WRITTEN STATEMENT

OF

OLIVER I. IRELAND

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

March 13, 2008

Good morning Chairwoman Maloney and Ranking Member Biggert. I am a partner in the law firm of Morrison & Foerster LLP, and I practice in the firm's Washington, D.C. office. Prior to joining Morrison & Foerster, I was an Associate General Counsel in the Legal Division of the Board of Governors of the Federal Reserve System ("Board") for over 15 years. Prior to that, I worked at the Federal Reserve Banks of Boston and Chicago. In all, I have over 30 years of experience working in banking and financial services, including working on various issues relating to credit cards. During that time, I have had the opportunity to be intimately involved in both drafting and interpreting regulations as a regulator and in advising financial institutions on how to interpret and comply with regulations. I have witnessed first hand the changes in industry practices brought about by various regulatory modifications and other difficulties incurred in compliance. I am pleased to appear before you today to discuss H.R. 5244, the Credit Cardholder's Bill of Rights Act of 2008.

Credit Cards Benefit Consumers

Today, credit cards are among the most popular and widely accepted forms of consumer payment in the world. In 2005, the total value of credit card transactions charged by U.S. consumers alone exceeded 1.8 trillion dollars. Credit cards can be used at millions of merchants worldwide. As a result of the convenience, efficiency, security and access to credit that credit cards provide to American consumers, credit cards have become a driving force behind the consumer spending upon which our national economy is largely based. Credit cards also have facilitated the development of new markets, such as the Internet, where credit cards play an essential role.

Credit cards offer other benefits to consumers including consolidation of transactions into a single statement payable once a month, the ability to accurately track expenses and freedom

from cash dependency when shopping locally or when traveling around the world. In addition, consumers typically enjoy protections that are unavailable in cash transactions when they use credit cards, including protection from loss or theft and preservation of claims and defenses that a consumer may have against the merchant. Credit cards also offer other benefits, such as product warranties and rewards, including, for example, cash back and airline frequent-flier miles. Moreover, approximately half of all cardholders pay their balances in full every month and, therefore, enjoy interest-free loans.

Although fees, and card issuer revenues from fees, have increased in recent years, because of vigorous competition among credit card issuers and the use of individualized pricing models, consumers are enjoying lower interest rates and more access to credit than in the past. For example, according to a recent Government Accountability Office report on credit card disclosure practices ("GAO Report"), the average credit card interest rate 15 years ago was approximately 20 percent and credit cards often had annual fees in excess of $20.[1] Today, according to the same GAO Report, the average interest rate is approximately 12 percent and nearly 75 percent of credit cards have no annual fees. In addition, although there has been much concern about levels of credit card debt, the GAO found that credit card debt is a small portion of overall consumer debt and has actually declined as a portion of overall consumer debt.

Despite the benefits that credit cards offer, in recent years, credit card practices, such as so-called "universal default" and "double-cycle billing," have been criticized as unfair to consumers in large part because these practices are inconsistent with consumers' expectations for their credit card accounts. These criticisms call into question whether the current credit card disclosure regime has kept up with the market. Simply put, it has not.

---

[1] http://www.gao.gov/new.items/d06929.pdf.

Recognizing this, in June 2007, the Board proposed a comprehensive revision to the credit card provisions of its Regulation Z, which implements the Truth in Lending Act ("TILA"). This proposal addressed many of the issues addressed in H.R. 5244. Moreover, the Board has recently announced that it is exploring additional credit card issues under its unfair and deceptive acts and practices authority. I believe that it is premature to address credit card practices in legislation until these regulatory initiatives are completed, probably sometime later this year. The regulation of consumer credit is highly technical and the risks of unintended consequences from acting on inadequate information or simply imperfect drafting are significant. I believe that H.R. 5244 demonstrates these problems.

H.R. 5244

The Credit Cardholders' Bill of Rights Act of 2008 would impose significant and far-reaching restrictions on the credit card industry that could have significant and adverse unintended consequences for consumers, the industry and, potentially, the U.S. economy. On balance, H.R. 5244 would significantly curtail the ability of credit card issuers to accurately price for risk on existing accounts, substantially reducing their ability to modify pricing to reflect changes in the creditworthiness of borrowers and changing market conditions.

The impact of these restrictions could be significant. Current credit card pricing is based on individual risk factors. Individual pricing allows a credit card issuer to provide credit cards with lower rates to lower-risk cardholders while still providing credit cards at higher rates to higher-risk consumers who otherwise might be unable to obtain credit. Under H.R. 5244, the current risk-based pricing model for credit cards is likely to be restructured to one in which cardholders with good credit histories who pay their bills on time would subsidize higher risk cardholders. It is also likely to lead to a tightening of credit availability for lower income

cardholders, or for those in acute financial stress, since many issuers may simply avoid offering credit to this segment of the market rather than increasing costs to other cardholders. This would reduce the availability of credit at a time when economic stimulus, not tightening, is needed.

The Board's proposal involves targeted initiatives that promote consumer control, choice and understanding with respect to the use of credit cards. In addition, the Board's efforts to address alleged unfair or deceptive practices are likely to go to the concerns being raised with respect to various credit card practices, but in a way that should limit unintended consequences that may hurt consumers and the U.S. economy.

