**Testimony of**

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**" H.R. 3639, the Expedited CARD Reform for Consumers Act of 2009"**

**Before the**
**House Financial Services Committee**
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## Introduction

Good morning Chairman Frank and Ranking Member Bachus. My name is Anthony Demangone and I am here today to testify on behalf of the National Association of Federal Credit Unions (NAFCU). I serve as NAFCU's Director of Regulatory Compliance and its Senior Compliance Counsel.

In my job, I am responsible for all aspects of NAFCU's compliance-related products and services. I personally have spoken to hundreds of credit unions regarding the Credit CARD Act and revisions to Regulation Z's lending rules in the past few months. I have devoted my time, as well as the time of my staff, to help our members understand and implement all of the changes we are facing.

NAFCU is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU is comprised of 780 federal credit unions—member owned financial institutions across the nation—representing more than 28 million individual credit union members. NAFCU–member credit unions collectively account for 79 percent of the assets of all federal credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this hearing regarding the *Expedited CARD Reform for Consumers Act of 2009*.

Historically, credit unions have served a unique function in the delivery of financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have no access to financial services. Congress established credit unions as an alternative to banks and to fill a precise public need—a niche that credit unions continue to fill today

for approximately 90 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 USC 1752(1)). While nearly 75 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- Credit unions remain committed to providing their members with efficient, low cost personal service; and,
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's 7,691 federally insured credit unions serve a different purpose and have a fundamentally different structure, existing solely for the purpose of providing financial services to their members. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without pay—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

**The Expedited CARD Reform for Consumers Act of 2009**

There have been a number of changes to the Truth in Lending Act (TILA) and Regulation Z over the last year and a half.

- As this committee knows, Congress amended TILA in May of this year, when it passed the *Credit Card Accountability, Responsibility and Disclosure Act* (CARD Act).
- The Federal Reserve Board (the Board) approved five amendments to Regulation Z in the last 15 months.
- An additional regulation on unfair or deceptive acts and practices (UDAP) was finalized by the functional banking regulators earlier this year. That regulation did not technically amend Regulation Z; however, it dealt with the very same issues regarding credit card lending.
- In September, the Board issued two comprehensive new proposals on closed end real estate lending and home equity lines of credit (HELOCs) spanning more than 1,200 pages.
- Just last week, the Board announced an 841 page proposal to implement provisions of the CARD Act set to go into effect on Feb. 22, 2010.

Notably, this most recent proposal – comprehensive though it may be – does not address the final provisions of the CARD act currently slated to go into effect in August of next year. Moreover, these changes are taking place within an environment that is witnessing major changes to other regulatory systems, such as RESPA reform, appraisal requirements, student lending, and overdraft protection. The list above represents a truly staggering number of changes to Regulation Z. In short, America's credit unions are reeling from the seemingly never-ending number of amendments to the lending law.

The credit union industry is quite small compared to the commercial banking industry. I fear that these myriad changes are being adopted with only those larger

institutions in mind. I assure you, however, the resources of the credit union industry, and other small institutions, are being stretched to the limit by the compliance burden created by the numerous, rapid changes to the law. The difficulty with complying with the number of changes is greatly exacerbated by the short effective dates that were included in the CARD Act; compliance dates that would be made even shorter by the legislation this Committee is examining today. Accordingly, NAFCU strongly opposes the *Expedited CARD Reform for Consumers Act.*

Let me be clear, NAFCU understands that the CARD Act was a response to a very legitimate need to reign in unscrupulous and deceptive credit card practices. Credit unions, by and large, do not engage in the sort of practices targeted by the CARD Act. That said, the credit union industry simply will not be able to comply with the myriad changes to TILA and Regulation Z by December 1st of this year. Though we are meeting the spirit of the changes already, many credit unions do not have the resources to fully analyze and implement the letter of the changes in such a short time period.

Congress should not act to move up the effective dates of the provisions included in the CARD Act. The 21 day notice requirement, which I discuss below, illustrates the unintended consequences of just the sort of action contemplated here. It would be impossible for regulations to be promulgated in time for lenders to comply. Shortening the already quick timeline for compliance will further deny institutions the time necessary to complete the strategic planning required to respond to the wholesale changes to lending law prompted by the CARD Act. For all these reasons, NAFCU requests the Committee not to take action on this proposal.

