TESTIMONY OF RICHARD H. NEIMAN

Superintendent of Banks

New York State Banking Department

On behalf of the Conference of State Bank Supervisors

House Financial Services Subcommittee on Financial Institutions and Consumer Credit

June 7, 2007

Introduction

Good morning Madam Chair, Ranking Member Gillmor, and distinguished members of the Subcommittee. I am Richard Neiman, Superintendent of the New York State Banking Department. I am pleased to be here today to testify on behalf of the Conference of State Bank Supervisors (CSBS) on the need to improve disclosures and protections for users of bank-issued credit cards. I am particularly pleased because this is where my introduction to financial institutions really began. As a congressional intern, I worked my way through college for the then-House Banking Committee under Chairman Wright Patman. No one could have predicted that I would return to that same Committee, 30 years later, only now as Superintendent, to address this important issue.

Background on CSBS

CSBS is the professional association of state officials responsible for chartering, supervising, and regulating the nation's 6,206 state-chartered commercial and savings banks, and 400 state-licensed foreign banking offices nationwide. CSBS represents the bank regulators of the 50 states, the District of Columbia, Guam, Puerto Rico and the Virgin Islands. For more than a century, CSBS has given state regulators a national forum to coordinate, communicate, advocate and educate on behalf of state financial regulation.

Background on New York State Banking Department

The New York State Banking Department is the nation's oldest bank regulatory agency, responsible for the licensing, regulation and supervision of domestic state-chartered banks; foreign agencies, branches and representative offices; savings institutions, trust companies, credit unions and other financial institutions operating within New York, including mortgage bankers and brokers, check cashers, money transmitters and licensed lenders. In total, the New York State Banking Department regulates nearly $1.3 trillion in assets.

I am pleased to be here today to share our views on the need to improve disclosures and protections for users of bank-issued credit cards.

Background on Credit Cards

The widespread acceptance of credit and debit cards has been a boon to consumers, small businesses and merchants alike, offering convenient and easy access to credit for large, essential purchases. Additionally, the payment systems created by the credit and debit card systems have provided revolutionary efficiencies.

It is hard to imagine a world without those small pieces of plastic, and state bank regulators would oppose any initiatives that reduced the availability of reasonably-priced credit and convenient payment systems to qualified, responsible borrowers.

We are concerned, however, about the potential for abuse and misunderstanding as banks' competition on interest rate margins leads to ever more aggressive pursuit of fee income. Credit cards, it is clear, have become a major source of fee income for the banks that issue them.

It is in everyone's interest to make sure that abusive practices are halted wherever we identify them, and that credit card users receive information about legitimate fees that is clear, concise, timely and easily understood.

Protecting Credit Card Users

Although the Conference of State Bank Supervisors (CSBS) has not formalized any federal policy recommendations on this issue, the question of how best to protect credit card borrowers is a priority for state bank regulators, and one with broad-reaching implications for state authority, preemption and the balance of our dual banking system.

Today I would like to highlight three areas that I believe need to be acknowledged and acted on:

1) the most troubling unfair and abusive credit card practices we have identified in New York;

2) the need for a federal response to address identified abusive practices and ensure that consumers receive meaningful information about credit card terms; and

3) the important role states have played and should continue to play in protecting consumers and helping to maintain strong financial markets in their states and nationwide. Toward this issue, Congress should communicate clearly with state legislatures on what authority is and is not reserved for the states regarding financially-related consumer issues.

1. Unfair and Abusive Credit Card Practices

Credit cards are a major source of complaints for state law enforcement authorities and regulators. The New York Consumer Protection Board received 1440 credit card complaints and inquiries in 2006 and the New York Attorney General's office reported receiving an astonishing 4,000 credit card complaints in 2006 -- second only to complaints about the Internet. A February 2006 GAO report to the House Financial Services Committee on the OCC's consumer complaint processes identified credit card complaints as the number one source of complaints to the OCC, FDIC and Federal Reserve.

