Testimony of

Kenneth J. Clayton

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Committee on Financial Services

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Chairman Frank, Ranking Member Bachus, and members of the Committee, my name is Kenneth J. Clayton, senior vice president and general counsel of the American Bankers Association (ABA) Card Policy Council, the group within the ABA that deals with card issues. The American Bankers Association brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.3 trillion in assets and employ over 2 million men and women.

I appreciate the opportunity to testify today on H.R. 3639, the Expedited CARD Reform for Consumers Act of 2009, which would significantly accelerate the effective dates of the broad provisions of the Credit CARD Act ("CARD Act") to December 1, 2009 from either the February 22, 2010 or August 22, 2010 effective dates already provided.[1] The changes made by the CARD Act will provide important benefits to many card holders, and are so broad they are affecting every aspect of the credit card business. As a consequence, all credit card issuers are currently undertaking a massive overhaul of their business practices.

Let me say at the outset that all card lenders – whether part of the largest financial institutions or the smallest community banks – are working vigorously to implement as soon as possible the protections afforded by the CARD Act. Indeed, they have already implemented the interest rate increase restrictions that went into effect on August 20, 2009. The CARD Act represents a fundamental shift in how the credit card marketplace must look, and consumers will be provided greater protections and control with respect to their credit cards.

[1] The vast majority of the provisions of the CARD Act are scheduled to come into effect on February 22, 2010, with certain other provisions scheduled to come into effect on August 22, 2010. The Congress specifically required two provisions – those requiring lenders to provide consumers with 45-days advanced notice of rate increases and that consumers have at least 21 days time from statement mailing to pay their bills – ***to become effective on August 20, 2009***. Essentially, Congress sought to provide consumers with the ability to avoid rate increases as soon as reasonably practical, while providing an expedited time frame for the implementation of the extensive changes to business systems otherwise required by the CARD Act. Prior to passage of the legislation, the Federal Reserve (and the Office of Thrift Supervision and the National Credit Union Administration) had previously issued proposed regulations on a wide range of issues subsequently included in the CARD Act. Those legislative provisions that were similar to those put forth by the regulators were subject to an earlier effective date (February 22, 2010) – one still four months earlier than the July 1, 2010 effective date in the proposed regulation. Provisions that went beyond those originally proposed by the Federal Reserve – such as those involving fee regulation, mandatory review of prior interest rate increases, and gift cards – were given longer implementation periods so as to provide sufficient time to make necessary changes.

Card issuers recognize that Congress has spoken and that changes must come to how we interact with our customers. But I cannot stress to you enough the enormity of this task for issuers. It requires a massive reworking of internal operations, risk management models, and funding calculations. It involves enormous employee re-training and computer recoding. And it requires significant testing and re-testing of the infrastructure necessary to service hundreds of millions of accounts every day, with all of this coming at a time of enormous economic uncertainty and pressure on institution profitability. To do this right requires an investment of hundreds of millions of dollars, thousands upon thousands of manpower hours, and perhaps most importantly, sufficient time. We do not believe that the time frame provided in H.R. 3639 is adequate for the task at hand, and, as a result, consumers, small businesses, and the American economy will suffer.

Simply put, the shortening of the original 18-month implementation period from that which was originally contemplated by regulators is already creating enormous operational challenges for institutions, with very little time cushion for the industry to get done all that it needs to. The Federal Reserve has just issued an 800-page proposed rule, with a short 30-day period for the public to comment.[2] The comments are due early to mid-November. The practical problem is obvious: there is not sufficient time for the Federal Reserve to review the comments received, re-write to incorporate all the changes necessary to get this right, and issue a final rule before December 1, 2009. In turn, lenders would have no time to implement any changes to existing automated programs and manual procedures and to test to be sure that they are in compliance with all the changes.

It becomes even more difficult when you consider that in some instances proposed rules do not yet exist, and that technological solutions to the various challenges posed by the new rules take time to develop. For example, there are some provisions, e.g., reasonableness of fees and requirements to reconsider re-pricings six months after such actions – that have not even been put out for comment by the regulators, yet under the terms of the proposed legislation would still be required to be complied with immediately, even though the industry has no idea what will be involved. Moreover, certain provisions of the CARD Act (e.g., requirements related to payment allocation, minimum payment calculations and disclosures, the posting of all agreements on the Internet, and ensuring that the payment date is the same date each month) cannot be avoided by simply changing practices or policies. They require certainty with regard to what the requirements are so that technological solutions and implementation procedures can be developed. Pushing the implementation date up to December 1, 2009 will make this virtually impossible to do, while placing institutions in violation of federal law and subject to class action litigation.

