STATE OF NEW YORK
EXECUTIVE DEPARTMENT
STATE CONSUMER PROTECTION BOARD

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Before
Congresswoman Carolyn Maloney (D- N.Y.)
Chair, Subcommittee on Financial Institutions and Consumer Credit
Washington, D.C.
June 7, 2007

In the Matter of
Improving Credit Card Consumer Protection

<u>Testimony to Examine the Credit Card Industry, and their Impact on Consumers.</u>

I. Introduction

I wish to thank Congresswoman Maloney for holding this hearing on such a timely and important issue. I look forward to the opportunity to work with the Congresswoman and her colleagues to address credit card practices and disclosure issues.

The New York State Consumer Protection Board (CPB) was established in 1970 pursuant to Executive Law Sections 552 and 553. It is the mission of the CPB to protect, educate and represent

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consumers. The CPB is experiencing programmatic, technological and staffing changes and has been reorganized with the goal of more effectively reaching consumers with informational and educational programs and policy development. Two (2) of our newly reconstituted bureaus are relevant to today's discussion.

The Outreach and Program Development Bureau is developing comprehensive consumer education and information programs on issues such as identity theft, Internet safety, financial literacy and credit card management. This bureau is inclusive of our Consumer Assistance Unit (CAU) which takes complaints five (5) days a week, 8:30 a.m. to
4:30 p.m. via our toll free helpline at 1-800-697-1220 and twenty-four (24) hours a day, seven (7) days a week via the web at www.nysconsumer.gov. The CAU responds to and resolves over 20,000 complaints and inquiries a year on a variety of topics including product refunds and returns, home improvement and credit card disputes.

From 2006 to the present, the agency received over twenty-one hundred (2,100) credit card related complaints and inquiries. The nature of these complaints includes billing disputes and erroneous charges, exorbitant fees, changes in interest rates and late payment fees. We have successfully mediated, resolved and satisfied over eight hundred (800) of these inquiries.

The Counsel, Policy and Research Bureau is responsible for the agency's legal functions including, enforcing the New York State Do Not Call Law; managing the Security Breach Notification Law as it applies to the CPB; drafting and implementing our legislative programs; conducting investigations and public hearings; developing policy; filing comments on State and federal consumer issues; and, collaborating with federal and local consumer protection agencies. This bureau includes our Public Information Unit which is responsible for cultivating media partnerships, issuing press releases and disseminating CPB consumer messages and alerts.

The CPB is expanding its focus to analyze and address new consumer issues and topics using a variety of tools. Additionally, our staff is mediating and resolving a larger volume of consumer complaints and offering more helpful information in response to consumer inquiries. We intend to propose and support proactive legislation that creates necessary administrative remedies for consumers. In serving as the consumer "think-tank" and "watchdog" for the State, the CPB plans on developing stronger public and private partnerships, initiating policy development, crafting innovative responses to consumer problems, and providing New Yorkers with greater access to the information and tools they need to make educated marketplace decisions.

II. Background/Cases

The credit card industry is a growth industry and it shows no signs of slowing down. According to Robert Manning, Research Professor of Consumer Finance and Director of the Center for Consumer Financial Services at the Rochester Institute of Technology, nearly seventy-five percent (75%) of U.S. household members have a bank credit card, up from fifty-four percent (54%) in 1989. Between 1980 and 2005, consumers increased their yearly credit card charges from an estimated $69 billion per year to more than $1.8 trillion. This has resulted in an increase in household debt, which grew from $59 billion in 1980 to approximately $880 billion in 2007. In an article by CNNMoney.com, it was reported that the average American household has almost $10,000 worth of credit card debt. From 1978 to 1996, consumer credit card debt grew from $50 billion to $378 billion, multiplying six-fold. In 2004, the Federal Reserve estimated that American consumers carry approximately five (5) credit cards each.

The credit card industry looks much different than it did when it first started over five (5) decades ago. In 1950, Diners Club introduced the first general-purpose charge card. This card enabled consumers to purchase goods and services from different merchants. However, because it was a charge card, it required the cardholder to pay off the balance every month. Subsequently, during the late 1950's, Bank of America (BOA) offered the first widely available general-purpose credit card, in which the balance could be paid over time and the cardholder had a credit limit.[1] Around 1966, to increase the number of consumers carrying the card and to reach retailers outside of BOA's area of operation, other banks were given the opportunity to license BOA's credit card. As the network of banks issuing credit cards grew, administrative operations were spun off into two separate credit card entities known today as VISA and MasterCard.[2]

Visa and MasterCard developed the infrastructure for a nationwide credit card payment system. However, these companies were bound to comply with state usury laws which prevented credit card lenders from reaping all the benefits of the nationwide system.

