Testimony of the

U.S. Public Interest Research Group

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Legislative Hearing On
HR 5244, the Credit Cardholders Bill of Rights

Before the Subcommittee
On Financial Institutions and Consumer Credit
Of the Financial Services Committee,
U.S. House of Representatives
Honorable Carolyn Maloney, Chair

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Chair Maloney, ranking member Biggert, members of the committee:

Thank you for the opportunity to offer U.S. PIRG's views in support of HR 5244, the Credit Cardholders Bill of Rights, sponsored by Chairwoman Maloney and by at least 94 other members. We commend you for having this timely hearing. I am Edmund Mierzwinski, Consumer Program Director of U.S. PIRG. As you know, U.S. PIRG serves as the federation of and national lobbying office for state Public Interest Research Groups. PIRGs are non-profit, non-partisan public interest advocacy organizations with offices around the country. We take on powerful interests on behalf of our members and other consumers.

(1) SUMMARY:

U.S. PIRG supports HR 5244, the Credit Cardholders Bill of Rights, as a good, measured first step and strong step forward to reforming the out-of-control, virtually lawless, credit card industry.

Owning a credit card company is truly a license to steal. The credit card industry, for years easily the most profitable form of banking according to Federal Reserve Board annual reports to Congress, has seen its profits grow to new heights on the wings of revenue derived from punitive APRs of 36% or more, imposition of late and over-the-limit fees of up to $39 issued on a repeat basis for purported violations that may not have been violations and from the cumulative effects of deceptive disclosures of the true cost of credit, especially in the case of minimum monthly payments. The failure to adequately disclose the cost of credit encourages the most at-risk members of the customer base to carry large unpaid balances at unaffordable interest rates and leaves them in a cycle of perpetual debt. Concentration of the industry has resulted in a tight oligopoly where the largest and most powerful players act with impunity. Once vigilant state enforcers have been de-fanged; private enforcement is hampered by unfair binding mandatory arbitration and federal agencies merely aid and abet bank practices, instead of regulating them. The credit card industry operates without fear of either market or regulatory action to temper its excesses, at the expense of the public's welfare.

HR 5244, the Credit Cardholders Bill of Rights, reins in the industry's most egregious practices.

- It bans retroactive imposition of punitive interest rate increases based on the notorious universal default or risk-based re-pricing schemes, where the increases are made despite a cardholder's perfect "paid as agreed" relationship with the company;
- It says "a deal is truly a deal, by prohibiting "any time for any reason, including no reason" contract term changes;
- It requires proportional allocation of consumer payments when their balance reflects different interest rates;
- It prohibits late fee due date "gotchas;"
- It imposes a variety of other "tell me first, don't trick me" disclosures, and bans arcane and unfair methods used to collect interest on already-paid balances.

While PIRG itself is not opposed to a reinstatement of usury ceilings, nor to limits on punitive fees, we note that the Credit Cardholder Holders Bill of Rights takes numerous steps to protect consumers without resorting to these reforms, so we are hope that when the bill is brought to markup, it garners widespread support, even from members who may philosophically oppose what some call price controls, although we disagree with that pejorative term. The bill reins in unfair practices, through tough disclosures and simple, but significant requirements to treat consumers fairly. All markets function better with rules, and the Credit Cardholders Bill of Rights simply imposes some reasonable rules.

We would expect that the industry witnesses will still oppose the bill and urge the committee to wait another year or more for the Federal Reserve's nearly final disclosure rules[1] that have been delayed even further by its laudable, but not worth waiting for, proposals to improve regulation of unfair and deceptive practices. Perhaps the industry will also engage in "don't hit us while we're down" rhetoric, either on the record or, more likely, in behind-the-scenes lobbying meetings. Losing money on bad hedge and derivative bets and, in some cases, predatory or even illegal practices in the mortgage business is no defense to treating credit card consumers unfairly.

Other major reforms that U.S. PIRG would urge to be included in the Credit Cardholders Bill of Rights and discussed below include the following:

- A ban on pre-dispute binding mandatory arbitration in consumer credit card contracts to allow consumers private enforcement rights to police the marketplace;
- Limits on granting credit cards to young people, based on their ability to repay, and limits on even making offers to young people, unless they first opt-in.

(2) PROFITS OF THE CREDIT CARD INDUSTRY

Credit card lending is the most profitable form of lending, according to the Federal Reserve's most recent report to Congress in 2007:

> Although profitability for the large credit card banks has risen and fallen over the years, credit card earnings have been consistently higher than returns on all commercial bank activities. For example, for all commercial banks, the average return on all assets, before taxes and extraordinary items, was 2.01 percent in 2006, well below the returns on credit card activities in that year.[2]

In recent years, those profits have been augmented by rapid increases in fee income.

There may be, as the industry witnesses will trumpet, some 6,000 credit card issuers. But there are only ten that matter. The actual marketplace is highly concentrated.

