protections nationwide.[15] As of 1978, credit card debt had

[12] For example, see information about the civil penalties assessed against Providian and other issuers, http://www.pirg.org/consumer/bankrupt/bankrupt2.htm; and the recent suit initiated against Capital One by the state of Minnesota, http://www.ag.state.mn.us/consumer/PR/PR_041230CapitalOneBank_FSB.htm.

[13] *Marquette Nat'l Bank of Minn. v. First of Omaha Serv. Corp.*, 439 U.S. 299, 99 S. Ct. 540, 58 L. Ed. 2d 534 (1978).

[14] Other depository institutions obtained the same most favored lender status when Congress enacted § 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (codified at 12 U.S.C. § 1831d).

[15] South Dakota and Delaware, at the beginning of the explosive growth of the financial services industry around

grown to $50 billion, up from just $5.3 billion when the Truth in Lending Act was passed.16 Today, credit card debt exceeds 1 trillion.

Industry executives also have recognized escalating pricing and advertising problems in the U.S. credit card market. In 2003, Duncan MacDonald, the former general counsel for Citigroup's North American and European credit card businesses, wrote about the credit card pricing mess in the American Banker.17 Mr. MacDonald observed that the Office of the Comptroller of the Currency – the primary regulator of Comptroller of the Currency – the primary regulator of national banks – had "turned a blind eye to [the] lawlessness" of certain credit card issuers. He described one particular issuer, Providian, as being "well known in the card industry as the poster child of abusive consumer practices."18

Among Providian's more shocking abuses was its imposition a $29 per month charge for unrequested "credit protection" insurance that was worthless to the vast majority of cardholders because under the fine print it did not halt interest charges but only delayed their payment. Moreover, the practice required customers to prove their temporary disability medically.

1980, sought to attract that industry as part of their economic development strategy. They wanted to "provide [their] citizens with the jobs and benefits a large national credit card operation can provide (attracted by the ability to export limitless credit card rates to other states)," while, it should be noted, protecting their local banks from competition with the exporting banks. *Indep. Cmty. Bankers' Ass'n of S.D. v. Board of Governors, Federal Reserve Sys.*, 838 F.2d 969, 975 (8th Cir. 1988). Cf. Richard Eckman, Recent Usury Law Developments: The Delaware Consumer Credit Bank Act and Exporting Interest Under § 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980, 39 Bus. Law. 1251, 1264 (1984). It worked, too. South Dakota's tax revenue from banks went from $3.2 million in 1980 to almost $27.2 million in 1987, with the comparable figures for Delaware rising from $2.4 million to almost $40 million. The Economist, July 2, 1988, at 26.

[16] Diane Ellis, The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-Offs, and in the Personal Bankruptcy Rate, FDIC--Division of Insurance, Bank Trends, 98-05 (Mar. 1998), available at http://www.fdic.gov/bank/analytical/bank/bt_9805.html.

[17] Comptroller Has Duty To Clean Up Card Pricing Mess, Letter to the Editor, Duncan A. MacDonald, American Banker, Nov. 21, 2003.

[18] I was co-lead counsel for the Plaintiffs and the nationwide settlement class in the *Providian* credit card cases, San Francisco Superior Court, Judicial Counsel Coordination Proceeding No. 4085, a nationwide consumer class action challenging the unlawful, unfair and deceptive practices of Providian Financial Corporation, Providian Bank, Providian National Bank and Providian Bank Corp. Services in connection with the entire operation of its consumer credit card program. The Providian entities were also sued by the City and County of San Francisco and an enforcement proceeding was instituted against them by the Office of the Controller of the Currency ("OCC") which required that Providian paid 300 million dollars to stay in business and retain its charter as a national bank.

Providian conducted a nationwide search to determine where to "best" locate its credit payment facility. It ultimately selected New Hampshire because it concluded on average it took longer for mail to reach New Hampshire over any other place in the United States. Even more shocking was Providian's use of bar-coded return payment envelopes that used the wrong zip code for the company's billing center. The payment envelopes literally guaranteed that cardholder payments would arrive late and, in turn, mandate a late fee on the cardholder account. Providian's practice, in this regard, were investigated on three separate occasions by the U.S. Postal Service.

Credit card abuses were not (and are not) limited to Providian. Mr. MacDonald also decried "The Frankenstein" (his word) that had been created by the Supreme Court's *Smiley* decision. He noted that credit card penalty fees were becoming a "substitute for APRs," and that the industry had devolved into "trip wire pricing," in which any cardholder misstep would set off a series of booby trap rates and penalty fees. He further observed that card pricing had become a massive subsidy for the rich. The penalty fees and rates charged to lower income cardholders -- who usually are financially unable to pay off their balances each month – were subsidizing the cash back and frequent flyer perks used to entice the super-creditworthy, who typically do not carry monthly balances.