The regulated credit card environment dramatically changed in 1978 with the landmark decision in *Marquette National Bank of Minneapolis v. First Omaha Service Corp.* ("Marquette") 439 W.S. 299 (1978). The Court held that a lender can charge the highest interest rate allowed in the lender's home state, regardless of usury laws in the consumer's state. This acted as a means for federally-chartered banks to export interest rates from their home states across state lines.[3] This enabled national banks to establish their headquarters in states that either raised or eliminated usury limits, granting banks

1 Ackerman, J.M. 1981. Interest rates and the law: a history; Arizona State Law Journal 27; Analysis of Emerging Risks in Banking, 1998.

2 Id.

3 Testimony before the committee on Homeland Security and Governmental Affairs Permanent Subcommittee on Investigations regarding Credit Card Practices: Fees, Interest Rates and Grace Periods. Presented by Alys Cohen, Staff Attorney National Consumer Law Center, March 7, 2007.

free rein to charge whatever interest rate it wanted across the country.[4]

The *Marquette* decision allowed credit card issuers to charge the highest interest rates to any consumer throughout the country. *Marquette* ushered in the deregulation of usury ceilings on consumer interest rates by allowing lenders in a state with liberal usury ceilings to export those rates to consumers residing in states with more restrictive usury ceilings.

Then, in 1996, the Supreme Court reinforced the *Marquette* decision and clearly defined the parameters for the credit card industry in *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735 (1996). In *Smiley,* the court approved a definition of interest that included a number of credit card fees applicable to late payments, going over the spending limit, taking a cash advance, dishonored payments, and membership.[5] This allowed national banks to charge their customers fees in any amount, under any category, as long as their home state's laws permitted it. *Smiley* set the stage for an increase in credit card fees, and clearly reinforced the ability of credit card issuers to charge multiple fees.

The actions of the credit card industry and its impact on consumers has not gone unnoticed. In October 2001, California passed the California Credit Card Payment Warning Act requiring card issuers to follow a specific set of procedures if the agreement allowed customers to make monthly payments of less than ten percent (10%) of the outstanding balance. The noteworthy requirements included printing a minimum payment warning on billing statements and showing how long balances of various sizes would take to be paid off if only the monthly minimum payment was made. However, in 2002, *American Bankers Association v. Lockyer,* 239 F.Supp. 2d 1000 (2002), held that federal law preempted California's minimum payment disclosure requirement. The Court stated, "consumer protection is not reflected in the case law as an area in which the states have traditionally been permitted

4 Id.

to regulate national banks." This renewed the federal government's position restricting the states' ability to govern terms of credit or mandate disclosures and content in billing statements.

It is through these court decisions that credit card companies have been able to offer appealing "incentives" while hiding the true costs associated with using a credit card. Credit card companies profit not only by charging interest but also from assessing transaction fees on merchants and various fees on consumers including late, over spending limit, cash advance, ATM, stop payment, telephone payment, and expedited payment. Prior to about 1990, credit cards were offered with annual fees, a relatively high fixed interest rate and low penalty fees, compared with average rates and fees being assessed today.[6]

Today, although many credit cards offer lower interest rates, most of them assess higher and more complex user fees. For example, a common fee is the late fee. According to CardWeb.Com, Inc., credit card late fees rose from an average of $12.83 in 1995 to $33.64 in 2005, an increase of over 160 percent (160%). The Government Accountability Office (GAO) reported that the average late fee penalty was $34, a one hundred-fifteen percent (115%) increase from 1995. In 2005, about thirty-five percent (35%), over one-third of active accounts, were assessed a late fee at least once. Adding numerous fees to an existing balance perpetuates consumer debt and enables companies to sometimes triple the original amount borrowed and expand its bottom line. Understanding these fees and having mechanisms available to consumers to specifically support their questions regarding contract terms, conditions and fees, is vital to their ability to understand the implications of the credit card agreements in which they enter.

5 Id. at 3. The OCC definition of interest is found in 12 C.F.R. § 7.4001(a).
6 Government Accountability Office report, p. 18. *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*.

