WRITTEN STATEMENT

OF

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ON

AN EXAMINATION OF THE FEDERAL RESERVE'S FINAL RULE ON THE CARD ACT'S "ABILITY TO REPAY" REQUIREMENT

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

JUNE 6, 2012

Good afternoon, Chairman Capito and Ranking Member Maloney. My name is Oliver Ireland. I am a partner in the financial services practice in the Washington, D.C. office of Morrison & Foerster LLP. I have over 35 years of experience in financial services issues. I also worked for the Federal Reserve System for 26 years, and spent 15 years as an Associate General Counsel of the Board of Governors of the Federal Reserve System ("Board") in Washington, D.C. One of my earliest experiences in the Federal Reserve System was being seconded to the Board in the summer of 1975 to work on the rules to implement the original Equal Credit Opportunity Act, which prohibited discrimination in the granting of credit on the basis of sex or marital status. More recently, I have worked with credit card issuers to implement the provisions of the Credit CARD Act of 2009, including in particular the provisions of section 109 of that Act on "Ability to Pay."

Section 109 of the Credit CARD Act of 2009 added a new section 150 to the Truth in Lending Act, which provides that:

> A card issuer may not open any credit card account for any consumer under an open end consumer credit plan, or increase any credit limit applicable to such account, unless the card issuer considers the ability of the consumer to make the required payments under the terms of such account.

As an initial matter, I note that credit card issuers have historically considered applicants and card holders' ability to repay in opening credit card accounts and in assigning credit lines to both new and existing accounts. Card issuers have developed and used sophisticated credit risk evaluation models for this purpose. Although the performance of credit card portfolios suffered during the recent recession, I believe that any problems were due to the severity of the recession and, in particular, the high level of unemployment, rather than any deficiencies in the historical credit risk evaluation process. Further, I believe that the statutory language could have been

implemented by allowing issuers to continue to rely on existing practices for determining cardholders' ability to pay.

Nevertheless, the Board, which was then responsible for writing rules to implement the Credit CARD Act, in rules published in the *Federal Register* on February 22, 2010, chose to implement this requirement by adding the further requirement that the ability to pay determination be based on the consumer's income or assets and current obligations. The Board also clarified that the analysis was to be based on the required minimum periodic payments. Accordingly, the rule stated that:

> A card issuer must not open a credit card account for a consumer under an open-end (not home-secured) consumer credit plan, or increase any credit limit applicable to such account, unless the card issuer considers the ability of the consumer to make the required minimum periodic payments under the terms of the account based on the consumer's income or assets and current obligations. (Emphasis added.)

Historically, card issuers have found that income is not a particularly useful predictor of repayment in the case of smaller lines of credit, although it tends to become relatively more important as the size of the credit line increases. Accordingly, these additional requirements could be expected to have little, if any, effect on improving the credit quality of credit card portfolios. The likely effect of this rule was to deny credit to persons who otherwise would have received it.

The rule writing under the Credit CARD Act was particularly challenging because of the number and complexity of the issues involved, as well as the significance of the changes that the Act required in existing practices. Despite the best efforts of the Board and the Board staff, the rules that were initially adopted to implement the ability to pay and other provisions of the Credit CARD Act were unclear in a number of areas and, therefore, difficult for card issuers to implement. Accordingly, the Board issued clarifications of a number of provisions in March of

2011. One of these clarifications added the word "independent" to the ability to pay provisions so that it now reads:

> A card issuer must not open a credit card account for a consumer under an open-end (not home-secured) consumer credit plan, or increase any credit limit applicable to such account, unless the card issuer considers the consumer's <u>independent</u> ability to make the required minimum periodic payments under the terms of the account based on the consumer's income or assets and current obligations. (Emphasis added.)

In adopting this final rule, the Board stated that it was "unaware of any evidence that card issuers who request 'income' or 'salary' extend less credit to married women who do not work outside the home or to low-income families than issuers that request 'household income.'"

