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**BEFORE THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT**

**IMPROVING CREDIT CARD CONSUMER PROTECTION:
RECENT INDUSTRY AND REGULATORY INITIATIVES**

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Good morning Chairwoman Maloney, Ranking Member Gillmor, and members of the Subcommittee. My name is Jim Huizinga and I am a partner in the Washington, DC office of Sidley Austin LLP. I have advised clients on credit card programs for over 25 years. It is my pleasure to appear before you today to discuss the evolution of the credit card industry and the recent proposed revisions to Regulation Z by the Board of Governors of the Federal Reserve System (“Board”).

Congress enacted the Truth in Lending Act, or TILA, almost 40 years ago to provide consumer protections in the developing consumer credit marketplace. The Board has regulatory authority to implement TILA through its Regulation Z. TILA requires comprehensive cost disclosures for consumers so consumers can shop for credit on an informed basis, and thereby facilitates competition among creditors. Standardized disclosures under TILA foster competition among credit card issuers on the basis of the account terms that Congress and the Board have determined are the most important to consumers, such as interest rates and fees. Competition facilitated by these disclosures is especially effective in the credit card industry because there is wide availability of credit card offerings, and balance transfer features allow consumers to move easily from one card issuer to another at little or no cost.

The last overhaul of the credit card rules in Regulation Z was in the early 1980’s, when credit cards were generally a “one size fits all” product. Many of us remember when it seemed like most cards had a \$20 annual fee and 19.8% APR. However, advances in credit underwriting and technology over the last 25 years have allowed card issuers to adopt more sophisticated and individualized pricing models. For example, risk-based pricing allows credit card issuers to tailor the costs of credit to the individual risks presented by different consumers. Risk-based pricing benefits consumers by lowering the cost of credit to many consumers while making it possible to offer credit to those who are less creditworthy. In addition, like in many other industries, credit card issuers have increasingly “de-bundled” pricing so that fees are imposed on users of particular services or cardholders that cause issuers to incur particular expenses. From an economic standpoint, the current pricing models can provide significant advantages to consumers.

The recent study of the credit card industry by the General Accounting Office (“GAO”) shows that newer pricing methods are providing benefits to many consumers. The GAO found that a majority of consumers had lower interest rates in 2005 than they had in 1990, and that

since 1996 credit card interest rates generally have fallen with market rates like the prime interest rate. In addition, the GAO found that, over the same general time period, there was no significant increase in the total of annual fees and penalty fees paid by cardholders, and the profits of major credit card issuers remained relatively level. In 2005, approximately 80% of credit card accounts were assessed interest at rates lower than 20% and about 40% were assessed interest at rates lower than 15%.

Although the credit card industry has evolved significantly over the years, TILA's basic methods of protecting consumers -- helping consumers shop for credit on an informed basis and increasing competition among credit card issuers -- can be just as effective today as when Regulation Z was first adopted. Indeed, the development of balance transfers in relatively recent years has intensified competition among credit card issuers and increased the effectiveness of disclosures. However, it is appropriate to update Regulation Z disclosures to enhance consumers' ability to shop for credit cards in today's marketplace on the basis of the most useful information. The Board recognized this need to update Regulation Z several years ago, and published an advance notice of rule making at the end of 2004. Further, just two weeks ago, the Board released an exhaustive 800-page proposal that comprehensively considers current pricing methods and practices in the credit card industry, and would rewrite major portions of the credit card rules in Regulation Z.

The Board's proposal seeks to increase the understandability and usefulness of Regulation Z disclosures. Although it is likely that industry and consumer groups will both seek many changes to the Board's proposal, I believe there is strong support for the notion that credit card disclosures can be improved. I also believe the proposal is, generally, a major step in the right direction. I think it is critically important that, for the most part, the proposal avoids price controls and similar restrictions. Price controls seldom work and it is far preferable to allow the fierce competition in the marketplace to drive the future development of credit card products. Credit cards have come to play an increasingly important part of most consumers' lives, providing many benefits not available through other financial service products. We take shopping on the Internet or by telephone, renting a car or reserving a hotel room, and obtaining interest free loans for granted. But price controls can threaten the widespread availability of credit cards, especially for those less creditworthy, and artificially distort pricing mechanisms. Price controls are especially unwarranted in light of the proposed improved disclosures under Regulation Z that will allow consumers to take better advantage of vigorous competition in the marketplace to find the credit card product most suited for them.

Significantly, the Board's proposal is based on actual consumer testing on which types of disclosures actually work. The Board has attempted to determine what consumers want to see in disclosures, not necessarily what consumer groups, industry, or the Board itself might assume consumers want. The Board used the consumer testing to develop disclosures that are aimed at those account terms most important to consumers in shopping for credit. The Board explicitly stated that consumers could easily suffer from information overload if the disclosures were too dense with jargon or terms that consumers do not understand, or simply too long. The Board also designed the revised disclosures to present important information in a way that increases consumer understanding, and also recognizes that many consumers do not want to spend a lot of time studying disclosures that are written in excessive detail.

The Board's proposal contains very significant changes in disclosures based on these considerations. Broadly speaking, among other things, the Board proposes:

- (1) to improve and increase disclosures relating to newer pricing methods, including "penalty" pricing;
- (2) to expand use of standardized charts to facilitate easy and quick review of credit terms, including new disclosure charts when an account is opened and when account terms are changed;
- (3) to use new terminology that consumers understand, such as "interest" and "fees," instead of legal terms such as "finance charge" that have little meaning to consumers; and
- (4) to group information on monthly billing statements so the disclosures are more meaningful and understandable to consumers.

The Board's proposal also would adopt a significant substantive protection to facilitate the ability of a consumer to move credit card balances to another creditor because of an interest rate increase. In particular, Regulation Z would extend the advance notice period for interest rate increases from 15 to 45 days and, for the first time, apply that longer notice period before penalty interest rates could be imposed. These changes are designed to better allow a consumer to shop for a new credit card, such as by responding to a solicitation in the mail or by walking into a local bank branch, and to transfer a credit card balance to a new creditor if the consumer qualifies for a better rate.

Having said this, I also believe the Board may need to consider some changes to its proposal. It is far too early to assess the operational impact some of the revisions may have. Some of the items included in the proposal, however, appear at first blush to impose significant costs on the industry without providing counterbalancing benefits to consumers. The net result may be increased credit costs for consumers without appreciable consumer benefits. For example, the expectation that certain disclosures would be provided on legal size paper is a costly proposition, especially when standard sized paper would probably provide comparable results for consumers. Furthermore, the Board's proposed complete redesign of periodic statements will require substantial resources for card issuers which may or may not be justified in light of the fact that periodic statements tend not to be particularly confusing for consumers today. The prohibition on adjusting consumers' APR based on risky behavior for 45 days—*even if the adjustment is part of the contract*—may also go too far.

In conclusion, I believe that the underlying approach of TILA and Regulation Z to consumer protection for credit cards is just as, if not more, effective as when originally adopted. Given the significant competition in the credit card marketplace, a well informed consumer can have literally dozens of options when choosing a credit card. Over the past several years it has become clear that Regulation Z needs an overhaul if consumers are to be well informed with respect to credit card products. The Board has done an admirable job in proposing necessary changes to Regulation Z to ensure consumers do, in fact, receive the information they need with

regard to today's credit card products. As Congress has determined time and time again when enacting, amending, and reviewing TILA, full disclosure is the best approach to consumer protection and credit cards. Given the Board's proposed revisions, I do not believe it is appropriate to change course.

Thank you again Chairwoman Maloney for the opportunity to appear before your Subcommittee today. I would be happy to answer any questions you may have.