In the pursuit of optimizing profits and increasing retail banking, financial institutions and retailers enhanced their consumer marketing efforts and directed credit card operations toward more marginal and financially insecure populations including college students, seniors and the working poor. The pressure to increase profits has actually raised the cost of borrowing on consumer credit cards. Financial mergers and acquisitions, has decreased competition and consumer choice. The GAO report states that in 1977, the top fifty (50) banks accounted for about one-half of the credit card market. At the beginning of 2006, the top three (3) card issuers (J.P. Morgan Chase, Citigroup, Bank of America) controlled over 61.8 percent of the market as defined by their proportion of outstanding credit card debt.

III. Recommendations

Consumers are at a disadvantage because often times, the real cost for the use of the credit card is hidden. Issuers entice consumers with promises of special no-interest introductory rates, low interest rates and rewards programs. However, the fees and contract terms are confusing and often times, not prominently displayed. Consumers are then blindsided by the confusing terms and the conditions under which fees are applied causing them to fall into a cycle of debt.

The CPB acknowledges that many of the practices used by credit card issuers perpetuate credit card debt. We agree with the concerns outlined in the 2006 GAO report, "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosure to Consumers." The following is an outline of those concerns and the CPB's recommendations for change.

1. **Universal Default Clauses**: Credit card lenders use this contract clause to enable them to impose penalty interest rates because the consumer was late in paying other creditors. Even if the consumer had a perfect history of on-time payments with the credit card issuer, the default on another line of credit triggers an increased Annual Percentage Rate (APR). In addition to default with another creditor, a drop in credit score can trigger the same penalties.

Recommendation: While some industry participants have indicated that they have eliminated this practice, the CPB recommends prohibiting the use of universal defaults.

2. Penalty Rates: Penalty rates are increases in the APR for a credit card. The increase in APR is triggered by events such as late payments or exceeding the credit limit on the card. Even if the credit limit is exceeded as a result of an imposed issuer fee, the APR may be increased by thirty percent (30%) to forty percent (40%).[7] Additionally, the increased APR is not a prospective penalty. It is often applied to the old balance and far exceeds the originally agreed upon rate.

Recommendation: The CPB recommends a national usury rate established by the federal government. Also, the CPB calls for prohibiting over-the-limit fees if the issuer does not deny a purchase transaction and permits the credit limit to be exceeded or imposes a fee causing the credit limit to be exceeded.

3. Late Payment Triggers: Most credit card companies assess late fees. Credit card issuers were once more forgiving, permitting a grace period of a few days, but now fees are often imposed even if the payment is one day late. Even if the payment is received in a timely manner, if it is not posted to the account by the due date, the payment will be considered late. In addition, if the payment date falls on a weekend or holiday, and the payment is not received by the prior business day, the payment may be considered late and the consumer may be assessed a fee and possibly an increased APR. In 2005, about thirty-five percent (35%), over one-third of active accounts, were assessed a late fee at least once.

Recommendation: The CPB calls for credit card issuers to use the postmark date as the date of receipt of payment. This is the method used by the Internal Revenue Service (IRS).

4. Unilateral Change-in-Terms: The unilateral ability of credit card issuers to change contract terms renders the contract with the consumer a contract of adhesion; that is when one of the contracting parties has little or no bargaining power and the other side has total control over the terms. Issuers can change any term of the contract with only a 15-day notice according to the Truth in Lending Act (TLA).

Recommendation: The CPB recommends that consumers be given at least 30-days to review the terms to determine if they will accept. The CPB suggests that credit card issuers provide consumers with a conspicuously placed and easily distinguishable opt-out option for consumers. In addition, consumers should be given a toll-free number dedicated to answering questions regarding the change in terms and its implications.

5. Subprime Credit Cards: Subprime credit cards give people access to credit who

7 Id. at 3.

have low credit scores, little or no credit history and those emerging from bankruptcy or have a questionable credit history. The limited number of consumer protection actions taken by the federal banking regulators have primarily focused on subprime credit cards and have targeted practices such as:[8]

- "Downselling" consumers by prominently marketing one package of credit card terms, but then approving consumers only for accounts with less favorable terms;
- Issuing credit cards with low credit limits, then adding mandatory fees or "security deposits" resulting in little or no available credit when the consumer receives the card; and
- Deceptively marketing credit "protection" products.

Recommendation: The CPB recommends stronger criminal and civil penalties and a more coordinated effort between the State and the federal government with respect to complaint intake and enforcement.

