H.R. 627, THE CREDIT CARDHOLDERS' BILL OF RIGHTS ACT OF 2009; AND H.R. 1456, THE CONSUMER OVERDRAFT PROTECTION FAIR PRACTICES ACT OF 2009

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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H.R. 627, THE CREDIT CARDHOLDERS' BILL OF RIGHTS ACT OF 2009; AND H.R. 1456, THE CONSUMER OVERDRAFT PROTECTION FAIR PRACTICES ACT OF 2009

Thursday, March 19, 2009

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:55 p.m., in room 2128, Rayburn House Office Building, Hon. Luis V. Gutierrez [chairman of the subcommittee] presiding.

Members present: Representatives Gutierrez, Maloney, Watt, Moore of Kansas, Waters, Green, Miller of North Carolina, Scott, Cleaver, Klein; Hensarling, Castle, Royce, Jones, Neugebauer, Price, Campbell, Marchant, Lee, Paulsen, and Lance.

Ex officio present: Representative Bachus.

Also present: Representative Maffei.

Chairman GUTIERREZ. This hearing of the Subcommittee on Financial Institutions and Consumer Credit will come to order.

Thank you to all of the witnesses for appearing before the subcommittee today.

Today's hearing is a legislative hearing that will examine two important consumer protection bills: H.R. 627, the Credit Cardholders' Bill of Rights Act of 2009; and H.R. 1456, the Consumer Overdraft Protection Fair Practices Act of 2009.

The subcommittee has asked our witnesses to discuss recent regulatory action in the areas of credit card reform and overdraft reform and comment on H.R. 627 and H.R. 1456. We will be limiting opening statements to 12 minutes per side, but without objection, the record will be open to all members. Opening statements will be made a part of the record.

I yield myself 4 minutes.

In 2008, this committee led the Congress in adopting tough but commonsense consumer protection measures for credit card borrowers. This legislation, appropriately entitled the Credit Cardholders' Bill of Rights, was approved by the House by a wide majority, but was not taken up by the Senate. The reintroduction of this legislation in the form of H.R. 627 in the 111th Congress is a sign that this Congress is committed to American consumers who demand commonsense consumer-oriented laws at a time of economic recession.

Credit cards, when used properly, are an important part of the American economic system. More than a convenient means of payment, they can be instrumental in starting a small business, helping in building a solid credit history, and are even effective in providing families with capital during times of economic crisis. Far too often, consumers come to rely on revolving debt or they are drawn to cards that offer low teaser rates and other mechanisms designed to create a never-ending cycle of debt.

Today Americans are suffering from rising unemployment rates, dramatically declining family wealth, and declining real wages, all of which make it harder for consumers to pay off credit card debt. In fact, in 2008, we saw the percentage of accounts 30 days past due go to an all-time high of 5.6 percent. On average, American families owe 24 percent of their income in credit card debt. These are daunting figures in an unstable time, but Congress can and must do something about it by making sure that unfair credit card practices and fees do not deter consumers from paying down their debt.

Among its many consumer protections, H.R. 627 would prohibit unreasonable interest rate increases by preventing credit card companies from arbitrarily increasing interest rates on existing balances. Additionally, it would end double-cycle billing, meaning that credit card companies could not charge interest on debt consumers have already paid on time.

The legislation also requires fair allocation of consumer payments, banning the process of crediting a consumer's payments to low-interest debt first, thus ensuring that the highest yielding debt for the insurer remains on the books the longest.

In addition, the Credit Cardholders' Bill of Rights protects vulnerable consumers from high-fee subprime credit cards by preventing these fees from being charged to the card itself. This is an important provision for minority consumers, many of whom are twice as likely to have an APR over 20 percent.

We set to work on this legislation with the knowledge that the Federal Reserve Board has mandated new regulations that mirror many of the protections included in H.R. 627. I applaud the Board for its work on UDAP and Regulation Z changes.

Today's hearing will also discuss H.R. 1456, the Consumer Overdraft Fair Protection Act. This bill would provide consumers with more notice choice regarding overdraft fees. Among other things, H.R. 1456 would require notice to consumers when an ATM transaction is about to trigger an overdraft. Consumers would then have a choice to accept or reject the overdraft service and the associated fee.

Of course, the Federal Reserve has also proposed new rules outlining additional consumer protections regarding overdraft fees, but similar to the credit card issue, I believe Congress should keep the proverbial legislative heat on the industry.

I am committed to working with the members of the subcommittee and the full committee to advance this practical and consumer-friendly legislation. I believe H.R. 627 fits these criteria as well, and with some work, so will H.R. 1456 soon.

I yield 5 minutes to the ranking member, Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman, and thank you for calling this hearing.

Last year, the House Financial Services Committee approved what I believe to be a dangerous piece of anti-consumer legislation that ultimately would restrict the availability of credit card credit. Instead of giving borrowers more tools to determine which card best meets their needs, the bill would outlaw certain practices, set arbitrary payment deadlines, and create industry mandates that will only make it harder for companies to use risk-based pricing methods.

The advent of risk-based pricing since 1990 has been a boon for consumers. Since then, interest rates have fallen substantially from 20 percent to below 15 percent. Consumer-hated annual fees on most cards have typically virtually disappeared and fringe benefit rewards, offers like frequent flier miles and cash back, have exploded.

Like a lot of people, I am not a fan of some of the practices and confusing legal manifestoes that credit card companies employ. In fact, both my wife and I have changed credit cards on several occasions when we have not liked the service or the product. And there is one particular credit card company with which we refuse to do business.

But this bill, instead of empowering consumers with enhanced competition and effective disclosure, instead represents another assault on personal economic freedom that will only exacerbate the credit crunch that already threatens so many of our citizens.

Let us take a quick look at the facts. According to the Census Bureau, over half of families almost always pay their credit card balance while only 24 percent hardly ever pay off their balance. Furthermore, industry statistics reveal that more than 19 of 20 credit card borrowers are paying at least their minimum monthly payment on time.

Discarding risk-based pricing for the sake of that small group of borrowers who aren't paying their debts on time would effectively turn the clock back to an era where there was little competition and a third fewer Americans had access to credit cards. Those who did paid the same universal high rate regardless of whether they paid their bills on time or regardless of their creditworthiness.

Make no mistake about it, if this bill passes, it is going to be a lot harder for people to access the credit they need to pay their bills, cover their medical emergencies, or finance a large purchase. I have heard from several of them in the Fifth Congressional District of Texas, which I have the honor of representing in Congress.

I heard from the Blanks family of Fruitvale who wrote me, "My new business would not be started if not for my credit and credit cards. I hate to say it, but with a daughter and wife in college, my credit card is all I have." I want to make sure that the Blanks family of Fruitvale, Texas, do not lose their credit card.

I heard from the Vian family of Rowlett, Texas: "In the fall of 2004, my wife and I were laid off from our jobs at the same time. We had just moved into our first home together in July of that year. Needless to say, the layoff was quite a shock and without access to our credit cards at that time, frankly, I don't know what we would have done." I want to ensure that the Vian family of Rowlett keeps their credit cards.

I heard from the Juarez family of Mesquite: "I oppose this legislation as I have utilized my credit cards to pay for some costly oral surgery. I do not want to get penalized by this legislation for making my payments on time." And the correspondence goes on and on and on.

And don't take my word for what will happen. Listen to the nonpartisan Congressional Research Service: "Credit card issuers could also respond in a variety of ways. They may increase loan rates across-the-board on all borrowers, making it more expensive for both good and delinquent borrowers to use revolving credit. Issuers may also increase minimum monthly payments, reduce credit limits, or reduce the number of credit cards issued to people with impaired credit.

Now I believe we already see in the credit crunch, we know what will happen if we start to restrict credit. We are already seeing it. And as badly as my friends on this side of the aisle want to vilify some of those in the credit card company, I think that most of their vehemence is directed at those in the payday industry and the pawn industry.

I have an article from the IndyStar, dated February 3rd, entitled, "More American Families are Seeking Payday Loans as Financial Turmoil Mounts."

I have another one from the Boston Globe, dated July 9th of last year, entitled, "Cash-Strapped Consumers Desperate for Deals are Increasingly Turning to Pawn Shops and Payday Lenders Instead of the Local Mall and Neighborhood Bank."

And last but not least, from the Washington Post, from our friends across the pond in Italy, "As Italy Banks Tighten Lending, Desperate Firms Call on the Mafia."

Those are the choices consumers will be faced with when they lose their credit cards.

Chairman GUTIERREZ. Congresswoman Maloney for 4 minutes.

Mrs. MALONEY. I would like to thank Chairman Gutierrez and the ranking member for holding this hearing on the Credit Cardholders' Bill of Rights and the Consumer Overdraft Protection Practices Act.

I would say to my good friend on the other side of the aisle that I agree with his constituent who wrote that she did not want her credit card fees to go up or interests rates to go up for any time, any reason. This bill stops some of the most egregious practices.

It came out of a series of meetings with stakeholders over 2 years, with issuers, with consumers, with those professionals in financial services. We came up with a set of principles and drafted the bill in support of those principles. Some financial institutions voluntarily instituted the gold standards, the gold practices, but other issuers did not; therefore, they were at a competitive disadvantage.

This levels the playing field not only for the consumer, but for financial institutions themselves, so that businesses that are coming forward with best practices are not penalized economically for going forward with them.

For too long, the playing field has been tilted against the American consumer as they have battled against unfair, deceptive, and anti-competitive practices. These are the words of the Federal Reserve.

Last fall, we took a major step forward in leveling this playing field when the House passed the Credit Cardholders' Bill of Rights by an overwhelming bipartisan vote of 312–112. This legislation works on the basis that a deal is a deal and would prohibit a penalty increase of an interest rate on an existing balance unless the customer is more than 30 days late. It bans double-cycle billing, charging interest rates on a balance that has already been paid, and requires all payments to be posted to account balances in a fair and timely fashion.

Regrettably, this legislation was not considered in the Senate before the end of this session.

In December, we saw another important step forward for consumers as the Federal Reserve, the Office of Thrift Supervision, and the National Credit Union Administration, after receiving more than 66,000 comments from Americans across this country, setting a record of support of a rule change, finalized their rule that tracks the major provisions of this legislation, labeling these practices unfair, deceptive, and anti-competitive.

While this final rule will provide significant new consumer protections, it does not go into effect until July of 2010. And unless it is codified into law, these new protections can be changed at any time in the future without the consent of Congress.

For more than 2 years, I have been working on this legislation, and during that time, we have garnered the support of more than 50 major editorial boards from across this Nation and have earned the endorsement of many respected national consumer groups, labor unions, and civil rights organizations. Many of these organizations have made passage of this legislation their very top priority.

Let me be very clear: credit cards remain a vital tool, a vital innovation in our economy, a tool that enables consumers to do everything from paying for an airline ticket or covering an emergency expense to paying for schoolbooks. However, with the now-near universal use of credit cards, we need to ensure that consumers have adequate fair protections.

The other bill before this subcommittee today is the Consumer Overdraft Protection Fair Practices Act. While I recognize the great benefits the increase in use in debit cards have provided American consumers, overdraft fees are becoming an increasing problem for bank customers.

A November 2008 Federal Deposit Insurance study—

Chairman GUTIERREZ. The gentlewoman's time has expired.

Mrs. MALONEY. Let me just say if I could at the end—both of these bills give tools to consumers to better manage their own credit, to allow them to make a choice whether or not they want to opt in to an overdraft protection. Some consumers have been charged $150 for having bought three cups of coffee. They did not know they were going to have an overdraft.

This allows them to better manage their credit during a time when we are in a credit crisis.

We are helping the financial institutions. We should also help the consumers. That is what these two bills do, and I believe it helps our economy and the institutions.

Chairman GUTIERREZ. Mr. Castle.

Mr. CASTLE. I ask unanimous consent that this letter from First Data be submitted.

Chairman GUTIERREZ. Without objection, it is so ordered.

Mr. CASTLE. Many of us are aware that in December of 2008, the Federal Reserve Board announced final rules to improve consumer understanding and eliminate unfair practices related to credit cards and other related credit plans. These rules were carefully crafted after holding rigorous consumer tests and after taking into consideration over 66,000 comments on the proposals during the allotted comment period.

After receiving these comments and running these tests, the Federal Reserve announced that the final list of comprehensive reforms would be implemented by July 1, 2010. This will allow 18 months for the industry to overhaul their current business models and to work on improving disclosures to comply with the new rules.

To the 6,000 companies that issue credit cards, this is no easy task. It will require planning and assistance in effectively implementing these rules to ultimately help consumers. However, this hearing, in part, will address a new bill that will only give the industry 3 months to implement new rules.

With any change in business models, there will be costs to consider and unexpected effects to prepare for, and 3 months is not enough time to do this.

I believe the new rules take a comprehensive approach to protecting consumers, and I remain convinced that enacting legislation that goes well beyond these carefully crafted rules is not wise.

I yield back the balance of my time, Mr. Chairman.

Chairman GUTIERREZ. I thank the gentleman.

Mr. Miller is recognized for 2 minutes.

Mr. MILLER OF NORTH CAROLINA. For millions of families, abuse of overdraft fees for debit and checking accounts has become an unconscionable burden. The problem is not that banks penalize their consumers who overdraw their checking accounts. The problem is the manner and frequency with which those fees are assessed to consumers, and those practices have become predatory.

In 2007, banks loaned $15.8 billion to cover overdrafts, and U.S. consumers paid $17.5 billion in overdraft fees. The typical overdraft transaction was a $20 purchase. The typical overdraft fee was $34, and about three-quarters of the overdraft fees were from families who were barely getting by.

Overdraft fees now account for 45 percent of the service fee revenue for some banks, and the number is rising. And they game the system. They develop fee harvesting software to manipulate the sequence in which checks and other debits are posted to maximize the charges for overdrafts. In some cases, they consciously do not post the overdrafts so the consumer will not understand, will not know that they have gone over their—that they are now overdrafting, so they will rack up more charges and more penalties.

The result is that consumers are hopelessly in debt and their next paycheck is largely going to go to their bank, not to put food on their family's table.

Mr. Hensarling said that they don't have overdraft. If we make banks reform their practices, they will go to payday lenders. They would be far better off with payday lenders. The actual rate of interest for an overdraft fee for a $10—it works out to a 3,500 20 percent interest rate for overdraft fees paid in 2 weeks.

This has to be reformed.

Chairman GUTIERREZ. Thank you. Mr. Price for 2 minutes.

Mr. PRICE. Thank you, Mr. Chairman.

Mr. Chairman, we are considering this legislation today against an economic background in our country that is uniquely challenging. I hear from constituents daily who have been unable to get loans or renew their lines of credit. I hear from banks in my district who are suffering under mark-to-market accounting rules, getting mixed messages from their regulators, and still wanting to lend to their customers. We ought to be pursuing every available avenue to loosen up credit.

To that end, this legislation is simply the wrong thing at the wrong time. As has been mentioned, the Federal Reserve just issued a 1,200-page rule—1,200-page rule—in December that completely overhauls the credit cash industry. This bill appears to be a poor attempt to "solve" what the Federal Reserve is already accomplishing, and I look forward to the comments of the panelists regarding that issue.

This legislation isn't focused on giving consumers control over their credit. By imposing significant restrictions and price controls on creditors, individuals will have fewer options, not more, fewer options available to choose from.

Consumers need access to key information about credit products in a concise and a simple manner. Information will empower them to make their own choices in determining what type of credit card is right for them. The Congress ought not restrict the choices that are available, especially in a time of restrained credit markets.

By statutorily preventing issuers from being able to price for risk, dictating how they must treat the payment of multiple balances, and implementing price controls, we will only see restricted access to credit for those with less-than-perfect credit histories, and an increase in the cost of credit for everyone. This means less credit availability.

Every Member of Congress wants to ensure that consumers have the information they need to make educated decisions about their credit. I hope that our commitment to ensuring access to affordable credit for all consumers is equally strong, especially in this time of strained credit markets.

Chairman GUTIERREZ. Mr. Paulsen for 1 minute.

Mr. PAULSEN. Thank you for holding this important hearing today.

I also appreciate the diligent work that has been done at the Fed and NCUA on the credit card rules, and I commend the collaborative way in which you have worked together and the way they have been devised. I hope the rules that you have issued prove to be helpful to the consumer.

However, I have some strong concerns about the proposed legislation that is going to be before us today, that it may duplicate not only efforts that you have done, but ask credit card issuers to implement those changes much, much too quickly. Giving issuers 3 months to dramatically change the way they do business could have very adverse consequences, hurting access to credit, especially in small businesses when they are relying on credit cards more heavily now than ever before, since many are unable to access more traditional lines of credit from banks and other institutions.

So I look forward to your testimony, and I yield back, Mr. Chairman.

Chairman GUTIERREZ. Thank you very much.

Ms. Sandra Braunstein is the Director of the Division of Consumer and Community Affairs for the Board of Governors of the Federal Reserve System and has appeared before the subcommittee this week. We welcome you back.

Ms. Yakimov is the Managing Director for Compliance and Consumer Protection at the Office of Thrift Supervision, and this is her first time before the subcommittee this year.

Ms. Sheila Albin is the Associate General Counsel for the National Credit Union Administration, and I would like to welcome you here before the subcommittee.

You may begin your testimony, Ms. Braunstein.

STATEMENT OF SANDRA F. BRAUNSTEIN, DIRECTOR, DIVISION OF CONSUMER AND COMMUNITY AFFAIRS, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Ms. BRAUNSTEIN. Thank you, Chairman Gutierrez, Ranking Member Hensarling, and members of the subcommittee. I appreciate the opportunity to discuss the Federal Reserve Board's recent regulatory actions to expand protections for consumers who use credit cards and overdraft protection plans.

Credit cards provide important benefits for many consumers, both as a source of credit and as a convenient payment mechanism. However, in recent years, credit card terms and features have become more complex, which has reduced transparency in credit card pricing.

In December 2008, the Board issued comprehensive, sweeping rules to enhance protections for consumer credit card accounts. One rule prohibits certain unfair card practices using the Board's rulemaking authority under the Federal Trade Commission Act, while a complementary rule improves disclosures for credit cards under the Truth in Lending Act (TILA).

The two credit card rules were the result of extensive consumer testing, data analysis, public comment letters, and outreach to consumer and community groups and industry representatives.

The final TILA rule includes both content and format changes to application and solicitation notices, account opening disclosures, and periodic statements. The rule also requires that consumers receive 45 days advance notice of rate increases or changes in other key account terms to ensure that consumers will not be surprised by unexpected changes and will have time to explore alternatives.

The data obtained in our consumer testing illustrated the limitations of disclosures for today's complex financial products. There are certain key credit card terms that cannot be explained to consumers in a way that would improve their ability to make meaningful decisions about credit.

Because improved disclosures alone cannot solve all the problems consumers face in managing their credit card accounts, the Board issued a rule prohibiting certain unfair practices.

The Board's final rule includes several key protections for consumers. First, it ensures that the consumers have an adequate amount of time to make payments once they receive their billing statements. Second, the rule requires banks to allocate payments in a manner that does not maximize interest charges. Third, the final rule contains several provisions that restrict the circumstances in which a bank may increase the interest rate applicable to the consumer's accounts. Fourth, the final rule prohibits two-cycle billings. And finally, the rule includes several provisions to protect vulnerable subprime consumers from products that charge high fees and provide little available credit.

The combined rules will impact nearly every aspect of credit card lending. To comply, card issuers must adopt new business models, pricing strategies, and credit products. Issuers must revise their marketing materials, application and solicitation disclosures, credit agreements, and periodic statements.

These changes will include extensive reprogramming of automated systems and staff training. Although the Board has encouraged card issuers to make the necessary changes as soon as practicable, the 18-month compliance period is consistent with the nature and scope of the required changes.

In addition to the final credit card rules, the Board also issued proposed rules for overdraft protection programs. In the past, overdraft services were provided only for check transactions. Institutions now have extended that service to other transaction types, including ATM withdrawals and point-of-sale debit card purchases. Most institutions have automated the process for determining whether and to what extent to pay overdrafts. The Board's proposal contains two alternative approaches for giving consumers a choice about the use of overdraft services.

The first approach would prohibit institutions from assessing any fees on a consumer's account after an institution authorizes an overdraft unless the consumer is given notice and a reasonable opportunity to opt out of the institution's overdraft service.

The second approach would require an institution to obtain the consumer's affirmative consent or opt in before fees may be assessed to the consumer account for overdrafts. The proposed rules would apply to overdrafts for ATM withdrawals and one-time debit card purchases.

In closing, let me emphasize that the Federal Reserve's commitment to enhancing the ability of consumers to use credit cards to their benefit. The Federal Reserve is also committed to helping consumers better understand the cost of overdraft services and providing a means to exercise choice regarding the use of these services.

I am happy to answer questions from the committee.

[The prepared statement of Ms. Braunstein can be found on page 70 of the appendix.]

Chairman GUTIERREZ. Thank you.
Ms. Yakimov.

STATEMENT OF MONTRICE GODARD YAKIMOV, MANAGING DIRECTOR FOR COMPLIANCE AND CONSUMER PROTECTION, OFFICE OF THRIFT SUPERVISION

Ms. YAKIMOV. Good afternoon, Chairman Gutierrez, Ranking Member Hensarling, and members of the subcommittee. I thank you for the opportunity to present the views of the Office of Thrift Supervision on the Credit Cardholders' Bill of Rights Act of 2009, the Consumer Overdraft Protection Fair Practices Act of 2009, and issues related to credit card lending and overdraft protection.

We appreciate your leadership on these important elements of the financial services market, and we share your commitment to protecting consumers from abusive practices.

My written comments go into detail on the provisions of the proposed legislation.

In my opening statement, I would like to focus on what the OTS and other Federal banking regulators have recently achieved in protecting consumers from unfair credit card practices. I would also like to emphasize the OTS's position on how best to approach consumer protection in this area and what recommendations we can offer for making continued progress.

As you know, the Office of Thrift Supervision, the Federal Reserve Board, and the National Credit Union Administration issued the final rule in January 2009 to protect consumers from unfair credit card practices. The rule was a result of the process that the OTS initiated in August of 2007 by issuing an advance notice of proposed rulemaking seeking comments and suggestions on what credit card practices and overdraft protection practices should be banned.

Comments in response to that advanced notice urged a uniform set of rules across the credit card industry, across the practices we might cover. So the OTS worked with the Federal Reserve and NCUA to provide consumers with uniform protections regardless of which financial institutions issued their product and the industry with a level playing field.

The rule prohibits raising interest rates on existing credit card balances when consumers are paying their card bills on time, and generally also prohibits increasing rates on new balances during the first year of the account.

It requires that consumers receive a reasonable amount of time to make their credit card payment. It bans double-cycle billing, prohibits payment allocation methods that unfairly maximize interest charges, and in the subprime credit card market, it limits fees that had been significantly reducing the available credit to the consumer.

As I explain in my written testimony, this will accomplish the primary goals of H.R. 627, the Credit Cardholders' Bill of Rights Act.

In general, the OTS believes that using the Agency's collective rulemaking authorities over these practices provides greater ability to address unfair practices as they emerge. The industry has shown remarkable ability to adapt and alter practices, including unveiling new products.

Consumers have generally benefited from the expansion of products and certain practices. By exercising their rulemaking authority, the Agencies can keep pace with these innovations while ensuring that they do not disadvantage the consumers.

Regarding the overdraft legislation, the OTS shares the concern that prompted the bill and we see the benefit of many of its provisions. However, we believe the regulatory initiatives enacted and in process address several key issues there. If Congress decides to proceed with legislation and moves forward with both of these bills, the OTS respectively requests that they be amended to provide implementing authority jointly to the Fed, the NCUA, and the OTS.

The history of the rule on unfair credit card practices demonstrates OTS's leadership in initiating the process to use the FTC Act rulemaking power to address abusive practices. The absence of such rulemaking authority would preclude OTS from providing the kind of policy perspectives that began and significantly shaped the credit card role and the important consumer protections it contains.

Additionally, there are other observations in my written testimony that we would recommend if the Congress should move forward with this legislation.

Thank you again, Mr. Chairman, for inviting me here today. I look forward to responding to your questions.

[The prepared statement of Ms. Yakimov can be found on page 201 of the appendix.]

Mr. GUTIERREZ. Thank you.

Ms. Albin, please, for 5 minutes.

STATEMENT OF SHEILA A. ALBIN, ASSOCIATE GENERAL COUNSEL, OFFICE OF GENERAL COUNSEL, NATIONAL CREDIT UNION ADMINISTRATION (NCUA)

Ms. ALBIN. Good afternoon, Chairman Gutierrez, and Ranking Member Hensarling. Thank you for the opportunity to testify on behalf of NCUA regarding credit cardholder and consumer overdraft protection legislation.

