Testimony of John P. Carey

Before the Subcommittee on Financial Institutions and Consumer Credit

June 7, 2007

Good morning Chairwoman Maloney, Ranking Member Gillmor, and Members of the Subcommittee. My name is John Carey, and I am the Chief Administrative Officer of Citi Cards. I appreciate the invitation to appear before you today to discuss the credit card business and how we serve our customers. Citi Cards is one of the leading providers of credit cards in the United States, employing 33,000 people in 28 locations across 20 states.

I understand that the Subcommittee's primary focus today is on recent industry and regulatory initiatives in the credit card industry that affect consumers, including, in particular, the Federal Reserve Board's new proposed revisions to Regulation Z. This is an important topic and we welcome the opportunity to discuss our initial reaction to the Fed's new proposal. We also would like to describe what we have been doing at Citi in recent years -- including new initiatives that we have implemented -- to ensure we are providing our customers unparalleled products and services with terms and conditions that are fair and easily understood. We are dedicated to putting our customers first, which is good for them and good for business. We think we do a very good job but are always looking for ways to improve on what we do.

Background

At the outset, I'd like to step back for a moment and provide some useful context on how the credit card business works, how it has changed in the past 20 years, and why we think these changes have served the public.

Credit cards have become an integral part of our nation's economy, providing meaningful benefits to merchants and consumers alike. Merchants of all sizes benefit from the liquidity, security, and efficiency of credit cards. Credit cards enable businesses to sell more, get paid faster, and protect against fraud. They have also made commerce on the Internet possible, enabling merchants to connect with consumers and businesses globally, increasing sales, improving payment reliability and controlling operating costs.

And for consumers, credit cards are a safe and convenient alternative to cash, making everyday purchases more efficient, making it possible to shop online, and facilitating consumers' ability to track and manage their spending. Responsible credit card use is often an individual's first step toward establishing the positive credit record necessary to finance a car, a house, or a small business, or to achieve some other personal financial milestone.

At the same time, to understand how the business of credit cards works, it is important to recognize what is actually going on whenever a person uses his or her credit card. While most people may not think of it this way, the fact is that every time a person uses a credit card to buy something, that consumer is in effect taking out an unsecured loan -- one that is a lot riskier from a lender's perspective than many of the loans consumers use. A credit card loan, after all, is not backed by any tangible security as are mortgages, auto loans, or home equity lines of credit. Nor is it based on any personal familiarity between a local banker and his or her customer. It is an extension of credit secured only by a customer's promise to repay.

Before the late 1980s, the credit card market was essentially a one-size-fits-all proposition and was far narrower than the market we see today. Customers were typically assessed a $20 annual fee and interest rates were nearly 20% across the board, regardless of the risk profile of any particular customer. In the last 15 years, this model has changed dramatically. Underwriting practices have become more refined, allowing banks both to offer lower priced credit for people with solid credit histories and to extend credit to consumers who were previously underserved or had no access to unsecured credit. Over time, the availability and competitive pricing for credit cards combined with more precise underwriting analytics has led to an expansion of consumer credit across the economic spectrum. Banks are able to open more new accounts, increase existing account credit lines, and offer rewards programs and the like to a broad range of consumers by using these more sophisticated analytical tools.

The capacity to consider risk when making credit available is key to making this system work. Without that ability to differentiate risk, less creditworthy consumers would have fewer appropriate means of accessing credit, relatively risk-free consumers would face a higher cost of credit, and bank lending strategies would be significantly curtailed. Industry practices need to be considered in this light.

As a general matter, the broad expansion of credit I've referred to -- some call it the democratization of credit -- has been a good thing. Average credit card rates have declined nearly six percentage points compared to the average rates that prevailed in 1990. Overall, credit card debt remains a small portion of household debt. The Federal Reserve has reported that credit card balances as a percentage of total household debt actually *declined* from 3.9 percent in 1995 to 3.0 percent in 2004.

The lending model for credit cards is unique, and the business works on a relatively thin margin. Year after year, we make roughly the same return of $2-2.50 for every $100 we lend, which equates to only about $1 for every $100 of sales charged to our credit cards. And even that margin depends on careful management of several different kinds of risk -- the credit risk involved in whether customers will be able to repay their obligations; the interest rate risk that our own cost of funds may rise more rapidly than expected; general economic risk; the fraud risk when cards fall into the wrong hands and are used illegally; and the operational risk that any business faces when managing complex systems.