This additional requirement, that the consumer's income be independent, is not only unsupported by any evidence that it is necessary to protect the safety and soundness of credit card issuers, it serves both to complicate the provision of credit to married couples and disproportionately to disadvantage married women. First, and fundamentally, the independent income standard fails to recognize that family households are typically joint economic enterprises. The largest component of household debt is typically a home mortgage that generally is structured as a joint obligation of husband and wife or other family partners. In households where both the husband and wife are employed and have comparable incomes, the joint mortgage obligation, under which either party is liable for the full amount of the payments, could render both the husband and the wife ineligible for individual credit if each of their income and obligations are considered separately. This is the case because the full household obligations would be attributed to each of them, but only half of the household income would be available to either the husband or the wife. This mismatch of income and obligations would make it appear that neither the husband nor the wife would have the ability to take on additional credit. This

mismatch of individual income and household debt not only complicates the credit-granting process, but also demonstrates the basic illogic of the independent income approach.

Second, where a married woman does not work outside the home or only works outside the home part time, the married woman may have little or no income to support credit in her own name and, therefore, may be ineligible to obtain a credit card, even though within the household division of labor, she is responsible for managing the household, and even the family finances. Based on my experience in working on the original regulations to implement the Equal Credit Opportunity Act, the unwillingness of creditors to extend credit to married women was a key concern at that time. The original rules to implement the Equal Credit Opportunity Act addressed this issue in part by trying to ensure that married women would benefit from the credit history on accounts that they are permitted to use, even if they are not jointly liable on the account.

As a practical matter, the independent income requirement in the ability to pay rule makes it difficult for married women to open credit accounts, particularly retail credit accounts, because they will have to get an application and get their husband to complete it either as an application in his own name, with the wife as an authorized user, or as a joint application. In dollars and cents, this inconvenience can translate into lost discounts on in-store purchases. More importantly, as Board economist James Smith noted in 1977, in an article on the costs and benefits of the original Equal Credit Opportunity Act, the benefits of that Act must be measured in terms of human dignity and the benefits to society that should flow from greater social equity.[1] In these terms, the current independent ability to pay rule is a step backward for human dignity and social equity and the cost is far greater than the cost in terms of dollars and cents.

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[1]The Equal Credit Opportunity Act of 1974; A Cost/Benefit Analysis, The Journal Of Finance, Vol. XXXIL No. 2, May 1977.

A more practical and equitable rule would base ability to pay decisions for credit card accounts on the income that an applicant states that the applicant is relying on to pay the debt, with a safe harbor for the consideration of household income. While this formulation raises issues as to the definition of household, the potential for abuse where applicants might list income inappropriately is limited and poses no real threat to the safety and soundness of credit card issuers. Credit card issuers typically use an ability to pay analysis to deny credit that otherwise would be granted under their historic risk analyses rather than to grant credit that otherwise would have been denied. Accordingly, a broader rule that allowed the consideration of income on which the applicant is relying, including household income, would pose essentially no additional risk to credit card issuers. Further, while I understand the concerns the Board has expressed about extending credit to married women who do not work outside the home and who may not be able to rely on future income from their husbands in the event that the marriage is dissolved, I do not think that these concerns outweigh the unfair treatment of married woman and the unintended consequences of the current rule.

With respect to the Board's statement that it was not aware of any evidence that the independent income rule would result in less credit to married women who do not work outside the home, I have worked with a number of credit card issuers to examine experience information as well as demographic data and market research on this point. Identifying the effects of the rule on individual applications across institutions has not proven to be feasible, and where effects can be identified, there are generally competing explanations for those effects. While it might be possible to identify some reductions in the availability of credit to married women who do not work outside the home either in terms of applications granted or denied or the size of credit lines,

I believe that these statistics would significantly understate the actual effects of the independent income ability to pay rule.