Since 1980, revolving debt, which is largely credit card debt, increased from just $56 billion to well over $800 billion, according to recent Federal Reserve data.[3] Approximately 55% of consumers carry balances (the rest are convenience users) meaning consumers with credit card balances average $10-12,000 each in total credit card and revolving debt.[4]

Credit card companies have increased profit by increasing the amount of credit outstanding. The firms do this by decreasing cardholders' minimum monthly payments, increasing interest rates, and piling on enormous fees. Until very recently, credit card companies engaged in a practice of decreasing the minimum percentage of the balance that cardholders must pay in order to remain in good standing. Today, despite recent changes mandated by the OCC to require that minimum payments reduce principal by at least 1%, most companies still require a minimum monthly payment of only 2% or 3% of the outstanding balance. As a result, cardholders who choose to pay only the minimum each month take longer to pay off their balances, paying more interest in the process. In its recent guidance, the OCC admonished banks to raise these minimum payment levels only modestly. "The required minimum payment should be sufficient to cover finance charges and recurring fees and to amortize the principal balance over a reasonable period of time"[5] but OCC allows banks to reduce principal by as little as 1% per month. According to a U.S. PIRG analysis, a consumer carrying just $5,000 of debt at 16% APR would take 26 years to pay off the balance if she only made a 2% requested minimum payment, even if she cut the card up and never used it again.

And, according to the Fed, industry aggressively seeks new customers: "An industry source indicates that in 2004, 71 percent of US households received an average of 5.7 offers per month, or 58 offers/year.[6] During 2004, US households received an estimated 5.23 billion credit card offers, up 22% compared to 2003 and exceeding the previous record of 5.01 billion offers set in 2001.[7]" While some recent reports indicate these offers may be down due to the economic slump, it is likely that this is temporary and banks will restructure the offers and start making them again. Remember that offers are made both to people with positive credit attributes and to people with negative attributes. The offers are simply different.

(3) UNFAIR CREDIT CARD COMPANY PRACTICES

The most common unfair or deceptive credit card company practices include the following:

- Unfair and deceptive telephone and direct mail solicitation to existing credit card customers – ranging from misleading teaser rates to add-ons such as debt cancellation and debt suspension products, sometimes called "freeze protection," which are merely the old predatory product credit life, health, disability insurance products wrapped in a new weak regulatory structure to avoid pesky state insurance regulators[8];
- Increasingly, the use of unfair penalty interest rates ranging as high as 30-35% APR or more, including, under the widespread practice of "universal default," imposing such rates on consumers who allegedly miss even one payment to <u>any</u> other creditor, despite a perfect payment history to that credit card company;
- Card companies now impose multiple APRs – one for balance transfers, one for purchases and one for cash advances, for example – but apply monthly payments first to the balance with the lowest APR, ensuring that it will take the longest to pay off the card.
- Card companies take advantage of Truth In Lending Act loopholes that allow a variety of unfair methods of balance calculation (the so-called two-cycle and the "residual" (or "trailing") interest methods) that allow companies to reach back into previous cycles to collect interest on balances already paid off.
- Imposing those punitive penalty interest rates retroactively, that is on prior balances, further exacerbating the worsening levels of high-cost credit card debt;
- Imposing higher late payment fees, which are often levied in dubious circumstances, even when consumers mail payments 10-14 days in advance;
- Using a variety of mail trickery, such as changing the due dates of monthly bills, making the due date a Sunday but not posting on the weekend; shortening the period between when a bill is mailed out and when that bill is due, etc.;

- Increasing the use of aggressive and deceptive marketing to new customer segments, such as college students with neither a credit history nor an ability to repay and to persons with previous poor credit history;
- Making partnerships with telemarketers making deceptive pitches for over-priced freeze protection and credit life insurance, roadside assistance, book or travel clubs and other unnecessary card add-ons;
- Imposing unfair, pre-dispute mandatory arbitration[9] as a term in credit card contracts to prevent consumers from exercising their full rights in court; and the concomitant growing use of these arbitration clauses in unfair debt collection schemes;
- The failure of the industry to pass along the benefits of what, until recently, were several years of unprecedented the Federal Reserve Board interest rate cuts intended to provide economic stimulus, through the use of unfair floors in credit card contracts.
- Using the clause "Any term can be changed at any time for any reason, including no reason" in credit card contracts as allowed by Delaware and other safe harbor state laws.

The practices described above can be illustrated with the following examples:

- Banks entice consumers to open or continue credit card accounts with promises of a fixed interest rate on unpaid balances on purchases. Thereafter, they unilaterally increase the so-called fixed rate, and may change it to a variable rate.[10]
- Banks bait and switch credit card consumers with teaser offers promising a low introductory interest rate on additional credit card debt and the consumer's pre-existing (regular) interest rate thereafter. But after individual consumers accept the offer and increase their unpaid balance, banks unilaterally and without notice raise the consumer's regular interest rates because now, the individual consumer's debt is allegedly "too high."
- Banks ignore consumers' disputes to charges, which, according to banks themselves, need not be paid pending resolution. Instead, banks unilaterally use such non-payment to charge late fees and raise interest rates.
- Banks reduce credit limits of consumers on their credit card accounts unilaterally and without advance notice, and do so in such manner and to such an extent as to intimidate consumers into abandoning their legitimate objection to charges.
- Banks fail to adequately inform consumers in advance of a proposed increase in interest rate based on the individual consumer's purportedly high debt or other information in such consumer's credit report. Thereby, consumers have no opportunity to avoid the increased interest rate, and are saddled with significant additional interest payments without advance notice.
- Credit card companies use low, short-term "teaser rate" introductory APRs to mask higher regular APRs. The introductory APR is one of the primary tools used to market a card, and it usually appears in large print on the offer and envelope. In a PIRG study, of the 100 card offers surveyed, 57 advertised a low average introductory APR of 4.13%. Within an average of 6.8 months, the regular APR shot up 264% to an average regular APR of 15.04%. The post-introductory APR, as well as the length of the introductory period, were not prominently disclosed.
- Important information is disclosed only in the fine print of the offer. For example, the fine print of most offers states that if an applicant does not qualify for the offered card, s/he will receive a lower-grade card, which usually has a higher APR and punitive fees (a practice