NCUA's primary mission is to ensure the safety and soundness of federally insured credit unions as well as their compliance with applicable Federal regulations. It examines all Federal credit unions and participates in the supervision of federally insured State-chartered credit unions.

As the administrator for the Share Insurance Fund, NCUA provides oversight and supervision to over 7,800 credit unions, representing approximately 88 million members. NCUA is responsible for monitoring and ensuring compliance with most Federal consumer protection laws and regulations in Federal credit unions. In State-chartered credit unions, the appropriate State supervisory authority has regulatory oversight and enforces State consumer laws and regulations.

In December 2008, NCUA, OTS, and the Federal Reserve Board jointly issued the UDAP rule, amending each Agency's credit practices rule to prohibit several questionable credit card practices. Based on comments received, the Agencies determined a more comprehensive approach addressing more than just Truth in Lending

Act disclosures was appropriate. Each of the Agencies oversees financial institutions that engage in the same type of business. And although practices addressed in the UDAP rule are not prevalent in the credit union industry, the NCUA Board recognizes the uniform approach to the topic is best.

Both total outstanding credit card debt and total loans in credit unions grew in 2008, albeit at slower rates than at previous years. This growth at a time when consumers are finding it difficult to obtain credit demonstrates that credit unions continue to strive to meet their members' credit needs.

In 2005, NCUA participated with member agencies of the FFIEC Act in issuing guidance for guarding overdraft protection programs focusing on automated systems. This guidance included a discussion of best practices and recommended that institutions provide consumers with an opt-out notice.

NCUA and the Federal Reserve Board has regulated the disclosures for overdraft programs using our authority under the Truth in Savings Act (TISA). NCUA amended its TISA rule in 2006 to address concerns relating to the uniformity and adequacy of fee disclosures in connection with overdraft programs. The amendment created a new requirement for credit unions that promote overdraft payment programs to disclose their fees and other information to address continued concerns about overdraft fees. Regulation DD recently extended the disclosures requirements for overdraft fees to all banks and now requires disclosure of the periodic and year-to-date totals for overdraft fees. Today, the NCUA board is proposing a substantially similar amendment to NCUA's TISA regulations.

The Federal Reserve Board has recently proposed additional requirements for overdraft protection programs under Regulation E that will also apply to credit unions. The proposed rule will limit a financial institution's ability to assess overdraft fees for ATM withdrawals and one-time debit card transactions. The proposed rule also offers a right of opt-out or opt-in as alternative regulatory approaches. Additionally, the proposed rule would prohibit assessing a fee if an overdraft is caused solely by a debit hold or funds in a consumer account.

In addition, NCUA's general lending regulation for many years has required credit unions to establish a written policy for fees for overdraft protection programs.

In summary, credit cards and overdraft protection programs are useful member services. Currently, approximately half of all federally assured credit unions issue credit cards to their members. Approximately 2,800 federally insured credit unions offer overdraft protection services.

Overdraft protection programs can benefit both credit unions and their members if members access the program infrequently because credit unions receive another source of fee revenue and members avoid the inconvenience and subsequent fees associated with returned checks.

NCUA is concerned with regulating overdraft programs under the Truth in Lending Act because treating overdraft fees as a finance charge will adversely affect Federal credit unions' ability to offer overdraft services to their members. This is because of the statutory limit on interest on lending which is currently set at 18 percent for Federal credit unions.

Thank you again for the opportunity to appear, and I would be glad to answer any of your questions.

[The prepared statement of Ms. Albin can be found on page 53 of the appendix.]

Chairman GUTIERREZ. Thank you very much.

Ms. Braunstein, I don't know if you got this letter when you were doing your reviews, but there were these great parents who had this wonderful daughter that they loved very much. When they sent her to college, they wanted to make sure that she had access to money, and so they went to the bank and got her a debit card that she could take to college with her. She would go to the bank frequently, and when she needed money, if there were insufficient funds, no problem. The ATM simply would not give her the money, and she would call these wonderful parents of hers, who would automatically go online and transfer more funds to the wonderful daughter.

Except on one occasion, she decided she was a little thirsty, and she used the ATM card issued by the bank as a credit card at a coffee shop, and the $1.89 overdraft cost these wonderful parents, who love their daughter very much, $185 because there was an initial $35 for the $1.89 overdraft and then the wonderful bank charged $10 a day for every day there were insufficient funds in this account, for a total of $185.

I don't know what the relationship is between $1.89 and $185, but it makes the payday lenders look really, really good in this case.

And there was a total of 20 days because, you see, the bank doesn't just call up and say, "Hey, you have insufficient funds." They wait until you receive your bank statement at the end of the month and you see these wonderful charges of $35, etc., and then you put the money in.

So did anybody ever in your public commentary send a letter like these two wonderful parents who sent their daughter to college?

Ms. BRAUNSTEIN. Congressman, I think we got a number of letters like that out of the 60,000 letters. We have gotten lots of letters.

Chairman GUTIERREZ. I am so happy to know my wife and I are not alone in this situation.

So let me ask you, in your regulations, did you address it at all?

Ms. BRAUNSTEIN. In the proposal that we have out now on Regulation E, that is one of the reasons why we want to offer alternatives of either opt-out or opt-in to overdraft programs. And basically what this would do was, if somebody chose not to take overdraft, it gives consumers a choice, it means that if they go to use their debit cards to buy something in a coffee shop or McDonald's or wherever and there is not sufficient money in their account, then the purchase should be denied.

And if for some reason the bank pays it anyway, if it goes through or the merchant authorizes it anyway, what it would do is prohibit the financial institution from charging a fee.

Chairman GUTIERREZ. It seems to be different. I remember when a debit card was a debit card; that is, it was to be used at ATM machines. And then all of a sudden, one day they became a debit/credit card; that is to say, now you can use it and merchants ask you, do you want a debit or do you want this used as a credit card?

I really think that we should—and hopefully in the legislation—look at making sure that when a consumer comes in, and he just wants a debit card, he gets one. If there is not money in the card, there is not money in the card, and it is just not used. If you want a credit card, you should get a credit card because when I use my credit card, they simply—the Visa is so much lower than on a bank-issued debit card, it is astronomical almost.

Ms. BRAUNSTEIN. Just to clarify. It is not that the debit card turns into a credit card. I understand what you are saying. Because of the fact that an overdraft is extended, it has the impact of being a credit card. But it still is a debit card.

Chairman GUTIERREZ. But when you go to the ATM machine and you ask for $20 and there isn't $20 in it, you don't get $20 in cash. Yet, you can walk over to an establishment, ask for $1.89 for a cup of coffee, and it turns into a financial bonanza for the issuer of the card.

And so I want to ask you one other question.

When Congresswoman Maloney introduced the Credit Card Protection Act Bill of Rights, I was very supportive of it, and continue to be very supportive of it. That is why we are having a hearing this early in the process so that we can get the work done and hopefully to the Senate. So I want to commend the gentlelady from New York on her work and share with her that I am not an unbiased spectator here.

Now, I noticed as I look, that there was a change, the one change, and I would like you to comment on it because I think it is important. In the original, it was 1 year of enactment for the credit card industry to institute the new practices under the legislation. And under the new legislation, it says 3 months. You guys came up with about 18 months from the time you put your regulations out. Did the industry want it to be 18 months? Did you at the Board think it was 18 months? How did you get to the 18 months? And what do you think about the changes in the legislation?

I am going to ask unanimous consent that she be allowed to answer the question.

Ms. BRAUNSTEIN. Actually, the industry wanted longer than 18 months. It was the Federal Reserve and the other Agencies (the OTS and the NCUA) that decided on the 18 months. And this was based on a number of things.

One of the things is that this was a package. There are the UDAP rules you are talking about that are contained in your legislation to a large extent. But there is also all the truth in lending changes which involves all new forms and also new processes that are involved with that.

So this is one very large, sweeping, comprehensive package that is going to fundamentally change the way the industry does its business. And when we looked at, in terms of talking to the industry, but also looking ourselves at everything that would be required in order to put everything in place to make this work well, we felt that 18 months was a reasonable time.

The danger is if you don't give sufficient time to the industry to get everything in place in a way that has been tested, that staff is trained, that it is running smoothly, if there is not sufficient confidence in the new risk models—which they are going to have to design all new risk models because of the pricing changes—it could severely hamper the markets in terms of credit availability.

So we wanted to provide sufficient time so that when this is implemented, it is implemented correctly, and credit will flow to consumers and that the market should still work well.

Chairman GUTIERREZ. I don't want to abuse the chairmanship. So your basic answer is the industry wanted more but the Fed thought in order for credit risk and other areas that the implementation, okay. Thank you very much.

Mr. Hensarling, please, for 5 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman. Ms. Braunstein, does Federal Reserve data indicate that credit card credit for consumers is contracting within our economy?

Ms. BRAUNSTEIN. I think that is right, but frankly all credit is contracted right now. It is very difficult to differentiate what might be the result of the pending rules versus what is happening just because of the economic situation. We are not in normal economic times.

Mr. HENSARLING. I believe we all understand that.

And coming up with your rules, and I know they have been, I believe, 3 years in the making, and I understand you have done extensive consumer testing, have you also examined other international models and studied case history?

Ms. BRAUNSTEIN. I would have to check on that. I am not sure.

Mr. HENSARLING. In 2006, the U.K. decided that credit card default fees were too high and ordered that credit card issuers cut them or face legal action. And independent studies have shown that led to a retrenchment of roughly $2 billion cost to the credit card industry, which caused them, 2 of the 3 biggest issuers, to impose annual fees on their cardholders, 19 major card issuers raised interest rates, and one independent study showed that credit standards became tighter, and 60 percent of new applicants were being rejected.

If the Federal Reserve has not had an opportunity to study the U.K. model—and it is very late in the game—I would respectfully recommend that you study the U.K. model.

Ms. Braunstein, does the Federal Reserve feel that we have an uncompetitive marketplace with credit cards? Do you feel that consumers have inadequate choices or is it more that there are simply what you would describe as unfair and deceptive practices?

Ms. BRAUNSTEIN. I think the market has been very competitive, but I don't think that there has been the transparency for consumers that is needed. I think that these are very complex products and that it is very difficult for consumers to understand what the terms are, and oftentimes it is difficult for them to shop and compare because there is such a wide array of products. And without the increased transparency, it is hard to compare one against the other.

Mr. HENSARLING. Since there is such a wide array of products, do you observe that there are at least products in the marketplace that are widely available to most consumers that do not contain what you would consider to be the unfair practices which your rules attempt to address?

Ms. BRAUNSTEIN. I don't know. I can't say that there are not products already out there.

Mr. HENSARLING. In page 2 of your testimony, you talk about limitations-of-disclosure-based approach, and I believe, if I am understanding you right, it is the position of the Federal Reserve that some terms are simply too complex, that consumers just cannot understand them, cannot fathom them.

I think you have said that double-cycle billing is too complicated for the average consumer to understand, but if I read your final rule summary document from December 2008, it explains both it and its repeal in just 63 words.

Did the Federal Reserve consider using that summary or, again, are consumers just too dumb to understand?

Ms. BRAUNSTEIN. Congressman, we did extensive consumer testing on these new credit card disclosures, and we tested a wide variety of terms, of which double-cycle billing is one, but we also tested the explanation of payment allocation and other terms. And I will tell you, our experience has shown us that it is not necessarily the number of words, but it is the explanation of the process. It just—some of these things just could not—and we tried many different ways. And it wasn't us, the Fed, you know. We hired experts on this who were trying many different ways. Some of these terms were not—

Mr. HENSARLING. Notwithstanding a competitive marketplace, notwithstanding a general credit contraction, you still advocate that consumers need to be protected against themselves even though potentially that could lead to a loss of their own credit cards?

Ms. BRAUNSTEIN. I think that when we decide to write rules on unfair and deceptive practices, we have to look at the risks and we have to look at the benefits and the harm. And we weighed all of that, and we felt these rules are needed in order to protect the consumer.

Mr. HENSARLING. What would happen, Ms. Braunstein—with the chairman's indulgence, one last question—if your rules, instead of having to be implemented in 18 months, had to be implemented within 90 days, what is your impression of the impact on the consumer credit marketplace?

Ms. BRAUNSTEIN. Very honestly, I am not sure how that could even be done. I mean, if legislation came out, we would have to write rules. The legislation does not quite mirror our rules, we would have to make adjustments. It also puts it all in TILA. We are using the FTC Act. We would have to make a lot of changes. We would have to put that out for public comment. We would have to get comments back. We would have to put out a final rule. And then you would have to leave some time for the industry to comply. I see no way that process could be done in 90 days.

Chairman GUTIERREZ. The gentlelady from New York, Mrs. Maloney, is recognized for 5 minutes.

Mrs. MALONEY. I want to thank all of my colleagues who have worked hard on this bill and have supported it, some on both sides of the aisle, and I want to thank all of the panelists, not only for your testimony today, but for your extraordinary work during what has been called the worst economic crisis in our lifetime.

I wanted to clarify one of the statements by one of my good friends on the other side of the aisle and place in the record two reports. This is about the risk-based pricing, and their claim that this bill would have a negative effect on risk-based pricing. And I would like to place in the record a GAO study and a report by the Federal Reserve. Both found that there is no evidence that risk-based pricing has decreased overall interest rates. Rather, the decrease in the Federal funds rate is more likely responsible for the decline in the interest rates consumers have seen.

I also would like to place in the record testimony before this committee, before the former head of Freddie Mac. He was testifying on housing, but then he started talking about credit cards. And he talked about how he and his wife had sat down at dinner and tried to figure out their credit card disclosure and could not figure it out. This is the former head of a very important financial institution. And I think that says volumes.

Also, the Federal Reserve, in some of the reports, testified that Reg Z, or transparency, was not enough, that you needed changes, fundamental changes for unfair, deceptive, and anti-competitive practices, and I feel strongly that we should move forward and pass the Credit Card Bill of Rights.

I would like to ask Ms. Braunstein, now that the Federal Reserve has labeled a number of practices as unfair, deceptive, and anti-competitive, how in the world can it be justified to the American people that they should have to wait until July 2010 until they get relief of these practices?

And secondly, you testified that you need roughly 18 months. Are there some aspects of the rule or the legislation that could be implemented quicker? Possibly there are some that have form changes which are more difficult, but are there others that we could implement in a more, I would say, reasonable timeframe?

Ms. BRAUNSTEIN. We did look at that. And what we found was that pretty much everything in there, it is part of a whole package and there is a lot of overlap between what is going to be on the new disclosures versus what would be changed in the pricing models. Everything kind of ties together and is interconnected, and it made more sense to have one effective date for everything.

So that is why we did that. We feel that it really is—there is a lot of interconnection between the different moving pieces.

Mrs. MALONEY. What was your personal recommendation for a timeframe?

Ms. BRAUNSTEIN. Eighteen months. The staff's recommendation was 18 months.

Mrs. MALONEY. I have spent so many hours and asked so many questions on this bill, I am going to give back my time so my colleagues can have more time to ask their questions.

I just want to conclude that of all of the issues that I have worked on, this one has generated the most comments. Like the Fed, it is hard for me to go to the Floor of Congress without getting a credit card story or to walk into a supermarket without getting a credit card story or get into the subway or the bus without strangers coming up and telling me a story that they feel was unfair and deceptive to them.

And I truly believe that our commerce works better, our democracy works better when people understand the rules and make a decision that that is the rule they want to follow.

I am very proud of having authored, along with many of my colleagues, the ATM disclosure. When you go to get your ATM money, many people wanted to ban institutions, financial institutions from getting any type of fee, but if they are providing a type of service, they are entitled to a fee. It allows the consumer to say "yes" for the convenience to access my bank account from Washington, I am willing to pay that fee. But it gives the consumer the power to control their own financial decisions, and I feel that is what is important. And I think that is what we tried to accomplish in the bill, to give consumers more choice and more control in making decisions about managing their own finances.

I yield back my time.

Ms. BRAUNSTEIN. Congresswoman?

Mrs. MALONEY. Yes.

Ms. BRAUNSTEIN. Can I just make one really quick comment? I do want the say in terms of the effective date that we have as an agency, and including Chairman Bernanke, has made public comments that we would expect and hope that the industry would implement pieces as soon as was practicable for them—and I say that in my testimony—so we could be—we are hopeful that we will see some implementation before the 18-month deadline.

Mrs. MALONEY. I thank you for that, and I would like to applaud the industries that have voluntarily gone forward and implemented these improvements.

Chairman GUTIERREZ. The time of the gentlelady has expired.

Mr. Bachus, you are recognized for 5 minutes.

Mr. BACHUS. Ms. Braunstein, back on December 18th, Chairman Bernanke asked you how long it would take to implement the Federal rules for credit cards and if it could be implemented before July 1, 2010, and your response was that card issuers are going to need to rethink their entire business models. They are going to have to redesign their marketing materials, their solicitations, their periodic statements, all of the pieces of paper that they use, their contracts, all of that is going to have to be redesigned. And you mentioned several other things they would have to do. And in fact, I would like to introduce into the record—these are the Fed rules and regulations that the credit cards companies have to comply with.

Chairman GUTIERREZ. Without objection, it is so ordered.

[The documents referred to can be accessed at the following link: http://www.federalreserve.gov/boarddocs/meetings/2008/20081218/openmaterials.htm]

Ms. BRAUNSTEIN. I am glad I didn't have to carry those up here today.

Chairman GUTIERREZ. The cost might be prohibitive, but we are going to introduce it.

Mr. BACHUS. Yes, I am not even sure I could read these in the time allotted. But all that is going to take a lot of time, so my question to you—and this may be kind of a set-up question. I mean, you could drive this a long way.

Is it still your belief that the credit card companies will literally be unable to meet the 90-day deadline in the Maloney bill?

Ms. BRAUNSTEIN. Yes. As I have said already, yes, I do think that would be an almost impossible task for all of us, not just for the industry but also for the regulators, to have to conform the rules and do what we need to do.

Mr. BACHUS. And with two alternatives the credit card companies would have if they couldn't comply, they could cut people loose from their credit. That would be one alternative. I mean, they would have to just stop—

Ms. BRAUNSTEIN. I don't know. I can't answer for the industry as to what they would do. But I know that we, as I said, we would be concerned that if it was rushed and they didn't do it correctly, there would not be confidence in the risk models. And that certainly could have impacts on the flow of credit in the marketplace.

Mr. BACHUS. Right. And if they didn't comply, they could all be sued, is that correct, for violating the rules? If they weren't able to comply and they did one little thing wrong that violated this—

Ms. BRAUNSTEIN. Well, yes, if the rule—depending on how you write the legislation, but right now, I think it is under TILA so there would be private rights of actions.

Mr. BACHUS. Okay. That would be something.

I yield the balance of my time to the gentleman from Delaware, Governor Castle.

Mr. CASTLE. Thank you for yielding.

Let me ask this question first, Ms. Braunstein. You have indicated that the Fed has said that the credit card issuers, 6,000 of them, should make their changes as soon as practicable; they shouldn't wait for the 18 months.

Do you have any evidence of that actually happening? It may be more anecdotal than will be actual data-wise, but can you fill us in on that?

Ms. BRAUNSTEIN. Well, anecdotally, I mean, we are constantly doing outreach both to the industry and also to consumer and community groups, and, in some of our conversations with industry, they have certainly started. I don't know—I don't have any anecdotal evidence as to what their timeframe is earlier than the 18-month compliance date, but we have had conversations where they have developed flowcharts and that they are trying to put the pieces in place. So it is underway. It is definitely underway.

Mr. CASTLE. I am really asking you to do my work when I ask this next question, I think, and perhaps it is a question for all of you. But can you explain if there are differences in the two bills that we are considering today and the regulations which you have drafted at the Fed, and, if there are, what they might be?

Ms. BRAUNSTEIN. There are differences. And one of the recommendations I would make is, if Congress does move forward with this bill, if your committee moves forward, is you may want to take a look at that on both sides. I know that, in pricing, we changed some things.

I think when the bill was drafted, it was done on the basis of the proposed rules we had issued in May of 2008. We made some changes in our final rules, and that was due to the public comments we received and our analysis of the issues. We actually went further than the bill does on pricing restrictions and repricing of existing balances and also making sure that you cannot change the price for any reason during the first year of the cards. We went a little further on that.

There are some differences in payment allocation. There are a few other things. And we would encourage you to, you know, take a look at those.

Mr. CASTLE. My time is up, but I may be next anyhow.

Mr. WATT. I don't think so.

Mrs. MALONEY. [presiding] Mr. Watt?

Mr. CASTLE. I mean, not next. After the other side. Excuse me.

Mrs. MALONEY. Mr. Watt, and then we will come back to Mr. Castle.

Mr. WATT. Am I recognized yet?

Mrs. MALONEY. Yes, you are recognized.

Mr. WATT. Thank you.

Actually, I want to follow the same question, but I want to get more specific. I actually would—I think the committee, the full committee, would benefit from side-by-side analysis of the differences from the regulators who drafted the regulations that are to go into effect.

Ms. BRAUNSTEIN. We would be happy to have staff come up—

Mr. WATT. Let me be clear on what I am asking for: a side-by-side analysis and an explanation of why any changes—any differences, why you chose to go either higher or lower, because I think that would be very helpful to the committee in assessing.

I know there are other differences in what you proposed and what the bill proposes other than just the July 1, I guess, 2010, implementation date is your drop-dead date at this point. And you have done an outstanding job of explaining why there are some implementation delays, but I think the committee would benefit from an explanation of all of the differences and why you opted for what you did, either greater or lesser than what the bill does.

And if I could request that in writing, then I would be happy to yield back all of my time.

Ms. BRAUNSTEIN. We have that information in-house.

Mr. WATT. Because I think that is the kind of thing that, really, even if we got it verbally, would probably not be all that helpful to us.

So I hope I have helped Mr. Castle. Even though he wasn't next, I kind of picked up on where he was going, and that was the question that I was planning to ask anyway.

I have an important assignment on a plane, so I am going to yield back.

Ms. BRAUNSTEIN. Congressman, can I just say that we have that information, we have done those kinds of analyses, and we will be happy to share those with you in writing.

Mrs. MALONEY. And share it with the committee.

Ms. BRAUNSTEIN. Yes.

Mrs. MALONEY. Thank you.

Mr. WATT. I know the committee will get one, but, you know, it takes a while, so I am asking this question for myself. So at least give the committee, Mr. Castle, and me one—

Ms. BRAUNSTEIN. Not a problem.

Mr. WATT. —since we are tag-teaming this question. Thank you.

Mrs. MALONEY. Thank you, Congressman.

Congressman Castle?

Mr. CASTLE. Thank you, Madam Chairwoman.

And I thank Mr. Watt for asking my questions better than I did, but I also would very much like to see that copy of whatever these differences are.

And, to me, it is going to come down, to a degree, not completely, but to a degree, to this time differential and the ability to be able to put this into effect or not. And I realize that you are speaking as a regulator, and maybe others should speak to it, as well. But we have all the issuers, too, and you spoke for them, to a degree, also.

But, you have the whole problem of passing legislation, which is going to get even closer to the 18 months left in yours, and then you are going to have the problem of dealing with the issuers, as well as whatever dealings you are going to have to do with the legislation. And, to me, it gets complicated.

When we first passed the chairwoman's legislation, I forget whether it was 18 months or not, but I guess it was, but that was 6 months or so ago or more at this point. And, as that time narrows, I think it is going to get even more complicated to complete this task. I think we need to be careful about this.

One thing we need to remember is we do have 6,000 credit card issuers. They are carrying out a business. They are, in many instances, in most instances, related to financial institutions which have had some strains, and I am a little concerned about how far we can push them at this point.

And I don't know if that is in the form of a question, but if you want to respond to it, you may, Ms. Yakimov.

Ms. YAKIMOV. Well, thank you, Congressman Castle.

I think the point about the implementation date, the effective date, is an important one to try to get right. And what we tried to balance was our interest in providing significant new consumer protections while, at the same time, giving the industry the time that they needed to get it right. And we certainly didn't want to cause major disruption.

One example to point to is the provisions that deal with the subprime issuers, where we have said that they cannot charge a fee in connection with getting the card that takes the majority of the credit line. And, taking it one step further, they can't charge more than 25 percent. So they can't charge more than 50 percent, and they can't charge more than 25 percent during the first month.

Issuers that have built a niche in this space will really have to think through what is their new business model so that they can continue to offer credit.

That is just one example of some major changes. The changes on the limitations to retroactive rate increases will have a significant impact. These protections are really important, but we wanted to give the industry time to, as Sandy points out quite well, comply with TILA changes, do the training, do testing, do they need new product lines, and all the rest.

Mr. CASTLE. Well, I appreciate that. I mean, I hate to make this comparison, but I watched what we did on the Floor today and how we have been handling some of the TARP money and the AIG issues or whatever. And sometimes when we rush legislation, like in the stimulus package, we end up with problems, such as the bonus situation with AIG.