Credit card debt has caught millions of Americans in a trap they simply cannot extricate themselves from without feeling the pressure to file bankruptcy. At the same time, credit card earnings have been consistently higher than returns on all commercial bank activities.19 The problem is not the profits, it is simply that these profits are based on abusive practices, and resulting harm inflicted upon American households. The root of these problems is that credit

[19] Board of Governors of the Federal Reserve System, *The Profitability of Credit Card Operations of Depository Institutions* (June 2004), *available at* http://www.federalreserve.gov/boarddocs/rptcongress/creditcard/2004/ccprofit.pdf. While the profitability of the credit card industry as a whole has fluctuated somewhat over these years, this is largely due to the changeability of the group of banks included in the sample. *Id.* at 2.

card transactions in this nation are now completely unregulated – and this must change.

Mandatory Arbitrations Clauses Limit Access To Justice

Additionally, many credit card companies have been and are now using mandatory arbitration clauses to circumvent basic due process protections and to obtain default judgments against consumers in distant forums. In California and Pennsylvania, for example, several credit card issuers obtained default arbitration awards against dozens of consumers from a Minnesota arbitration company, the National Arbitration Forum, that they attempted to have enforced by the courts. The courts found that the method of service for the arbitrations and the distant forum did not comply with basic due process rules, analogizing the arbitrations to long-outlawed confessions of judgment. *See, e.g., Patterson v. ITT Consumer Fin. Corp.,* 14 Cal.App.4th 1659, 18 Cal. Rptr. 2d 563 (1993).

Many State and some federal courts have concluded that the prohibition of class actions or class wide adjudication is unconscionable.20 In truth and in economic reality, few if any consumers can take on an allegedly deceptive credit card practice individually. The stakes are just not high enough for any one consumer, and the time commitment alone far outweighs any potential economic award. I hear from my colleagues all the time that no lawyer can handle an individual consumer credit card complaint, because his or her factual investigation will nearly always exceed in time and money the amount that could be recovered for the individual consumer. These were the precise findings of the California Supreme Court in the *Discover Bank* case, the Washington State Supreme Court in the *Scott* case and the District Court in Ninth Circuit in the *Ting* case.

[20] *See Ting v. AT&T*, 182 F.Supp.2d 902 (N.D. Cal. 2002), *aff'd in part* 319 f.3d 1126 (9th Cir.), *cert. denied*, 540 U.S. 811 (2003); *Discover Bank v. Superior Court* (2005) 36 Cal.4th 148, 113 P.3d 1100; *Muhammad v. County Bank of Rehoboth Beach, Delaware* (2006) 189 N.J. 1, 20-21, 912 A.2d 88, *cert denied* 127 S.Ct. 2032; *Scott v. Cingular Wireless* (Wash. 2007) 161 P.3d 1000, 1006.

As described in more detail in my resume, my firm represented the plaintiffs in *Badie v. Bank of America*, 67 Cal.App.4th 779, 79 Cal.Rptr.2d 273 (Cal. App. 1st Dist., 1998) and the *Ting* litigation. Both cases were challenges to the attempts of Bank of America and AT&T, respectively, to impose binding mandatory pre-dispute arbitration clauses on millions of their consumer customers. Both cases resulted in published decisions which held with respect to Bank of America that its attempt to change a material term - "elimination of the right to trial by jury" via a bill stuffer was inadequate where there was no evidence that the provisions in the bill stuffer had come to the attention of any customers other than the four individual plaintiffs in the case and in *Ting* that AT&T's attempts to oppose a binding mandatory pre-dispute arbitration clause coupled with numerous provisions unconscionable under California law was invalid. The abuses detailed in these and other cases would be eliminated through the Arbitration Fairness Act, as introduced by Representative Hank Johnson and Senator Russ Feingold.

Credit Card Debt Pushes Borrowers Into Bankruptcy

In 2003 Congress enacted draconian and unbalanced bankruptcy legislation. As a result of this new law, bankruptcy relief is now more complicated and more expensive for every individual who needs it. Despite the breathtaking scope of the new law, it did not place a single constraint on abusive practices by creditors. Yet, a large body of evidence links the rise in consumer bankruptcies over the last twenty years or so to a direct increase in consumer debt. And, as the examples of abusive credit card practice in this statement demonstrate, a substantial portion of that consumer debt can be attributed to sky high interest rates, penalties and fees that credit card companies tack on to the bills of consumers each month.

After years of experience with the new bankruptcy law, Congress should eliminate some of the unnecessary and costly burdens it has placed on financially struggling families seeking relief from debts they cannot pay.