called "bait and switch"). The fine print is easy to overlook, and as a result, a consumer may receive a card that s/he did not want.

- Free does not mean free. The "free" offers that are advertised with many cards are not usually as impressive as they appear. Most have significant restrictions or hidden costs, such as enrollment fees or expiration dates.
- Fine print fees for cash advances, balance transfers, and quasi–cash transactions such as the purchase of lottery tickets significantly raise the cost of these transactions. But the terms governing these transactions are buried in the fine print, where consumers can easily miss them. Minimum fees, also stated only in the fine print, allow credit card companies to guarantee themselves high fee income regardless of the transaction amount.

(4) DISCUSSION OF KEY ELEMENTS OF THE CREDIT CARDHOLDERS BILL OF RIGHTS, HR 5244

A. IT ELIMINATES THE MOST ONEROUS CREDIT CARD TERMS SO CONSUMERS CAN REPAY

1. No Retroactive Interest Increases After Universal Default

Consumer advocates remain unconvinced that universal default or "risk-based re-pricing" schemes – based on factors external to a cardholder's "paid-as-agreed" relationship – are truly based on risk modeling. We have also seen no data to prove that the practice is implemented fairly. As one example, picture this: when consumers apply for credit cards, their applications and credit scores are reviewed and they are placed in one of numerous pricing "buckets" based on their risk. You may get a 10% APR "gold" card with a $10,000 available credit limit. I may get an 18% APR "classic" card with a $500 limit. Our neighbors and friends and colleagues may get any of 7 or 8 different combinations in between, depending on their risk.

Yet, some banks will use either one alleged late payment to another creditor or a minor drop in a credit score, to raise any or all of us – whether we are paying a preferred rate of 0% APR or 10% APR, or a not-so-good rate of 18% APR – immediately to a punitive rate of 31-36% APR or more. This increase is applied not only to our prospective purchases, but retroactively to our current balance.

This is not a proportional response:

- Why isn't a first offense subject only to a penalty fee?
- Why doesn't a second offense result in an incremental increase (for example, of 5%), so the person at 10% APR goes to 15% APR, and the person at 18% APR goes to 23% APR?
- Why does everyone's risk go immediately to the same punitive level (31% - 39% APR or more) even though they were each previously at different risk levels, solely on the basis of one (or two) dings, or even on the basis of a decline in credit score, which could occur with no dings?

Simply, universal default in our view is not based on risk. No data have been provided to the Congress to justify it on the basis of risk modeling. It is more likely that banks use universal default to increase revenue because they can, rather than because it is a justifiable, proportional risk-based response.

Worse, by applying universal default retroactively to an existing balance, it actually increases a consumer's risk of non-payment.

To illustrate: a consumer who has a $10,000 credit card balance at 12% APR owes a monthly minimum payment (if he/she owes no penalty fees) of $200, but would owe $400 each month at 36% APR (under the OCC minimum payment requirements) with the additional $200 going to increased interest penalty, not reduction of principal.[11] Paying twice as much each month (in this case) makes it harder to pay off a balance, not easier. Of course, paying as much as you can afford (twice the minimum payment or more) does result in a more rapid reduction of your balance.

Finally, by imposing punitive interest rate changes retroactively, the credit card industry is allowed to change the prices of products consumers have already bought.

For these reasons, we would support a total ban on universal default or risk-based re-pricing. But again, your moderate bill does not go this far. While your bill would not prohibit this wrong-headed result in all circumstances, it prohibits it only in the most unfair circumstance. We support your moderate approach—allowing the new interest rate for future purchases, but banning imposition of punitive rates retroactively, whenever that new punitive rate is based on alleged conduct not related to the card's use.

2. **It Eliminates Any-Time Any-Reason Changes in Terms**

The outrageous rule that credit card companies have operated under for too long is that they can impose a "take it or leave it" contract of adhesion on consumers that allows one side, their side, to change the rules at any time, for any reason, including no reason. While Citibank has "voluntarily" reversed this policy, and even run ads in Capitol Hill tabloids saying that "a deal is a deal," we do not believe that the credit card marketplace operates in a free and open fashion, so the Congress should adopt this rule as statute, in case Citi changes its mind, and to force other banks to be fair.

3. **It Provides Advance Notice of Credit Card Account Rate Increases and Right To Cancel Account**

Consumers deserve better notice, as even the Fed's proposals when implemented presumably will provide, but they also need rights. Your bill gives 45 days notice of interest rate increases, as the Fed would provide, but also grants the right to cancel the card and pay it off under the old terms.