Citi's Record of Serving Our Customers

Citi operates in a highly competitive marketplace in which consumers have numerous payment card choices. Customer satisfaction drives our revenues and lost customers are difficult to replace. We constantly work to meet consumer demand and maintain customer loyalty, because we know that if we don't provide the best products and the best service, our customers will go elsewhere. With this in mind, let me turn to the subject of disclosure and the Fed's new proposal and then touch briefly on some of the steps we have taken in recent years to improve the products and services we offer.

The Fed's New Reg Z Proposal/Understandable Disclosure. Two weeks ago, the Federal Reserve Board issued its long-anticipated proposal to revise Regulation Z, focusing on disclosure and certain other practices. This is a lengthy, comprehensive proposed rule and we will of course study it carefully in the weeks to come as we prepare our detailed comments for submission to the Fed. But let me state up front in no uncertain terms that in the proposal's thrust and sweep and direction, we applaud what the Fed has done and believe it can foster significant improvements for consumers.

The new proposal is aimed at enhancing the clarity of disclosures, improving customer understanding of key credit card terms and conditions, and maximizing transparency. We fully support that approach. Indeed, we have tackled this challenge ourselves in recent years, as I'll describe in a moment, and we welcome a broad regulatory initiative that will move the whole industry in that direction.

The Fed's effort, in effect, brings us back to a core Congressional finding of the Truth in Lending Act – that economic stability would be enhanced and competition among consumer credit providers strengthened by the informed use of credit that results when consumers understand what credit costs. The proposed changes usefully require that certain information – in a consistent readable format – be provided at each stage of the consumer's interaction with his or her credit card company. These changes would ensure that consumers not only have the opportunity to understand how their credit card works, but that they also can readily compare credit terms available in the marketplace in order to make informed choices. And the changes would ensure that financial services providers are able to compete on a level playing field.

In essence, the new proposed Reg Z changes seek to move credit card disclosures toward the successful model of food labeling, where consumers can get all the information they need in simple, uniform terms that allow them to readily compare one product to another. Consumers should be able to do the same thing in the world of credit cards, relying on the consistent presentation of important information when applying for credit, when opening an account, when receiving their statement or when the terms of the account change. This is the right approach and we strongly support it.

We also appreciate the fact that the Fed engaged in extensive consumer testing to understand the effectiveness of disclosures while preparing its proposed rule. The Fed used this testing to identify the information consumers generally need to make informed choices about the products they choose and how to use those products.

We also support making available opportunities for consumers to learn about credit products through such resources as the Fed website and the American Bankers Association ("ABA") proposal for a government-issued Guide to Credit Cards. As the ABA has said, a supplement beyond what can be reasonably included in short, simple disclosures could be quite valuable to consumers and should be made widely and readily available.

In all, we believe that the Fed's proposal will be good for consumers and will be good for ensuring a competitive marketplace where banks compete on quality, service, and value.

Our own efforts to make credit card disclosures clear and understandable are entirely consistent with the approach taken by the Fed. Indeed, all of the effective and simpler to read disclosures cited by the Government Accountability Office ("GAO") in its September 2006 report on credit cards were Citi disclosures.

Our work in this area intensified in early 2005, following a public call from the Office of the Comptroller of the Currency for improved credit card disclosures. Citi was among the first card issuers to revise its solicitation letters, promotional materials, and cardmember agreements to disclose prominently the important pricing terms in the product.

We also introduced an enhanced "*Facts About Rates and Fees*" table in our cardmember agreements, summarizing all rates and fees in clear, easier to read language – similar to what the Fed is now proposing. At the same time, Citi introduced a more consumer-friendly notice to better inform each customer of a change in terms and the right each customer may have to opt out of that change. And we also enhanced our "responsible lender" disclosures by adding a simple paragraph to the front page of all solicitation letters making clear, among other things, any balance transfer fee, the circumstances under which a customer may lose a promotional rate, and the balances to which the promotional rate does and does not apply. All of these efforts are embodied in the Fed proposal.