It just seems to me that the Fed has gotten all these different 56,000, I guess, inquiries as a result of the preliminary rules which you have issued. You have now gone back, and all your Agencies have been involved, and you have looked at what that should be, and you have come up with a plan, and it takes a long time to implement it. We are talking about a lot of credit card issuers.

And I don't in any way discredit the legislation. I happen to believe that the chairwoman is right in terms of what she is trying to do. But I am mightily concerned about the ability to do this. I mean, the credit card companies don't like what you have done much more than they like the legislation. But they may be put in a situation where you can't carry out your responsibilities and they can't carry out their responsibilities. And that concerns me a great deal.

So my hope is that we could, at some point, agree to just move forward as rapidly as we can with the regulatory practices which the Fed has drawn up as just a better way of proceeding for everybody who is involved with this in getting to the same end, on which there is general agreement, I think, in this committee and probably in the Congress, if I had to guess.

And with that, I yield back, Madam Chairwoman.

Mrs. MALONEY. I thank the gentleman for his concern, but we have had well over 4 hearings on this legislation over a 2-year period and numerous smaller roundtable discussions and meetings with stakeholders and industry and regulators on it. So it has been very deliberative.

I now recognize Congressman Moore.

Mr. MOORE OF KANSAS. Thank you, Madam Chairwoman. And I appreciate your efforts to strengthen consumer protections on the use of overdraft services. In this time of financial crisis, we need to do what we can to protect our consumers.

Ms. Braunstein, in your testimony, you note that the Fed has offered a proposal to, "give consumers greater control over the payment of overdrafts."

I understand the Fed has already issued rules to address depository institutions' disclosure practices related to overdraft services that take effect January 1, 2010, and the public comment period of the Fed's overdraft protection proposal ends on March 30, 2009.

You also note that, "After evaluating the comments and conducting additional consumer testing, we expect to issue a final rule later this year."

Ms. Braunstein, when would you expect the Fed to issue that rule? And do you have any comments on H.R. 1456, the Overdraft Protection Act, as it relates to the Fed's efforts?

Ms. BRAUNSTEIN. As you say, our comment period on the Reg. E proposal we put out ends the end of this month, and we will look at the comment letters. We are hoping to have final rules out during the summer. And so, you know, we are moving forward on that. So we are hoping to have the final rules in the summer.

Mr. MOORE OF KANSAS. Final rules, that will be?

Ms. BRAUNSTEIN. For overdraft protection. I am talking about on the proposal we just issued on giving consumers a choice.

Mr. MOORE OF KANSAS. Any better estimate as to when, besides this summer? Is that the best estimate you can give me right now?

Ms. BRAUNSTEIN. Yes, I think so, at this point, because we need to see what comments come in, how long it takes to do the analysis, and get the final rules completed.

Mr. MOORE OF KANSAS. Thank you.

I yield back, Mr. Chairman.

Chairman GUTIERREZ. The gentleman yields back. Mr. Lee is recognized for 5 minutes.

Mr. LEE. Thank you.

I think I am going to try to take this in a slightly different direction. I actually may be an advocate of what you are going through because my background was running manufacturing businesses, and I lived through, firsthand, doing major implementations of our enterprise system of our business. And I can attest on some of the difficulties.

But starting off with—I agree with Chairwoman Maloney's bill in terms of the content of we ultimately want to protect consumers and that this is an issue that we definitely want to move forward on. At the same time, I see what the Federal Reserve has done over the past few years and is painstakingly taking the time to make sure we get this right, and I do applaud that.

But my concern is, when we have ever, from a business perspective, done an implementation on major changes, which you, Ms. Braunstein, have alluded to, the best case is you can do that in a year. And, like you, I am concerned about the risk of trying to push through legislation that, within 90 days, could have a very detrimental effect.

In one of the implementations we did for our company, when we ultimately went live, after testing for almost a year, our go-live scenario almost put our company under, based on the fact that the system did not work the way we thought it would. We had thousands of lost records and lost many customers along the way. So my concern is making sure we do this in a way that not only protects the consumer but also makes sure that we have a system put in place that adequately functions.

My question to you is—because, like everyone, we want to get this implemented as fast as possible—is there any time we could shave off this, at this point, 18 months if we were focused?

Ms. BRAUNSTEIN. I don't know. I really think—I know that we looked at it very thoroughly when we came up with the 18 months. We knew, frankly, that that was going to be something that we would get a lot of criticism on from consumer community groups, from certain Members of Congress. We didn't go into that blindly.

So we did spend a lot of time looking at that and talking about that issue and searching it out, and that is where we came out on this. I think that is a discussion you need to have, in terms of—

or have with the industry and see if you think it could be done sooner.

Ms. YAKIMOV. May I add something?

One of the things that we are doing, as we look at the institutions that offer credit cards within OTS, is checking on the progress they are making in terms of preparing. In December, we issued a CEO letter from our principal, saying, "Look, we are looking for you to implement as soon as you possibly can." Through the exam process in there, we can continue to monitor that.

The other thing I point to is we just recently, last month, had a conference call collectively with the Federal Reserve and NCUA. We had more than 700 institutions participate, 700 lines. We are hearing from the industry that they are working hard, they are getting after this. So we will continue to monitor.

Mr. LEE. Would anybody be able to offer up any—if we flipped the switch in 90 days, which I am dramatically opposed to, just based on what my historical reference has been on doing 3 implementations from a software standpoint, could you name any specific risk that you would see that would come out of this?

Ms. BRAUNSTEIN. Well, as I have mentioned a couple of times today, I think the risk—I am not sure that it is even doable, but the risk of rushing this would be that the models would not be fully developed. New funding mechanisms would not be in place because the risk models would be in doubt, and that could put some severe constraints on the availability of credit. I think that is a very real concern.

Mr. LEE. Thank you.

I yield back.

Chairman GUTIERREZ. Thank you.

Mr. Green, you are recognized for 5 minutes, sir.

Mr. GREEN. Thank you, Mr. Chairman.

And I thank the witnesses for their testimony.

I, too, am going to pursue this line of questioning with reference to the timeline. Do you have any empirical evidence to support the notion that one time is more beneficial than another, that having 18 months is more beneficial? I understand that you have beliefs, but what empirical evidence did you acquire?

Ms. BRAUNSTEIN. We spent a lot of time talking to industry. We also have a lot of years' experience with implementation of other regulations, and we looked at those and how long it took to put systems in place to get those regulations up and running.

Mr. GREEN. Give me an example, if you would, please. I am looking for the actual empirical evidence, as to opposed to a commentary about how you approached it.

Ms. BRAUNSTEIN. Can we get back to you with that information?

Mr. GREEN. Well, could you just give me one example of another industry or some other time that you actually had to do this and the actual amount of time that it took?

The obvious answer is, yes, you are going to get back to me, but if you have something today, I would be more than anxious to hear it.

Ms. BRAUNSTEIN. Well, I know when we put major TILA changes, truth-in-lending changes, in place in the past, we have always had to go out at least 12 months in advance to get those in place. And this is even more comprehensive than that, because this is involving several regulations.

Mr. GREEN. Did you exercise this 12-month rule based on other empirical evidence, or has this just become custom and tradition?

Ms. BRAUNSTEIN. No, as I say, we have talked extensively about the kinds of systems changes that are needed, you know, the forms that need to be developed, the time it takes to do that. I think you could probably get even better data from the industry, in terms of their workflows.

Mr. GREEN. Well, my suspicion is that the industry will give me enough information to help me with my 18-month conclusion, if that is my end. But what I am trying to do is actually fairly understand what went into the computations. And so far I am hearing you say, we have talked and, after talking, we sort of came to a conclusion.

And I am interested in knowing, for example, it takes "X" amount of time to develop the computer program, it takes "X" amount of time to run the model. Have you done that kind of analysis?

Ms. BRAUNSTEIN. We could get back to you with that information. I am not prepared to go into that level of detail today, but we could certainly get back to you.

Mr. GREEN. Yes, ma'am.

Ms. YAKIMOV. I would just add, some of the comments that we got from industry and from some of the vendors that the industry worked with to process changes, such as 21 days to make sure that people have a reasonable period of time to make their payment, those types of systems-based changes that we have made in the rule. We did get a fair amount of fairly specific comments from industry and from vendors that are part of the record. I can't give you rule-specific—

Mr. GREEN. Would you do this for me? Define "industry" for me. When you say "from industry," I think I know what you are referencing, but why don't you tell us so that we will have it for the record?

Ms. YAKIMOV. From some of the major credit card issuers that commented about the implementation period. They commented about what, from their experience, they felt they would need to do in order to comply with the rule as it was proposed. We got comments from them and from, as I said, vendors that provide backroom support.

Mr. GREEN. Is it possible that there may be a hint of—may be a scintilla of bias associated with that sort of intelligence coming from what you have defined as the "industry?"

Ms. BRAUNSTEIN. Absolutely. That is why, like I said in the beginning, this was a conclusion we came to. I think the industry actually requested longer. From what I remember in my conversations—this was months ago now—but, you know, most of the industry was telling us they would need a minimum of 2 years or even longer. So, yes, we did put that factor into our calculations.

Ms. YAKIMOV. Right.

Mr. GREEN. Well, just as a parting comment, and I am really doing some soul searching, but the anecdotal comments that I get from consumers would connote it can be done right away and I want it done right now. So consumers have an immediate need, as they see it, when they talk to me. I understand that industry has a need, as well, which is why I conclude that empirical evidence is the best way to arrive at a reasonable decision. Thank you.

I yield back. Thank you, Mr. Chairman.

Chairman GUTIERREZ. Congressman Neugebauer, please.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

One of the problems with getting to the dance late is the dance card gets filled up. And so, a lot of the questions that I have were already asked, but I want to go back on a couple of things.

Ms. Braunstein, one of the things you said was—and I think Ms. Yakimov—I think you both said that some of these things the industry is already starting to incorporate into their business model. And one of the things—I am obviously not in that credit card business, but this is going to require a lot of software modifications, a lot of internal operational procedures, and somebody is not just going to flip a switch in 2010 and say, okay, we are on the new system.

So I have to believe that the industry—and we will have some of those folks here—but I have to believe that, as I understand it, they will have to be in compliance by that date, if I am not mistaken. And so it would appear to me that process is going to be an evolving process. Am I misreading that?

Ms. BRAUNSTEIN. No, that is correct.

Ms. YAKIMOV. That is right.

Mr. NEUGEBAUER. You believe that is true? And, as you said, in some of the banks that you all have been in, you have begun to see some of that implementation already taking place?

Ms. YAKIMOV. We have a group at OTS that specializes in following credit card issues. We have seen, for example, we track, are there noncurrent and charge-off—the amount of noncurrent loans and charge-offs, how is that changing over time.

This is the group that specializes in collecting a whole host of data from the institutions through our supervisory process. And that is the group that we are using to give us periodic reports on how the industry is preparing, and we will continue to do that.

Mr. NEUGEBAUER. Because I have some credit cards, and I am already getting changes in the contract and changes in the terms that are very consistent with the new regulations. And so I think some of the credit card companies are already moving in that direction.

And, of course, I guess I want to continue to be "Mr. Disclosure" to all of you, as Ms. Braunstein knows—she has appeared before us before. We have to get to a universal consumer disclosure that is simple and easy to read, because I think a lot of the issues that are driving a lot of our consumer complaints and people who are getting into trouble with their credit, some of that is poor choices that they are making. And we can't legislate nor can we correct poor choices. We can fix poor information and poor disclosure.

And I know there are some reforms in this, but I think one of the things that we almost need to get our consumers used to is, whenever they are looking at any kind of credit, they are looking at that same disclosure statement, no matter what type of credit is, so they get accustomed to seeing that and so they know what to look for on that, so that we don't have people who say, "Oh, I didn't know."

So I thank these witnesses.

And, with that, I will yield back, Mr. Chairman.

Ms. BRAUNSTEIN. Congressman, could I just say a word about disclosures?

Mr. NEUGEBAUER. Yes, please.

Ms. BRAUNSTEIN. This package includes a complete redesign of credit card disclosures under the Truth in Lending Act, and those are all consumer-tested. And we did indeed find, one of the interesting pieces of that, as you know, years ago Congress legislated something that is referred to as the "Schumer Box" for credit cards that has all kinds of information in the solicitations in a box. People did recognize that and found that very useful.

So, in fact, when we redesigned disclosures, we made the account opening statements consistent with the solicitations, utilizing a box tabular format, because we found—so what you are saying is absolutely right. Consumers look for certain information. And we try to, you know, do that in the redesigned disclosures. And hopefully we have been—

Mr. NEUGEBAUER. So over at HUD and all of the other places—

Ms. BRAUNSTEIN. Well, that was last week's panel.

Mr. NEUGEBAUER. I know, but I find if you say it over and over and over and over again, eventually maybe it gets done. So, thank you.

Chairman GUTIERREZ. Thank you.

Mr. Cleaver, you are recognized for 5 minutes.

Mr. CLEAVER. Mr. Chairman, I will forego any questions in an attempt to bring the next panel up.

Chairman GUTIERREZ. Thank you so much. With unanimous consent, we will accept that. Thank you so much, Mr. Cleaver.

I want to thank all of the panelists for their testimony here this afternoon.

And, Ms. Braunstein, since last week, you know, we are kind of a little critical about how long it took between the time the legislation—we really would like to compliment everybody at the Fed for working so quickly on the new regulations, the UDAP and the Z regulations, and working on them quickly. You know, we have to balance ourselves out.

Ms. BRAUNSTEIN. Thank you so much.

Chairman GUTIERREZ. Thank you so much to all of the panelists for being here.

Let me introduce the second panel.

Mr. Kenneth J. Clayton is senior vice president/general counsel for the American Bankers Association Card Policy Council.

Ms. Linda Echard is president and CEO of ICBA Bancard and is testifying on behalf of the Independent Community Bankers of America.

Mr. Douglas Fecher is the president and CEO of Wright-Patt Credit Union, Inc., and is testifying on behalf of the Credit Union National Association.

Mr. Oliver I. Ireland is a partner at Morrison & Foerster, LLP, here in Washington, D.C., and is testifying on his own behalf.

Mr. Todd McCracken is the president of the National Small Business Association.

Mr. Ed Mierzwinski is a senior fellow at the Consumer Program at U.S. PIRG.

And last, but not least, Mr. Travis Plunkett is the legislative director of the Consumer Federation of America, who is appearing before the Financial Services Committee for the second time this week.

Thank you all for appearing this afternoon.

Mr. Clayton, you may begin your testimony.

STATEMENT OF KENNETH J. CLAYTON, SENIOR VICE PRESIDENT/GENERAL COUNSEL, AMERICAN BANKERS ASSOCIATION CARD POLICY COUNCIL

Mr. CLAYTON. Thank you, Mr. Chairman, Mr. Castle, and Mr. Lee. My name is Kenneth J. Clayton, and I am here on behalf of the American Bankers Association. I appreciate the opportunity to testify today on both credit card and overdraft protection issues.

Credit cards are responsible for more than $2.5 trillion in transactions a year, and they are accepted at more than 24 million locations worldwide. It is mind-boggling to consider the systems needed to handle 10,000 card transactions every second around the world. It is an enormous, complicated, and expensive structure, all dedicated to delivering the efficient, safe, and easy payment vehicle that we have all come to enjoy. They are an integral part of today's economy.

As you have heard today, regulators have taken unprecedented action in response to consumer concerns over credit cards. These changes have forced a complete reworking of the credit card industry's internal operations, pricing models, and funding mechanisms.

The rule essentially eliminates many controversial card practices. For example, it eliminates the repricing of the existing balances, including the use of universal default and so-called "any time, any reason" repricing. It eliminates changes to interest rates for new balances for the first year that card is in existence. It eliminates double-cycle billing, and it eliminates payment allocation methods perceived to disadvantage consumers.

The rule likewise ensures that consumers will have adequate time to pay their bills; adequate notice of any interest rate increases on future balances so they can act appropriately; and clear information in all card materials that they will notice, understand, and use to take informed actions in their best interests.

In sum, the final regulation already covers the core issues sought to be addressed by H.R. 627.

Card companies are committed to implementing these vast changes as soon as possible. But policymakers need to understand that this is an enormous undertaking, requiring companies to redesign entire risk and operating models that support hundreds of millions of accounts. And we need to do this during a time of unprecedented economic turmoil, with rising delinquencies and locked funding markets that reduce our ability to make loans, further complicating our task.

Some things to think about: Lenders must rework every piece of paper, from solicitations to applications to periodic statements to advertisements; create entirely new business models that adequately manage investor willingness to fund lending and regulatory concerns over safety and soundness; rework, integrate, and test multiple internal systems and retrain hundreds of thousands of employees so that everything seamlessly operates together; and subject every step of this process to detailed legal and regulatory reviews that ensure we get it right.

Under H.R. 627, we are asked to do all of this in 90 days. This is extremely difficult. And if such a proposal were enacted, we would envision three likely outcomes: operational problems that create billing mistakes and significant confusion for millions of consumers, while opening ourselves up to significant legal liability; a significant pullback in available credit to protect against underwriting risk that we have not yet had the time to adequately assess; and a potential for increases in the cost of credit for the very same reason.

Such outcomes will harm consumers, small businesses, and the broader economy at a time when it can least afford it. We would urge members to refrain from taking such action.

Let me quickly comment on legislative efforts on overdraft protection. Overdraft protection provides significant benefits to millions of consumers every day. It keeps checks from bouncing and transactions from being denied and avoids the cost and embarrassment associated with such occurrences. With such value comes some cost; yet the cost for such protection is completely manageable. Consumers can take numerous steps to keep track of their balances and manage the risk associated with overdrafts in their accounts.

H.R. 1456 would impose operational challenges that are nearly impossible to implement and that may have the effect of reducing the availability of this service to consumers, thus denying them a product in which they find great value. And we note that legislating in this area may be premature.

The Federal Reserve has a current rulemaking intending to go at the very issues that are the subject of this legislation. The comment period for that proposal closes on March 30th; that is 11 days from now. And the Fed will be poised to act based on significant input from all interested parties. We urge Congress to refrain from acting and let the regulatory process be completed.

Thank you, Chairwoman Maloney. Thank you for the opportunity to comment on these two legislative proposals. I will be happy to answer any questions you may have.

[The prepared statement of Mr. Clayton can be found on page 84 of the appendix.]

Mrs. MALONEY. [presiding] Thank you very much for your testimony.

Ms. Linda Echard?

STATEMENT OF LINDA ECHARD, PRESIDENT AND CEO, ICBA BANCARD, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA

Ms. ECHARD. Thank you, Madam Chairwoman, Ranking Member Hensarling, and members of the subcommittee. My name is Linda Echard, and I am president and CEO of ICBA Bancard.

Twenty-five years ago, the Independent Community Bankers of America hired me to help them leverage the negotiating power of their members in order to put together a program so they could afford to be in the credit card business. Today, I work to help keep their playing field level so the community-bank credit and debit card issuers can afford to participate and meet the demands of competing.

I would first like to discuss H.R. 627, the Credit Cardholders' Bill of Rights Act. While we agree that a small number of issuers have engaged in practices that are harmful to consumers, any legislative remedy should focus on transparency, disclosure, and encouraging consumer choice. The most powerful force for a change in a market as competitive as credit cards is the ability of an educated consumer to shop with his or her feet.

Instead, this measure attempts to prohibit specific practices, imposing additional costs and burdens on community bankers who did not contribute to the problems in the industry. The consequences will cause small lenders to struggle to meet the credit needs of their consumer and small-business customers and possibly exit the business entirely. No one benefits if community banks exit the marketplace.

Throughout my career, I have seen firsthand the implications of burdensome regulations and mandates, such as these, on small issuers. At a time when the government is encouraging efforts by community banks to assist in the recovery of our economy, passing this bill sends the wrong message to those who are actually in a position to help.

I would also note that the 25-day statement mailing requirement and deadline set forth in this legislation for full compliance are simply not feasible for community banks or their third-party processors. The mailing requirement does not take into account statement cycles that fall on or near weekends and holidays.

Today, community banks can offer credit cards that are tailored to the needs of their individual consumers, allowing them to differentiate themselves from the competition. But the limitation on an issuer's ability to adjust for risks in the cost of funds in this legislation will fundamentally change the credit card features that consumers have come to rely on.

I can also see community banks shifting away from fixed-rate credit card models to variable-rate cards. More broadly, these restrictions will begin to shift credit cards from an open-ended, unsecured loan where the consumer largely decides his or her own repayment schedule to something like the old-fashioned finance company installment loan.

Shifting to H.R. 1456, the Consumer Overdraft Protection Fair Practices Act, many community banks offer overdraft protection programs that are valued by their customers. Overdraft programs are not all created equal, a fact that gives community banks the ability to leverage the unique and close relationship they have with their customers to offer them competitively priced programs to best meet their needs. This competitive advantage is an important part of what allows community banks to serve their communities.

ICBA supports ensuring consumers are fully informed about the terms and conditions of an overdraft program and are made fully aware of the choices available to them. However, the burdens imposed in H.R. 1456 would reduce community banks' ability to competitively offer these services. This legislation presents technical and practical difficulties that will serve to reduce the availability of overdraft coverage to community bank customers.

Subjecting these programs to regulation under TILA will likely cause many community banks to do away with discretionary overdraft programs, leaving consumers only the choices of linking with another account or qualifying for a line of credit in order to cover overdrafts. For community bank customers at the margin, those may not be viable options.

In conclusion, our concerns with these two pieces of legislation are straightforward: Overly restrictive approaches, such as H.R. 627 and H.R. 1456, while serving well-intentioned purposes of addressing questionable practices, will create more difficulties than they cure.

Community banks want to be able to offer competitive credit card products and also want to help their customers with reasonable overdraft programs. Setting rigid parameters under which a bank may operate a card business or overdraft protection program will discourage already overly burdened community banks, pushing them to reduce the number of products and services they can currently offer.

Thank you for the opportunity to be here today.

[The prepared statement of Ms. Echard can be found on page 107 of the appendix.]

Mrs. MALONEY. Thank you.

Mr. Fecher?

STATEMENT OF DOUGLAS FECHER, PRESIDENT AND CEO, WRIGHT-PATT CREDIT UNION, INC., ON BEHALF OF THE CREDIT UNION NATIONAL ASSOCIATION (CUNA)

Mr. FECHER. Good afternoon. Thank you for giving me the opportunity to testify today regarding H.R. 627 and H.R. 1456 on behalf of the Credit Union National Association. My name is Doug Fecher, and I am president and CEO of Wright-Patt Credit Union in Fairborn, Ohio.

Wright-Patt Credit Union serves 170,000 everyday Americans in the Miami Valley, just outside of Dayton, Ohio, including the airmen and airwomen of Wright-Patterson Air Force Base. Our philosophy is to help everyday people save more, smartly use credit, and improve their family's financial wellbeing.

My written testimony goes into greater detail regarding CUNA's concerns with the two bills under consideration today. In general, we support what the legislation is trying to do; however, we do have serious concerns with the approach being taken by H.R. 1456.

I am a practical thinker and come from the perspective of the people I serve: Americans who are faced with making daily, routine financial decisions that are best for their family, often with limited resources. What matters to them is making their paycheck last from one payday to the next, how they are going to pay for the things they need, not to mention the emergencies that they sometimes face.

The bounce protection legislation being considered is well-intentioned but, as a practical matter, will limit consumer's access to legitimate financial services and may be technically impossible to implement.

I want to be clear: Credit unions support reasonable changes to laws governing overdraft programs. While we oppose this legislation in its current form, we would like to work with supporters to eliminate predatory activity without making it impossible for responsibly offering these services to consumers.

We have three suggestions aimed at improving this bill:

First, instead of amending the Truth in Lending Act, we recommend that the bill be redrafted to amend the Truth in Savings Act. This gives Congress the opportunity to require meaningful disclosures to users of these programs, such as the true dollar cost and the available alternatives.

It would also avoid the problem that the bill in its current form creates with respect to the Federal credit union usury ceiling. If this bill were law, it would cause credit unions offering these programs to exceed the usury ceiling prescribed by the Federal Credit Union Act, presently 18 percent. Since even a modest fee would exceed this threshold, as a result, credit unions would no longer be able to offer these services, driving their members to higher-cost service providers.

Second, H.R. 1456 has the potential to present significant operational issues by requiring a written agreement with the member prior to the extension of any overdraft coverage. CUNA suggests that the bill provide a change-in-terms disclosure when overdraft protection is offered and specifically require that a consumer can fully opt out if he or she so desires.

Finally, the requirement that consumers be notified at an ATM or point of sale that the transaction will cause an overdraft represents a compliance burden that we do not believe can be met, given credit union current technology. There may be other ways to notify consumers that they are about to trigger an overdraft event. A sticker or a first-screen general notice alerting the consumer that a withdrawal from the ATM may trigger an overdraft may be appropriate.