B. IT REQUIRES PRO RATA PAYMENT ALLOCATIONS

Importantly, the bill requires that when consumers have a balance subject to multiple interest rates, that his or her payments be allocated proportionately. Currently, on all but a few proprietary label cards, it is standard industry practice to allocate partial payments of an unpaid balance to the portion of the balance with the lowest available interest, often a 0% APR balance transfer. Meanwhile, interest on high-cost cash advances (when you use a "convenience" check provided by the card company, you are taking out a cash advance) piles up.

At a hearing last summer, full committee ranking member Spencer Bachus explained the problem best:

> [In an opening statement] … "I have constituents who come to me, like a young man … [who] was paying his credit card on time. He realized it was the last day to pay his mortgage payment, so he called his mortgage company up, and they said, ''Well, you can use your credit card,'' so he said, ''Great.'' He used his credit card. When his credit card bill came in, he noticed that not 8.5 percent interest was charged on that, but 24.9 percent interest on the mortgage payment. So, he said, ''Oh, my gosh,'' you know, so he called his credit card company, and he said, ''I want to pay that off today, I am going to send you a check,'' so they said, ''Okay.'' He sent that check in, plus his minimum payment for the month, and they applied it to his lowest balance. Now, here is a young man who would have never come into my office; he probably didn't have time. He saw me in a restaurant, and he came up to me and he basically said, ''Congressman, I don't think that's right.'' And, quite frankly, I don't, either. .." [And responding to Federal Reserve Governor Mishkin] "Now, it would obviously be always unfavorable to the consumer to target that to the balance where there is either no interest rate, or where there is a low interest rate instead of the high interest rate. That is never going to be anything but unfavorable to the consumer, or unfair."[12]

The bill also commendably restricts certain other unfair interest practices, such as taking advantage of archaic Truth In Lending Act loopholes to charge interest on balances already paid through either the "double-cycle-billing method" or the "trailing" (or residual") interest method. Both these methods inappropriately allow companies to reach back to previous periods in calculation of average balances for the purpose of determining interest owed.

C. IT SAYS: NO MORE LATE FEE "GOTCHAS" THROUGH DUE DATE CHICANERY

The Credit Cardholders Bill of Rights takes several steps to make sure that payments sent on time are recorded on time, so consumers can avoid unfair late fees and concomitant, double-whammy increases to a punitive penalty interest rate. Most importantly, the bill establishes a presumption that payments mailed 7 days in advance are timely. It also eliminates the practice of claiming that bills that arrive after "1pm" or "noon" can be considered late by making payments received before 5PM Eastern Standard Time timely. It extends the current minimum period for mailing bills to consumers from the current 14 days to 25 days before the due date. Finally, it requires that phone or Internet payments be considered timely if made on the due date before 5PM Eastern Standard Time.

We would support additional amendments to these laudable provisions. First, there should be no "pay to pay" fees for paying over the phone or on the Internet. Second, we would support changing the 5PM EST time to midnight Pacific Time.

Finally, we support additional prohibitions on "jumping due dates" and making bills payable on weekends or holidays. According to a recent news story "Floating Due Date Snags Chase, Citibank Customers:" [13]

Consumers complain that Chase and Citibank are routinely changing the due dates on their statements from month to month, often making customers with automatic payments late, thereby saddling them with late fees and higher interest rates. "(Citibank) moved my due date to cause me to be late and give them the ability to charge a late fee and move my rate from 3.99% (for the life of the balance) to 24.44%," wrote Jeff of Noblesville, Ind. "I have always paid electronically on the 24th. ... It sent my monthly bill for Citibank from $211 to $495."

D. OTHER POSITIVE PROVISIONS OF THE CREDIT CARDHOLDERS BILL OF RIGHTS

The bill also includes other provisions we have long supported.

- It limits over-the-limit fees.
- It bans misleading use of the terms "fixed" or "prime."
- It gives consumers the right to reject cards without having their credit record damaged.
- It allows cardholders to set limits on available credit.
- It requires greater oversight of the industry by improving data collection.

In addition to these provisions, the bill includes a provision which attempts to rein in sub-prime "fee-harvester" credit cards, which have a business model that relies only on squeezing vulnerable consumers for fees and never allowing them access to the promised credit. We support the intent of the provision but would like to work with the committee to ensure that the provision achieves its intent without unintended consequences.

(5) LACKING STATE OR FEDERAL ENFORCERS, OR CONSUMER RIGHTS, THE CHANGES IN THE CREDIT CARDHOLDERS BILL OF RIGHTS ARE CRUCIAL TO POLICING THE MARKETPLACE

In previous testimony before the committee, I have pointed out in detail that the wrong-headed state preemption doctrine accepted by the Congress, the courts and the federal regulators has eliminated the ability of states to enact better laws and state attorneys general to enforce the law. Without states coming up with new legislative ideas, and without state attorneys general – the best consumer cops on the beat – we are left to the permissive, lax supervision of the federal regulators. Leaving consumer protection to the chief national bank regulator, the OCC, or Office of the Comptroller of the Currency, is as if we have no consumer protection at all. Waiting for the Federal Reserve Board to issue modest rules largely based on disclosure is unacceptable.