The 21 Day Notice Requirement

The most compelling – not to mention, timely – argument against moving the current effective date forward is the unintended consequences of the 21 day notice requirement included in Section 106 of the CARD Act. This seemingly innocuous and well-intentioned provision appeared to require credit card issuers to mail out periodic statements for credit card accounts at least 21 days before the payment due date. The existing law required periodic statements to be mailed out 14 days in advance. Thus, issuers simply needed to send out the statements seven days earlier. Further, many issuers already provided more than the 14 day minimum required by law. Consequently, the provision was not a concern for most issuers. However, this one provision in the CARD Act applies to all "open end consumer credit plan[s]", which includes some auto loans and signature loans, amongst others. The rest of the CARD Act applies only to credit card accounts. This seemingly small issue, in fact, proved to be a very substantial and costly problem for credit unions and other lenders. More importantly, it is an issue that probably could have been resolved relatively easily, were it not for the fact that the effective date followed so quickly after the bill was signed in to law.

Many credit unions use multi-featured open-end lending systems. Under a master open-end agreement with each member, credit unions can offer several sub-accounts, including open-end automobile loans and signature loans. First, however, credit union members must establish a share account. Subsequently, the member may add share draft (checking), share certificates and loan products to their membership relationship. The credit union membership, rather than a single product, drives the members-credit union relationship. For that reason, many credit unions send a combined member statement,

which includes information about the member's savings accounts, checking account, and loans. Therefore, if a member has an open-end automobile loan, the loan's periodic statement is normally included with the members' monthly share statement. Credit unions mail the statements early in the month to reflect activity from the previous month. For open-end automobile loans, members often choose their due date, based on what makes sense for their personal situation. The TILA requirement that periodic statements be mailed at least 14 days before the expiration of a grace period does not apply, as open-end automobile loans have no grace period. They are simple-interest loans with no advances and no retail-purchase component. For that reason, credit unions could previously mail these statements any time for these accounts after the billing cycle closes.

Using consolidated statements is beneficial for two primary reasons. First, our members enjoy receiving a single periodic statement, summarizing all of the accounts they have with the credit union. Second, consolidated statements save the credit union money in printing and postage costs. The provision in the CARD Act, however, forced credit unions to alter their operations in a way that cost a considerable amount of time and money, without providing any tangible benefit to consumers.

Credit unions generally have only two options for complying with the 21-day rule. First, the credit union may simply send a notice in the mail at least 21 days before the due date for each loan. Sending notices for every loan, however, increases operating costs. More importantly, this option will almost certainly cause confusion for many borrowers who do not understand why they are receiving several statements each month, instead of the single consolidated statement to which they have grown accustomed. While sending out new disclosures for each loan will be costly and potentially confusing

for members, many credit unions have chosen that route as they believe keeping the current due date is the least burdensome solution for the membership.

The second option is to push back due dates towards the end of the month. This will enable the institution to continue providing statements at the beginning of each month, as is the current practice, without running afoul of the 21-day notice requirement. Regardless of what option credit unions choose for current accounts, very few institutions plan to continue allowing borrowers to pick their own due dates in the future.

While moving back due dates is one of only two viable options under the rule as it exists, this practice will harm consumers more than it helps. Consumers invariably appreciate being able to choose their own due dates. For many consumers this is a mere luxury. However, others who live paycheck to paycheck, plan their payments accordingly; paying known expenses first, then spending what remains. Ideally, moving back the due date would have no impact as it does not affect the consumer's salary or expenses. Nonetheless, it is a certainty that some consumers, who live paycheck to paycheck, and who get paid at the beginning of the month, will end up having not quite enough to pay all of their bills if every loan is due at the end of the month.

Additionally, credit unions will almost certainly eliminate the practice of allowing weekly or bi-weekly due dates as it would be extremely onerous to provide the 21 day disclosures on loans that are due every 7 or 14 days. Weekly and bi-weekly due dates are, of course, beneficial to consumers as they are a useful tool in budgeting. Further, weekly and bi-weekly due dates decrease the overall cost of the loan.

Once a credit union determined whether to keep due dates as is or move them back, a number of other time consuming and costly adjustments had to be made. For

credit unions that push back due dates, members must be notified of the new due date, and phones must be answered when members call asking why their due date has been changed.