To the extent that the subcommittee feels that real-time disclosure is important, we suggest limiting that type of requirement to disclosure on ATM networks that are controlled by the financial institution to which the consumer is affiliated.

To summarize our overdraft concerns, we should not make legislation that removes choice from the market. Credit unions offer these services in a way that solves a sometimes serious problem for consumers. While we should disallow having the manipulation of accounts done for the sole purpose of extracting more and higher fee revenue from unaware consumers, we should not eliminate responsible providers from the market.

We look forward to working with the subcommittee to address these concerns.

I would like to make a brief comment with respect to H.R. 627, the Credit Cardholders' Bill of Rights Act. We agree with most provisions of this legislation. However, we do have two concerns we would like the subcommittee to address and one suggestion.

Our primary concern is the bill's effective date. Were this bill to become law, credit unions would have only 90 days to comply with the same requirements with which they are already currently adjusting their systems to comply with about 15 months from now. We believe such a requirement would be overly burdensome and expensive for America's credit unions and ultimately unnecessary, as the credit unions will be in compliance in due time.

Our second concern involves the provision prohibiting the issuance of a credit card to a consumer under the age of 18 unless the consumer has been legally emancipated under State law. While we agree with this provision, we believe there should be an exception for cards that are co-signed by a parent or guardian.

Finally, we ask that the subcommittee include in this legislation a provision that directs the Government Accountability Office to study the impact of merchant data breaches on consumers and financial institutions. When merchants lose consumers' personal data, including credit card information, the cost of the breach is borne almost entirely by the financial institution and the consumer. We believe this imbalance deserves additional scrutiny and study.

Again, thank you for giving me the opportunity to testify today. I will be available to answer questions. Thank you very much.

[The prepared statement of Mr. Fecher can be found on page 118 of the appendix.]

Mrs. MALONEY. Thank you.

Mr. Ireland?

STATEMENT OF OLIVER I. IRELAND, PARTNER, MORRISON & FOERSTER LLP

Mr. IRELAND. Good afternoon, Acting Chair Maloney, and Ranking Member Hensarling. I am a partner in the Washington, D.C., office of the law firm of Morrison & Foerster. Prior to joining Morrison & Foerster, I was an Associate General Counsel at the Board of Governors Federal Reserve System for over 15 years and worked at the Federal Reserve Banks of Boston and Chicago before that. I have almost 35 years of experience in banking and financial services, and I am pleased to be able to appear here before you today to discuss H.R. 627 and H.R. 1456.

Today, American households are experiencing extreme financial pressure. Equity that households have in their homes is at an all-time low, and their net worth has fallen 20 percent since the third quarter of 2007. Moreover, unemployment in February of 2009 was 8.1 percent, the highest since 1983.

As unemployment grows, affected households must increasingly rely on the ability to borrow to meet day-to-day expenses. Any congressional regulatory efforts to modify credit card practices need to pay particular attention to the potential to unnecessarily limit the availability of this source of credit for these households.

H.R. 627 would limit credit card practices by credit card issuers, and H.R. 1456 would limit overdraft practices at institutions holding consumer deposit accounts. In both cases, recent or pending Federal Reserve Board rule-writing efforts would address these policy concerns.

For example, in December of last year, the Board, working with the OTS and the NCUA, adopted the most sweeping regulatory changes to credit card practices ever. The Board also is in the process of addressing fees for overdrafts and consumer accounts, including whether there should be an opt-in or opt-out for overdraft fees, the form of the notice to be given, the treatment of debit holds, and related issues.

At this point in time, adopting either H.R. 627 or H.R. 1456 runs the risk, at best, of creating conflicting statutory and regulatory regimes. At the extreme, new legislation or credit card practices could lead to significant limitation on the availability of credit to American households.

For example, H.R. 627 calls for its provisions to become effective in 3 months, instead of July 1, 2010, the effective date for the UDAP and Regulation Z rules. Similarly, the provisions of H.R. 1456 differ significantly from the Board's proposal. Some aspects of H.R. 1456, such as the opt-out for point of sale, are simply unworkable, and others, such as the opt-in, are likely to lead to a significant disruption in consumer payments, to the detriment and ire of both consumers and merchants.

A 3-month effective date in H.R. 627, in particular, would present serious operational problems and could significantly curtail access to credit. Credit card issuers will be faced with enormous changes in highly automated systems. Any effort to accelerate these automation changes may simply fail or result in significantly higher levels of processing errors.

Perhaps more significantly, the repricing and payment allocation provisions would affect as much as $12 billion a year in revenue for credit card issuers. In order to recover this lost revenue, as a practical matter, credit card issuers only have two possible options: raise rates and fees; or reduce the amount of credit risk in their portfolios.

Early implementation of the repricing limitations, however, would severely limit the rate option. Credit card issuers would have no cushion of profitability to absorb the increased costs and would have no choice but to take steps to reduce risks in their portfolios. These steps would reduce the amount of credit available to households significantly when they need it most for ready access to credit.

I appreciate the opportunity to appear before you here today and would be pleased to answer any questions.

[The prepared statement of Mr. Ireland can be found on page 127 of the appendix.]

Mrs. MALONEY. Thank you very much.

Mr. McCracken?

STATEMENT OF TODD McCRACKEN, PRESIDENT, NATIONAL SMALL BUSINESS ASSOCIATION (NSBA)

Mr. MCCRACKEN. Good afternoon, Madam Chairwoman, Ranking Member Hensarling, and members of the subcommittee. My name is Todd McCracken, and I am the president of the National Small Business Association, America's oldest small-business advocacy organization.

Historically, small businesses have led America's resurgence out of periods of economic distress and uncertainty. Previous small-business-led economic recoveries were based substantially on the creation of millions of new small firms.

How did these aspiring small-business owners do it? Besides possessing an entrepreneurial streak, they were able to finance their dreams through a number of means, most of which are currently unavailable or restricted. They borrowed from themselves, often through second mortgages and the like; they borrowed from their friends and family; or they borrowed from a bank.

Aspiring business owners would be hard-pressed in the current environment to self-finance their entrepreneurial dreams. Home prices are down, and so are the stock portfolios. The same is true for their friends and families. Banks have tightened their lending standards, and there has been a drastic reduction in the number of SBA loans being made. Even those banks on the receiving end of billions of dollars of taxpayer dollars have not increased their small-business lending.

Where does this leave the aspiring entrepreneurs who will lead the Nation out of its recession? Increasingly reliant on their credit cards. Credit cards are now the most common source of financing for America's small-business owners.

Although they are increasingly turning to credit cards to finance their business ventures, more than two-thirds of surveyed small-business owners report that the terms of their cards are worsening, however. This is not good news for America's economy, which is heavily reliant on a robust and thriving small-business community. The billions of dollars generated from outlandish retroactive interest rate hikes, the escalating imposition of undisclosed fees, and unilateral and unforeseen interest rate increases is money diverted from economic development.

America's small-business owners are not in the habit of advocating for the passage of increased Federal regulations, as I am sure you know, preferring free enterprise and market solutions. But the current practices of the credit card industry defy the principles of a competitive market. While welcoming the enactment of the Unfair and Deceptive Acts or Practices, UDAP, rule, NSBA believe that it is necessary to codify these rules and enact them sometime before July 2010.

While NSBA supports the enactment of H.R. 627, there are two major aspects of credit card reform the bill does not address. One is interchange fees, and the other is exemption of small-business cards, and we urge Congress to address both of these things.

As much as $2 of every $100 in credit or debit card receipts goes to card issuers through interchange fees, which have increased over the last decade from being about 13 percent of card issuer revenue to being about 20 percent, and inflating the cost of nearly everything consumers buy. In total, Americans paid more than $42 billion in interchange fees in 2007, about twice as much as they paid in credit card late fees. NSBA urges Congress to adopt legislation similar to the Credit Card Fair Fee Act or the Credit Card Interchange Fees Act of 2008, which were introduced during the 110th Congress.

The largest loophole in H.R. 627 is the absence of explicit protection for small-business owners who use their cards for business purposes. Since H.R. 627 amends the Truth in Lending Act, which, except for a few provisions, does not apply to business cards, its protections are limited to consumer credit cards. Although the credit cards of many, if not most, small-business owners are based on the individual owner's personal credit history, it is conceivable that issuers could legally consider them exempt from H.R. 627's vital protections.

TILA defines a "consumer" as a natural person who seeks or acquires goods, services, or money for personal, family, or household use other than for the purchase of real property. While a small-business owner who opens a personal credit account and uses it occasionally for business should be covered, it is far from clear that this legislation would protect a small-business owner who used his card exclusively or even primarily for business purposes.

Although in the past issuers appear largely to have kept most of their cards in compliance with TILA, there is no guarantee this convention will continue, especially when one considers that its basis appears to have been practicality and not legal obligation. Since issuers were able to subject consumer cards to the most egregious of practices, there was little incentive to distinguish between consumer and small-business cards. An unintended consequence of H.R. 627, if it remains unamended, is that this legislation could provide just such an incentive.

Accordingly, NSBA urges Congress to correct this oversight and extend the protections of TILA, the UDAP rule, and H.R. 627 to business cards of small businesses. It is inconceivable that Congress would knowingly allow issuers to perpetuate practices recognized as unfair and deceptive against America's small businesses, especially given their essential role in the Nation's economic recovery.

In conclusion, the small-business community is not opposed to the credit card industry, nor does it begrudge its profits. In fact, as I previously outlined, the small-business community is increasing reliant on credit cards for its very existence. Small business simply asks the credit card industry to play by the same rules as the rest of us.

Thank you very much.

[The prepared statement of Mr. McCracken can be found on page 136 of the appendix.]

Mrs. MALONEY. Thank you.

And this will be followed by two consumer advocates in alphabetical order.

Mr. Mierzwinski?

STATEMENT OF EDMUND MIERZWINSKI, CONSUMER PROGRAM DIRECTOR, U.S. PIRG

Mr. MIERZWINSKI. Thank you, Madam Chairwoman, Mr. Hensarling, and members of the committee.

As you will note from my written testimony, Mr. Plunkett and I are submitting a joint written testimony on behalf of a dozen organizations, and we will each talk about one of the bills. I will talk first about the overdraft bill. And all of our organizations strongly support, Madam Chairwoman, your introduction of these two bills.

I would say one thing about the consumer credit card bill of rights. Until your bill passed last year, in the 20 years I have been here in Washington, no bill ever opposed by the credit card industry made it through any congressional committee that I can remember. So that is my point on that.

In terms of overdraft fees and the overdraft bill, H.R. 1456, the invention of so-called bounce protection programs in the 21st Century is not a sign of the advance of civilization; it is more a sign of the decline of civilization. I want to make just a couple of quick points.

First, it is essentially banks making payday loans. It used to be that banks and credit unions were the good guys. We had the rent-to-own industry, the payday loan industry, the auto title pawn industry, and the check cashers who were the bad guys. This is essentially the banks' entry into predatory lending, and that is too bad, and it is something that your bill would stop.

Second, the problems have been exacerbated by two trends. The first thing is that, in 2004, Congress made it easier for banks to get access to the checks that were written more quickly when it enacted Check 21, but Congress hasn't given consumers faster access to their deposited funds since the original law was passed in 1987 and took effect in 1988. So banks hold our checks and deposited funds as long as they can, and they manipulate our transactions in order to increase fee income from unfair overdraft programs. The second trend is that banks have encouraged the use of plastic. Plastic has not just become a substitute for checks; it has become a substitute for cash transactions. So both these trends have increased the ability of banks to make money on this program of bounce protection, or, as they prefer to call it, courtesy overdraft.

What is good about a program that you don't ask for, that you don't sign up for, and that costs you more money than it benefits you? In a word, nothing is good about it. Without asking for our consent, banks and credit unions unilaterally permit most customers to borrow money from the banks by writing a check, withdrawing funds at an ATM, using a debit card, or preauthorizing electronic payments that overdraw our accounts. Instead of rejecting purchases that are electronic, they choose to have the purchases go through so they can make more money.

One important point is that small debit transactions—and, again, these are not checks; these are small debit transactions—are a growing source of the income from overdraft protection accounts. About half of all overdraft fees are caused by small debit transactions, the $4 latte that costs $35. In fact, the average debit overdraft is $17. The average fee is double that, $34.

Consumers want choice. These programs don't give us choice. Your bill would require the consumer's consent before he or she participated in this overdraft program. If you have that consent, you might think about, instead of this bank-friendly overdraft program, getting a more traditional overdraft program that costs you a lot less; apply for an overdraft line of credit; apply for a transfer from your savings account or your credit card. Eighty percent of consumers would rather have that sort of choice, and an opt-in is the way to do it. An opt-out simply won't work.

By the way, 80 percent of consumers also want the choice at point of sale as to whether or not their transaction would go through. I am not going to be embarrassed at the Starbucks or at other coffee shop if they say my card did not work, and I have to take out a $5 bill. It is absurd for banks to claim that people want that kind of choice:

"Would you rather pay $35 for that $4 coffee or would you rather pay for it in cash, Mr. Mierzwinski?" I would rather pay for it in cash or walk away.

The fact is that the cost of overdrafts, over $17 billion a year, is actually more than the so-called "benefit." The total number of transactions is less than $16 billion a year. The costs are inordinately borne by lower-income people, minorities, younger people, and senior citizens on fixed incomes, many of them receiving government benefits. Many people on government benefits are receiving their benefits through prepaid debit cards, and these cards are often subject to these fees.

By the way, the banks claim, using Federal Reserve data—first of all, the Federal Reserve says that it is feasible to provide overdraft protection warnings at point of sale. They claim it might cost as much as over $1 billion. Well, the most vulnerable senior citizens pay over $1 billion in overdraft protection fees every year. All in all, senior citizens pay over $4 billion in overdraft protection fees.

So this is a program that hurts people who cannot afford it. It is a program that has nothing to do with choice. Your bill would fix all the problems. The Fed's program would not. The Fed's program is narrower, and they are asking, "Do we want to opt out," which is not really a choice, or "Do we want opt in?"

You have already decided on the right choice, opt in.

Sorry. We cannot see the red light.

Mrs. MALONEY. Thank you. The gentleman's time has expired. Thank you for your testimony.

[The joint prepared statement of Mr. Mierzwinski and Mr. Plunkett can be found on page 145 of the appendix.]

Mrs. MALONEY. Mr. Plunkett is recognized for 5 minutes.

STATEMENT OF TRAVIS B. PLUNKETT, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA

Mr. PLUNKETT. Congresswoman Maloney, Ranking Member Hensarling, it is good to be here, and thank you for the opportunity to testify.

I am going to focus my remarks on the very serious financial consequences that unfair and deceptive credit card practices are having on many families in this recession and how the Credit Cardholders' Bill of Rights Act will help stop these traps and tricks.

The President spoke yesterday afternoon, actually, on the need for a credit card bill of rights. He said, "The truth of the matter is that the banking industry has used credit cards and has pushed credit cards on consumers in ways that have been very damaging."

First, let me tell you what is in the bill that is important for consumers, and then I would like to give you three reasons why it is important to implement credit card reform on a very timely basis.

We have heard about the 30-day rule. This proposal says no interest rate increases on existing balances unless you are more than 30 days in paying your bill. This bill says you can't allocate payments for debt at different interest rates unfairly anymore; you have to allow consumers, at the very least, to write a check and pay off payments at both the higher and the lower interest rate debt.

It bans deceptive and unfair double-cycle billing. It takes several steps to stop the assessment for late fees for on-time payments, and unlike the regulators rule, which is also substantively good, it will provide timely protection from these abusive practices to consumers. It takes effect 3 months after enactment instead of in July 2010, as we have heard. Also, codifying protections in law has the advantage of preventing regulators from quietly undoing important protections at a later date.

So why do we need to do this, and why do we need to do it fairly quickly?

First, the number of families in trouble with their credit card loans is approaching historic highs. One often-watched measure is the monthly credit payoff rate; this is the amount of money people are paying on their credit card bills. It has been dropping precipitously for credit cards, and it is now at one of the lowest levels ever reported, indicating people are having a harder and harder time affording their bills.

The amount of charge-offs, the amount of debt written off, is uncollectible, and delinquencies are at their highest levels since 2002. Most experts are saying they could peak at their highest levels ever by the end of this year.

Personal bankruptcies are up by a third since this time last year.

Card issuers share a great deal of responsibility for putting so many Americans in such a vulnerable financial position. For 15 years, CFA and many others have been warning that issuers were irresponsibly pushing consumers to take on more debt than they can afford; and now, in the recession, we are seeing the implications of those actions.

Let us just talk about exactly what is happening now, about some of the practices that credit card issuers are using now in this recession:

They have added new fees. They have increased the amount of fees. They have used harmful, rather than responsible, methods to lower credit lines, and they are hitting people with a lot of interest rate increases.

Citigroup back-pedaled last fall on promises not to raise rates at any time for any reason and promptly raised rates for much of their portfolio. Chase has started charging hundreds of thousands of cardholders $120 in fees a year while increasing the minimum monthly payment for cardholders who were promised a fixed rate for the life of the balance.

Bank of America has used a variety of questionable methods they claimed were risk-based to raise rates substantially on many cardholders. Capital One and other issuers are using vague clauses in their agreements to raise interest rates, often by 5 percent or more, on millions of cardholders with a good credit history because of market conditions.

So we are now hearing that this bill is somehow going to lead to a scarcity of credit, lead to interest rate increases on consumers who shouldn't have interest rate increases and harm them; and we seem to have missed the major lesson of the current economic crisis, that poor regulation can harm consumers and the economy.

I mean, look at what started happening in the credit card industry before regulation was implemented. Defaults were at record highs, as I have mentioned. Issuer costs to borrow money was increasing. Securitization was grinding to a halt, of credit card loans. Credit was being cut back as we have heard, and rates for many consumers were increasing. They can't blame that on regulation; it hasn't taken effect. This was the effect of a market that had not been properly regulated for 20 years.

So, in closing, what I will say is, we have to have a discussion that understands what the current situation is and what the hazards of poor regulation have been, and then we can have a reasonable discussion about the pros and cons of various regulatory proposals. Thank you.

[The joint prepared statement of Mr. Plunkett and Mr. Mierzwinski can be found on page 145 of the appendix.]

Mrs. MALONEY. I want to thank all of the panelists for their very thoughtful presentations.

I just have one question for industry and for consumer groups. I am sure you were all here for the debate from the Fed and OTS and NUCA. I just want to ask one question: Putting aside the debate about implementation, do you support the regulations that have been finalized on credit cards?

I will start with you, Mr. Clayton. Just a "yes" or a "no."

Mr. CLAYTON. I just want to note that the regulations have the force of law. We are responsible for complying with them, and we will in a very aggressive manner.

Mrs. MALONEY. Okay. Thank you.

Ms. ECHARD. We, too, support most of the changes, but we need the time to implement them; and we will be ready in July 2010.

Mrs. MALONEY. Well, I just want to respond to her very important statement, and I just would like to make a statement about community banks.

They have really come to the forefront during this financial crisis with loans to individuals and communities, and you have done a fantastic job. I hear great reports of credit availability from community banks.

I would like to say that issuers would have yet another 3 months before having to comply. Issuers have already had 3 months since the release of the rules, and it will be a few months more before this could possibly pass both Houses and be signed by the President.

These practices that have been labeled by the Federal Reserve—not by consumers, but by the Federal Reserve, who are charged with safety and soundness of our financial institutions—have called them unfair, deceptive and anticompetitive. Arguing for any delay simply does not match the needs of consumers.

You know, I just wanted to put that out there. It has been a long time, and it will probably be a long time before it finally passes both Houses and is signed.

Mr. Fecher, do you support the Credit Card Bill of Rights?

Mr. FECHER. Most credit unions do not engage in those practices. So, yes, we do support those.

Mrs. MALONEY. Mr. Ireland?

Mr. IRELAND. We certainly support compliance with Federal law.

Mrs. MALONEY. Mr. McCracken?

Mr. MCCRACKEN. Yes, we do.

Mrs. MALONEY. Mr. Mierzwinski?

Mr. MIERZWINSKI. Yes, of course, Representative Maloney, we support the bill; and I concur with your comments about why they really have a lot more time.

Mrs. MALONEY. Mr. Plunkett?

Mr. PLUNKETT. Yes.

Mrs. MALONEY. Thank you very much.

I yield to Mr. Hensarling.

Mr. HENSARLING. Thank you, Madam Chairwoman.

Ms. Echard, I think I heard in your testimony some discussion of what you thought community bankers might do if this would become law.

What would happen to their credit card offerings? Can you elaborate on what you would anticipate the consequences of the passage of this legislation to be?

Ms. ECHARD. Thank you. Yes.

The change-out of the disclosures and of the materials alone, by a conservative estimate, for our 700 institutions is probably going to cost them in the neighborhood of—somewhere from $6 million to $9 million, and that is just covering 200 new applications per branch. That is going to be equivalent to 2 years of their credit card profitability, to 2 to 3 years of their credit card profitability.

Mr. HENSARLING. Do you predict that some banks may drop credit card offerings, or will they raise interest rates and fees in other areas to compensate for that loss?

Ms. ECHARD. I believe that some community banks, even though they do not engage in any of these practices, will find the burden of complying, especially getting the implementation done in 90 days, to be too much, and they will sell their credit card portfolios.

Mr. HENSARLING. In your time and in your familiarity with the banking industry, if there are consumers who find out that through the passage of this legislation that ultimately the credit cards they could have accessed in the past are no longer available to them and they lose those credit cards, do you have an opinion on where they may end up going to access credit?

Ms. ECHARD. With the concentration, they will have the choice of going to a large financial institution and not with their local institution. Thousands of community bank customers may be faced with having their banking in one place and their credit card elsewhere.

Mr. HENSARLING. Again, going back to the timing issue, if this became law within 90 days, how many community banks might be able to comply within the 90-day time limit?

Ms. ECHARD. Not a single one. The 6,000 community banks that were mentioned, or the 6,000 banks, most of them are small issuers. They are credit unions, community banks. Most of them rely on processors.

We have been meeting with our processor and a focus group of our community bank every single week since implementation was announced. While it is not as huge as the Y2K project, it is somewhat on that scale in that we have the communication bulletins.

If you think of the July 1st enactment date, that means that all of the statement processing systems have to be done in June because all of the statements being mailed out beyond that date have to be correct. So that means testing in May and April. We have a system freeze so that the cards will operate smoothly for all merchants and for all consumers; there is no processing, no changes, nothing. It is a sacred time in the credit card industry from November to January, so that knocks out those 3 months.

I mean, we are starting on it now. It is going to take a huge effort to get this done, and the last thing we will be doing will be the training of client services, the training of customer service, the training of bank personnel, and the completion of the applications in the agreements and the review of all of that. So it is a tremendous, tremendous undertaking.

Mr. HENSARLING. Earlier, with the testimony of the representative of the Federal Reserve, she offered her opinion that the credit card industry was a competitive industry. Does anybody on the panel wish to disagree with that particular assessment?

Mr. Plunkett hit his button first.

Mr. PLUNKETT. Well, it is becoming considerably more concentrated. Nobody wants to impose unnecessary costs on any bank, especially small banks. But let us just point out that the 6 largest issuers control approximately 80 percent of the market; if you look at the top 10, it is approximately 90 percent of the market. So the costs are going to be borne by the largest companies, which are among the largest banks in the world.

Mr. HENSARLING. Mr. Plunkett, since your organization has "consumer" in its title and you speak about a concentration in the industry, what public policies of your organization furthered or proposed or endorsed that which would increase competition within the credit card industry?

Mr. PLUNKETT. We think this is a competitive proposal. I mean, I cannot tell you how many times I have had behind-the-scenes, off-the-record discussions with people in the credit card industry when they have said, "You know, we are trying to do our best, but those guys over there, they are using, you know, a tactic that we think is reprehensible, but we have no choice. We are leaving money on the table if we do not do the same thing."

This sets a level playing field of fair practices. Everybody has to comply, and there is plenty of room for competition and plenty of room to price to risk.

Mr. HENSARLING. So your prediction is, there will be more credit card offerings to consumers after this legislation passes?

Mr. PLUNKETT. Well, my prediction is this will not harm competition.

Mr. HENSARLING. Thank you.

My time has expired.

Mrs. MALONEY. The Chair recognizes Congresswoman Waters from California.

Ms. WATERS. Thank you very much. I am extremely appreciative for this hearing that you are holding today and for all of the work that you have done in taking on one of the toughest tasks of the last Congress and of this Congress, to try and get some justice for credit cardholders. I thank you for your work.

I have been intrigued by the discussion on overdraft abuses and on the need for overdraft protection. I would like to ask—Mr. Mierzwinski, is it?