PROPOSED SOLUTIONS

More Disclosure Is Not the Answer

Because of the deregulation of bank credit, virtually no state regulation on creditor conduct applies to the practices of the credit card industry.21 While there are some – very few – limits placed on the most outrageous abuses of consumers by banks by the federal banking regulators, the Truth in Lending Act ("TILA") is the primary regulatory structure applicable to the relationship between credit card issuers and their customers. The TILA was intended to be – and remains – primarily a disclosure statute. Through its enactment and enforcement, Congress intended to enable consumers to compare the costs of credit.22 However, the TILA was never intended to stand on its own – to be the sole and primary means of regulating and limiting a powerful industry vis-à-vis the individual consumers who borrow money for personal, family or household purposes. Indeed, when the TILA passed in 1968, state usury and fee caps applied to credit card transactions.

Uniform and accurate disclosures are useful for consumers, but they are no meaningful substitute for real regulation. The best proof of this is the unbalanced and dangerous situation that the American consumers find themselves in with the open-end credit industry today.

Disclosures can never and should never replace outright statutory prohibitions of established and well documented credit card abusive and insidious credit card practice. Disclosures are only useful for consumers when all of the following conditions exist –

- The consumer has the opportunity to read the disclosures fully;

[21] For example, when the state of California tried to address the issue of tiny minimum payments by requiring creditors to provide information to each consumer on how long it would take to pay off a sample credit card balance if only the minimum payment was paid each month, a federal district held the statute was preempted by federal banking statutes. *Am. Bankers Ass'n v. Lockyer*, 239 F. Supp.2d 1000 (E.D. Cal 2002).

[22] 15 U.S.C. § 1601(a).

- The disclosures are unambiguous and understandable;
- The disclosures are true and apply to the entire term of the contract;
- The consumer has the knowledge and sophistication to understand the meaning of the information provided in the disclosures; and
- The consumer has the opportunity to make choices based on the information gained through the disclosures.

Moreover, disclosures alone are not sufficient to protect consumers from overreaching creditors. This is because --

- Consumers lack equal access to information – most consumers will not have the knowledge to understand the legal consequences of the terms of credit.
- Consumers lack any real bargaining power – no consumer has the market power to call up a credit card company and negotiate either the basic terms or those in the adhesion contract.
- The credit card market does not provide real choices. With the increasing consolidation of credit card providers, the industry guarantees less meaningful competition. There is generally competition only on the surface, on a few prominently-advertised terms such as the periodic rate and annual fee.
- Consumers have little or no meaningful choices on the terms that create the bulk of the cost of open-end credit.
- Without basic substantive regulation, there will continue to be competition between industry players only as to which can garner the most profit from the most consumers – regardless of the fairness, or the effects on consumers.

Recommendations for Statutory Reform

The credit card market in the U.S. is extraordinarily mature. To increase market share, industry participants are extremely aggressive in their pricing strategies. Because the APR is the primary measure of competitiveness, back-end penalty fees will continue to increase in numbers and dollar amount to offset the risks in credit card marketing plans. Consumers do not, however, shop for credit cards based on their penalty fees, and no real competition will ever exist to decrease the escalation of those fees with Congressional retribution of prohibition. To restore real competition based on the APR, all bank penalties should be controlled by the longstanding common law rules on penalties – the fees are capped by the actual or reasonably expected cost to the bank from a cardholder's breach. This is the principles-based standard reiterated for such fees by the Office of Fair Trading in the United Kingdom and Europe, and it should be applied here as well. Without such an approach, we will continue to see a race to the bottom for backend penalties while the banks deceptively tout unrealistically low APRs.

Accordingly, it is time for the Congressional re-regulation of credit card transactions. Real, substantive limits on the terms of credit, and the cost of the credit, including the interest rate and all fees and charges, must be re-imposed. These include:

- A cap on all periodic interest rates, for example, prime plus 10%.
- A cap on all other charges, whether considered a finance charge or not, to an amount the card issuer can show is reasonably related to cost.
- No unilateral change-in-terms allowed.
- No retroactive interest rate increases allowed.
- No penalties allowed for behavior not directly linked to the specific card account at issue.
- No over limit fees allowed if issuer permits credit limit to be exceeded.

- No improvident extensions of credit–require real underwriting of the consumer's ability to pay.
- No mandatory arbitration, either for consumers' claims, or for collection actions against consumers.
- Meaningful penalties for violating any substantive or disclosure requirement that provide real incentives to obey the rules.
- A private right of action to enforce section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive practices by businesses, including banks.

It is no longer a question of balancing the appropriate regulation with the need to assure access to credit. The increasing mountain of debt held by American consumers, coupled with the growing number of abusive practices by the credit card companies, illustrate amply de-regulation has not worked. Since biblical times government has recognized that consumers need strong, enforceable limits placed on the power of lenders to exert their far greater bargaining power in the marketplace. The age old protection of borrowers from over-reaching lenders needs to be reinstituted. We look forward to working with Chairman Dodd and other members of this committee to develop and enact this year strong, effective credit card legislation.