Additionally, the 21 day notice requirement has three significant operational effects on credit unions that choose to move payments towards the end of each month. First, lenders previously were able to rely on a more-or-less steady stream of loan income throughout the month. With open-end loan income only arriving at the end of the month, operational changes may be necessary to accommodate the fact that there will be significantly less loan income during the rest of the month.

Second, all payments will be due the same day, or at the very least, within just a few days. This will put a tremendous strain on payment processing as every open-end loan in the lender's portfolio will need to be processed and posted to the customer's account in short order. This will, in turn, create staffing issues. Currently, most credit unions process transactions in one of two ways. Some credit unions have a dedicated staff for processing payments. Most credit unions, however, employ a two pronged approach for processing transactions. These credit unions have a small number of staff dedicated to processing; however, that staff is augmented by tellers who also process payments during down time. Regardless of which approach a credit union uses, grouping all open-end loan payments at the end of the month will cause staffing issues. A full time staff for processing transactions will no longer be necessary as each month will feature a short period full of activity, followed by a long period with very few payments to process. Likewise, tellers will no longer be able to augment the process throughout the

month as the sheer number of payments coming in at the end of each month will require a dedicated staff for a very short period of time.

The change also will require relatively expensive modifications to the credit union's software in order to reconfigure periodic statements and/or send out new statements for each loan that was previously included on the periodic statement.

NAFCU, and indeed the entire financial services industry, attempted to work with Congress and the Federal Reserve to find a solution to this problem. However, as of today, there has been no resolution.

When Congress passes legislation it dictates *what* must be done. Federal agencies and the industries they oversee, however, are responsible for determining *how* it gets done. Simply put, there needs to be sufficient time between when Congress decides what must be done and when industry can reasonably be expected to have the operational systems in place to accomplish that end. The myriad problems created by this seemingly trivial issue is a particularly timely and elegant argument in favor of providing longer, not shorter, effective dates for the sort of comprehensive changes encompassed in the CARD Act. For this reason, NAFCU opposes any effort to speed up any provisions in the CARD Act.

<u>It is Impossible to Comply with the Act by December 1.</u>

The Federal Reserve will, almost certainly, not be able to promulgate new regulations in time to meet a Dec. 1 effective date. Congress passed the CARD Act on May 20, 2009. On July 22, the Federal Reserve issued an interim final rule implementing the provisions of the CARD Act set to go into effect on August 20. Lenders had less than

one month from the day the regulations were published until the effective date. The provisions that went into effect in August were, relative to the rest of the legislation, simple and straightforward. Even still, the Federal Reserve indicated it will provide additional time to come in to compliance because it understands that financial institutions could not possibly make all of the operational adjustments necessary in the short amount of time provided.

As mentioned above, the Board recently announced an 841 page proposed rule to implement the provisions that go in to effect in February. That proposal, however, does not even address the provisions set to go into effect in August of next year. Yet, H.R. 3639 would require all of the bill's provisions to go into effect less than eight weeks from today. As a practical matter, the Federal Reserve could simply decide to make its recently announced proposed rule a final interim rule. However unlikely, the Board also could theoretically issue another final interim rule implementing the provisions of the bill that are not set to go in to effect until August of next year.

Such a rapid rulemaking process, however, would prove problematic. First, such a short timeline, with little or no chance for notice or comment, would almost certainly lead to more unintended problems, similar to the 21 day issue. Moreover, it is just the kind of substantive issues addressed by the bill, and the accompanying operational burdens, which spurred Congress to pass the *Administrative Procedures Act* (APA), which generally requires a notice and comment period for federal rulemakings. Moving up the effective date to Dec. 1, however, would force the Federal Reserve to promulgate regulations with virtually no input from any of the affected parties.

Regardless of whether the Federal Reserve can issue final rules in time, I assure this Committee that industry will not be able to fully comply with the provisions by Dec. 1. The February provisions include new disclosure requirements, new rules on when terms can and cannot be changed, new rules for accepting payments and new requirements on assessing consumers' ability to repay, just to name a few. Periodic statements need to be reconfigured, disclosures need to be rewritten and printed, and software must be modified. In short, it would simply be impossible for the entire industry to make all of the changes necessary to comply with all of the new requirements by Dec. 1. Given that compliance is a factual impossibility, there seems little reason to move the date forward.