Worse, the OCC, the other regulators and the Congress have allowed banks to impose pre-dispute binding mandatory arbitration as a condition of credit card contracts, which has virtually eliminated private enforcement against unfair credit card company practices.

Absent legislation to eliminate state preemption and mandatory arbitration, two reforms which we would enthusiastically support, the need for the Credit Cardholders Bill of Rights is even more apparent. Here is why we need these two additional reforms.

A. THE FAILURES OF THE OCC CALL FOR REINSTATEMENT OF STATE ATTORNEY GENERAL AUTHORITY, AT A MINIMUM

The failures of the OCC to protect consumers have been well-documented before this committee. OCC has not taken a public enforcement action against a large credit card issuer since 2000, and in that case, it was shamed into acting against an albeit large, but relatively upstart mono-line[14] credit card bank, Providian (now part of Washington Mutual (WAMU)) only after the tiny San Francisco District Attorney and the California Attorney General initiated earlier and widely-praised enforcement actions. A number of states aggressively took action against credit card companies in this time frame as well. Yet, most if not all of these state and local actions would generally be prohibited now, after promulgation of the 2004 OCC preemption rules.

In 2006, as in previous years, 39% of OCC's complaints were against credit card banks, according to the GAO.[15] Yet, while even the GAO explains that the large number of credit card complaints to OCC versus to other regulators is because it supervises so many large banks, to our knowledge, the OCC has not imposed public penalties or sanctions on any of the "Top Ten" banks under its regulation even though most advocates believe the sharp practices are endemic to the industry, including its largest players. Further, Professor Art Wilmarth has testified before this subcommittee in concordance with these views: "The OCC's record is similarly undistinguished with respect to consumer enforcement actions taken against national banks for violations of consumer protection laws." [16]

We would urge the committee to rescind OCC-passed rules eliminating state Attorney General authority over national banks and preempting state laws. Further, we urge the committee to reverse the Marquette and Smiley decisions that enable the exportation of interest rates and fees from bank "safe harbor" states.

Although states had until recently aggressively sought to enforce unfair and deceptive practices laws against credit card companies, the states have been limited in their enforcement by the growing use of preemption theory to restrict their regulation of the industry. In 1978, in Marquette,[17] the Supreme Court held that states could export nationally the interest rates of the bank's home state, prompting a concentration of the industry in a few bank-friendly states, including Delaware and South Dakota. In 1996, the court in Smiley[18] extended the Marquette holding by defining late fees as "interest," for the purpose of allowing a bank's home state late fees rules to similarly be exported nationally.

These onerous decisions applied to the regulation of interest. In 2002, a U.S. District Court used National Bank Act preemption theory, backed by the OCC, to overturn an important new California law requiring a monthly minimum payment warning, further restricting the states.[19] Then, of course, in 2004, the OCC imposed two onerous administrative rules restricting states from enactment or enforcement against national banks and their state-licensed operating subsidiaries[20] which has resulted in further court decisions upholding the rules.

These decisions and actions have aided and abetted the anti-consumer practices of this industry and deserve careful scrutiny by the committee. We remain disappointed that, at a minimum, the committee has not reined in the over-reaching OCC rules, although it did in 2004 condemn the OCC[21] when it passed a bipartisan budget resolution[22] on a vote of 34-28, stating that the OCC action "may represent an unprecedented expansion of Federal preemption authority" and "comes without congressional authorization, and without a corresponding increase in budget resources for the agency." The committee also pointed out that without a budget increase, the OCC cannot really expect its modest staff of forty consumer-complaint specialists to both continue their own work and also take over much of the work of an estimated 700 state consumer enforcers and examiners. "In the area of abusive mortgage lending practices alone, State bank supervisory agencies initiated 20,332 investigations in 2003 in response to consumer complaints, which resulted in 4,035 enforcement actions."

B. <u>MANDATORY PRE-DISPUTE ARBITRATION CLAUSES IN CREDIT CARD CONTRACTS DETER PRIVATE ENFORCEMENT AGAINST SHARP PRACTICES</u>.

The Congress has enacted legislation protecting car dealers from unfair arbitration clauses in their contracts with car manufacturers. The Senate has in the past passed (and is now considering again) legislation similarly protecting farmers from arbitration in their contracts with powerful agri-business concerns. Legislation protecting consumers in nursing homes is under consideration, It is time to enact similar legislation to protect consumers in credit card contracts, as well as other contracts.

Studies have shown that arbitration programs essentially run as collection mills on behalf of credit card companies and hospitals, among others, not the vaunted low-cost alternatives to court proceedings their marketing purports them to be. Further, imposing the arbitration requirement as a condition of obtaining a card is simply unfair. Finally, companies are allowed to persist in unfair practices because they have achieved an enforcement trifecta—no consumer enforcement of the law allowed, no state attorney general enforcement of the law allowed, and a cozy relationship with their so-called federal regulators means no enforcement happens at all.

Congress Should Ban Mandatory Arbitration In Consumer Contracts: Rep. Gutierrez has introduced HR 1443, the Consumer Fairness Act, to ban mandatory pre-dispute arbitration in consumer contracts. Rep. Hank Johnson has introduced HR 3010, the Arbitration Fairness Act, which bans arbitration in consumer and other contracts (small farmers, franchisors). These bill deserve support and consideration as amendments to HR 5244.