First, credit card issuers do not identify card holders by gender and, therefore, do not have records that would show changes in the patterns of application approvals or line assignments on the basis of gender. Any gender identification would have to be done *post hoc* based on names, with the obvious confusions for Pats, Tonys and other gender-neutral names. Further, there is a great reluctance on the part of credit card issuers to undertake analyses of portfolios on prohibited credit granting bases, such as gender. The fact that the application and line assignment is blind to prohibited bases is the first defense against potential claims of discrimination.

The analysis of application and line assignment data is complicated further by the fact that credit card issuers implemented the independent income ability to pay rule at different times and at times when both economic conditions and other regulatory requirements were changing. These other changes affected the condition of applicants, credit underwriting standards and business strategies all at the same time. All of these factors make meaningful comparisons across institutions and analysis of data at individual institutions difficult. Further, some effects of the rule are inherently difficult to measure. For example, a reduced rate of applications declined may be due to married women's failure to complete applications once it is clear that they must have individual income in order to receive credit. Thus, even if it is possible to identify an increased rate in the denial of applications for married women attributable to the independent ability to pay rule, those numbers would likely understate the actual problem significantly.

Despite the difficulties inherent in individual institution data, the 2011 census data shows that among households where only the husband or the wife is in the labor force, the husband is almost three times more likely to be employed than the wife.[2] More detailed analyses of demographic data by individual issuers using hypothetical credit criteria have shown the likely result of the independent ability to pay rule on married women to be significant, with more adverse effects likely for younger and older applicants. For example, the attached chart based on analysis of more detailed 1999 census data shows that if all married men and women applied for credit under the independent ability to pay rule, the applications of married women are far more likely to be declined than the applications of married men.

For the reasons stated above, I strongly believe that the current independent income rule needs to be replaced by a provision that allows the consideration of household income. I do not believe that such a rule would increase risk in the credit granting process and I strongly believe that it would promote fairness, equity and human dignity.

Thank you. I would be happy to respond to any questions.

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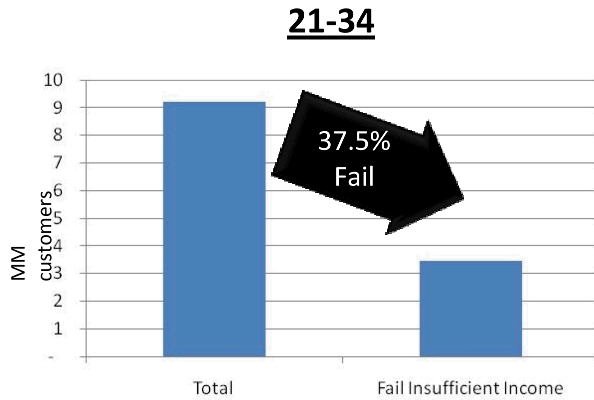
[2] Table FG1. November 2011.

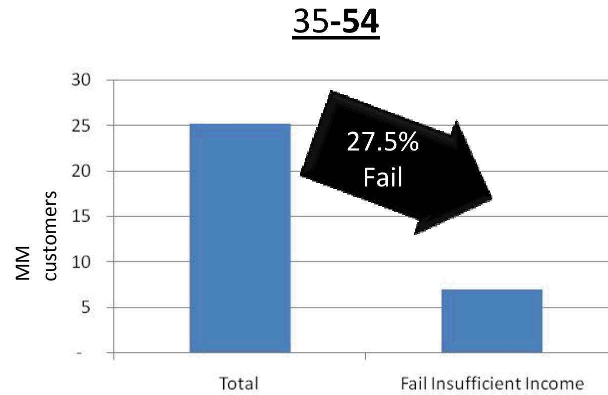
Likely Approval Rates for Married Men and Women