When the Federal Reserve first required many of the changes ultimately enacted into law, it stated very clearly the consequences of ***not*** providing a reasonable time frame for institutions to come in to compliance: "If institutions were not provided a reasonable time to make changes to their operations and systems to comply with the final rule, they would either incur excessively large expenses, which would be passed on to consumers, or

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[2] Typically, regulators provide two or three times as long for comments so that affected institutions and the public have time to fully evaluate the impact of any proposal.

cease engaging in the regulated activity altogether, to the detriment of consumers."[3] Thus, it should come as no surprise that what the Federal Reserve had predicted has largely come true. Any further acceleration – ***which takes the original regulatory implementation period from 18 months to 10 months (CARD Act) and now to 7 months*** – certainly does nothing to ease the compliance burden on banks and will only further exacerbate the problems lenders are encountering, which inevitably will lead to further credit restrictions in the market for consumers.

Beyond the consequences of a shortened time period for implementation, it is important to understand that there are significant consequences resulting from the changes that were made in the CARD Act. Clearly, changes made will benefit consumers and there will be greater clarity about the credit products and terms on their credit cards. But many of the changes impede lenders' ability to quickly assess increasing risk of loss that some borrowers pose and to take remedial action. As we testified before the CARD Act was enacted, the inevitable result will be that the cost of credit will rise and that some amount of available credit will decline. These natural consequences are now becoming a reality, not because there is an attempt to make changes before the compliance date, but rather because these are a response to the fundamental economic forces to which these laws have become a contributing factor. In other words, these same forces exist before ***and*** after any arbitrary compliance date. We testified before to this trade-off: that greater consumer protection and greater restraint on banks' ability to adjust to changing risk comes at a price of higher cost of credit and less access to credit for many small businesses and individuals. Shortening further the time frame for implementation only exacerbates the burden, resulting in even more disruption for lenders and their customers.

In my statement, I would like to focus on three points:

- Legislation requires extensive reworking of all internal systems, funding mechanisms and risk management tools, which take time, manpower, and resources. Aggressively moving implementation dates forward will only exacerbate the substantial challenges lenders face in meeting the existing timetable.

- The provision requiring 45-day advanced notice for any re-pricing of existing and future balances is already in effect – ***as of August 20, 2009.*** Thus, consumers are already protected from re-pricing actions taken by lenders.

- At a time when the economy is still fragile and consumer spending is anemic, consideration should be given to the unintended consequences of accelerated implementation that can truly harm consumers, small businesses, lenders and the broader economy.

I'll address each of these in turn.

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[3] 74 Federal Register 5548

I. Legislation requires extensive reworking of all internal systems, funding mechanisms and risk management tools

The sweeping nature of the CARD ACT is affecting all aspects of the card business – funding, pricing, credit availability, marketing, and compliance. The 800-plus pages of proposed rules (which cover all aspects of card practices) and the new disclosures required (which cover all the printed – and electronic – materials, advertising, applications, solicitations, and credit card contracts) means that compliance with this new law is an enormous undertaking.

Integral to all of these key business decisions are the operational changes that must be made to business practices, software/programming, product design, periodic statements, advertisements, contracts, testing/auditing for compliance, customer service, training, printing of new forms, and training of customer service personnel, just to mention a few. Training for customer service personnel alone requires hundreds of thousands of hours for each of the largest card issuers. Changes to the huge technological infrastructure that underpins the entire card system – including billing and account receivables – is taking hundreds of thousands of hours. Periodic statements must be completely revamped, involving programming changes, testing, legal analysis to ensure compliance, focus group testing, and modifications of services from outside vendors. These changes are likely to take an additional hundreds of thousands of hours for large issuers.

Beyond the business decisions and technical changes that must be made, every issuer must make sure that they are in full compliance with the changes. The penalties can be severe for non-compliance, including significant administrative penalties and class-action lawsuits. With a proposed rule of over 800 pages in length, and potential changes expected following the public comment period, the legal and compliance reviews are time-consuming and expensive. The acceleration of the deadline would make compliance practically impossible, which, in some instances, means that the lender will have no choice but to stop providing credit and reduce existing lines until there can be greater certainty of compliance.