An Early Effective Date will Complicate Long Term Strategic Planning

Taken together, the CARD Act and the subsequent changes to Regulation Z will create significant changes in the credit card industry. It is customary, natural, and necessary for lenders to reconsider their own business plan and practices in light of such dramatic changes. Indeed it would border on negligence for a credit card issuer to blithely carry on its current practices, changing only as much as necessary to comply with the new law, without considering the long term effect the changes will have on the market. Yet, a shorter effective date would force many lenders to ignore or discount long term planning for the simple reason that they would have to spend so much time, energy and money ensuring compliance.

The bill's provisions regarding increasing interest rates and changing terms make sense when considered individually, and few of them are exceedingly onerous. Taken

together, however, they will require many institutions to reassess risk based lending programs. Some institutions may reasonably decide to eliminate or significantly curtail lending to individuals with low credit scores. Other lenders may decide to aggressively pursue that exact same market. Likewise, given the considerable changes to disclosure requirements, periodic statements and payment processing, now would be a wise time for credit card issuers to thoroughly review their current systems to determine whether they are well suited for the changes to Regulation Z. Some lenders may choose to simply modify their existing systems. Others may realize that the changes are sufficient to justify upgrading to new systems for managing credit card accounts. If institutions are forced to comply even sooner, existing systems will be updated only to the extent necessary to comply with the changes in the law. Later, when issuers have time to examine the big picture, many will realize they wasted money making minor modifications to existing systems, when they should have been upgrading to entirely new systems.

An artificially short effective date – and I believe that is what this bill would create – handcuffs senior management. When forced to choose between *what we have to do* – comply with new changes in the law – and *what we know we should do* – comply with new changes in the law while also taking stock of the long term – we will choose the former for the simple reason that we have been denied the opportunity to perform the latter.

Further complicating the matter is the subject of the earlier portion of this hearing; the issue of interchange fees. Interchange revenue helps make it possible for credit unions to offer card services to their customers on an equal footing with larger banks.

These fees also play an integral role in providing credit union members with important services and benefits. Interchange revenue also helps offset the cost of card re-issuance in the event of a data security breach and helps pay for critical credit union compliance costs discussed earlier.

Merchants, on the other hand, derive tremendous benefits from accepting credit and debit cards, in the form of increased average sales per transaction and limited risk of non-payment. At the point of sale, merchants get paid immediately and all of the risk is transferred onto the card issuing financial institution. The consumer also benefits from the convenience provided by the electronic payment system.

The *Credit Card Interchange Fees Act of 2009* would allow merchants to ignore the "Honor All Cards" requirement contained in rules set out by Visa and Mastercard. This exemption would allow merchants to pick and choose which cards they accept and open the door for card discrimination, possibly at the expense of credit unions. The Welch bill would also grant the Federal Trade Commission broad authority over the current electronic payment system. Given this authority, the FTC will have the ability to place a cap on interchange fees and thus dramatically reduce this revenue stream for credit unions, in some cases up to 50%.

Therefore, it is NAFCU's belief that Congress should not interfere with a system that is clearly working, by enabling the government to impose price controls. A government set price will drive up costs for consumers, strangle innovation and dramatically reduce credit union ability to pay for compliance costs. Ultimately, any cap on interchange fees will be passed on from financial institutions to consumers in the form of higher interest rates, and lower yields on investment products.

## Conclusion

NAFCU respectfully opposes both H.R. 3639, the Expedited CARD Reform Act of 2009 and H.R. 2382, the Credit Card Interchange Fees Act of 2009. While we understand your legitimate concerns with abuses in the credit card industry, a Dec. 1 effective date for the CARD Act will do little to alleviate those problems. At the same time, an earlier effective date will exacerbate existing operational problems, likely create new problems, and increase the overall cost of compliance for all lenders, with very little – if any – benefit for consumers.

The problems highlighted by the 21 day notice provision, the literal impossibility of complying by Dec. 1 and the costs created by forcing institutions to work towards short term compliance at the expense of long term strategic planning are all compelling reasons not to accelerate the effective date of the CARD Act. The *Credit Card Interchange Fees Act of 2009* will have the net effect of severely limiting a revenue stream for credit unions, which helps pay for the costs associated with data security breaches and compliance associated with increased regulation. Arbitrarily limiting these fees will come at the expense of the consumer, the 90 million credit union members in America, and our nation's smaller financial institutions. I thank you for your time and I am happy to field any questions the Committee may have.