Married Male Applicants by Age

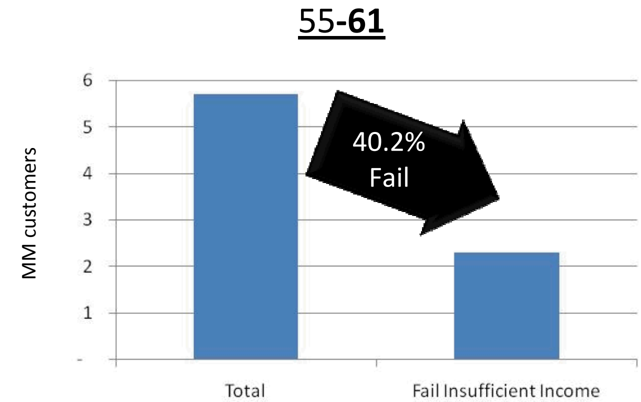
21-34



35-54

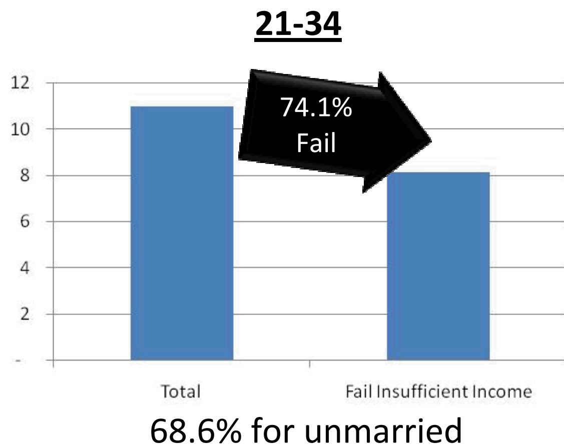


55-61



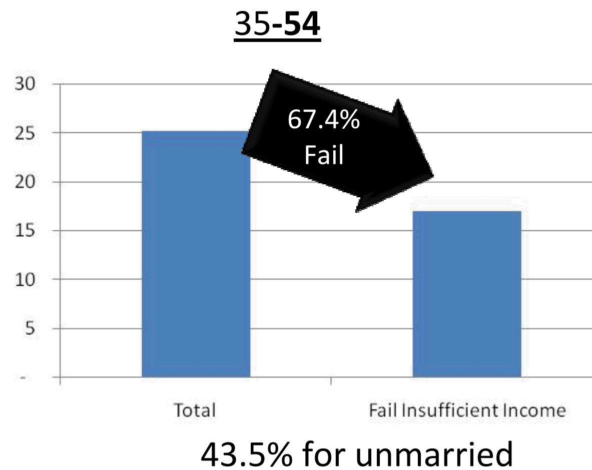
Married Female Applicants by Age

21-34



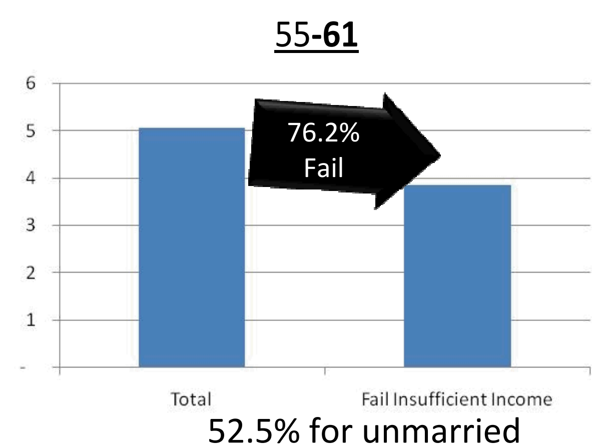
68.6% for unmarried

35-54



43.5% for unmarried

55-61



52.5% for unmarried

The impact is pronounced on married females, even where household income is high.

*Analysis using 1999 Census data regarding persons aged 21 –61 in households with a household income of ≥$28,000 in 1999 dollars (equivalent to $40,000 in 2010). Failure occurs where personal income <$28,000.