Because of the massive changes to pricing models, funding options and internal operations precipitated by the rule, overall compliance is going to take time. As Sandra Braunstein, the Director of Consumer and Community Affairs for the Federal Reserve stressed in testimony before this Committee that "[i]n order to implement this, card issuers are going to need to rethink their entire business models…reprogram all their systems…redesign all the pieces of paper that they use…there needs to be adequate time allotted for that." And, as there are 6,000 credit card issuers, it is unreasonable to assume that all could easily or simply change to be in compliance.

While it is natural to think of the credit card industry as being composed of very large institutions, it is important to note that there are thousands of small banks with credit card programs. Smaller issuers simply do not have the staff or resources to deal with many of the changes, let alone deal with an acceleration of the compliance date. In fact, we have heard from some of these smaller issuers that they may be forced to exit the business and sell portfolios to larger issuers. This would create more consolidation in the industry and hurt many smaller banks.

Let me provide some practical examples that illustrate the problems that are created by the shortened time frame:

- **System changes would be impossible under such tight time frames.**
  Changes require extensive computer recoding, the application of complicated algorithms, coordination among various computer systems, and rigorous testing. It is impossible for a bank to implement the final rules before the details of that rule are known. Given the process underway by the regulators, it is likely that banks will not know the details until mere days before they must be implemented.

- **Private label cards offered by retailers face real risk of system failure.**
  Not having sufficient time to make changes can have a significant impact on private label cards – those offered by retailers to consumers, in partnership with card lenders. This partnership requires seamless integration among multiple operating systems at both the retailer and the card lender, with any change requiring the dedication of extensive man-hours of computer recoding, testing, employee retraining and the like. It also involves coordination among all stores of the retailer, which can be quite complicated for large nationwide (and international) retail stores with hundreds and even thousands of locations. Such changes would be difficult even under the best of circumstances. Given the limited implementation time contemplated by the pending legislation, it is highly likely that system failures would occur, potentially causing significant loss of revenue to retailers during the peak holiday season, as well as substantial customer confusion, loss of convenience and anger.

- **Gift cards may not be available for the holiday.**
  Gift cards are an extremely popular gift during the holidays. Merchants value these as they increase sales not only during the holiday season, but for many months after. The gift card provisions of the CARD Act include substantive restrictions and required disclosures for gift cards that are not currently provided. It will not be possible to make software and card changes and provide new disclosures (especially as it is not clear what those disclosures are) for new cards in time for the holiday season. In order to avoid violating the CARD Act, gift card issuers, including retailers who issue or sell cards, would need to pull cards already delivered or already in stores by December 1. This is an almost impossible task, and again one that could expose gift card issuers, including retail merchants, to class action liability.

These are just some of the problems the shortened time frame imposes. There are also problems with implementing the payment allocation requirement, the requirement to have payment dates fall on the same day each month, the requirement to make minimum payment disclosures correctly, and the requirement to post credit card agreements on the Internet. All require sufficient time for system development, testing and execution, and cannot be done in the time frame provided under the bill. As a result, this would place these practices in violation of federal law and subject lenders to the possibility of class action lawsuits. Lenders will be faced with a Catch-22 – move forward and provide a card product that may be subject to significant administrative problems, customer confusion, and potential litigation risk, or take drastic action to somehow mitigate that risk, which may include increased prices and reduced access. It is hard to see how the vast majority of American consumers, let alone our economy, can benefit from such a result.

II. Notification of re-pricing is already in effect

Increasing rates on existing balances was one of the biggest concerns of policy makers, and one that Congresswoman Maloney, Chairman Frank and others have repeatedly emphasized. Yet the Committee, and the Congress, heard testimony that imposing any immediate freeze on re-pricing exposed institutions to significant credit risk and substantial compliance challenges. As a result, Congress enacted the provision (that had been proposed by Congresswoman Maloney) that provides customers 45-day advanced notice for rate or fee increases related to existing and future balances, and the right to decline the price increase and pay off the existing balances over time at the original rate. ***This provision is already in effect – as of August 20, 2009,*** thus ensuring that concerns over re-pricing have already been addressed.

III. At a time when the economy is still fragile and consumer spending is anemic, the impact of unintended consequences can be magnified

With any proposed change, it is important to consider the potential long-run consequences as well as the near-term consequences on consumers, small business, and lenders. The underlying changes are already having an impact on lending and the price of credit, and any acceleration of the implementation dates will only add turmoil and make matters worse – all of which have implications for the depth of the recession and speed of recovery.