Earlier this year, we began developing a new, simplified "Schumer Box," reduced from a 9th grade to 7th grade reading level and a new card agreement reduced from an 11th grade to 8th grade reading level. We intend to proceed with these changes rather than wait for Reg Z to be finalized because we believe they will enhance now the ability of our customers to understand the terms of their cards.

We are also in the midst of rolling out a major redesign of our customer statements. We are currently using the redesigned statement with some two million of our customers and are working with them to understand how we might continue to improve the statements. Some key features of the current new statement include color printing, clarified purchase section, enhanced display of rewards information, improved display of statement messages, prominent messaging for checks, laser high-quality charts/graphs/photographs, more flexibility with varying typefaces and type treatments, and increased point size.

We believe that the more people understand the world of credit, the better off both the providers and consumers of credit will be. Our own new book on credit education and financial literacy, entitled: *The Citi Commonsense Money Guide for Real People* underscores this connection. In our view, a transparent marketplace is not only customer friendly, it is business friendly. We want consumers to understand clearly what we're offering and what our competitors are offering so that they can make informed choices. We are confident that if we can compete on quality, service, and value, it will be good for customers and good for Citi.

But improving disclosures isn't the end of the discussion. Citi also has taken a number of steps to improve the products and services we offer our customers that we hope other issuers will adopt as well.

Elimination of Repricing Based on Non-Citi Behavior. First, Citi Cards was one of the first issuers to eliminate re-pricing for what we call "off-us" behavior, known by some as "universal default." It is standard practice for credit card issuers to consider a customer's credit behavior with other financial commitments to other creditors and to increase the customer's interest rate if warranted by such behavior. That is not an illogical practice, since a customer's credit behavior elsewhere has proven to be predictive of their behavior with us. Still, we recognized why customers, and others, would question the practice. So two years ago, we took the step of giving customers advance notice and the right to opt out of any such proposed increase in interest rates, while still maintaining full use of their card until expiration.

In March of this year, we decided to go even further. We eliminated the practice altogether for all customers during the term of their card. Citi will consider increasing a customer's interest rate only on the basis of his or her behavior with us -- when the customer fails to pay on time, goes over the credit limit, or bounces a check. This change will be described in our customer communications by later this summer.

Elimination of "Any Time Any Reason" Repricing. Second, we eliminated what is commonly known as "*any time for any reason*" increases to the rates and fees of our customer accounts. Traditionally, credit card issuers have taken the position that they can increase the rates and fees of a cardholder's account at any time for any reason, for example, to respond to general conditions in the financial markets. But in March, we announced that we are giving up that practice. Once a card is issued, we will not voluntarily increase the rates or fees on the account until the card expires and a new card is issued (generally two years). The interest rate on the card, if linked to the prime rate as is typically the case, would still go up or down as the prime rate moves. But the only reason we would consider increasing the rates or fees before the card expires would be if a cardholder becomes delinquent with Citi, exceeds the credit limit, or pays with a check that bounces. We believe we are the first bank to adopt this policy.

When a credit card expires and a new card is issued we will, as is customary, consider a customer's credit risk and general market conditions in establishing new rates, fees, and terms of the account. If we believe any changes are needed at that time, we will give the customer advance notice and the right to opt out and pay down the loan under the old terms. We implemented the change immediately for both new and existing Citi branded credit card customers. It will be reflected in our customer communications later this summer.

Enhanced Customer Alerts. In recent years, we have seen our customers change the way they prefer to interact with us. They have demanded greater utility online and look for us to provide the tools that allow them to manage all of their account needs through the Internet. This has included viewing their account activity in real time, making payments, changing addresses, requesting statements, and ordering additional cards.

In response to customer expectations, we also have developed a set of online tools that are designed to make it easy for cardholders to avoid late fees and to understand and manage their relationships with us. For example, because pay days vary, our customers can choose the day of the month they would find it most convenient to pay their bills. And they can elect to be notified, in advance, about key dates and information related to their bills when they are approaching their credit limit or a payment due date, for example. These alerts are particularly helpful for people who tend to wait until the last minute to pay their bills. We think this kind of customer is better off interacting with us on the Internet. The program is highly flexible: cardholders can choose which alerts to receive and, for some alerts, how often to get them -- daily, weekly, or monthly. These individualized services exist now but are going to be improved in the months ahead to make sure customers are aware of these opportunities and can use them easily.

