

WRITTEN STATEMENT

OF

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OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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Good afternoon Chairman Gutierrez and Ranking Member Hensarling. I am a partner in the law firm of Morrison & Foerster LLP, and I practice in the firm's Washington, D.C. office. Prior to joining Morrison & Foerster, I was an Associate General Counsel in the Legal Division of the Board of Governors of the Federal Reserve System ("Board") for over 15 years. Prior to that, I worked at the Federal Reserve Banks of Boston and Chicago. In all, I have over 30 years of experience working in banking and financial services, including working on various issues relating to credit cards. During that time, I have had the opportunity to be intimately involved in both drafting and interpreting regulations as a regulator and in advising financial institutions on how to comply with regulations. I am pleased to appear before you today to discuss H.R. 627, the Credit Cardholders' Bill of Rights Act of 2009, and H.R. 1456, the Consumer Overdraft Protection Fair Practices Act.

Importance of Credit Cards to American Households

Today, credit cards are among the most popular and widely accepted forms of consumer payment in the world and have become a driving force behind the consumer spending upon which our national economy has come to rely. In light of the current economic crisis, however, credit cards are becoming even more important to American households.

American households are experiencing financial pressures that they have not experienced before in their working lives. The percentage of equity that households have in their homes was lower at the end of 2008 at 43% than it has ever been since World War II. In addition, the equity markets that hold many households' investment and retirement funds have declined by over 50% from their highs in 2007. Similarly, overall household net worth has fallen 20% since the third quarter of 2007. Moreover, unemployment in February of 2009 was 8.1%, the highest level since 1983. Needless to say, the future is at best uncertain. For example, information recently

provided by the Department of the Treasury and the bank supervisory agencies for the purpose of stress testing the largest banks suggest that unemployment may continue to rise and homeowners' equity numbers will only continue to fall through 2010. In 2010, the more adverse assumptions in the stress tests provide for a 10.3% unemployment rate and a decline in home values that could leave overall household equity at as little as 21.4%.

As unemployment grows, affected households must rely increasingly on their savings and their investments (both of which are concentrated in the wealthiest households) and ultimately their ability to borrow against the equity in their homes and lines of credit in the form of credit cards to meet day-to-day expenses. As households' equity in their homes erodes, households may need to turn to credit cards in order to meet unanticipated needs for credit. As a result, any Congressional or regulatory efforts to modify credit card practices need to pay particular attention to the potential for such modifications to unnecessarily limit the availability of this source of credit for these households when they may need it most.

H.R. 627 and H.R. 1456

The Credit Cardholders' Bill of Rights Act of 2009 (H.R. 627) would limit credit card practices by credit card issuers, and the Consumer Overdraft Protection Fair Practices Act (H.R. 1456) would limit overdraft practices at banks holding consumer deposit accounts. In both cases, recent or pending Board rulewriting efforts would address the policy concerns raised by these bills. For example, in December of last year, the Board, working with the Office of Thrift Supervision and the National Credit Union Administration, adopted the most sweeping regulatory changes to credit card practices ever. First, the Board has overhauled the disclosure regime for credit cards based on consumer testing. Hundreds of pages of new rules laying out changes to Regulation Z, which implements the Truth in Lending Act, will require credit card

issuers to change virtually all of their disclosures and to revamp their billing statements and advertising. This is an enormous undertaking that will be both extremely expensive and time consuming.

However, on top of this overhaul of the information provided to credit cardholders, the Board and the other agencies have adopted rules on unfair or deceptive acts or practices (“UDAP Rules”) in five new areas that will change the fundamental structure of credit card pricing. These rules address the repricing of credit card accounts for both existing and new balances, payment allocations, balance computation methods, the time to make payments and fee-based accounts. Although credit card pricing, like the pricing of other consumer credit products, has increasingly focused on risk and credit card issuers have thereby been able to expand access to credit by underserved consumers, the UDAP Rules severely limit credit card issuers’ ability to reprice credit card accounts based on a change in a cardholder’s risk profile. The UDAP Rules will require substantial changes in credit card issuers’ price structures that will socialize the risk of declines in cardholders’ credit standing over time.

Although at an earlier stage, the Board also is in the process of addressing fees for overdrafts in consumer accounts. The Board has issued a carefully considered proposal to change Regulation E, which implements the Electronic Fund Transfer Act, to address overdraft practices. Overdraft issues are complex and are highly dependent on the state of account-holding depository institutions’ technology and systems. This proposal addresses whether there should be an opt in or opt out for overdraft fees, the form of the notice to be given, the treatment of debit holds and related issues. The comment period for this proposal closes on March 30, 2009.

At this point in time, adopting either H.R. 627 or H.R. 1456 runs the risk, at best, of creating conflicting statutory and regulatory regimes designed to address the same issues. At the

extreme, new legislation, with respect to credit card practices, could lead to a significant limitation on the availability of credit to American households at a time when they may need access to credit most. For example, a number of provisions of H.R. 627 appear to be based on the proposed version of the UDAP Rules rather than the final version. To the extent that the goal of H.R. 627 is to codify the agencies' actions to limit future regulatory changes, it should be based on the final UDAP Rules and Regulation Z changes. On the other hand, H.R. 627 departs from the final UDAP Rules and Regulation Z changes by calling for its provisions to become effective in three months, a time potentially well short of the July 1, 2010 effective date for the UDAP Rules and Regulation Z.