In contrast, H.R. 5244 likely would result in a number of significant unintended consequences. For example, section 2(a) of H.R. 5244 would prohibit increases in APRs that are based on negative information that is not directly related to account performance. This provision would encourage credit card issuers to charge higher rates initially in order to take into account the potential deterioration in cardholder creditworthiness. The effect of this provision would be compounded by section 3(f) on payment allocation, which would prolong the pay-off of existing balances. In addition, section 2(b) would limit changes in terms to specific reasons and subject to specific limitations in the credit card agreement. Moreover, section 2(c) generally would require 45 days advance notice, and an additional 90 day opt-out period, for any rate increase on a credit card account. This provision would delay credit card issuers from re-pricing for risk at the time that risk has become readily apparent, thus requiring them to account for that risk in other ways, including, for example, by pricing accounts higher at the outset.

I believe that the Board's proposal should address the concerns inherent in these provisions—the fairness of changes in terms at any time for any reason with little prior notice. The Board's proposal would require that credit card issuers provide 45 days prior written notice

before changing rates or charges or increasing minimum payment requirements disclosed in the account-opening disclosure. This 45-day notice period would apply to both changes in terms and default pricing. These prior notices would give a cardholder ample opportunity to seek a better rate elsewhere.

Section 3(a) of H.R. 5244 would prohibit the application of interest to credit card balances that have been paid within the so-called "grace period," if the credit card issuer provides such a grace period—a practice that the bill refers to as "double-cycle billing." This provision, for example, would discourage credit card issuers from providing grace periods for anyone (*i.e.*, eliminate the interest-free loan aspect of credit cards even for those that pay on time and in full), or encourage them to impose higher rates on all accounts if they continue to offer grace periods. In addition, section 3(a) may outlaw current interest rate calculation practices that are not considered to be double-cycle billing. Under the Board's proposal, double-cycle billing would continue to be disclosed in solicitations and account-opening disclosures. This disclosure would be directly below the disclosure table. Although this proposal may not fully address all concerns about double-cycle billing, additional disclosures could alert consumers to the practice effectively without disrupting other existing billing practices that have not been the subject of controversy.

Section 3(f) of the bill would require pro-rata allocations of payments to different balances that are subject to different rates. This provision would significantly change industry pricing models and would, for example, discourage credit card issuers from offering low promotional rates, thereby reducing competition in the marketplace. In practice, these rate options would provide added incentives for consumers to change accounts in response to notices of rate increases or other changes in terms. Under the Board's proposal, credit card issuers

would be required to add a new disclosure to credit card solicitations and account-opening disclosure tables stating that any discounted cash advance or balance transfer rate does not apply to purchases, that payments will be allocated to balances subject to the discounted rate before being allocated to any purchases and that the consumer will be charged interest on the purchases until the entire account balance is paid off. This type of disclosure could be broadened to other circumstances where different rates apply to different unpaid balances.

Section 3(g) of H.R. 5244 would require that each periodic statement be provided to a cardholder at least 25 calendar days before the due date identified in the statement, representing more than a 75 percent increase over the time currently required by section 163 of TILA. This provision would discourage credit card issuers from offering grace periods or require card issuers to charge higher rates to address the income lost due to extended grace periods. In light of the fact that TILA currently requires that periodic statements be mailed at least 14 days prior to the due date and also requires the prompt crediting of payments, I believe that issues with late payments are more appropriately addressed through improved disclosures. In this regard, the Board's proposal would require that the periodic statement disclose the due date, cut off time on the due date for the receipt of payments if it is before 5 p.m. and any late payment fees or penalty rate that will apply due to a late payment. These disclosures would be grouped together on the first page of the periodic statement.

Section 4 of H.R. 5244 would give consumers the right to opt out of over-the-limit transactions where an over-the-limit fee may be imposed and, more generally, restrict the imposition of over-the-limit fees even where consumers have not opted out. This provision would encourage card issuers to deny transactions that might, but will not necessarily exceed, credit limits making it more difficult for a consumer to rely on the ability to use his or her credit

card for emergencies or as he or she may otherwise choose. In addition, compliance with this provision would create significant operational difficulties for credit card issuers and would require consumers to continually monitor their account balances to determine if an anticipated purchase will exceed the limit and be declined. Under the Board's proposal, credit card issuers would be required to disclose specified fees, including over-the-limit fees, in credit card solicitations and account-opening disclosure tables. In addition, fees would be grouped separately on periodic statements under the heading "Fees" and labeled as transaction fees or fixed fees. The periodic statement also would include a year-to-date total for fees.

Small Businesses

An often overlooked point is that the vast majority of America's small businesses rely on credit cards for their everyday operations. According to a 2007 SBA report to the President, small businesses account for over 50.9 percent of the domestic work force, 50.7 percent of the non-farm gross product and all of the net job growth in 2004.[2] In 2003, the Board surveyed small business finances and found that over 77 percent of small businesses used credit cards to pay business expenses and nearly 30 percent used cards to help finance their business operations.[3] H.R. 5244 could have a direct and adverse impact on small businesses, raising interest rates and reducing the availability of credit for this very important segment of the U.S. economy.

---

[2] http://www.sba.gov/advo/research/sb_econ2007.pdf.
[3] *See* http://www.federalreserve.gov/pubs/oss/oss3/ssbf03/ssbf03home.html.

Financial Markets

Finally, in addition to likely increasing rates for consumers and small businesses, H.R 5244 may have other adverse affects that are more difficult to assess but that could be even more significant. In a retail market, such as credit cards, where a significant source of funding is derived from asset-backed securities, and in an environment where market confidence in asset-backed securities has been shaken, any market perception that the risk profile of credit card receivables is changing could well lead to a reduced appetite for assets backed by credit card receivables that would, in turn, require issuers to tighten credit standards and raise rates even further.

I appreciate the opportunity to appear before you today, and I would be pleased to answer your questions.