The good news is that credit opportunities for all consumers have expanded. The bad news, however, is that burdensome fees associated with credit cards – particularly for the majority of consumers who do not and cannot pay their credit card bills in full each month -- have skyrocketed and can cause consumers to fall deeper into debt. Early and minor mistakes in securing and using credit can lead to spiraling debt burdens, punitive fees, and the long-term destruction of borrowers' financial well-being.

In New York we have identified a number of credit card issuer practices we consider misleading or abusive. We consider these seven practices of greatest concern:

1. **Universal default**: This practice, which has been widely criticized, permits credit card issuers to increase a consumer's interest rate – often to 30% or higher – for conduct that has no relationship to the consumer's payment history with the card issuer. Such conduct includes a drop in the consumer's credit score, a late payment to another creditor, or if the consumer has too much credit. Moreover,

the information that triggers application of the default rate might not even be correct. Just recently my office received a complaint from a consumer whose credit card company increased her interest rate to 24% because of a "report" received from Experian. When the consumer checked with Experian, she found no negative report, and had an outstanding credit score of 761.

2. **Penalty rates and late fees**: Consumers are often penalized for minor transgressions. For example, a credit card payment that is only nominally late can trigger huge interest rate increases and/or over-limit fees. Higher interest rates are often applied retroactively to existing balances – not just to new purchases.

3. **Double cycle billing and other similar practices:** Many credit card issuers charge interest even for the amount of credit card debt paid on time. For example, if the credit card debt is $1,000 and the consumer only pays $500 on time, the consumer is charged interest on the full $1,000, not simply the $500 balance.

4. **Over-limit fees:** Many credit card issuers charge over-limit fees not just once but each month the debt exceeds the consumer's credit limit, even if no new transactions occur in the billing cycle.

5. **Unilateral changes in terms**. Many credit card agreements are one-sided and allow the creditor to change the terms for "any reason" with as little as 15 days notice to consumers.

6. **Deceptive promotion of subprime credit cards:** These cards target consumers in economic distress or who have troubled credit histories with deceptive solicitations that misrepresent the terms of credit and conceal the existence of excessive fees that push consumers further into debt. In 2003, New York sued one of the nation's largest subprime credit card issuers, Cross Country Bank, for engaging in fraud, deception and illegality in the marketing and collection of its subprime credit cards. Cross Country Bank's credit card solicitations represented that the recipient was specially selected and pre-approved for a premium credit card with a credit limit up to $2,500. In fact, most consumers received a credit limit of $300 that was immediately reduced by $150 in fees. Many consumers did not understand the terms of the credit card and quickly exceeded their credit limit. Indeed, more than one-third of all cardholders exceeded their credit limits and incurred additional over-limit fees within the first two billing cycles, often before receiving their first billing statement. The court found the bank's solicitations to be deceptive and ordered it to pay almost $9 million in penalties.

   More recently, in 2006, the New York Attorney General reached an $11 million settlement with another subprime credit card issuer, Columbus Bank & Trust that engaged in similar practices. The settlement required the bank to improve their disclosure of fees and charges, clearly state credit lines, and reform debt collection practices.

7. **Lack of Clear Information about Credit Card Terms**

The problem is not simply a proliferation of onerous credit card terms and fees. As the GAO found in its September 2006 report on credit cards, many consumers do not understand the key aspects of their cards, including when they will be charged for late payments and what actions would cause their interest rate to increase. Consumers are often overwhelmed and confused by the complexity and length of credit card disclosures and are unaware of harmful credit card terms until it is too late. When the federal Truth-in-Lending Act first took effect in 1980, the typical credit card contract was one page long. Now many contracts are as many as 30 pages long and filled with densely worded, incomprehensible text. Therefore, it is no surprise that the GAO found that:

- Existing federally-mandated disclosures are too complicated for cardholders to understand;
- The typical credit card disclosure documents contain content that is written at a level higher than many consumers can understand;
- Credit card disclosures are not organized or presented in a manner that is easy to understand and through which consumers can readily absorb important information.