6. Readability of Terms: The GAO reported that credit card disclosures are written at a level well above the reading level of an eighth-grader. About half of U.S. adults read at an eighth-grade level, leaving many consumers powerless to understand the terms and conditions of credit card agreements. In addition to the average reading level,[9] certain portions of the typical disclosure documents require even higher reading levels to be understandable. For example, the information about annual percentage rates, grace periods, balance computation, and payment allocation methods required a minimum of a fifteenth-grade education. Also, text describing the interest rates applicable to one issuer's card was written at a twenty-seventh-grade level. However, solicitation letters commonly required lower reading levels because these documents generally included more information in a tabular formation than cardmember agreements.

Recommendation: The CPB recommends that initial contract terms, as well as any change in terms, be written in a more readable format and in a manner that reflects the average reading level across the nation. In addition, credit card companies should provide a toll-free number dedicated to contract questions. We also recommend reformation of the Schumer box with input from consumers and advocacy groups. Redesigning the box should not be done without consideration of the type of information most beneficial to consumers and that such information be presented in a clear, uniform, and standard format.

Additionally, the CPB recommends strict regulations on lending to youth. Students are able to obtain credit without showing a history of credit usage, evidence of the ability to pay or proof of employment. Financial institutions have recognized that students will assume higher levels of debt at a

8 Id.

more accelerated pace if their consumptive behavior is obscured from their parents. Thus, for many of our youth, their debt capacities will be compromised at much earlier ages resulting in bankruptcy in their young adult years.

Furthermore, the Federal Reserve Board has recommended amendments to Regulation Z (Truth in Lending) intended to improve the disclosure notices connected to credit cards and other forms of revolving credit. These proposed amendments affect the five (5) primary types of open-end credit disclosures governed by Regulation Z:[10]

1. Applications and solicitations. Suggested changes to the format and content would make the credit and charge card applications and solicitations' disclosures more meaningful and easier for consumers to use.

2. Account-opening disclosures. The proposal would revise the cost disclosures provided at the opening of an account to make the information more conspicuous and easier to read.

3. Periodic statement disclosures. Recommended are revisions to make disclosures on periodic statements more understandable, primarily by making changes to the format requirements, for example by grouping fees, interest charges, and transactions together.

4. Changes in consumer's interest rate and other account terms. The proposal would expand the circumstances under which consumers receive written notice of changes in the amount of time these notices must be sent before the change becomes effective.

5. Advertising provisions. Also recommended are revisions to the rules governing advertising of open-end credit to help ensure consumers better understand the credit terms offered.

The proposed amendments to Regulation Z is an admirable first step. However, pure notification is not enough. Credit card issuer practices such as charging interest on debt that has been paid in full and late fees if a credit card issuer delays crediting a payment are just two egregious practices that should be prohibited. The proposed amendments should go beyond just notice, and

9 Id. at 6 p. 38.

propose banning some of the practices currently employed to keep consumers drowning in debt.

IV. NYS Consumer Protection Board Initiatives

To address the abuses and strengthen consumer protections, the CPB is forming a Credit Card Practices Task Force to further examine issues and practices. The CPB will seek the partnership of various groups to advance State involvement in this issue since traditionally states have played major roles in advancing consumer protections and enforcement. This effort is aimed at federal preemption and the OCC's determination that nationally chartered financial institutions do not need to give deference to states' consumer protection laws.

The CPB has upgraded its consumer financial literacy and education program that will help New Yorkers make more educated financial decisions. Through this outreach opportunity, we are able to inform consumers on the benefits and pitfalls of credit card use. Additionally, we will be focusing our efforts on our youth and working with schools and community-based groups to communicate our message.

The CPB is expanding its website resources in this area, including access to a credit card debt calculator. This will help consumers calculate how much time and money it will take to pay off their debt. This tool will illustrate debt duration and the ultimate cost to the consumer. Another addition to our website is the posting of a model letter for consumers to send to regulators requesting an evaluation of credit card practices.

Finally, the CPB will be surveying consumers and industry participants regarding credit card practices. The results will be posted on our website to facilitate further analysis and discussion.

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10 Federal Register Notice: Section 1, Summary of major proposed changes.

V. Conclusion

The CPB acknowledges that credit cards enable consumers to purchase items and services during emergencies. Credit cards provide purchase protection and allow consumers to experience immediate gratification. Most importantly, credit cards provide convenience and a degree of safety. However, they also cause consumers to remain in debt and encourage people to live outside their means. Credit card issuers have resisted efforts to shine a brighter light on their practices and provide more meaningful and usable information to consumers.

Together, we can lead the effort to improve the marketplace providing consumers with more usable and helpful information and more meaningful protections.

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