Mr. MIERZWINSKI. That is correct.

Ms. WATERS. Okay. Would you explain to me how a cup of coffee—was it you who described that?

Mr. MIERZWINSKI. Sure. Well—

Ms. WATERS. —could end up costing what—$30 because of overdraft abuses? Would you kind of break that down for me?

Mr. MIERZWINSKI. Sure.

Very simply, as consumers have switched from writing checks for their bills and using cash for their day-to-day transactions in stores, they have switched to debit cards, an ATM card that can be used at point of sale.

Even when the consumer's debit card shows a negative balance or when the bank reorders the transactions at the end of the day to increase the number of negative items on that day, in either case what happens is, you buy something with your debit card for $4 or for $2, depending on the kind of coffee you buy, and they accept the transaction. At the end of the day, they bounce it and charge you $35.

The statistics from the studies that our colleague organization, the Center for Responsible Lending, has done show that the average debit card transaction is only about $17, but the average fee is $35.

Ms. WATERS. Wow.

Mr. Clayton, is that what happens with the overdraft abuse that was just described by Mr. Mierzwinski?

Oh, let's see. You are with the American Bankers Association Card Policy Council?

Mr. CLAYTON. That is correct.

Ms. WATERS. Is that what happens? Is that what you know happens or is this just being made up?

Mr. CLAYTON. No, that is not our understanding of how things operate in the real world.

Ms. WATERS. How does it operate? Tell me how it operates.

Mr. CLAYTON. As a practical matter—and the Federal Reserve has done some consumer testing on this—consumers really very much appreciate the availability of overdraft protection plans to help them in a bind.

Ms. WATERS. No. I just want to know how it works.

Mr. CLAYTON. Say again?

Ms. WATERS. I want to know how it works.

I just had him describe what happens with the overdraft. He described a cup of coffee at $4 or $2 that, at the end of the day, is an overdraft because there is no protection for the consumer in stopping that purchase at the point of purchase.

So tell me what is wrong with what he just described?

Mr. CLAYTON. There is enormous protection for consumers in stopping the purchase at purchase time. Consumers have a great deal more control in this process than people give them credit for. It is exactly the same as when they were working with checking accounts for many years.

Ms. WATERS. Just tell me how it works.

Mr. CLAYTON. People keep track of their balances. They can go online and check out where it is. They can keep cushions—

Ms. WATERS. No, but what he said was, you buy a cup of coffee at Starbucks for $4, I guess, with a debit card or something, and the card does not have $4 on it; I guess they only have $2 on the card.

So you use the card. They get the coffee. They drink it.

At the end of the day, it is an overdraft that you charge $35 for. Is that correct or not?

Mr. CLAYTON. If they overdraft their accounts, they will be subject to fees.

Ms. WATERS. So what he just described is correct?

Mr. CLAYTON. If they overdraft their accounts, they will—

Ms. WATERS. So what he just described is correct?

Mr. CLAYTON. Yes.

Ms. WATERS. Okay. So, if it is correct, do you think that that is overdraft abuse? Do you think that that is a practice that should be discontinued because it is too harsh, because it is costing too much money and that, if you wanted to, you could reject the card and avoid the abuse?

Mr. CLAYTON. Well, first of all, the technology does not exist to actually do that at the point of sale.

But notwithstanding that—and there are significant costs that have been talked about here—consumers have a responsibility to manage what is in their accounts. There are fees for not complying with what is in their accounts in overdrafting. So to the extent that you think it is inappropriate for consumers to get fees for overdrawing on the amount of money they have, then you can take the position that the whole process is inappropriate.

From our perspective, we are taking a risk. We are putting out a convenience and a service to consumers that they seem to value and that they have a lot of control over, whether they are going to incur costs or not, so we understand where you are coming from.

Ms. WATERS. Do 18-year-olds and 17-year-olds have access to these debit cards? Can they use them at Starbucks in the way that was just described?

Mr. CLAYTON. Well, you have to have an account, and I think you have to be an adult to have an account, and you have to be of voting age, so 18 and above.

Mrs. MALONEY. The gentlelady's time has expired.

Ms. WATERS. Thank you very much.

Mrs. MALONEY. Mr. Lee from New York.

Mr. LEE. Thank you very much.

It was nice to hear the general consensus through both the first and second panel today. I think everyone is in agreement that we do need to do modifications to try to protect consumers and to make it easier for them to understand the contracts and to try to protect consumers. I do not think I heard from anyone who was not in agreement with making strides in that regard.

The one thing that I did hear overwhelmingly was the fact that the timeline is inappropriate and, furthermore, that it would, in my opinion and from what I have heard, put consumers at risk.

I used the earlier example because I am a lowly freshman here, but I came from a manufacturing business where I went through three occasions, through various businesses that I had an opportunity to run. We went through major software implementations, not much different than you would see here when you are modifying your business systems for a credit card. I can assure you, a good implementation is doing it in a year.

My concern is—and I would like to hear from some of the individuals here—what risk we would run if we do rush this; because I think, at the end of the day, Chairwoman Maloney and her ideas that she has passed are all good ideas. But what I do not want to do is jeopardize businesses that are already struggling, credit card companies, and put them at further risk, because when you do do an implementation, you need a large number of people focused on this project.

Right now, we have companies that are cutting back on staff. I just do not want to see this thing fail when, at the end of the day, we are trying to do things that are positive for consumers.

I guess I would start with Mr. Clayton. If you could, define what specific risks we would see if in 90 days we were to flip the switch and this were to occur. In your mind, what specifics to consumers, what negative effects, would they see?

Mr. CLAYTON. Operationally, we would expect to see mistakes in billings for millions of consumers. That is the first step.

The second thing is, we do see significant problems in our ability to manage our risk models in this kind of economically challenging time. There is a significant amount of delinquency increase in the marketplace today. There are significant pressures on funding as witnessed by the TALF program that the Treasury Department and the Federal Reserve are trying to bring into place.

With credit card lending, what people do not always notice is that around one-half of credit card lending is actually funded by investors who buy securities backed by credit card receivables, and that market is frozen. If those investors believe that we cannot adequately gauge risk in this challenging environment, they will not buy the paper that supports one-half of the credit card lending in this country.

Mr. LEE. I am sorry. What was the total value of that?

Mr. CLAYTON. The actual amount currently that the Federal Reserve has talked about is about $450 billion.

So adequately measuring your risk in this environment and doing it operationally and in a consistent manner limits litigation risk. In other words, it is a significant challenge that you have to not only overcome your internal views on it, but that you have to overcome the investor community.

So we are very worried that, if you do this, you will ultimately limit the ability for us to find reasonable cost funding to loan to consumers, and you will see a significant contraction of credit in the marketplace.

Mr. LEE. Thank you.

Ms. Echard, could you chime in on that, please?

Ms. ECHARD. Yes. Thank you.

Potentially, the banks being out of compliance is an issue, the posting of payments. All of the systems are being examined right now, including the consumer facing systems like the actual statement—does that need to be redesigned?

The system that produces that: the billing cycles, the number of billing cycles, the staffing for those billing cycles, the Web site that consumers can go on to make their payment should they choose to pull down their transactions, every single system—the client services system, the customer service system—needs to be examined to do that—

Mr. LEE. I know that all too well.

Ms. ECHARD. —in order that everything gets posted properly and is handled properly.

Mr. LEE. We saw today even on the House Floor, when Congress rushes to try to push through legislation, you have outcomes that are less than desirable.

So, just in closing, I appreciate all of your comments today. Thank you for the education.

Mrs. MALONEY. Thank you, Congressman.

Congressman Cleaver is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman. Let me express my appreciation for you and for all of the work that you have done on this.

Most of the members who could get an airplane out, did; and I could have gotten one out as well. I did not. I stayed. I sat through the whole testimony. I only got up once to get some water.

When I was mayor in Kansas City, I was part of an economic development effort to help bring one of the credit card operations into our City. One of the things I have tried to do today is—I wanted somebody to say something to convince me that I should go to my colleague and ask her to remove my name as a cosponsor for the legislation. I wanted desperately to come to the conclusion that maybe this legislation was ill-conceived. That has not happened.

I am, frankly, interested in knowing just a couple of other things.

Mr. Clayton and, I think, Mr. Fecher, maybe the first four of you mentioned—and maybe Mr. McCracken as well—that the 90-day timeline was too problematic. So let me ask you—and if you can, just answer it quickly—if that were changed, would your organization then submit a letter in support of the legislation?

Mr. CLAYTON. Mr. Cleaver, I am afraid not. I mean, the bill does not match the rules. There are significant differences.

Mr. CLEAVER. Okay.

Yes.

Ms. ECHARD. Normally, I probably would not be agreeing with the ABA, but in this case, codifying this does not give the regulators the flexibility to work with the institutions.

Mr. CLEAVER. Mr. Fecher?

Mr. FECHER. I think we would strongly consider that, actually.

As I stated before, most credit unions do not engage in these practices in the first place, and our significant objection to the bill is the 90 days. So, assuming a close reading of the bill does not turn up anything else that is unsuitable, I think we would tend toward supporting it, yes.

Mr. CLEAVER. Okay.

Mr. Ireland?

Mr. IRELAND. I have no problem with the idea of codifying the Federal Reserve rules to make that a statutory law.

I think it is impossible to implement that in 90 days. I think there are provisions from the bill that are inconsistent with the Fed rules and that won't work very well.

Mr. CLEAVER. But back to my question about the 90 days, you are saying—

Mr. IRELAND. You cannot do it. It is much worse, I think, than Mr. Clayton suggests.

Mr. CLEAVER. Okay.

Mr. McCracken?

Mr. MCCRACKEN. I was not one of the people who raised the concern.

Mr. CLEAVER. I am sorry. So let me go back.

Mr. Clayton, give me the one thing that I can amend the bill with that would then generate your organization's support.

Mr. CLAYTON. I assume other than the 90-day requirement?

Mr. CLEAVER. Yes.

Mr. CLAYTON. There is more than one thing.

Mr. CLEAVER. How many?

Mr. CLAYTON. Three or four beyond that.

Mr. CLEAVER. What are they?

Mr. CLAYTON. The first one is that you would have to conform the bill to the Fed rule, and I do not—first, let me back up.

I cannot tell you whether our industry would support the bill at that point, but raising concerns about the bill, which is what—is that what you are asking me to respond to?

Mr. CLEAVER. No. No.

What I am trying to find out is if you are just opposed to the codification, period, if you just do not want to do it. If that is the case, then in the absence of some compelling statement that would just cause me or somebody to say, "Gee, we need to leave this bill alone," then there would be no choice for me but to support it.

Mr. CLAYTON. We are not opposed to the codification of the Federal Reserve rule; although we would note that that takes away important flexibility that, if you got it wrong, you could no longer easily adjust in the marketplace, and that could be a problem for consumers. So we would start with that premise.

Then there were a number of things within the bill that we think need to be changed.

Mrs. MALONEY. The gentleman's time has expired.

Mr. CLEAVER. Thank you, Madam Chairwoman.

Mrs. MALONEY. Thank you very much. And I congratulate you on your important amendment to the bill on students.

Congressman Maffei.

Mr. MAFFEI. Yes. Thank you, Madam Chairwoman, and thank you for introducing this piece of legislation.

I have been hearing from my constituents who have had their interest rates raised, even very often when they have not been late on their bills. Most upsetting to these individuals—and, I will be frank, to myself as well—is that the companies are raising rates on the preexisting revolving balances.

I think we all understand that if you raise rates on future purchases or on future balances, then they have a chance to just say, "Well, I will switch to another card," or what have you. But on current existing rates, that gives them only the choice of trying to find another credit card that would be able to take their balance over, which they do not have that option, particularly in this environment; or to pay it off, which again, given the environment, they do not really have that option.

So there is really a huge challenge for consumers, and this is one of the prime reasons I am a sponsor of Mrs. Maloney's legislation, because what I see is unfair.

I do want to ask everybody on the panel—and maybe I am incorrect here—do you see raising rates on currently existing balances as fair or unfair?

A quick answer from everybody on the panel would be great. I will start with Mr. Plunkett and work to the other side.

Mr. PLUNKETT. Well, as I said previously, it is very damaging financially, and most of the time, it is completely unfair. You are absolutely right. A lot of the rate increases that are occurring now are not based on the fault of the borrower at all.

An additional reason to move fast here is that, as we talked about, many of the largest banks are the largest credit card issuers, and many of those banks are receiving Federal money. There are efforts to restart lending on the credit card front. How can we do that and not have fair terms on those loans?

Mr. MAFFEI. All right. Thank you, sir.

Mr. MIERZWINSKI. We would agree with Mr. Plunkett.

I would just add to his last point that in our testimony we went into detail, that we believe that all of the recipients of TALF money should comply with the Fed rules immediately and with additional consumer protections.

Mr. MAFFEI. All right. Thank you.

Mr. McCracken?

Mr. MCCRACKEN. Yes. Well, it is unfair, but more importantly, to our small business members, if they are not sure at what interest rate they are borrowing money, often for business purposes it is very difficult to make a business decision about where the best source of capital is for them.

Mr. MAFFEI. Okay.

Mr. Ireland?

Mr. IRELAND. I am going to be a little bit different, unfortunately.

I think what is unfair depends on what the parties understand they are doing. If you look at the Federal Reserve's own discount windows circular, that it lends to banks, it says they can raise the rate at any time, and they do, and it applies to existing balances as well as to future balances. That is a common term in open-end, revolving credit of this nature; it is not a common term and it is virtually never seen in closed-end credit.

So the question is, what do people understand they were doing when they entered into the relationship?

Now, I think what has happened is that people's understanding and use of credit cards over the last 20 years has changed and that what used to be retail installment credit has become revolving credit. So I understand the Federal Reserve's change in the rules to say, you cannot change it on existing balances because the credit that used to be could not be changed on existing balances.

Mr. MAFFEI. No. No. That is fine. I think—you are not avoiding the question exactly.

So you see it as fair given the rules that we have been working under?

Mr. IRELAND. Given the rules we have been working under, I have no problem with the change going forward.

Mr. MAFFEI. Okay. Mr. Fecher.

Mr. FECHER. We generally see that to be unfair with one caution. Credit unions tend to be balance sheet lenders. In other words, the money that they are using to fund the credit card balances are their members' deposits. If the costs of those deposits were to go up because of economic conditions, rising interest rates in the economy, you could face the position where the cost of the funds to fund the credit union balances could go above the credit card.

So, with that one caution, raising the rate through no fault of the borrower, we would believe to be unfair with the caution of the cost-of-funds issue.

Mr. MAFFEI. Thank you.

Ms. Echard?

Ms. ECHARD. Thank you, Congressman.

Community banks are honest brokers. They are not going to play games with the interest rate. However, they have the same concerns. If their cost of funds rises, they need the ability to make an adjustment, or many of them who today offer fixed rates would convert to a variable rate product.

Mr. MAFFEI. Okay.

Mr. Clayton?

Mr. CLAYTON. Let me add to that.

The cost of funds can clearly move, but so does the risk. I mean, delinquencies are at a significantly higher level than they have been in a while. There is an unprecedented amount of economic turmoil. We do not know which borrowers are not going to pay us back, beforehand.

Mr. MAFFEI. So you want to raise the rates on all of them?

Mr. CLAYTON. In order for us to continue to make loans, we have to get some kind of assurance to manage our risk appropriately. If we cannot do that, we cannot make loans to everybody.

So to put a real face on it—and I will put it in a small business environment—if a small business using a personal credit card has a small business balance at $25,000 and it defaults, that takes $25,000 of loan losses right out of our capital. Because we can lend, essentially, 10 to 1 to that capital, we can lend $250,000 with just—

Mr. MAFFEI. Well, I am out of time.

Mr. CLAYTON. I will be really quick.

The point is, if we lose $25,000 in that one context, we cannot make loans to 10 other businesses of the same amount; and that is where the real hurt comes.

Mr. MAFFEI. I appreciate it, Mr. Clayton. I understand, sir, where you are coming from. I actually think that is sort of the fundamental problem here.

Again, it is very, very difficult to—I think if you try to get outside of yourself, it appears unfair to that borrower, and they do not really care too much about the future loan.

Thank you very much.

Mrs. MALONEY. I now recognize Congressman Cleaver.

Mr. CLEAVER. Madam Chairwoman, if there is no objection, I would like to submit for the record a letter from one of my constituents where she explains how her interest rates were raised recently, without her knowledge, from American Express, Capital One, and Chase.

Mrs. MALONEY. Without objection, it is so ordered.

I also would like to ask unanimous consent for a letter from the president and CEO of the National Association of Federal Credit Unions to Chairman Gutierrez, and Ranking Member Hensarling to be entered into the record.

Without objection, it is so ordered.

I want to thank the witnesses and members for their participation.

The Chair notes that some members may have additional questions for the witnesses which they may wish to submit in writing. Therefore, without objection, the hearing record will remain open for 30 days for members to submit written questions to the witnesses and to place their responses in the record.

The subcommittee hearing is now adjourned.

[Whereupon, at 5:32 p.m., the hearing was adjourned.]

A P P E N D I X

March 19, 2009

March 19, 2009

Statement of Congressman Kenny Marchant

Subcommittee on Financial Institutions hearing on credit cards

Mr. Chairman thank you for holding this hearing today.

I have a few concerns I hope will be addressed in this hearing. Mainly I am curious as to what impact the new UDAP rules will have on: (1) the availability of credit for lower income or higher risk consumers and (2) the cost of credit overall.

I also see that the Federal Reserve has set an effective date for the new regulations of July 1, 2010.

I am hoping we will be able to asses the impact of accelerating that implementation period to three months, as this bill suggests. I wonder if the Fed could even make that deadline, given that the legislation (H.R. 627) would require the Fed to issue new regulations that are slightly different than the existing regulations.

There is an urge by many in Congress to do something regarding credit card practices. I am concerned that if Congress overshoots and places too many restrictions on how the industry manages its business by establishing controls over pricing, fees and other practices, such restrictions could squeeze off the availability of credit for consumers. This would be especially harmful in such tough economic times.

The Federal Reserve has spent years developing rules that balance the needs of consumers with the need to ensure that banks operate in a safe and sound manner and that the availability of consumer credit is sustained in the marketplace. In preparing these new regulations, the Fed has also had the benefit of more than 60,000 comments from consumers, legislators, advocates, and the industry regarding the proposed regulations.

Given this tremendous amount of research and development, I am not sure Congress should be adding additional rules or insisting on a faster timeline for implementation.

STATEMENT

OF

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NATIONAL CREDIT UNION ADMINISTRATION

"H.R. 627, THE CREDIT CARDHOLDERS' BILL OF RIGHTS ACT OF 2009;
AND
H.R. 1456, THE CONSUMER OVERDRAFT PROTECTION FAIR PRACTICES ACT OF 2009"

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

MARCH 19, 2009

I. Introduction

The National Credit Union Administration's (NCUA) primary mission is to ensure the safety and soundness of federally insured credit unions, as well as their compliance with applicable federal regulations. It performs this function by examining all federal credit unions (FCUs), participating in the supervision of federally insured, state-chartered credit unions (FISCUs) in coordination with state regulators, and insuring credit union member accounts. In its statutory role as the administrator for the National Credit Union Share Insurance Fund (NCUSIF), the NCUA provides oversight and supervision to 7,806 federally insured credit unions, representing 98 percent of all credit unions and approximately 88 million members.[1]

The NCUA regulates and insures all FCUs and insures most state-chartered credit unions. Under this framework, the NCUA is responsible for enforcing regulations in FCUs and evaluating safety and soundness in all federally insured credit unions. The NCUA is also responsible for monitoring and ensuring compliance with most federal consumer laws and regulations in FCUs. In federally insured, state-chartered credit unions, the appropriate state supervisory authority has regulatory oversight and enforces state consumer laws and regulations.

[1] Approximately 162 state-chartered credit unions are privately insured.

II. Summary of Legislation

Credit Card Bill. The Credit Cardholders' Bill of Rights Act of 2009 would amend the Truth in Lending Act (TILA) to prohibit or restrict certain practices regarding open-end consumer credit.[2] This comprehensive credit card reform legislation is aimed at protecting consumers and abolishing industry abuses that have been described as "unfair," "deceptive," and "anti-competitive." Specifically, the bill would:

- Protect cardholders against arbitrary interest rate increases;
- Prevent cardholders who pay on time from being unfairly penalized;
- Protect cardholders from unauthorized due date changes;
- Shield cardholders from misleading terms;
- Empower credit cardholders to set limits on their credit;
- Require card issuers to fairly credit and allocate payments;
- Prohibit card issuers from imposing excessive fees on cardholders;
- Prevent card issuers from giving subprime credit cards to consumers who cannot afford them; and,
- Provide for better oversight of the credit card industry.

Overdraft Protection Bill. The Consumer Overdraft Protection Fair Practices Act would extend the protections of TILA to overdraft protection programs and services provided by financial institutions.[3] Specifically, the overdraft bill would require consumers to opt-

[2] H.R. 627, 111th Cong. (2009).
[3] H.R. 1456, 111th Cong. (2009).

in to overdraft protection programs, would require financial institutions to provide enhanced disclosures, and would prohibit financial institutions from manipulating the posting of checks and other debits to generate overdraft fees.

III. Credit Card Programs

In December 2008, the NCUA, the Office of Thrift Supervision (OTS), and the Board of Governors of the Federal Reserve System (FRB; collectively, the Agencies) jointly issued the Unfair or Deceptive Acts or Practices (UDAP) rule amending each agency's credit practices rule to prohibit certain credit card practices.[4] Specifically, the UDAP rule addresses the following credit card practices:

- The amount of time card issuers give cardholders to make payments must be reasonable. The rule provides a safe harbor for financial institutions that send periodic statements at least 21 days before the payment due date.
- The financing of security deposits and fees for credit availability is prohibited if the charges assessed during the first 12 months will exceed 50 percent of the initial credit limit and is limited to 25 percent of the initial limit at account opening. Any additional amounts greater than 25 percent but less than 50 percent may be spread evenly over at least the next five billing cycles.
- The amount of cardholder payments exceeding the minimum payment must be allocated first to the portion of the outstanding balance with the highest annual percentage rate (APR) or pro rata among the portions of the outstanding balance with varying APRs.

[4] 74 Fed. Reg. 5498 (January 29, 2009).

- The practice of calculating interest on an account balance using days in a previous and the current billing cycles, often referred to as "two-cycle" or "double-cycle" billing, is prohibited, except when adjustments to an account balance are required for a returned payment or resolution of a dispute.
- The application of increased interest rates to pre-existing balances is prohibited, except when a temporary rate and the subsequent rate at expiration are disclosed at account opening; the rate is based on a public index; the financial institution, after the first anniversary of the account, provides the cardholder notice 45 days before the higher rate becomes effective; and, the minimum payment is received more than 30 days after the due date.

Several factors prompted the issuance of the UDAP rule, including congressional inquiries directed to the Agencies, proposed amendments to the FRB's Regulation Z[5] in June 2007, and an OTS advance notice of proposed rulemaking in August 2007.[6] Based on comments received in response to the rulemakings, the Agencies determined a broader, more comprehensive approach, addressing more than just TILA disclosures, was appropriate. Because each of the Agencies oversees financial institutions that engage in the same types of business, however, the NCUA Board determined a uniform approach to the topic was important.

The UDAP rule was issued in accordance with section 18(f) of the Federal Trade Commission Act (FTC Act), which makes the Agencies responsible for prescribing

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[5] 72 Fed. Reg. 32948 (June 14, 2007) (proposing amendments to 12 C.F.R. part 226).
[6] 72 Fed. Reg. 43570 (August 6, 2007) (requesting comments on 12 C.F.R. part 535).

regulations that prevent unfair or deceptive acts or practices in or affecting commerce within the meaning of section 5(a) of the FTC Act.[7] The rule amended the NCUA's credit practices rule, which is codified at 12 C.F.R. part 706 and applies to FCUs only.[8]

Legal Standards for Unfairness and Deception. Under section 5 of the FTC Act, an act or practice can be declared unfair if: (1) it causes or is likely to cause substantial injury to consumers; (2) the injury is not reasonably avoidable by consumers themselves; and (3) the injury is not outweighed by countervailing benefits to consumers or to competition.[9] An act or practice is deceptive if: (1) there is a representation or omission of information that is likely to mislead consumers acting reasonably under the circumstances; and (2) that information is material.[10] The Agencies applied these standards in determining which practices to regulate.

Credit Card Statistics and Trends. The percentage of federally insured credit unions offering credit card services has remained constant at about 51 percent over the last several years. The total number of federally insured credit union credit card accounts has also remained relatively constant at approximately 12 million accounts.