Extensive Financial Literacy and Consumer Credit Education. Citi is an industry leader in financial education and literacy and we have put in place numerous programs to encourage and promote responsible borrowing. We believe it is in the industry's interest to do business with educated consumers who have the ability to pay their bills on time and avoid credit pitfalls.

The centerpiece of our credit education effort is the "*Use Credit Wisely*" program, an online program designed to assist consumers in understanding credit basics, how credit works, budgeting, and how to work through difficult situations such as disability or living on a fixed income. The "*Use Credit Wisely*" program also includes specific information and resources on fraud prevention, identity theft, and legal rights for consumers; a credit education web site in Spanish for Hispanic consumers; and "*Use Credit Wisely for Business*," a site designed specifically for the needs of business owners.

In addition, through the innovative components of our *Credit-ED* program, Citi provides ongoing support and the latest resources through a variety of targeted channels to help students manage their credit and money responsibly. Since its inception in 2000, the *Credit-ED* program has distributed more than five million credit education materials free to students, administrators, and parents. Our *mtvU Card* was acknowledged by the advocacy group *Consumer Action* as the most impressive program for rewarding students based on good grades and responsible credit behavior.

We are proud that Drexel University's LeBow College of Business in Philadelphia, Pennsylvania has incorporated the *Credit-ED* challenge as part of the university's financial education curriculum requirement for freshmen. For students, parents, and campus administrators, *Credit-ED*'s comprehensive credit education site, *Students.UseCreditWisely.com*, features a number of free interactive tools and information on using credit wisely.

Moreover, in 2004 Citigroup and the Citigroup Foundation made a 10-year, $200 million global commitment to financial education and to date have made donations of nearly $53 million to financial education programs in 68 countries.

Improved Security and Protection. Citi is an industry leader in protecting customers from theft and fraud and in offering immediate and effective help to victims. We pioneered the prevention and detection of credit card fraud and have been in the forefront of researching and discovering new and innovative ways to protect our customer accounts and personal information. Starting in 1989, we offered customers our *Fraud Early Warning* feature, which allows us to screen out and detect potentially fraudulent use of our customers' cards. In 1992, we introduced *the Photocard* to help deter unauthorized use of credit cards, and more recently, we began offering virtual account numbers to enhance the security of internet purchases.

Today, should our card members become victims of identify theft or fraud, we offer the most comprehensive and innovative free service — *Citi Identity Theft Solutions* — to help them. We offer our customers free access to a dedicated team of specialists who immediately assist victims of identity theft and fraud and help prevent victims' accounts and credit status from being adversely affected. Our service streamlines and simplifies the entire process of re-establishing a victim's identity and credit history – saving the customer significant time, money, and inconvenience – even if the fraud happened on another credit card.

Responsive Customer Service. Finally, we have put in place a number of processes to better understand our customers' concerns and respond to them. We review customer calls to help us identify the principal sources of customer concerns; we survey customers to capture feedback from those who have not reached out to us; and we engage in an ongoing dialogue with consumer advocacy groups. Customers are encouraged to contact us for any reason, and we constantly review and enhance our employees' authority to ensure that they are equipped to take appropriate action for our customers. We ask our employees to give our customers the individualized attention that they deserve, but we also challenge them to propose ideas that will enhance the Citi Card experience for all of our customers.

Available Hardship Assistance. Citi has put in place a number of customer assistance programs to help people in need. We know that keeping up with credit card bills can become difficult in times of sudden illness, job loss, or other catastrophic event. For these temporary hardships, we offer programs that can include full or partial deferments, APRs as low as 0%, and/or suspension of late and over-credit-limit fees for up to 12 months. And we also offer longer-term paydown programs that include fee waivers and reduced interest for five years, with the goal of helping the customer to pay off his balance by the end of the period.

Going Forward

Madam Chairwoman, we are working on a daily basis to enhance the products and services we provide our customers. At Citi, we put our customers first and we know that by doing that they will put us first. We seek always to treat them fairly and communicate with them in a clear and understandable way. Above all, we want to make sure that our customers' Citi Card is a convenience that can make managing their financial affairs as easy and stress free as possible. This job is never finished and we know that there is always room for improvement. I look forward to answering any questions that you may have.