Congress Should Ban The Use of Arbitration in Debt Collection Schemes: Arbitration agreements are not only being used in attempts to prevent consumers victimized by deceptive advertising and interest rate practices to have their day in court. Increasingly, according to a recent report by the National Consumer Law Center, major credit card companies are partnering with arbitration firms to establish debt collection mills that force consumers into paying debts, including debts they may not even owe:

> Now, at least two giant credit-card issuers and one of the nation's largest firms arbitrating their consumer disputes have combined these practices in a disturbing new way: They're using binding, mandatory arbitration primarily as an offensive weapon, by fast-tracking disputes over credit-card debt into rapid arbitration. A number of consumers charge that the banks often do this with little notice, after long periods of dormancy for the alleged debt or over consumers' specific objections -- then force those who don't respond swiftly or adequately into default. The arbitrator often forces the consumer to also pay for the hefty arbitration costs and the card issuer's attorney, making the total tab for consumers several times the original amount owed and many times what it would have been in more

> traditional debt settlements. So it's a neat pathway to turbo-charged profits for both the card issuer and the arbitrator.[23]

A more recent study by Public Citizen[24] found that MBNA (now known as FIA Card Services and part of Bank of America) allegedly used the National Arbitration Forum to collect disputed debts from consumers, including debts not even owed-- from identity theft victims who never had accounts with the bank. As the Wall Street Journal reported last week, the City of San Francisco has sued NAF and FIA Card Services:

> The suit alleges that in specific cases NAF approved an inflated award, improperly imposed attorneys fees and didn't respond to a consumer's request to appear at an arbitration, among other things…From 2003 through March 31, 2007, 18,075 consumers' arbitrations in California were resolved through hearings conducted by the NAF, according to the suit, citing data reported by the NAF. Thirty of the matters, or fewer than 0.2%, were won by consumers.[25]

(6) ABUSIVE CREDIT CARD INDUSTRY PRACTICES EXTENDING ONTO CAMPUS AND TO NEW CUSTOMER POPULATIONS

How do banks increase their already massive credit card profits? As has been widely reported and is the subject of these Congressional inquiries, first, banks can squeeze their existing customers for greater profits in several ways, including the following:

(1) using a variety of rewards and tricks such as encouraging extremely low minimum payments to maintain highly-profitable high revolving card balances;
(2) raising interest rates on those balances through a variety of traps including imposition of penalty interest rates for late payments and changing due dates to encourage more of those late payments;
(3) using misleading teaser rates and,
(4) raising the rates of otherwise good customers by claiming that their credit score had declined or that they were late to another lender (called "universal default")

Further, banks can market to customers of other credit card companies, urging them to switch by offering low teaser rates on balance transfers and other incentives. But this marketing is expensive both because of the cost of the zero-interest offers and the cost of sending out the billions of solicitations.

Finally, having saturated the working adult population with credit card offers, credit card companies are now banking on new markets: college students and others who have never had, or had only limited access to, credit cards, including recent immigrant populations.[26]

According to a March, 2008 PIRG Report, the Campus Credit Card Trap[27], college students are among the most prominent targets for this marketing. They are young and understand that they need credit to get ahead in the world. Some need credit because of the rising cost of a college education. Finally, most of them are clumped together on campuses that they either commute to or live at. This makes them easy to target. Companies use a variety of techniques, from buying lists from schools and entering into exclusive marketing arrangements with schools to marketing directly to students through the mail, over the phone, on bulletin boards and through aggressive on-campus and "near-campus" tabling-- facilitated by "free gifts."[28]

College students, under regular credit criteria, would not be able to get a card because they have no credit history and little or no income. But the market for young people is valuable, as industry research shows that young consumers remain loyal to their first cards as they grow older. Credit card marketing, coupled with students' lack of financial experience or education, leads many students into serious debt. According to another recent PIRG study, the Burden of Borrowing, credit card debt exacerbates skyrocketing student loan debts. That 2002 study found that thirty-nine percent (39%) of student borrowers now graduate with unmanageable levels of debt, meaning that their monthly payments are more than 8% of their monthly incomes. The study also found that student borrowers were student borrowers were even more likely to carry credit card debt, with 48% of borrowers carrying an average credit card balance of $3,176.[29]

The 2008 PIRG study of campus credit card marketing found that students support a variety of reforms: We asked students their views on whether colleges and universities should regulate the practices of credit card companies on campus. The results show that students overwhelmingly support stricter regulation of campus credit card marketing. Four out of five (80%) students supported adoption of strong campus credit card marketing principles. Only 1 in 5 students replied yes to the proposition that students could handle credit card marketing without regulation. Some of these also supported some of the reform principles anyway. Of those who supported one or more strong principles, nearly three-in-four students (74%) asserted that only cards with fair terms and conditions should be marketed on campus. Students also overwhelmingly (67%) opposed the sale or sharing of student lists (which can include home and dorm addresses, email addresses and land line and cell phone numbers) with credit card companies.