[7] 15 U.S.C. 45(a), 57a(f)(1).
[8] Under the FTC Act, the NCUA does not have regulatory or enforcement authority for state-chartered credit unions. *See* 15 U.S.C 57a(f).
[9] 12 U.S.C. 45(n).
[10] FTC Policy Statement on Deception (October 14, 1983).

Credit Card Services		
Date	Percentage Of Federally Insured Credit Unions With Card Services	Number of Credit Card Accounts
12/31/2004	50.67%	12,240,573
12/31/2005	50.59%	12,101,618
12/31/2006	50.64%	12,110,246
12/31/2007	50.29%	12,442,704
12/31/2008	50.93%	12,609,099

The following Loan Growth table reveals that both total outstanding credit card debt and total loans grew in 2008, albeit at slower rates than in previous years. However, this growth, at a time when consumers are finding it more difficult to obtain credit from other sources, demonstrates that credit unions continue to strive to meet their member credit needs.

Annual Loan Growth Rate		
Yearend	Total Credit Card Loans	Total Loans
12/31/2005	6.29%	10.72%
12/31/2006	11.22%	8.09%
12/31/2007	13.43%	6.67%
12/31/2008	7.66%	6.40%

As disclosed in the Credit Card Delinquency Trends table below, total outstanding credit card debt in relation to total outstanding loans has been historically low and, as of yearend 2008, was at 5.8 percent. Though delinquent credit card debt to total loans is relatively low, credit card delinquency rates have been increasing since 2006. For yearend 2008, delinquent credit card debt to total outstanding credit card debt was 1.9 percent, and delinquent credit card debt to total outstanding loans was 0.1 percent.

Credit Card Delinquency Trends			
Date	Total Credit Card Debt To Total Loans	Delinquent Credit Card Debt To Total Credit Card Debt	Delinquent Credit Card Debt To Total Loans
12/31/2004	5.44%	1.27%	0.07%
12/31/2005	5.22%	1.17%	0.06%
12/31/2006	5.37%	1.04%	0.06%
12/31/2007	5.71%	1.34%	0.08%
12/31/2008	5.78%	1.88%	0.11%

The following Credit Card Charge-Off Rates table reveals increasing losses relative to credit card services. Both the increasing delinquency and loss rates are not unexpected in today's economic conditions. The increase in credit card charge-off rates indicates federally insured credit unions are appropriately recognizing the losses associated with this unsecured debt.

Credit Card Charge-Off Rates		
Date	Net Credit Card Charge-Offs To Total Credit Card Debt	Net Credit Card Charge-Offs To Total Loans
12/31/2004	2.01%	0.11%
12/31/2005	2.13%	0.11%
12/31/2006	1.48%	0.08%
12/31/2007	1.61%	0.09%
12/31/2008	2.72%	0.16%

Independent industry research indicates that the fees, rates, and terms of the largest United States credit card providers compared poorly to credit cards issued by credit unions with similar purchase interest rates. Federally insured credit union credit card products tended to have fewer fees, lower fees, and clearer disclosures. The study concluded there is a clear difference between credit cards issued by banks and those issued by federally insured credit unions. The terms and conditions of credit cards issued by the large banks are generally more complex than those of the large federally insured credit union issuers. Those complexities are likely to result in the bank customers not understanding the full cost of using the cards and, therefore, incurring much higher fees. The details of federally insured credit union credit card programs show credit card lending is sustainable without exorbitant penalties and misleading terms and conditions.[11]

IV. Overdraft Protection Programs

The Agencies have been concerned about overdraft protection programs for several years. In September 2004, the Federal Financial Institution Council (FFIEC)[12] published an informational brochure entitled *Protecting Yourself From Overdraft and Bounced-Check Fees.*[13] The purpose of the brochure is to educate consumers about overdraft programs and to provide information on alternative methods of covering overdrafts that may be less expensive.

In 2005, the NCUA participated with three other member agencies of the FFIEC in issuing guidance addressing several aspects of overdraft protection programs.[14] The guidance focused on automated systems that have largely replaced the more traditional, *ad hoc* types of programs financial institutions historically used to determine

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[11] The Woodstock Institute, *Blindfolded Into Debt: A Comparison of Credit Card Costs and Conditions at Banks and Credit Unions*, July 2005.
[12] FFIEC is composed of the five federal financial regulators, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision, and the State Liaison Committee.
[13] The brochure is available for download from the NCUA's website at www.ncua.gov.
[14] 70 Fed. Reg. 9127 (February 24, 2005).

whether to pay an item despite insufficient funds. The guidance included a discussion of best practices and recommended, but did not require, institutions provide consumers with an opt-out notice.

The NCUA and the FRB have regulated the disclosures associated with overdraft protection programs using authority under the Truth in Savings Act (TISA).[15] Following an amendment to 12 C.F.R. part 230 (Regulation DD) in 2005,[16] The NCUA amended its TISA rule to address concerns relating to the uniformity and adequacy of fee disclosures in connection with overdraft programs.[17] The amendment created a new requirement for federally insured credit unions that promote the payment of overdrafts in advertisements to disclose fees and other information.

To address continued concerns about the fees consumers pay for overdraft services, Regulation DD recently extended the disclosure requirements for overdraft fees to all banks, regardless of whether they market their overdraft protection programs.[18] Regulation DD now requires banks to disclose the periodic and year-to-date totals for overdraft protection fees a consumer pays on every periodic statement. The NCUA Board is proposing a substantially similar amendment to Part 707 of the NCUA's regulations for federally and privately insured credit unions.

[15] 12 U.S.C. 4301 *et seq.*
[16] 70 Fed. Reg. 29582 (May 24, 2005).
[17] 70 Fed. Reg. 72895 (December 8, 2005).
[18] 74 Fed. Reg. 5584 (January 29, 2009).

Additionally, the FRB has proposed additional requirements for overdraft protection programs under Regulation E.[19] The proposed rule would limit a financial institution's ability to assess overdraft fees for paying automated teller machine (ATM) withdrawals and one-time debit card transactions that overdraw a consumer's account, unless the consumer is given the right to opt-out of the overdraft protection program and does not opt-out. The proposed rule offers a right of opt-in as an alternative regulatory approach. Additionally, the proposed rule would prohibit financial institutions from assessing a fee if an overdraft is caused solely by a debit hold on funds in a consumer's account that exceeds the actual amount of the transaction. If finalized, the proposed amendment to Regulation E would apply to federally and privately insured credit unions.

Overdraft Protection Fees. The NCUA's Call Report does not collect specific data concerning fee income on individual services; however, the Call Report does collect total fee income. The NCUA's Financial Performance Report computes a net operating expense/average assets ratio (fee income is reduced by expenses in the numerator). This ratio considers the relationship of fee revenue and expenses. Total fee income, the net operating expense ratio, and return on assets, provides insight into a federally insured credit union's fee income.

Examiners consider the reasonableness of fee income when reviewing federally insured credit union programs. Fee income, if excessive, can create safety and soundness issues depending on what the officials do to generate the fees and how the funds are spent. For overdraft programs, the NCUA's general lending regulations require

[19] 74 Fed. Reg. 5212 (January 29, 2009).

federally insured credit union boards of directors to establish a policy and the fees for overdraft protection programs.[20]

Although there is no statutory or regulatory ceiling that specifically limits the amount of fees a federal credit union may assess, market forces work to impose reasonableness in this area. Some states regulate in this area and impose a ceiling on the fee state credit unions may charge for overdraft services. Examiners, in addition to compliance risk, consider the effects of fees on other risk categories of the risk-based examination, i.e., strategic, reputation, credit, liquidity, and transaction risks.[21] The NCUA CAMEL Rating System also evaluates the composition of earnings, which includes fees.[22]

The examiner's review of Call Report and Financial Performance Report data provides insight if a federally insured credit union is generating increased fee income relative to operating expenses, product growth, and return on assets. Peer data available to examiners helps identify outliers, and the NCUA generates internal risk reports to isolate and monitor trends and risk.

Fee schedules, disclosures, and annual percentage yield calculations provide federally insured credit union members a basis to compare the cost of having a share draft or other demand account. Federally insured credit unions market and compare their

[20] A federally insured credit union must have policies that: set a cap on the total dollar amount of all overdrafts it will honor consistent with its ability to absorb losses; establish a time limit not to exceed 45 calendar days for a member either to deposit funds or obtain an approved loan to cover each overdraft; limit the dollar amount of overdrafts it will honor per member; and establish the fee and interest rate to charge members for honoring overdrafts. 12 C.F.R. §701.21(c)(3).

[21] The NCUA Letter to Federal Credit Unions 02-FCU-09, *Risk-Focused Examination Program* (May 2002).

[22] NCUA Letter to Credit Unions 07-CU-12, *CAMEL Rating System* (December 2007).

products and services to be competitive. In some cases, federally insured credit unions have low minimum balance requirements making a service more cost effective for members. Some other financial institutions limit the services offered to their customers with lower balances, including restricting access to personal assistance. A federally insured credit union sometimes receives financial support from a sponsoring employer, which allows the federally insured credit union to charge lower fees. The NCUA's risk-focused examination approach focuses on whether or not management can support the fees charged for the type of service provided.

Oversight Effectiveness. To date, the NCUA has not taken formal enforcement action concerning overdraft fees. The NCUA has effectively used examiner findings, documents of resolution, warning letters, and letters of understanding/agreement to resolve issues. However, enforcement action is available if necessary.

Review of the NCUA's examination and supervision program reveals minimal violations, in 2008, regarding federally insured credit union overdraft protection programs. The NCUA examiners issued eighty-six documents of resolution to addressing overdraft protection program weaknesses.

Beyond relying upon the examination and supervision program to identify emerging issues and concerns, The NCUA also relies upon the member complaint process. Each NCUA regional office has staff dedicated to reviewing member complaints. Typically, when the NCUA receives a member complaint, staff forwards it to the supervisory committee for the named federal credit union or appropriate state supervisory authority for investigation and a response to the complaining member. Federal credit unions generally resolve their members' complaints voluntarily. Therefore, no member complaint has resulted in an enforcement action related to fees and disclosures on share and demand accounts. The NCUA, however, will invoke its authority to take an administrative action against a credit union if necessary to achieve the proper outcome.

Unlike traditional lines of credit, overdraft protection programs do not require individual underwriting or written agreements. Instead, federally insured credit unions choose to honor drafts, up to an aggregate dollar amount, even if there are insufficient funds in a member's account to pay the drafts. Members are charged a per item fee for this service, and outstanding amounts must be quickly repaid.

The NCUA encourages federally insured credit unions to advise members about less costly products and consider suspending access to overdraft protection when members repeatedly access it. For example, a federally insured credit union may choose to limit the number of overdraft transactions to be covered for a member or it may choose to contact members and describe other available options. Members may qualify for other types of loan products based on successful repayment under an overdraft protection program.

V. Potential Impact of Proposed Legislation on Credit Union Industry

Credit cards and overdraft protection programs are useful member services. Currently, approximately 3,973 federally insured credit unions issue credit cards to their members.[23] The aggregate outstanding balance on these portfolios is approximately $32.7 billion, a small portion of the credit card debt nationwide.[24] Increasing credit card delinquency and losses could lead to increased fees relative to credit card services. However, the NCUA believes it has the proper controls and oversight in place to ensure any abuse is appropriately identified and addressed. The NCUA will continue to monitor federally insured credit union credit card programs and services to ensure unfair and deceptive practices do not materialize.

Approximately 2,804 federally insured credit unions offer overdraft protection services. The NCUA recognizes overdraft protection programs can benefit both credit unions and credit union members if members rarely access the program. Federally insured credit unions receive another source of fee revenue and members avoid the inconvenience and subsequent fees associated with returned checks. To promote fiscal responsibility and to help members make informed choices, federally insured credit unions offering overdraft protection programs should continue to educate members about costs, program details, and less expensive options.

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[23] The data is current as of the December 31, 2008 financial reporting cycle.
[24] According to the Federal Reserve Statistical Release G.19 Consumer Credit (July 8, 2008), total outstanding revolving credit in America was estimated at $962 billion in May 2008.

While overdraft protection programs may assist infrequent users in avoiding the inconvenience and merchant fees associated with returned checks, repeat use of overdraft protection can result in high aggregate fees that negatively impact a member's financial position. Notwithstanding the concerns regarding excessive fees, the NCUA is concerned with regulating overdraft protection programs under TILA because treating overdraft fees as a finance charge will affect federal credit unions' ability to offer overdraft services to their members.[25]

VI. Conclusion

Briefly summarized, the NCUA believes the UDAP rule addresses most of the practices and problems to which H.R. 627 is directed. To the extent areas of concern remain, The NCUA is prepared work to with its sister agencies to address those problems. Regarding overdraft protection regulations, recent changes in the TISA rule and the regulatory proposal from the FRB address key areas of concern to which H.R. 946 is directed. The NCUA believes it is unnecessary to include overdraft protection fees within the meaning of a finance charge because current and proposed regulations will provide an opt-in or opt-out right for overdraft protection programs and full disclosure regarding associated fees. Moreover, including overdraft fees within the meaning of finance charges for purposes of Regulation Z would make it difficult for FCUs under current NCUA policy to offer the service.

[25] The Federal Credit Union Act limits the amount of interest, including finance charges, federal credit unions can charge on loans. 12 U.S.C. 1757(a). Federal credit unions are subject to a statutory interest ceiling of 15%, which the NCUA Board may adjust based on various factors. The current maximum interest rate for federal credit unions is 18 percent. NCUA Letter to Federal Credit Unions, *Permissible Interest Rate Ceiling* (January 2008). The NCUA's long-standing policy is to include all finance charges, as defined under Regulation Z, in computing the permissible interest rate.

The NCUA is to providing strong regulatory and supervisory controls and monitoring federally insured credit unions to ensure member protection. As the Agencies continue deliberations policies that would prevent unfair or deceptive practices in credit card lending and overdraft protection programs, the NCUA will continue to ensure compliance with all federal laws and fulfill its enforcement responsibilities for any regulatory or statutory changes.

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Statement of

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Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions and Consumer Credit

Committee on Financial Services

U.S. House of Representatives

March 19, 2009

Chairman Gutierrez, Ranking Member Hensarling, and members of the Subcommittee, I appreciate the opportunity to appear today to discuss the Federal Reserve Board's recent regulatory actions to expand protections for consumers who use credit cards and overdraft protection plans.

The Federal Reserve is committed to enhancing consumers' ability to use credit cards in a responsible and informed manner. Credit cards provide important benefits for many consumers, both as a source of credit and as a convenient payment mechanism. However, in recent years, credit card terms and features have become more complex, which has reduced transparency in credit card pricing. Growing complexity has increased the risk that consumers will not understand or notice key terms that affect a plan's cost.

In December 2008, the Board issued sweeping rules to enhance protections for consumer credit card accounts. One set of rules prohibits certain unfair card practices using the Board's rulemaking authority under the Federal Trade Commission Act (FTC Act), while complementary rules improve disclosures for credit cards under the Truth in Lending Act. Together, these rules are the most comprehensive changes to regulations that govern consumer credit cards ever adopted by the Board. These rules affect nearly all aspects of consumer credit card accounts, including marketing and advertising, disclosures given with applications and at account opening, billing statements, and issuers' ability to change account terms.

In addition to these final credit card rules, in December 2008 the Board also proposed rules that would give consumers the right to instruct their depository institutions whether to pay or not pay overdrafts for ATM withdrawals or one-time debit card purchases.

In my testimony today, I will first discuss highlights of the Board's revisions to improve the Truth in Lending disclosures provided in connection with consumer credit card accounts, including some of the limitations of a disclosure-based approach. I will then summarize the final rules prohibiting certain unfair acts or practices by banks in connection with consumer credit card accounts, which were issued in conjunction with the Office of Thrift Supervision (OTS) and the National Credit Union Administration (NCUA). Finally, I will discuss the Board's pending efforts to provide consumer protections in connection with overdraft protection plans.

Truth in Lending Disclosures

The Federal Reserve has primary rule-writing authority for the Truth in Lending Act, which is implemented by the Board's Regulation Z. One of the purposes of the Truth in Lending Act is to assure a meaningful disclosure of credit terms so that consumers can compare available credit terms and avoid the uninformed use of credit. Clear disclosure of credit card terms has always been a challenge. However, this disclosure challenge has grown substantially with the increasing complexity of credit card plans.

The Board drew on several sources of data and information in developing improved disclosures to communicate key information to consumers in ways that they would be more likely to pay attention to, understand, and use in their decisionmaking. First, the Board conducted extensive consumer testing, using focus groups and several dozen one-on-one interviews with consumers. The testing first identified what information consumers currently use in making decisions about their credit card accounts, and how they use existing disclosures. The Board used these insights to develop revised credit card disclosures, which also were tested with consumers. Prior to issuing final rules, the Board conducted quantitative testing with over 1,000 consumers nationwide to gauge consumers' comprehension of the newly developed disclosures compared to existing disclosures and formats. In addition, in response to proposed revisions to Regulation Z issued in June 2007 and May 2008, the Board received and considered over 3,000 comment letters representing a broad spectrum of views. The Board used lessons learned from testing and input from those commenting in order to develop a final rule and model disclosures that would enhance consumer understanding of credit card terms.

Credit Card Applications and Solicitations

The final rule includes several changes to the content and terminology of the tabular disclosure of key costs and terms currently provided with credit card applications and solicitations, commonly known as the "Schumer box." These changes were based largely on information from our consumer testing about what information consumers do and do not notice or find important when shopping for credit. The final rules mandate that certain terminology be used in the table in order to enhance consumer understanding, such as by requiring that issuers use the term "penalty rate" to describe the increased rate that may apply if a consumer engages in behavior such as paying late. In order to target the tabular disclosure to those terms that are most useful to consumers, the final rule does not permit a creditor to include in the table information that testing revealed consumers do not use in comparing different credit card offers, for example detailed information about the calculation of variable rates.

Account-Opening Disclosures

Currently, the key terms Truth in Lending requires to be disclosed at account opening are often interspersed within long, complex credit agreements. To make the information more conspicuous and more useful to consumers, the final rule requires creditors to provide a table summarizing the key terms to consumers at account opening. This new account opening table is substantially similar to the Schumer box, based on consumer testing findings indicating that consumers tend not to read disclosures that are in small print and dense prose, but generally are familiar with the table on applications and solicitations. Replicating the tabular format that is familiar to consumers should enhance consumer understanding of the disclosures given at account opening, and also should make it easier for consumers to compare the terms of the offer for which they applied with the terms that they receive.

Periodic Statements

The final rule contains a number of revisions to the periodic statement to improve consumers' understanding of the costs associated with using their credit card accounts. First, the rule includes new formatting and terminology requirements that require creditors to group costs together and identify them as interest charges or fees. Consumer testing demonstrated that consumers more readily understand costs disclosed in dollars than costs disclosed as percentage rates. The final rule also imposes a new requirement to disclose year-to-date totals for interest charges and fees. Finally, the final rule eliminates the requirement to disclose an effective APR, which is an annual percentage rate figure that reflects fees as well as interest charges. Consumer testing demonstrated that consumers find the disclosure of an effective APR that combines rates and fees to be confusing, and that for some consumers, disclosure of an effective APR makes it more difficult to identify the interest rate applicable to the account.

Changes in Consumer's Interest Rate and Other Account Terms

The final rule increases advance notice of rate increases or changes in other key account terms from 15 days to 45 days, in order to ensure that consumers will not be surprised by unexpected changes and will have time to explore alternatives. For example, a consumer who receives 45 days' advance notice of an impending rate increase will have time to seek alternative sources of financing for future transactions, or to alter his or her account usage in order to mitigate the impact of the change. The final rule also expands upon the current requirements of Regulation Z by requiring that 45 days' advance notice also be given when a rate increases due to the consumer's delinquency or default or as a penalty. Finally, for rate increases and changes in key terms, the final rule imposes new formatting requirements. Specifically, creditors must disclose changes in key terms in a summary table to enhance the effectiveness of the change-in-terms notice.

Additional Protections

Other consumer protections in the Regulation Z final rule include:

- Prohibiting advertising a rate as "fixed," unless the rate truly is not subject to change either for a clearly disclosed period or for the life of the plan.
- Requiring that cut-off times for receipt of mailed payments on the due date be reasonable, with a safe harbor for a cut-off time of 5 p.m. or later.
- Requiring a creditor that does not accept mailed payments on a Sunday or holiday due date to treat a payment received the next business day as on time.

The Board's Rules under the FTC Act

The data obtained in consumer testing informed the development of new rules under Regulation Z to improve the effectiveness of the content, format, and timing of credit card disclosures. However, the testing process also illustrated the limitations of disclosures for today's complex financial products. There are certain key credit card terms, such as how an issuer allocates payments among balances on which interest accrues at different rates, that consumer testing indicates cannot be explained to consumers in a way that would improve their ability to make meaningful decisions about credit. In addition, consumers who commented on the Board's proposals under Regulation Z encouraged the Board to prohibit certain credit card practices that they believe to be unfair. Because improved disclosures alone cannot solve all the problems consumers face in managing their credit card accounts, in December 2008 the Board issued a rule prohibiting certain unfair practices in connection with consumer credit card accounts.

The Board has authority under the FTC Act to prescribe regulations to prevent unfair or deceptive acts or practices by banks. The OTS and NCUA have corresponding rule-writing authority for savings associations and federally-chartered credit unions, respectively. In May 2008, the Board, OTS, and NCUA jointly proposed rules to prohibit certain unfair acts or practices with respect to consumer credit card accounts and overdraft services for deposit accounts. The Board received and considered more than 60,000 comments in response to this proposal, more than for any other regulatory proposal in our history. The overwhelming majority of these comments came from individual consumers. In addition to reviewing and considering the comments, the final rules also were informed by the Board's consumer testing, as well as outreach regarding credit card practices with consumer advocates, industry representatives, members of the Board's Consumer Advisory Council, and other federal agencies. The Board's final rule pursuant to its FTC Act authority is set forth in Regulation AA.

Time to Make Payments

The Board's final rule seeks to ensure consumers have an adequate amount of time to make payments once they receive their billing statements. Banks are prohibited from treating a payment as late for any purpose unless consumers have been provided a reasonable amount of time to make payment. The rule establishes a safe harbor for banks that send periodic statements at least 21 days prior to the payment due date. This rule responds to concerns that credit card issuers have reduced the amount of time provided to consumers to make payment while increasing the costs imposed on consumers whose payments are not received by the due date (such as late payment fees and penalty interest rates).

Allocation of Payments

Credit card accounts often permit consumers to carry multiple balances at different APRs, for example a purchase balance, cash advance balance, and balance transfer balance. When different annual percentage rates apply to different balances on a credit card account, the final rule requires banks to allocate payments in excess of the minimum payment either to the highest rate balance first or pro rata among all the balances on the account. Currently, credit card issuers generally allocate payments first to the balance with the lowest interest rate, which maximizes the assessment of interest charges. Consumer testing conducted by the Board demonstrated that disclosures alone are not sufficient to enable consumers to avoid the higher interest charges caused by current payment allocation practices.

Protections Against Interest Rate Increases

The final rule restricts the circumstances in which a bank may increase an interest rate applicable to a consumer's credit card account. These provisions address concerns that increases in the interest rate on a credit card account can come as a costly surprise to consumers who relied on the rate in effect when engaging in transactions. For example, many credit card issuers impose penalty rates that can be more than twice the consumer's normal rate on purchases when a payment is late. Some card issuers impose penalty rates based on factors not directly related to the account, such as a drop in the consumer's credit score or the consumer's default on a different account, a practice sometimes referred to as "universal default." In addition, issuers typically reserve the right to increase rates on existing balances at any time, for any reason, in order to, for example, adjust for changes in the creditor's cost of funds.

To address these concerns, the final rule restricts penalty pricing and prevents "any time, any reason" repricing of a cardholder's outstanding balances. It also generally prohibits rate increases on new transactions during the first year after account opening. The Board's consumer testing indicated that interest rates are a primary concern for consumers when shopping for credit cards. This final rule promotes fairness in credit card pricing by ensuring that consumers who open accounts based on the rate or rates stated by the card issuer can rely on those rates when engaging in transactions. In addition, the final rule should spur efforts by lenders to improve upfront underwriting by reducing reliance on after-the-fact penalty rate increases.

The final rule contains several limited exceptions to the general prohibition on increasing rates on credit card accounts. Each of these exceptions is intended to give issuers sufficient flexibility to respond to changes in the market or changes in the consumer's financial condition while still protecting consumers from unfair surprise.

- First, creditors may offer a discounted rate that expires after a specified period of time, provided they also disclose at account opening the rate that will apply after the introductory rate expires. For example, this exception permits a creditor to offer an introductory rate, such as a 0% rate that will be in effect for six months and then change to a 15% rate.
- Second, creditors may offer a variable rate that increases based on changes to an index that is outside of the creditor's control.
- Third, institutions may generally increase the rate prospectively for new transactions after providing 45 days' advance notice as required by Truth in Lending and Regulation Z. However, a creditor generally cannot change the rate for new transactions during the first year after account opening.
- Fourth, institutions could increase a rate that applies to outstanding balances if the account becomes more than 30 days' delinquent.