Credit card loans are the riskiest consumer credit product made available since they are unsecured, have no limits on use, and can be used 24/7 anywhere in the world. They are often the first bill – not even the first loan – that goes unpaid when a borrower loses income. The current environment is no exception; the cumulative impact of six straight quarters of job losses – 7 million since the recession began – is placing enormous financial stress on some individuals. With jobs lost and work hours cut, it does not take long for the financial pressure to become overwhelming. Falling behind on debt payments is an unfortunate side effect of high unemployment and a frozen job market. Last week, ABA reported that second quarter delinquencies (30-days past due) on credit cards reached an all-time high of 5.03 percent (seasonally adjusted). Charge-off of bad loans is also running at very high levels. This picture will not change until the labor market improves and the economy picks up steam – something that most economists believe is not likely until the middle of next year. Simply put, this has made for a very difficult lending environment, requiring lenders to take steps to mitigate risk – ***steps which our bank regulators demand we take***.

While the risk is substantial (and increasing during this recession), the new statutory requirements and prohibitions limit lenders' ability to manage it. Thus, it exacerbates the need to price for risk on the ***front*** end since lenders cannot do so on the ***back*** end. Lenders are deeply concerned about the impact their actions will have on their customers; after all, lenders have a vested interest in having their customers happy and willing to stay with them, as there are a multitude of choices in this very competitive marketplace. However, lenders are left with no other choice but to take risk-averse actions like we have seen in the marketplace; it is the only prudent course and way to stay in business.

As you are aware, the ability of bankers to prudently leverage available capital to make loans is an important ingredient to our economic recovery. Today, $1 of capital supports $10 of bank assets (loans and securities). Thus, any additional cost or losses to capital have an impact up to 10 times the initial impact. Analysts have already noted that the economic downturn and newly-imposed regulatory restrictions will lead to a substantial loss of available liquidity – that is, potential new loans – up to as much as $2.7 trillion.[4] We run the risk that inappropriately speeding up the effective date of the CARD Act will further exacerbate this already serious problem. That will have a real impact on consumers, small businesses, and the broader economy dependent on these loans as their lifeblood.

Moreover, the disruption to the flow of credit – ***at the start of the holiday season*** – is likely to be enormous. This year, loss of income and wealth has meant that consumers are saving more and spending less. ***Any*** disruption in the availability of credit for consumers will dash the hopes of retailers, who rely on holiday sales for the majority of their yearly revenue. Simply put, accelerating this deadline at any time during the year would have a negative impact, but moving the date to December 1 could greatly exacerbate this problem.

Finally, we would urge Congress to consider the impact of not just this proposal to shorten the implementation period, but also the impact of various other proposals that affect a lender's ability to profitably offer credit. The actions we have seen taken by lenders in the marketplace are in many ways the only rational course they have to follow under the circumstances. Failure to do so – in other words, to get the right balance – will only lead to greater losses, a greater pullback from lending, and a greater impact on consumers, small

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[4] For example, well-known equity analyst, Meredith Whitney, estimated the potential cost in a Wall Street Journal Op-ed on March 10, 2009: "Just six months ago, I estimated that at least $2 trillion of available credit-card lines would be expunged from the system by the end of 2010. However, today, that estimate now looks optimistic, as available lines were reduced by nearly $500 billion in the fourth quarter of 2008 alone. My revised estimates are that over $2 trillion of credit-card lines will be cut inside of 2009, and $2.7 trillion by the end of 2010."

businesses and the American economy. We would urge Congress to consider these important points as they deliberate on this and other important proposals.

Conclusion

Mr. Chairman, Mr. Bachus, and members of the committee, ABA believes that credit cards provide an invaluable service to consumer and small businesses, and have become integral to our economic system. Any additional actions must be carefully considered so as to not further limit the availability of credit at reasonable rates to all creditworthy borrowers. This is particularly important given the current weak economy and the need for consumers to have access to credit to meet their daily needs.

The adjustments required under the CARD ACT need time to implement even under the best of economic circumstances. Unfortunately, the economic recession adds additional concerns; changes in rules and business practices – and their implications for credit availability and pricing – will certainly be magnified in this recession. Secondary market funding is already in disarray; unemployment is rising; and delinquencies and losses on credit cards are increasing as individuals struggle to make ends meet. Further shortening the implementation period will only make the adjustment more complicated, expensive, and potentially risky (as failure to comply with law and regulation carries with it significant penalties). This will only further inhibit credit availability and raise the cost of credit for all borrowers.