While some of these reforms may more appropriately be considered on campus, this committee should consider amendments to restrict marketing to youth in the following ways:

Ban giving credit cards to young people who cannot demonstrate an ability to re-pay. Bank witnesses and spokespeople have largely admitted that even though young applicants do not have adequate credit reports to qualify for cards, their mere "status as students" is an adequate criterion for approving a card. This is unacceptable. Banks should underwrite credit cards for students and young people, just as they do for all other applicants. It may be appropriate to substitute completion of an approved, legitimate financial literacy class as an alternate criterion. It may also be appropriate to restrict the credit card limits and maximum number of cards available to young people. A variety of bills make proposals in this area and we would be happy to work with the committee and student groups on the best amendment.

Ban Marketing Cards To Young Consumers Unless They Opt-In To Receive Solicitations. A broad credit card reform proposal, S 2753, the Credit Card Reform Act, by Senator Robert Menendez includes this laudable provision. In the 2008 PIRG study, 8 of 10 students reported receiving mailed offers from credit card companies.

(7) CONCLUSION

We thank you for holding this important oversight hearing. We have attempted to describe a failed enforcement climate that has led to a pattern of sharp industry practices. We hope that we have provided you with adequate information to support the need for action by the Congress to rein in the credit card industry's most unfair and abusive practices. We believe that your bill, HR 5244, the Credit Cardholders Bill of Rights, is a careful, measured response to the problem. It could be strengthened with the additional amendments we suggest, but, as is, it is deserving of widespread support and not deserving of untoward and shrill industry opposition. We look forward to working with the Committee to advance this bill.

ENDNOTES

[1] See Comments of National Consumer Law Center, U.S. PIRG, Consumer Federation of America et al "Regarding Advance Notice of Proposed Rulemaking: Review of the Open-End (Revolving) Credit Rules of Regulation Z," Federal Reserve System, 12 CFR Part 226, Docket No. R-1217 available at http://www.consumerlaw.org/initiatives/test_and_comm/content/open_end_final.pdf The consumer group comments provide a window on the way that the industry exploits loopholes and inconsistencies in the act to hurt and exploit consumers. The TILA was supposed to be a remedial act, a law written to prevent unfair practices, and has often been correctly interpreted that way in the courts, yet the regulators have insisted on allowing the industry to carve out nooks and crannies that allow it avoid the spirit of the law. The proposals augment and update the disclosures in the important 1988 disclosure legislation that established what is known as the "Schumer" box, which requires credit card company solicitations to clearly and prominently disclose all fee and interest related "trigger terms." The proposed rules have been delayed, following recent testimony by Board Chairman Ben Bernanke that additional proposals on unfair and deceptive practices would augment the disclosure proposal.

[2] Report to the Congress on the Profitability of Credit Card Operations of Depository Institutions Submitted to the Congress pursuant to section 8 of the Fair Credit and Charge Card Disclosure Act of 1988 July 2007, available at http://www.federalreserve.gov/boarddocs/rptcongress/creditcard/2007/default.htm, last visited 16 April 2007.

[3] The February 2008 Fed data estimate consumers have $952 billion in revolving debt. This figure must be deflated to account for non-credit card debt and for a share of debt that is paid off on a timely, monthly basis, so we use "over $800 billion." See G19 Consumer Credit release 7 April 2008 available at http://www.federalreserve.gov/releases/g19/current/default.htm

[4] The banks frequently cite a Federal Reserve analysis of University of Michigan Survey of Consumer Finances polling data to allege that only 45% of consumers carry a balance. Consumer group contacts with industry sources indicate that these numbers are low. If true, of course, average balances would be even higher. Consumer groups use a conservative figure of 55% carrying balances, with some sources putting the number as high as high as 60% or more. For a discussion of our analysis of credit card debt, see the state PIRG report "Deflate Your Rate," March 2002, available at http://www.truthaboutcredit.org

[5] OCC Advisory Letter AL 2004-4, April 28, 2004, available at http://www.occ.treas.gov/ftp/advisory/2004-4.txt

[6] Report to the Congress on the Profitability of Credit Card Operations of Depository Institutions Submitted to the Congress pursuant to section 8 of the Fair Credit and Charge Card Disclosure Act of 1988 July 2007, available at http://www.federalreserve.gov/boarddocs/rptcongress/creditcard/2007/default.htm, last visited 16 April 2007.

[7] According to Mail Monitor, the direct mail tracking service from Synovate.

[8] See an Office of the Comptroller of the Currency (OCC) regulatory interpretative letter endorsing debt cancellation and debts suspension products at http://www.occ.treas.gov/interp/jan01/int903.doc

[9] The consumer organizations testifying today, U.S. PIRG and the Center for Responsible Lending, and many others, including the Consumer Federation of America and Consumer Action, are all members of a broad new campaign to educate the public and the Congress about the need to eliminate one-sided binding mandatory arbitration (BMA) clauses in consumer contracts. See http://www.givemebackmyrights.org/

[10] It is the bank position that the Truth In Lending Act allows them to change fixed rates with as little as fifteen days notice and that a fixed rate is merely a rate that is not variable. A variable rate is defined as one tied to an index, such as the Wall Street Journal prime rate as disclosed on a certain date.