2. THE FEDERAL ROLE

State regulators all acknowledge that the OCC's and OTS's preemption of state laws has significantly limited state authority to address the issues identified above. While CSBS has not developed policy in this area regarding federal legislation, as the New York State Superintendent, I believe a strong federal response is needed. As the GAO noted in its September 2006 report, the 10 largest credit card issuers hold 90% of the outstanding balance of credit card debt nationwide. Of these 10 issuers, three are state-chartered: Capital One Financial Corp., a Virginia-based bank, Discover Financial Services, a Delaware-based bank, and American Express Centurion Bank, a Utah-based, FDIC-insured industrial loan company. With these three exceptions, states have essentially no authority to apply their consumer protection laws to the activities of the nation's largest credit card issuers.

Industry-wide, states supervise 12 of the 26 financial institutions the FDIC characterizes as "credit card banks," which means that their credit-card loans plus securitized receivables total more than 50% of their total assets plus securitized receivables. These 12 banks hold just over 22% of total assets in credit card banks nationwide; the large majority of these assets, close to 78%, are held by the 14 federally-chartered and regulated credit card banks.

Credit Card Banks: Assets by Chartering Agency

Chartering Agency	**Assets (000's)**	**Percentage**	**Number of Banks**
OCC	$315,516,048	77.26	12
State	$91,110,850	22.31	12
OTS	$1,763,072	0.43	2
Total	$408,389,970	100	26

Source: FDIC

A series of court decisions over the past 30 years has essentially eliminated states' ability to protect consumers from what some states have defined as abusive lending practices by lenders, other than those we directly charter. In 1978, the Supreme Court ruled in *Marquette v. First of Omaha Service Corp.*, 438 U.S. 299 that the National Bank Act allowed national banks to "export" the interest rates allowed in their home states to borrowers living in other states. This decision preempted state laws enacted to protect consumers from usurious interest rates. Eighteen years later, in the case of *Smiley v. Citibank (South Dakota), N.A.*, the Supreme Court upheld a OCC regulation that states "interest," for the purposes of this preemption, included all fees "material to the determination of the interest rate" numerical periodic rates, annual and cash advance fees, bad check fees, over-limit fees, and late payment fees.

Although the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 included specific language to provide for equal application of state consumer protection laws to the branches of national banks located in other states ("host" state branches), the OCC ruled in 1998 that this applicable-law provision did not apply to interest rates. The OCC issued an interpretive letter finding that a national bank could export the interest allowed by the laws of any state in which the bank maintained a main office or a branch.

Most recently, the Supreme Court ruled in *Watters v. Wachovia Bank, N.A.* that the independent subsidiaries of national banks are not subject to state regulation or oversight.

CSBS has vigorously resisted efforts to preempt state enforcement and protection of consumers within their borders and believes that the public is best served by a system that provides for dual federal-state regulation. Given an industry that is dominated by national bank credit card issuers and subject to the realities of federal preemption, state regulation of credit card practices is presently not a viable option. State regulation would apply only to a minority of consumers and would have the unfortunate and unintended consequence of putting state chartered entities at a competitive disadvantage. Based on court decisions it seems that the only option is for the federal government to adopt national standards to address credit card problems on a nationwide basis which would then protect all of the citizens in our states.

The Federal Reserve Board's May 23 release of proposed changes to Regulation Z, which implements the Truth in Lending Act, after a comprehensive review of TILA's rules for open-end or revolving credit, is an important step in ensuring that consumers receive meaningful disclosure of credit card terms. Our initial review of the proposed changes finds a number of valid recommendations that will improve consumer disclosure, including new disclosure format, multiple interest rates, payment allocation, penalty rates and advance notice in change of terms.