The final rule also establishes rules regarding the repayment of balances on which the rate cannot be increased. These restrictions limit card issuers' ability to accelerate repayment. They complement the rule on repricing of balances by ensuring that consumers are given a reasonable amount of time to pay off any outstanding balances that an issuer may not reprice. Creditors are permitted to establish a repayment period of five years or more, to double the consumer's repayment rate, or use a repayment schedule that is no less beneficial to the consumer than the two specified methods. Finally, in order to prevent banks from imposing new fees in lieu of rate increases, the final rule prohibits the assessment of fees or other charges based solely on a balance that cannot be repriced.

The rule strikes a balance between increasing certainty and transparency in the cost of credit for consumers and allowing issuers sufficient flexibility to adjust to changes in borrower creditworthiness and market conditions. In addition to protecting consumers from unexpected increases in the cost of transactions that have already been completed, this rule will enable consumers to more accurately assess the cost of using their credit card accounts at the time they engage in new transactions, particularly during the first year after account opening. Finally, the new rules should enhance competition because issuers that offer rates that realistically reflect risk and market conditions will no longer have to compete with issuers offering artificially reduced rates that can increase unexpectedly.

Computing Interest on Account Balances Over Two Billing Cycles

The final rule prohibits the balance computation method sometimes referred to as "two-cycle billing." In general, an institution using the two-cycle method assesses interest not only on the balance for the current billing cycle but also on the balance for days in the preceding billing cycle. The Board's consumer testing indicates that disclosures cannot adequately explain the two-cycle method in a way that enables consumers to make informed choices among credit products with different balance computation methods.

Security Deposits and Fees That Limit Credit Availability

The final FTC Act rule includes several provisions to protect vulnerable subprime consumers from credit card products that charge high fees and provide little available credit. Specifically, the final rule prohibits banks from financing security deposits and fees that, in the aggregate, constitute a majority of the initial credit limit in the first year. The final rule also limits the total security deposits and fees that can be charged at account opening to 25 percent of the initial credit limit.

Effective Date

These rules represent the most comprehensive and sweeping reforms ever adopted by the Board for credit card accounts and will apply to more than one billion accounts. Given that the changes affect nearly every aspect of credit card lending, card issuers must be afforded sufficient time for implementation to allow for an orderly transition that avoids unintended consequences, compliance difficulties, and potential liabilities. The effective date for both the revised credit card rules under the FTC Act and Regulation Z is July 1, 2010.

To comply with the final rules, card issuers must adopt different business models and pricing strategies and then develop new credit products. Depending on how business models evolve, card issuers may need to restructure their funding mechanisms. In addition to these changes, issuers must revise their marketing materials, application and solicitation disclosures, credit agreements, and periodic statements so that the documents reflect the new products and conform to the rules. Changes to issuers' business practices and disclosures will involve extensive reprogramming of automated systems which subsequently must be tested for compliance, and personnel must receive appropriate training.

Although the Board has encouraged card issuers to make the necessary changes as soon as practicable, an 18-month compliance period is consistent with the nature and scope of the required changes.

Regulatory Proposal on Overdraft Services

Finally, I will discuss the Board's recent proposal to give consumers greater control over the payment of overdrafts. The term "overdraft service" generally refers to an institution's practice of paying a consumer's transaction that overdraws the consumer's account and charging a fee for doing so. In the past, overdraft services were provided only for check transactions. More recently, institutions have extended the service to apply to other transaction types, including automated teller machine (ATM) withdrawals and point-of-sale debit card purchases. Most institutions have automated the process for determining whether, and to what extent, to pay overdrafts.

In most cases, consumers are automatically enrolled in overdraft services. Each time an overdraft is paid, the consumer is charged a flat fee, regardless of the amount of the overdraft. Institutions commonly charge the same amount for paying an overdraft as they would if they returned the item unpaid. According to the Government Accountability Office (GAO), the average cost of overdraft and insufficient funds was just over \$26 per item in 2007.[1] For point-of-sale debit card transactions in particular, the overdraft fee may substantially exceed the dollar amount of the overdraft.

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[1] *See Bank Fees: Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts*, GAO Report 08-281, at 14 (January 2008).

The Board's December 2008 proposal under the Electronic Fund Transfer Act (Regulation E) would provide consumers with the opportunity to choose whether overdraft services meet their needs. The proposal contains two alternative approaches. The first approach would prohibit an institution from assessing any fees on a consumer's account after the institution authorizes an overdraft, unless the consumer is first given notice and a reasonable opportunity to opt out of the institution's overdraft service. The second approach would require an institution to obtain the consumer's affirmative consent, or opt-in, before fees may be assessed to the consumer's account for overdrafts authorized by the institution.

The proposal would apply to overdrafts for ATM withdrawals and one-time debit card purchases, and thus would not cover overdrafts by check or recurring debit. Consumer testing conducted for the Board indicates that consumers would not opt out if opting out meant that their most significant bills--those typically paid by check or recurring debit--would not be paid. In addition, if their check or recurring debit payment is dishonored for insufficient funds, consumers could incur fees, both from their institution and from the merchant. In contrast, if a consumer does not have sufficient funds to cover an ATM withdrawal or a one-time debit card purchase, the transaction would simply be declined without the assessment of any fees. Thus, limiting the rule to these transactions, and excluding checks and recurring debits, seems appropriate to ensure consumers are given a meaningful choice regarding the payment of overdrafts.

The public comment period for the overdrafts proposal concludes on March 30, 2009. After evaluating the comments and conducting additional consumer testing, we expect to issue a final rule later this year.

Conclusion

In closing, let me emphasize the Federal Reserve's commitment to enhancing the ability of consumers to use credit cards to their benefit. The Board believes that the package of substantive and disclosure-based regulations issued in December 2008 appropriately promotes fairness in the terms of consumer credit card accounts and ensures that consumers receive disclosures at a time and in a form that meaningfully assists them in making informed decisions regarding the use of credit. The Federal Reserve also is committed to helping consumers better understand the cost of overdraft services and providing a means to exercise choice regarding the use of these services.

Testimony of

Kenneth J. Clayton

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Financial Institutions and Consumer Credit

Committee on Financial Services

United States House of Representatives

Testimony of Kenneth J. Clayton
Before the
Subcommittee on Financial Institutions and Consumer Credit
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March 19, 2009

Chairman Gutierrez, Ranking Member Hensarling and members of the Subcommittee, my name is Kenneth J. Clayton, senior vice president and general counsel of the American Bankers Association (ABA) Card Policy Council, the group within the ABA that deals with card issues. The American Bankers Association brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.6 trillion in assets and employ over 2 million men and women.

I appreciate the opportunity to testify today on H.R. 627, the Credit Cardholders Bill of Rights Act of 2009, and on H.R. 1456, the Consumer Overdraft Protection Fair Practices Act. I will address these issues in series, first dealing with credit cards, then with overdrafts.

Today, credit cards are responsible for more than $2.5 trillion in transactions a year and are accepted at more than 24 million locations in more than 200 countries and territories. It is mind-boggling to consider the computer network, communications system, billing and processing facilities, fraud protection programs, and customer service requirements needed to handle up to 10,000 payment card transactions ***every second*** around the world. It is an enormous, complicated and expensive structure – all dedicated to delivering the efficient, safe and easy payment vehicle we have all come to enjoy.

Credit cards are so easy and convenient to use that people often take them for granted. But make no mistake – these are loans, just like loans to buy a car or a home, or to pay for a child's education. Credit cards are incredibly flexible, leaving it generally to the borrower to determine when to borrow the money, in what amount, and how quickly to pay it back. Lenders who make these loans face significant operational, risk management, and funding challenges in making this product readily available to millions of Americans every day. Credit card issuers have developed sophisticated systems for seamlessly handling the enormous dollar volumes that flow through our economic system.

The ubiquity of credit cards has not always been the case. As recently as thirty years ago, some 38 percent of American families had credit cards. Today, that percentage has nearly doubled. This is a testament to how valuable this important payment instrument has become for meeting the daily needs of most Americans. It also demonstrates how integral credit cards are to our economy, both as a payments vehicle and source of credit. Today's credit card marketplace provides a dizzying array of options and choices for consumers. It is clear, however, that as the marketplace has evolved to provide greater benefits and broader access, it has also become more complex. As a result, the adequacy of disclosure and other regulation in this new marketplace has been called into question, and we recognize the legitimacy of concerns policymakers have raised over the last several years.

In response to concerns, the Federal Reserve Board, Office of Thrift Supervision and National Credit Union Administration released (on December 18, 2008) comprehensive revisions to the regulation of credit cards, fundamentally changing the protections offered consumers while forcing a complete reworking of the credit card industry's internal operations, pricing models and funding mechanisms. These new rules (referred to here as the Federal Reserve's rule[1]) carry the full weight of the law, and failure to comply with them subjects the issuer to potentially significant fines – potentially up to $1 million per day for non-compliance – and enforcement actions. The extensive protections provided to consumers under the new rules were based on four years of intensive work that included consumer testing, review of thousands of public comment letters, and input from important policymakers. The changes are so broad they will affect every aspect of the credit card business.

As Federal Reserve Chairman Ben Bernanke stated, these rules represent "[t]he most comprehensive and sweeping reforms ever adopted by the Board for credit card accounts." As a consequence, all credit card issuers are currently undertaking a massive overhaul of their business practices.

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[1] We use this term for ease of reference throughout this statement, but it is intended to include the rules issued and authority to make changes by the Office of Thrift Supervision (for savings associations) and the National Credit Union Administration (for credit unions).

It is clear that a sea change has occurred in the area of card regulation, and that card industry efforts going forward need to be focused on addressing both the new requirements of the law and the residue of skepticism that currently surrounds business practices. However, we would urge that any discussion over further legislation in this area be viewed in the context of the recent Federal Reserve rule, recognizing its sweeping nature, protection to consumers, impact on operations, and perhaps most importantly, its potential impact on the broader economy and the provision of credit to consumers and small businesses. It is our belief that this impact will be broad and not uniformly positive, potentially leading to reduced access to credit for millions of Americans and small businesses at the very time when they need that access to credit.

The regulators acknowledged the possible negative effects that this complete reworking of the credit card business will have on the provision of credit to consumers and others. To minimize the negative impacts, the Federal Reserve provided for an 18-month time period for implementation. While we understand that some policymakers may view this implementation period to be too long, we urge a full exploration of the potential unintended negative consequences that may occur if a shorter time frame is mandated. In fact, the regulators specifically noted that any shortening of this implementation period could cause "more harm to consumers than benefit."[2]

The Federal Reserve's actions addressed the past evolution of the credit card market and, just as importantly, put in place a regulatory framework to address the future evolution of this market. In fact, the Federal Reserve's rule provides the necessary authority and flexibility for regulators to take action regarding practices that may be deemed unfair or deceptive in the future, whatever form they may take. It is inevitable that cardholder preferences will change, new payment system technologies will be developed, and competitors will offer new products and choices. We believe that the Federal Reserve is well positioned to oversee and make the necessary adjustments appropriate to this dynamic market. Given all this, we question whether further legislating in this area is necessary.

In addition to credit cards, overdraft protection is a service that is highly valued by bank customers, who appreciate the ability to avoid the embarrassment, hassle, costs and other adverse consequences of having a check bounce or a transaction denied. Whether made by check or electronically, returning a payment usually means the consumer pays additional fees charged by the entity receiving the payment. Overdraft protection also carries a fee, completely avoidable when

[2] 74 Federal Register 5548

customers keep track of transactions and balances, an activity that is easier than ever. H.R. 1546 attempts to limit overdraft fees by imposing requirements that are operationally difficult for banks, merchants, and consumers, if not completely unworkable. Moreover, the bill attempts to make changes at the same time the Federal Reserve is attempting to promulgate a rule ***based on significant consumer testing*** that would resolve many current consumer issues. Given that many issues addressed by the bill are already being addressed by the new rule due out this year, we believe legislative action is not necessary at this time.

ABA, on behalf of our membership, pledges to work with this committee, bank regulators, and other interested parties to address any issues in these areas.

In my statement, I would like to focus on four points:

- The Federal Reserve regulations constitute sweeping reform of credit card practices and have addressed the core concerns of cardholders.

- The changes already made will have a significant impact on card issuers, consumers and the economy.

- H.R. 627 would dramatically shorten the implementation period for new regulations, which would pose serious risk and harm to consumers and the economy.

- Overdraft protection is highly valued by consumers; legislation seeking to amend current practices proposes technically difficult changes and may result in fewer choices for consumers.

I will address each of these points in turn.

I. The Federal Reserve regulations constitute sweeping reform of credit card practices and have addressed the core concerns of cardholders.

The evolution and increasing complexity of credit cards has raised some concerns about the ability of cardholders to understand the terms and conditions of their cards. While there certainly has been disagreement over how to address these issues, the ABA firmly believes it is in the best interests of all parties that cardholders fully understand the obligations they assume, the interest rate and fees they should expect, and how the management (or, in some cases, mismanagement) of credit card debt can affect their terms and access to other types of credit. The changes in rules announced by the Federal Reserve are significant and will affect every aspect of credit card lending. Among other things, the changes should provide a better understanding of the terms and conditions, and allow consumers to compare different cards and understand what they are paying for credit. These changes should be allowed to work.

While the focus, understandably, has been on the areas of disagreement about card practices, it must be said at the outset how critically important credit cards are for customers as a convenient, safe, and secure payment vehicle and the vital role that credit cards play in our economy.

We believe that the Federal Reserve's rule – which represents the most sweeping reforms in the history of credit cards – has addressed the fundamental concerns of cardholders. These were many of the same concerns expressed by many members of this committee and, indeed, the changes made mirror many provisions in proposed legislation.[3] During that process, the Federal Reserve (and OTS and NCUA) attempted to balance additional consumer protections with the impact that restrictions may have on safe and sound lending and the broader economy.

The rule makes significant changes in three broad categories.

- The rule effectively eliminates many card practices, including "double-cycle billing" and repricing of existing balances (including "universal default");
- The rule enhances consumer protections, by giving consumers more time to pay bills and limiting up-front fees for cards; and
- The rule simplifies communications to help consumers make better credit decisions.

Specifically, the rule takes the following aggressive actions:

Practice Eliminated: Interest Rate Increases on Existing Balances. Interest rate increases will not be allowed on existing balances, except for promotional rate cards where rate increases are disclosed at account opening, variable rate cards based on a public index, accounts that are 30 days late, or where consumers fail to comply with workout agreements. Issuers have re-priced existing balances, for example, based on some borrowers' actions that suggest they present a higher risk of

[3] In fact, the Committee sought to conform its bill in many respects to the rules set forth by the regulators. However, it did so imperfectly, changing its provisions to mirror the then-proposed rule, not to its final version. We would urge the Committee to conform the bill's provisions to those contained in the final regulation.

non-payment or due to increased funding costs. In essence, the regulators have prohibited these re-pricing practices except in certain limited circumstances, and have directly addressed broad-based criticisms over increased interest rates on existing balances. A similar provision was included in Sec. 2 of H.R. 627.

Practice Eliminated: Interest Rate Increases on Certain Future Balances. Interest rates may not increase on balances from transactions made within the first year, except in the circumstances listed above for interest rate increases on existing balances. In addition, consumers will have 45 days prior notice regarding rate changes before an increase in rates can take effect, giving consumers more than enough time to avoid such increases if they occur down the road. This provision of the final rule actually goes beyond proposed versions of the regulation and many versions of proposed legislation, and essentially locks-in interest rates going forward for the one-year period following the opening of an account.

Practice Eliminated: Double-cycle billing. The Federal Reserve eliminated the practice of charging interest on balances from the previous billing cycle due to the loss of an interest-free period. When a customer with no revolving balance makes a purchase, the issuer makes near-immediate payment to the merchant; however, the customer is billed in the next statement, often weeks after the purchase. The customer then decides whether to pay for the purchase or carry it as a revolving debt. Customers who pay the balance in full essentially get an interest-free loan for the period between the purchase and when they pay the issuer. However, in cases where a customer who paid in full the previous month, and then the following month chooses to revolve part of the balance, some issuers then charged interest from the date of purchase – essentially charging interest from the day the loan was taken. In other words, the customer forfeited the interest-free period. This is referred to as "double-cycle billing" because this interest charged is derived from transactions made in a prior billing period. The Federal Reserve has eliminated this practice. This is similar to provisions in Sec. 4 of H.R. 627.

Practice Eliminated: Payment Allocation Methods that Pay Off Low Rate Balances First. Card issuers will no longer be allowed to apply payments to the lowest interest-rate balances first. Under the rule, payments in excess of the minimum payment must either go to higher interest rate balances first, or *pro rata* based on the balances at different interest rates. Issuers often use low, promotional interest rates to encourage prospective cardholders to transfer balances to their new card – often to the cardholders' significant benefit. Some issuers are able to offer low initial interest rates to prospective cardholders because they are able to allocate payments on the account to these lower rates first. The rule prohibits this practice. A similar provision was included in Sec. 3 of H.R. 627.

Enhanced Customer Protection: Extended Time to Pay. Cardholders will be given additional time to pay. Statements must be sent at least 21 days prior to the due date, giving customers more time to pay and avoid consequences such as late payment fees. Sec. 3 of H.R. 627 includes a similar provision.

Enhanced Customer Protection: Limited Up-Front Fees. Up-front fees on subprime cards have been criticized as, among other things, misleading the borrower by reducing advertised credit limits through the application of high up-front fees. The final rule caps the amount of any up-front fees and requires that fees over a certain amount be amortized over six months, thus protecting these borrowers. This is similar to provisions in Sec. 6 of H.R. 627.

Enhanced Customer Protection: 45 Days Advanced Notice Before Higher Rates Apply. As noted, the rule prohibits the changing of interest rates for existing balances except under very limited circumstances, and even limits rate increases on ***future*** balances during the first year of the card. In addition, once card issuers are allowed to change interest rates for future charges (i.e., after the first year), the rule requires that cardholders must be given a 45-day advance notice of any changes, giving them more than adequate time to take action. Similar language was included in Sec. 2 of H.R. 627.

Simplified Communications: Helping Customers Make Better Credit Decisions.
Perhaps the most important changes in the new rules are significant enhancements to credit card applications, account agreements, monthly statements, change in terms notices, and other communication materials. The changes are based on actual consumer testing, demonstrating one of the key advantages of allowing regulators to consider and change regulations as appropriate to changing consumer needs. Major changes will be made to ensure that consumers have information they want, in a manner they will understand, and in a format they will notice. These changes, along with format and terminology requirements, will ensure that consumers understand credit card terms and know what they are paying for credit based on their own use.

Applications will contain a significantly revised summary box that clearly explains the most important terms and conditions of the credit card in a manner consumers will understand. This will help them select an appropriate card. That same format and terminology will now be carried over and required on the account agreement that comes with the credit card. Thus, important terms will be highlighted in a special, noticeable and understandable box format that arrives with the card. This will make it easier for consumers to understand the terms once the card arrives and also provide a useful reference for consumers to consult later on.

The regulation also imposes comprehensive new requirements for periodic statements that will ensure consumers understand what they are paying for credit and how to avoid additional costs. For example, warnings about late payments and minimum payments will be listed and explained on monthly bills right where the payment information is presented. (See chart at the right for an example.) In addition, totals of interest and fees, for the period and year-to-date must be provided on each periodic statement. Changes in terms will be clearly highlighted, as demonstrated in the example below.

Payment Information

New Balance	$1,784.53
Minimum Payment Due	$48.00
Payment Due Date	4/20/12

Late Payment Warning: If we do not receive your minimum payment by the date listed above, you may have to pay a $35 late fee and your APRs may be increased up to the Penalty APR of 28.99%

Minimum Payment Warning: If you make only the minimum payment each period, you will pay more in interest and it will take you longer to pay off your balance. For example, if you had a balance of $1,000 at an interest rate of 17% and always paid only the minimum required, it would take over 7 years to repay this balance. For an estimate of the time it would take to repay your actual balance making only minimum payments, call 1-800-XXX-XXXX.

Please send billing inquiries and correspondence to:
PO Box XXXX, Anytown, Anystate XXXXX

Important Changes to Your Account Terms

The following is a summary of changes that are being made to your account terms. You have the right to opt out of these changes. For more detailed information, please refer to the booklet enclosed with this statement.

These changes will impact your account as follows:

Transactions made on or after 4/2/12: As of 5/10/12, any changes to APRs described below will apply to these transactions.

Transactions made before 4/2/12: Current APRs will continue to apply to these transactions.

If you are already being charged a higher Penalty APR for purchases: In this case, any changes to APRs described below will not go into effect at this time. These changes will go into effect when the Penalty APR no longer applies to your account.

Revised Terms, as of 5/10/12	
APR for Purchases	16.99%
Late Payment Fee	$32 if your balance is less than or equal to $1,000; $39 if your balance is more than $1,000

II. The changes already made will have a significant impact on card issuers, consumers and the economy.

These changes will provide benefits for many cardholders. However, these changes will have other economic impacts as well. This is because the new rule will affect every aspect of the credit card business, from how cards are funded, to how they are priced, to how they are marketed, and to how credit is allocated among customers of differing credit histories and risk. Because the rules are so strong, card lenders may have to increase interest rates in general, lower credit lines, assess more annual fees, and reduce credit options for some customers. The full impact of these changes will likely not be fully known for several years as business practices are changed and as the credit availability works its way through the economy.

Impact of the new rules on credit availability: Restrictions on re-pricing higher risk accounts means two things: (1) that higher risk customers will likely see less credit available to them; and (2) since the higher-risk customers do not bear the full cost of the risks they pose, lower-risk customers will bear some of added cost. The Federal Reserve acknowledged this impact, as its Vice Chairman Donald Kohn stated: "There will be some reduction in available credit to some people." Other experts did as well, as Scott Valenin of Friedman, Billings, Ramsey noted: "Because the new regulatory system eliminates preventive pricing…, rates across the board will go up, and availability of credit will go down."

The impact on credit availability can be large. For example, Oppenheimer analyst Meredith Whitney estimated that card lines could decline by 57 percent (about $2.7 trillion) because of economic and regulatory landscape.[4] A study by Morrison & Foerster that covered 70 percent of card balances found that credit lines could be reduced by $931 billion (an average of $2,029 per account) and tightening lending standards could put credit cards out of reach for as many as 45 million consumers. It is likely that consumers perceived to have higher levels of risk – including those that are new to credit – will bear the brunt of these reductions, though even those with lower risk levels will feel the pain. Thus, the inability to price risk effectively may well mean less access to credit for very deserving individuals just because card issuers are unsure of the credit risk involved

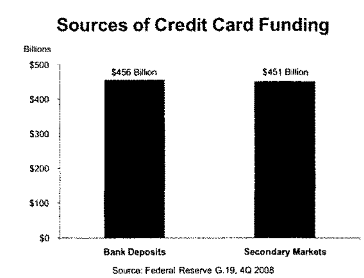
[4] "Credit Cards Are the Next Credit Crunch: Washington shouldn't exacerbate the looming problem in consumer credit lines." Wall Street Journal. 11 Mar. 2009: A15.

and will not be able to price for that risk as it becomes more apparent. This means that many very creditworthy borrowers who do not have perfect credit histories or who have had limited experience with credit (and, therefore, have less credit history to guide issuers of their true risk of default) may not have access to credit.

It may also lead to higher interest rates or fees (such as annual fees) for all cardholders in order to compensate for the inability to price risk effectively. Thus, the least risky borrowers must now bear the cost for higher risk borrowers because the higher-risk borrowers may no longer bear the full cost of the exposure they pose to lenders. It may also be the case that payment allocation requirements will lead to the elimination of low-rate balance transfers that consumers and small businesses previously used to lower overall debt costs. Simply put, the sum total of all these rules will likely lead to reduced access to credit and higher prices to all consumers.

Impact of the new rules on funding: Credit cards are funded from two primary sources: deposits and secondary market funding, each accounting for about half – approximately $0.5 trillion dollars – of the total funding of card loans to consumers (see chart below). Funding in the secondary market relies on investors willing to hold securities that are backed by credit card receivables. ***Any change*** in the terms of issuance can greatly impact the receptivity of investors to holding these securities. If investors perceive that there is greater risk, they are less likely to hold these securities, or may require significantly higher interest rates or other enhancements to compensate them for the risk. This means that less funding will be available, and if available, more costly. This translates into less credit available at higher cost to customers.