[11] The OCC requires that minimum payments reduce principal by 1% (1% of $10,000 is $100) and pay current interest (and fees). For an annual interest rate (APR) of 12%, the monthly or periodic rate is 1% (12% X 1/12) or $100, resulting in a minimum payment of $200 ($100 + $100). At 36% APR, the monthly periodic rate is 3% (36% x 1/12) or $300, resulting in a minimum payment of $400 ($100 + $300).

[12] Remarks of Rep. Spencer Bachus (AL), transcript of hearing of the Subcommittee on Financial Institutions and Consumer Credit, 7 June 2007.

[13] "Floating Due Date Snags Chase, Citibank Customers," by Joseph Enoch, ConsumerAffairs.Com, 14 March 2008, available at http://www.consumeraffairs.com/news04/2008/03/floating_due_dates.html, last visited 15 April 2008.

[14] Primarily a credit card bank, as opposed to a multi-faceted bank with a variety of products.

[15] See OCC Consumer Assistance: Process Is Similar To That of Other Regulators But Could Be Improved by Enhanced Outreach, at page 23, U.S. Government Accountability Office, February 2006, available at http://www.gao.gov/new.items/d06293.pdf

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[16] See testimony of Professor Art Wilmarth, 26 April 2007, before Financial Institutions and Consumer Credit Subcommittee, available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/htwilmarth042607.pdf

[17] In 1978, the Supreme Court in Marquette vs. First Omaha Service Corp invalidated state usury laws as they apply to national banks. Marquette held that under Section 85 of the National Bank Act (NBA) of 1863 national banks could export to any of their customers, no matter where they lived, the highest interest rate allowed in the bank's home state, now usually Delaware, Virginia, Nevada or South Dakota. See Marquette Nat. Bank. V. First of Omaha Services, 439 US 299 (1978).

[18] In Smiley, the Supreme Court extended Marquette to allow exportation of a home state's fees. The court paid deference to a new OCC rule that added a wide range of fees to the definition of interest under Section 85 of the National Bank Act, including late fees, over limit fees, annual fees, and cash advance fees. See Smiley v. Citibank (South Dakota). 517 US 735 (1996)

[19] Since the federal Truth In Lending was non-preemptive with respect to certain account statement disclosures, California enacted legislation (Civil Code Section 1748.13) requiring that monthly credit card statements disclose information about how long it would take to pay off a card if you only made the minimum requested monthly payment. Federal law did not then require this, although a similar, weaker provision is included in the Bankruptcy law recently signed (Public Law 109-8). The law was overturned on summary judgment in American Bankers Association v. Lockyer, 239 F. Supp. 2d 1000, 1009 (E.D. Cal. 2002).

[20] See the PIRG OCCWatch website for detailed information on the OCC's anti-consumer actions, including links to its rules, http://www.pirg.org/occwatch Also see "Preemption Of State Consumer Laws: Federal Interference Is A Market Failure," by U.S. PIRG's Edmund Mierzwinski, which appeared in the Spring 2004 (Vol. 6, No. 1, pgs. 6-12) issue of the Government, Law and Policy Journal of the New York State Bar Association. The article includes a major section on the OCC rules, available at http://www.pirg.org/consumer/pdfs/mierzwinskiarticlefinalnysba.pdf

[21] News story on committee vote available here: http://www.housingchoice.org/news%20stories/2004/02272004.htm

[22] See Comm. On Fin. Serv., 108th Cong., Views And Estimates Of The Committee On Financial Services On Matters To Be Set Forth In The Concurrent Resolution On The Budget For Fiscal Year 2005, At 15–16 (Comm. Print 2004).

[23] See 17 February 2005, "New Trap Door for Consumers: Card Issuers Use Rubber-Stamp Arbitration to Rush Debts Into Default Judgments," National Consumer Law Center, available at http://www.consumerlaw.org/issues/model/content/ArbitrationNAF.pdf

[24] The Arbitration Trap: How Credit Cards Companies Ensnare Consumers, 27 September 2007, Public Citizen, available at http://www.citizen.org/publications/release.cfm?ID=7545 last visited 16 April 2007.

[25] San Francisco Sues Provider of Arbitrators, by Nathan Koppel, the Wall Street Journal, 7 April 2008, page A3.

[26] See, for example, "Eliminating Barriers to Credit and the Challenges of Credit Card Use for Latino Consumers," testimony to the Senate Banking Committee summarizing a recent report by the National Council of La Raza, by Beatriz Ibarra, 1 February 2007, available at http://www.nclr.org/content/publications/detail/44284/ The report details a variety of challenges Latino credit card consumers face, including greater vulnerability to scams, reliance on higher-priced cards and difficulty working with the OCC's "obscure consumer complaint system."

[27] See "The Campus Credit Card Trap, March 2008, by Edmund Mierzwinski and Christine Lindstrom, U.S. PIRG, available at http://www.truthaboutcrdit.org .

[28] Recently, Ohio Attorney General Marc Dann sued Citibank and Potbelly Sandwich Works because a "free" sandwich was conditioned on first filling out a credit card application. General Dann has settled with the sandwich store, but not with Citubank. News release, 10 March, 2008, "Attorney General Announces Agreement with Potbelly," Office of Ohio Attorney General Marc Dann.

[29] See "The Burden of Borrowing," the State PIRGs' Higher Education Project, March 2002, available at http://www.pirg.org/highered/highered.asp?id2=7972