CSBS, the New York Banking Department and many other states will be reviewing the proposal in more depth and offering more specific comments. We appreciate the efforts of the Federal Reserve to revise credit card disclosure requirements in a manner that will help consumers identify information that is most important to them. Clear rules and plain-English disclosures will benefit both honest lenders and borrowers.

We are concerned, however, that credit card issuers not be permitted to perceive compliance with required disclosures as a license to engage in unfair and deceptive solicitation and other practices that confuse or mislead consumers. We also note that better disclosures, while important, are not a panacea to the problems I have outlined in the credit card industry.

3. State Efforts to Protect Vulnerable Borrowers

The third and final area I will discuss today is state efforts to protect vulnerable borrowers. In considering solutions to the problems in the credit card industry, Congress should look at the role states have played and continue to play in protecting consumers. To illustrate this, I will give three examples.

1. **States have played and should continue to play an important role in enforcement**. It is questionable whether the federal regulatory agencies have sufficient resources or incentives to adequately respond to all credit card complaints. States are closer to their consumers and their lenders, and may be better equipped to respond to the needs of both. Enforcement actions such as those brought by New York's Attorney General against Cross Country Bank and Columbus Bank & Trust for deceptive subprime credit card practices demonstrate the importance of vigilant state enforcement in combating abusive credit card practices.

2. **States have played and should continue to play an important role in developing regulatory and legislative solutions that can serve as models for federal regulation.** Creative legislative solutions often derive from state initiatives. With respect to predatory lending and subprime loans, New York has pioneered initiatives that can serve as models for federal regulation. For example, New York's high cost mortgage statute, Banking Law Section 6-l, has an affordability standard that ensures that consumers can repay loans – not just at initial teaser rates – but at the reset rate. It also prohibits various oppressive practices, including balloon payments, increasing interest rates after default, negative amortization, mandatory arbitration clauses, loan flipping and the financing of various insurance products.

In 2001 California passed a simple disclosure bill which would have, if not for preemption, caused credit card issuers to provide consumers a warning about total costs and length of time for repayment if the consumer were to only make the minimum payments.

The First Circuit Court of Appeals just affirmed the preemption of a New Hampshire law concerning gift cards issued by national banks through third parties. The New Hampshire law placed limitations on the expiration and fees that could be charged on gift cards to stop card issuers from quickly draining the balances of the cards before they are ever used.

3. **States can and should play an important role in gathering information and monitoring compliance.** When considering legislative options to reform credit card lending practices and disclosures, Congress should remember that states can play an important role in gathering information and monitoring compliance. On the state-federal front, the regulatory landscape post-*Wachovia* demands more, not less interaction.

    - One example of inter-governmental partnership is the Memorandum of Understanding (MOU) New York entered into with the OCC this past November to enhance the resolution of consumer complaints. The MOU provides for complaint referrals between the Banking Department and OCC and reflects a commitment on behalf of both agencies to share information concerning the status and resolution of complaints.
    - States are also in a position to provide valuable public information about credit card practices and the cost of credit. The New York State Banking Department publishes a quarterly survey of credit card interest rates that is available online and in hard copy upon request. The survey provides comparative information about rates, over-limit and late fees and the existence of universal default and penalty provisions for each credit card.

Conclusion

In conclusion, we believe that credit cards are a convenient method of payment for millions of Americans, and the availability of credit to Americans across income lines has undeniable benefits to individuals, households and the economy. Lending practices that have the effect of destroying credit ratings and borrowers' financial futures, however, destabilize the economy and ultimately fly in the face of our goal, which is to make the widest possible range of safe and sound banking services available to consumers at all levels of our economy.

The Conference of State Bank Supervisors will be discussing this issue at length in the months ahead, and looks forward to sharing its views with the Federal Reserve as it continues the process of amending Regulation Z. We seek additional opportunities to work with the federal banking agencies to share best practices on monitoring compliance with consumer protection laws.

Thank you for inviting me to be here today. I would be happy to answer any questions the Committee may have.