Similarly, the provisions of H.R. 1456 differ significantly from the Board's proposal. Overdrafts are a highly technical issue. Some aspects of H.R. 1456 are simply unworkable, such as the opt out at debit card point-of-sale transactions. Other aspects, such as the opt in, are likely to lead to a significant disruption in consumer payments, to the detriment and ire of both consumers and merchants. Further, the overall approach to addressing overdrafts as loans under the Truth in Lending Act conflicts with the Board's conclusions in other areas, based on consumer testing, that the effective annual percentage rate is not the best way to call consumers' attention to fees on their accounts.

Timing of Rules for Credit Card Pricing

H.R. 627 would strictly limit the repricing of new and existing credit card balances, prohibit double-cycle billing, limit payment allocation methods and increase cardholders' time to make payments, among other requirements. These same issues are addressed in the final UDAP Rules and the Board's new disclosure requirements. As discussed above, H.R. 627's repricing limitations are similar to the corresponding limitations under the proposed, but not the final,

UDAP Rules. Presumably these provisions would be reconciled with the final UDAP Rules, which, in some respects, are even more stringent than the proposal. It is important to note that this would be no simple task. For example, my firm, Morrison & Foerster, operated an Internet list to gather issues requiring clarification in the final UDAP Rules and the Board's disclosure requirements and sent to Board staff over 85 questions for further clarification. Any attempted reconciliation between H.R. 627 and the UDAP Rules would need to consider these uncertainties. However, even if these provisions are conformed to the final UDAP Rules, a three-month effective date would present serious operational problems and could significantly curtail access to credit.

It would be difficult, if not impossible, to separate reconciled provisions of H.R. 627 from the rest of the UDAP Rules and disclosure requirements. In light of the fundamental changes to industry pricing practices that would be required, credit card issuers will be faced with enormous changes in the highly automated systems that have allowed credit cards to be made available widely and to be used for billions of transactions. From a systems standpoint, any effort to accelerate these automation changes may either simply fail or result in significantly higher levels of processing errors.

Perhaps more significantly, an empirical study estimated that the cost to credit card issuers of the UDAP Rules' repricing and payment allocation limitations and related provisions, as initially proposed, was approximately \$12 billion a year. In order to recover this significant cost, credit card issuers only have two possible options. First, card issuers could raise their rates. Early implementation of the repricing limitations, however, would severely limit this option. Second, card issuers could reduce potential credit losses in their portfolios by reducing credit lines, closing existing accounts and tightening their underwriting standards.

In the current economic environment, an accelerated implementation date would limit price changes and, therefore, would almost inevitably lead to a sharp and immediate reduction in the availability of credit to households. Credit card issuers will have no cushion of profitability to absorb the increased costs. From August 2007 through December 2008, the percentage of credit card accounts becoming 90+ days past due in each month increased 54%. Similarly, the percentage of balances becoming 90+ days past due in each month increased 66%. The increase in losses coupled with the narrowing interest rate spread has had a significant impact on issuer profitability. As a result, from August 2007 through the end of November 2008, the average return on assets for a credit card portfolio decreased 48%, and the average return on equity decreased 52%. In response, credit card issuers have begun to reduce potential risk in their portfolios. From August 2007 through December of 2008, the percentage of accounts closed each month increased by 425%. During this same period, the percentage of accounts with a line reduction has increased by 185%.

In evaluating more current conditions, it is important to note that credit card accounts are typically not charged off until they are 180-days past due, and, therefore, credit card losses significantly trail other economic events, such as job losses. For example, the 90+ days past due statistics cited above only reflect job losses through September of 2008 when unemployment stood at 6.2%. As unemployment correlates highly with credit card losses and current unemployment exceeds the September number by 1.9 percentage points, the past due statistics can be expected to increase sharply as the current employment figures show up in households' inability to meet their credit card payments. The Treasury stress test scenarios would, if true, result in even more significant increases in credit card losses.

To date, account closures and line reductions have been limited because credit card issuers have had the option to reprice accounts. Accordingly, account closures have been most common in accounts that do not have current balances, including dormant accounts. Line reductions, however, have been applied to accounts that are carrying balances, as well as accounts that are paying the balance in full and dormant accounts. In each group, the focus of line reductions has been on account holders with lower FICO scores. Although the statistics indicate that credit card issuers have attempted to maintain credit to their customers who use and need it, these, and potential future, reductions threaten to remove a safety net from cardholders.

For example, job losses due to a deteriorating economy will force many households to look to credit to help them meet their day-to-day expenses until the economy begins to recover, especially in light of the sharp reduction in homeowners' equity. Current and future growth in unemployment would assuredly increase the level at which credit card issuers must reduce the amount of credit that they provide in order to maintain profitability. Accordingly, credit card issuers will have no choice but to take steps to reduce risks in their portfolios. These steps would reduce the amount of credit available to households significantly and hurt American households when they most need ready access to credit.

As a result of this process, credit card lines will tend to be concentrated in wealthier account holders with higher FICO scores, potentially leaving those who need credit the most with little or no access to credit. Given the potential loss of most households' ability to borrow against their home equity and the likelihood that reductions in credit card availability will fall most heavily on households with lower FICO scores, which in many cases will also be households without significant savings or liquid assets, early implementation of the new credit

card limitations on repricing could significantly limit any remaining private resources that might be available to many households to address unemployment or other contingencies.

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