Investors are extremely sensitive to changes in the terms and conditions of the underlying asset, as has been evident in the current market, where investors have shunned nearly all forms of asset-backed securities over fears in the underlying economy. The new rule, in fact, may exacerbate these problems, at least in the short term, particularly if time frames for implementation are dramatically reduced. For example, the new rule restricts the ability of issuers to quickly re-price risk for borrowers who have, for example, missed payments or whose level of borrowings has risen to high levels. Investors may



well be concerned about the performance of the credit cards backing their securities and shy away from holding them.

This problem can become particularly acute if these investors do not believe issuers have had the time to sufficiently vet their new risk models – necessitated by the new rule's limits on risk-based pricing – in light of challenging economic conditions. In fact, both the Treasury and the Federal Reserve have recognized the severe problems that exist in the funding area, and have proposed the Term Asset-Backed Securities Lending Facility (TALF) as a means of unlocking investor concerns. Shortening the implementation time frame, for example, may well act in direct conflict with the efforts under TALF by creating greater investor uncertainty over bank risk modeling approaches. ***The integral part that investors play in helping fund consumer loans – and the broader economy – cannot be understated,*** and we would urge Members to closely examine the consequences of any legislative approach on this important aspect.

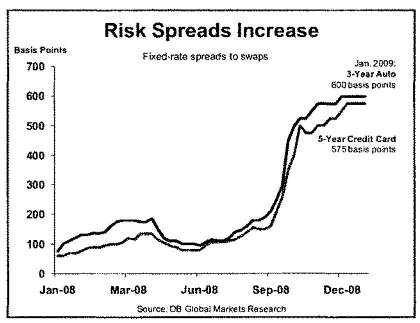
Impact on risk-based pricing models: The requirements will force all credit card issuers to completely overhaul their pricing models to ensure that the risk for any cardholder is appropriately set to satisfy both regulatory concerns over safety and soundness and investor demands for strict underwriting and investment yield. Adequate time needs to be provided to ensure that the pricing is appropriately calibrated to the risk assumed so that the issuers are compensated for the risks they assume and investors are confident that securities backed by card loans will perform as expected. All of this affects the ability of issuers to make loans to consumers.

Impact on systems and operations: Overarching all of the key business decisions that must be made under the new rule (funding, pricing, credit availability, and marketing) are operational changes that must be made to business practices, software/programming, product design, periodic statements, advertisements, contracts, testing/auditing for compliance, customer service, training, printing of new forms, training of customer service personnel, just to mention a few. For example, training for customer service personnel and modifications of call scripts could require hundreds of thousands of hours for each of the largest card issuers. The huge technological infrastructure that underpins the entire card system – including billing and account receivables – will demand hundreds of thousands of more hours for each issuer to comply. Periodic statements must be completely revamped, involving programming changes, testing, legal analysis to ensure compliance, focus group testing, and modifications of services from outside vendors. These changes are likely to take an additional hundreds of thousands of hours for large issuers.

Beyond the business decisions and technical changes that must be made, every issuer must make sure that they are in full compliance with the changes. The penalties can be severe for non-compliance. Thus, legal and compliance review are critical, time-consuming, and expensive. The sweeping nature of the rules (which cover all aspects of card practices) and the new disclosures required (which cover all the printed – and electronic – materials, advertising, applications, solicitations, and credit card contracts) means that this undertaking is enormous.

Given the breadth of the changes anticipated, the Federal Reserve rule provided for an 18-month implementation period, with the expectation that card issuers will need all of it. When the rule was published in the *Federal Register* in December 2008, the regulators emphasized that: "If institutions were not provided a reasonable time to make changes to their operations and systems to comply with the final rule, they would either incur excessively large expenses, which would be passed on to consumers, or cease engaging in the regulated activity altogether, to the detriment of consumers."[5] In other words, consumers may immediately see much higher costs, and lenders may significantly cut back on lending even more than the regulations already will cause.

The 18-month implementation period is particularly important given the current economic recession, which is expected to last well into this year. There has already been a huge strain placed on the economy as credit from secondary markets – for mortgages, credit cards and auto loans – has largely disappeared due to the large risk-premium now demanded by investors (see the chart at right for autos and credit cards). While the 18-month implementation period may help ease the impact of the new rules, any additional restrictions that limit the ability of issuers to effectively price according to risk, and any shortening of the time period to adopt the new rules, will send further chills in a market already in deep freeze.



We recognize that some observers believe this implementation period is too long. Certainly, we expect that some issuers may be in compliance, at least in part, before the end of the 18-month

[5] 74 Federal Register 5548

period, perhaps because they did not engage in or had already changed some practices or because they wish to compete on the basis of early compliance. However, because of the massive changes to pricing models, funding options and internal operations precipitated by the rule, overall compliance is going to take time.

III. H.R. 627 would dramatically shorten the implementation period for new regulations, which would pose serious risk and harm to consumers and the economy.

While we have some general and specific comments on H.R. 627, we believe changes made by the bill to the implementation period for the new regulations deserve special mention.

H.R. 627 would allow only three months to implement the new regulations, which will apply to every personal card in circulation in America – currently more than 700 million – and all accounts opened after the implementation date. Implementing these new regulations for every existing account will be a monumental challenge for credit card lenders. When the regulations were unveiled, Federal Reserve Consumer and Community Affairs Director Braunstein, stressed that "card issuers are going to need to rethink their entire business models… [meaning] 18 months is a challenge in and of itself." In the notice the three federal agencies submitted to the Federal Register, the regulators emphasized the need for sufficient time – otherwise consumers would see higher prices and lenders might just stop lending, "to the detriment of consumers."

Complying with the new regulations requires a conceptual redesign of each lender's entire risk and operating models and, indeed, of every aspect of their businesses. The attached document provides a detailed schematic of the many interrelated processes that must be overhauled to ensure compliance with the new regulation. Consider, for a moment, that behind every piece of plastic, there is a complex network of brains, data, and technology designed to give each cardholder convenience and security. The whole, complex network must be completely overhauled, including statements, all customer service support scripting, training and execution, the chargeback system, all marketing materials, and the entire collections system. This simply cannot be accomplished in three months. We believe it would be a mistake to move the time period for compliance up in such a dramatic fashion and that such an action will cause undue harm to both consumers and the broader economy. We provide more detail on this harm below:

Harm to Consumers:

Increased costs would emerge and card lenders would be forced to redirect efforts from opening new accounts, granting credit, and providing customer service in order to meet a reduced time schedule. But even worse, with hasty implementation, billing and other errors that negatively impact millions of consumers become more likely. Given this potential for error, lenders are faced with two options: go forward with lending, inconveniencing millions of people and opening themselves up to significant fines and private suits; or, pull back on lending so as to minimize risk. This will only exacerbate the reduction in credit lines and increase in interest rates that we are already seeing in the marketplace as a result of increased default rates and higher funding costs. And, given consumers' increased reliance on credit to tide them over in times of economic turmoil (e.g., job loss, medical problems), this tightening credit, then, causes an important consumer safety net to disappear or harshly decrease.

The impact on individuals would likely be difficult, but small businesses would bear a greater burden. According to the most recent Survey of Small Business Finances conducted by the Federal Reserve, 77 percent of small businesses used either a business credit card or personal credit card for business expenses in 2003.[6] A more recent survey by SurePayroll, an online payroll service provider, puts the figure at 90 percent.[7] This puts small businesses more at risk in a tightening credit environment. Because of these genuine risks, it is important that the next 18 months provide time for full implementation of the new customer protections.

Harm to the Economy:

As noted earlier, a card lender's ability to lend to customers is assisted by a vibrant secondary market that helps fund about one-half of all consumer revolving debt. Yet these markets are currently frozen, and problems in this area will only be exacerbated by a rushed implementation schedule. To comply with the new regulations, lenders must create entirely new risk models ***during a time of unprecedented economic turmoil***, thoroughly testing these models for performance and to the satisfaction of wary investors. If issuers are perceived to be rushed, investor confidence

[6] Traci L. Mach and John D. Wolken, "Financial Services Used by Small Businesses: Evidence from the 2003 Survey of Small Business Finances," *Federal Reserve Bulletin*, October 2006, p. A167.

[7] News Release, SurePayroll, SurePayroll Insights Survey: Business Owners Share Opinions on Perks and Pitfalls of Business Credit Cards, April 16, 2007, *available* at http://www.surepayroll.com/spsite/press/releases/2007/release041607.asp

in the new risk model could be shaken. Failure to allay these fears will have serious consequences for marketplace liquidity, potentially working at cross-purposes with the efforts of the Federal Reserve and Treasury to unlock frozen market through TALF. This economy cannot afford legislative actions that exacerbate the credit contraction in the marketplace.

Further Concerns with H.R. 627

Should the Committee wish to move forward with H.R. 627, we would like to point out some additional concerns:

- The bill was originally drafted to correspond with the Federal Reserve's "proposed" rule and should be conformed to the final rule's provisions so as to avoid unnecessary implementation burden and confusion. This permits the Committee to take advantage of regulators' expertise, the deliberative process in which they engaged, and the broad comments from interested parties.
- The bill also includes several provisions that go beyond the new rules. For example, we are concerned that a provision that allows a cardholder to opt out of over-the-limit transactions would lead card issuers to deny transactions that might, but will not necessarily, exceed credit limits, making it more difficult for a consumer to rely on the ability to use his or her credit card for emergencies. (Sec. 4(m)) Another provision that prohibits issuers from providing information to credit bureaus on the opening of new accounts until the card is activated could allow fraudsters to open multiple accounts without issuers knowing. This poses significant fraud potential that potentially places innocent consumers and lenders at risk, and also hides borrower activity that may have a significant impact on a borrower's ability to pay. This is a serious problem that should be addressed. (Sec. 3(d))

We would be happy to provide additional comments on these and other provisions of H.R. 627 as the Committee's deliberative process goes forward.

As we stated earlier, many of the core issues included in H.R. 627 are already addressed by the new credit card regulations, raising the question over whether legislation in this area is even necessary. Like the bill, the regulations prohibit rate increases on existing balances with some exceptions, ban double-cycle billing, provide more advance notice of rate changes and more time for consumers to pay bills, and require that more payments go to higher-rate balances first.

Addressing consumer protections in regulation, rather than legislation, has some benefits. The rules carry the force of law with significant penalties (up to $1 million per day), with enforcement authority vested with bank regulators to ensure compliance and corrective action. Rules also have the flexibility to be changed, if problems arise, but only in a manner consistent with the Administrative Procedures Act, which ensures full notice and opportunity to comment. Thus, if changes need to be made, they could be done in an expedient way, subject to broad input and congressional oversight.[8]

IV. Overdraft protection is highly valued by consumers; legislation seeking to amend current practices proposes technically difficult changes and may result in fewer choices for consumers.

Consumers value banks' practice of paying overdrafts. Indeed, they expect it. They value the ability to avoid the embarrassment, hassle, costs and other adverse consequences of having a check bounce or transaction denied. Whether made by check or electronically, returning a payment usually means the consumer pays additional fees charged by the entity receiving the payment. Recently, the Federal Reserve released a study[9] that documents just how much customers value this service. According to the study, most participants wanted coverage to ensure their transactions went through.[10]

While this service may cost the customer money, as there are fees associated with its availability, in many cases it would cost the customer more to endure the inconvenience, embarrassment, and fees charged by the merchant or payment recipient, were the payment to be declined. It is important to remember that ***this cost is completely avoidable.*** Consumers have

[8] It should also be noted that the rule adopted in December 2008 is not the end of the story. The Federal Reserve and other bank regulators will clearly monitor the implementation process. They will aggressively examine institutions for compliance. They will be able to gauge the full extent of the impact of the changes and can propose additional measures as appropriate. Even more significantly, the development and issuance of the rule has established a framework for future developments. In fact, the rule provides the necessary authority and flexibility for the Federal Reserve to take action regarding other practices that may be deemed unfair or deceptive. It is inevitable that card holder preferences will change, new payment system technologies will be developed, and competitors will offer new products and choices. We believe that this framework puts regulators in the best position to oversee and make the necessary adjustments appropriate to this dynamic market in response to the inevitable innovations in the payments system and in changes in customer preferences.

[9] "Review and Testing of Overdraft Notices," Federal Reserve, December, 2008 p. 8

[10] Ibid. p. 8

many options in order to avoid incurring fees. First, consumers can simply keep track of transactions and balances – which is easier to do now than ever before – by phone, the Internet, ATM, or handheld device. Also, consumers can avoid overdraft fees by keeping a cushion in the account or by linking their checking account to a savings account, line of credit, or credit card account. Finally, consumers can also arrange with the bank to send an alert by e-mail or text message that the account balance has fallen below a set amount – thus avoiding the need for overdraft protections. Simply put, consumers are in control of their finances and can avoid overdraft fees altogether.

Legislation introduced last week, H.R. 1456, the "Consumer Overdraft Protection Fair Practices Act," attempts to limit overdraft fees, though we believe it will have much more far-reaching effects. We remain very concerned that this legislation will impose operational challenges that are nearly impossible to implement and that may have the effect of reducing the availability of this service to many consumers who benefit from it. We would also suggest that it is unnecessary, given the pending Federal Reserve proposed rule, currently open for comment, which seeks to deal with this complex subject. That rulemaking was initially proposed in May of 2008, and was later re-proposed in December, as the Federal Reserve became more aware of the complexities involved through the comment process. The rule is now nearing completion. We would urge the Congress to withhold judgment on this issue pending completion of that process.

To give you an example of potential unintended consequences of the bill, one provision in general prohibits banks from imposing an overdraft protection fee for electronic fund transfers "initiated at an automated teller machine." The bank may impose a fee for such transaction if: (1) the bank notifies the customer at the time of the transaction that an overdraft fee will be imposed and the amount of that fee, and (2) the consumer has "opted in" to have automated teller machine (ATM) and point of sale (POS) transactions paid. In the alternative, if such a notification system is not "feasible," institutions may not impose a fee for any ATM or POS debit card overdraft. However, given the reality that current systems cannot technologically provide such notice (explained below), this provision would essentially eliminate ***for everyone*** overdraft services ***for all debit card transactions*** – including increasingly popular bill-pay transactions. To make matters worse, these are precisely the type of transactions that the Federal Reserve's consumer testing found ***customers want paid***, yet the legislation would preclude that from happening.

In general, the notification system described by the bill is infeasible as systems are currently arranged. Transmitting the required notice, the amount of the fee, the customers' response, and the final authorization would necessitate prohibitive, technical changes. Bandwidths used by the ATM (and POS, if applied to POS) networks and the financial institutions would have to be increased to accommodate additional message traffic. Software would have to be developed and installed at all points in the system to allow systems to recognize and process related messages. The ATM software would have to be altered in order to provide the necessary notices. To provide the amount of the fee, institutions may have to apply a single overdraft fee to all accounts and eliminate tiered structures where the customer pays less for the first overdraft, for example. If also applied to POS terminals, POS terminals and software would have to be changed or replaced in order to comply. It is not clear how depository institutions would know whether the merchants' terminals can convey the notice. As such, there are enormous technical hurdles that would have to be overcome before the bill's requirements could even possibly be met.

Even if such a system were feasible, it is clear that costs for providing the service would increase significantly, as the ATM and POS networks would charge the depository institution for the cost of the additional message processing.[11] Beyond the costs and challenges (as acknowledged by a recent GAO study), including significant expansion and modifications to the networks systems and the upgrading or replacement of millions of merchant terminals (if applied to POS), there are other challenges posed by such a systems update. For example, determining the real-time account balance, addressing privacy and security concerns, and allowing for the increased time to conduct the transaction must all be considered. Moreover, if applied to POS terminals, providing a notice and option to not continue would not be feasible in some newer applications. One new application is "tap and go" or contactless debit cards for mass transit payments that have been created in order to reduce costs, increase customer convenience, and improve the speed of traffic flow. Application possibilities range from subways, to toll highways, to buses, to regional railroads, to taxis. Key to these applications, however, is minimal equipment and minimal processing time. The screen requirement necessary to provide notice under the bill would increase costs, and the time needed to provide and respond to the notice would stall information flow, nullifying the benefits of this application. For similar reasons, the notice requirements would make it infeasible to use debit cards at vending machines.

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[11] *Bank Fees: Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management.* General Accounting Office, January 2008 (GAO-08-281), p. 59-71. This appendix provides many details on the issues involved with implementing this requirement.

Overdraft debit card transactions represent a small percentage of debit card transactions. Simply put, the cost of revamping the entire system would not justify the expanded functions. Therefore, in effect, the bill would prohibit debit card overdrafts at POS and ATMs, even for customers who want the service.

However, the prohibition would go far beyond just ATM and POS transactions. It would also prohibit debit card bill-pay overdrafts. More and more consumers use their cards for both recurring and one-time bill payments. For example, consumers may and do use a debit card number to pay a credit card or other bill. If the customer is paying close to the due date, for example, they may use a debit card number rather than a checking account number (if that option is available) because the checking account number or checkbook is often not readily available, whereas the debit card is typically carried in a wallet. Customers may also use debit cards for recurring bills, such as utility bills.

However, from a processing standpoint, bill payments are indistinguishable from any other debit card transaction. For example, a customer's online debit card authorization to pay a store credit card bill is indistinguishable from the customer's debit card transaction to make an online purchase with that store. Accordingly, from an operational standpoint, it would not be possible to allow customers to choose to have *purchases* declined, but have *bills* paid: the bank cannot distinguish between them. This means that if there is a choice of having overdraft debit card transactions paid, the choice for consumers is to have all debit card transactions, including bill payments, paid or declined.

Indeed, even that choice will not be available to most consumers. In effect, overdraft services will not be available for any debit card transactions for most bank customers because most depository institutions can only provide overdraft services on debit card transactions on a payment channel basis; they cannot offer it on an account-by-account basis. This means that if the overdraft service is not to be available to some customers, it will not be available to *any* customer. In effect, the bill will mean that most customers will have no choice but to have all debit card overdrafts (purchases and bill payments) declined or returned. Yet, the Federal Reserve found that most consumers want important payments paid, which would include debit card bill payments. They want to avoid the costs, inconvenience, and other consequences of having an important payment declined or returned.

Furthermore, legislation is not necessary, as the Federal Reserve is in the process of promulgating regulations related to overdraft services – ***based on actual consumer testing***. In May 2008, the Federal Reserve published for comment a proposal that would have required depository institutions to allow consumers to opt out of having overdrafts paid and a fee assessed. Subsequently, based on those comments and consumer testing, in December 2008, it published a second proposal which sought to take into consideration the further complexity of the issue as learned through the process. Comments are due on March 30. The latest proposal would limit the ability of a financial institution to assess an overdraft fee for paying ATM withdrawals and one-time debit card transactions that overdraw a customer's account, unless the consumer is given the notice of the right to opt out of the payment of overdrafts, and the consumer does not opt out. As an alternative approach, the proposal would prohibit imposition of overdraft fees unless the customer has affirmatively consented or "opted in" to have such overdrafts paid. We believe that Congress should allow the rulemaking process to continue and permit the Federal Reserve Board to adopt regulations based on public comment and consumer testing before taking any action.

ABA is concerned about several other issues included in H.R. 1456. The bill would require consumers to consent in writing to having overdrafts paid and require depository institutions to calculate an Annual Percentage Rate (APR) when overdraft fees are charged. We offer further comments on these changes below.

Opt-in Overdraft Accommodation. Under the bill, banks cannot pay more than three overdrafts per year and charge a fee unless the consumer has provided specific written consent. We believe that bank customers will be greatly inconvenienced and upset when their checks and electronic payments are returned unpaid and they incur additional fees from merchants and others because they forgot or were unable to notify the bank in a timely manner in writing that they wish these items to be paid. They will also be confused and unpleasantly surprised when the fourth item is returned after the first three are paid, expecting the same courtesy for the fourth item as they received for the first three. As discussed above, consumers today expect their banks to cover them for those situations. Again, consumers typically pay even more when their transactions are not honored due to nonsufficient funds.

Effective APR Calculation. H.R. 1456 appears to classify as a "finance charge" – and hence include them in disclosed calculations of interest rates – any overdraft fee beyond the first three fees paid in a year.[12] This means that banks would have to calculate an effective annual APR for those fees, that is, those overdraft fees beyond the first three paid in a year. Given that the number, amount, and duration of overdrafts are unknowable in advance (and are entirely within the control of the customer), it is not possible to incorporate them in an effective APR calculation.

More importantly, bank customers don't understand the term "effective" APR, raising questions over whether this cumbersome process for calculating interest rates in the bill makes any sense. In a recent study, the Federal Reserve noted, "The quantitative consumer research conducted by the Board validated the results of the qualitative testing conducted both before and after the June 2007 proposal; it indicates that most consumers do not understand the effective APR, and that for some consumers, the effective APR is confusing and detracts from the effectiveness of other disclosures."

Further, even if it were possible to calculate an "historical" APR, that is, an APR calculated ***after the fact***, based on the consumer's actual behavior, it would not be helpful or meaningful to consumers. Any time an ***annual*** percentage rate is calculated for a term ***less than a year***, the inclusion of a fixed fee, even a modest one, will distort and overstate the APR. The shorter the repayment period, the greater the APR will appear in instances where there is a fixed fee. This means that the *sooner* the consumer repays, the *greater* the calculated APR – a difficult concept to explain to consumers, as it appears that paying *earlier* actually *increases* the cost of credit.

Given the nature of overdraft fees, the APR will be greatly inflated to the point of distortion. In these cases, the fee is fixed, the overdraft often small, and the term of repayment short (as the banking agencies encourage banks to request prompt repayment). It is easy to see how triple digit APRs would result. However, it is not at all clear how this would assist consumers. Rather, the inflated and distorted APR will confuse consumers as they attempt to reconcile this APR with other APRs with which they are familiar, such as the APRs for credit card, home, auto, and personal loans. The result will be to dilute the effectiveness of the APR generally, rather than enlighten them with regard to overdrafts. In the overdraft fee context, consumers understand a dollar amount far better than an inflated and meaningless APR.

[12] "Overdraft protection fee" is defined as "any fee or charge imposed in connection with any account on which checks or other debits are paid . . . even though there are insufficient funds. . . unless such fee or charge "is imposed on an incidental basis as a customer accommodation and no more than three such overdraft fees are imposed during any calendar year."

For over forty years, the Congress and Federal Reserve Board have worked to produce a calculation that consumers can use to compare the cost of credit in a meaningful way. For the reasons given above, classifying overdraft fees as finance charges simply undermines those efforts and goals.

In sum, these requirements would not only cause immediate and significant costs, inconveniences, and confusion for debit card users, they would limit customer choices and significantly curtail new applications under development that seek to expedite day-to-day transactions that are beneficial and attractive to consumers. As such, we believe that Congress should refrain from acting in this area for fear that such action will actually create problems for consumers that outweigh the benefits. Given that many of the issues addressed by the legislation are being addressed by the new rule which is due out this year, forced action at this time is unnecessary.

Conclusion

Mr. Chairman and members of the committee, ABA believes that both overdraft protection and credit cards provide an invaluable service to consumers and small businesses. Any additional actions on either of these topics must be carefully considered. This is particularly important given the current weak economy. We stand ready to work with this committee as it continues to review the pros and cons of any further changes.

INDEPENDENT COMMUNITY
BANKERS *of* AMERICA

Testimony of

Linda Echard
President and CEO, ICBA Bancard

On behalf of the
Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

Hearing on

"H.R. 627, the Credit Cardholders' Bill of Rights Act of 2009; and H.R. 1456, the Consumer Overdraft Protection Fair Practices Act of 2009"

March 19, 2009
Washington, D.C.

Chairman Gutierrez, Ranking Member Hensarling, Members of the Subcommittee, my name is Linda Echard and I am President and Chief Executive Officer of ICBA Bancard. Twenty-five years ago I helped the Independent Community Bankers of America (ICBA) leverage the negotiating power of its membership to allow community banks to enter the costly and competitive business of issuing credit cards to their customers. Today, with a staff of eleven, I work to help level the playing field in the card industry so community bank credit and debit card issuers can afford to participate and meet the costs to compete. As a collective, ICBA Bancard ranks as the 29th largest card issuer by outstandings.[1] On behalf of the Independent Community Bankers of America's[2] nearly 5,000 member banks, 70% of which offer credit cards to consumers and small businesses[3], I appreciate the opportunity to share our views on H.R. 627, the Credit Cardholders' Bill of Rights, and H.R. 1456, the Consumer Overdraft Protection Fair Practices Act.

The Credit Cardholders' Bill of Rights

Community banks believe they have an obligation to treat customers fairly, honestly and without deception. They cannot afford to harm their customers by taking advantage of them through deceptive credit card offerings and practices. There is no denying that a handful of large issuers have engaged in practices unfair to consumers. However, thanks in no small part to the urgings of this Committee, these practices have been largely abandoned.

[1] *The Nilson Report*. Issue 918, January 2009. Page 10.
[2] The Independent Community Bankers of America, the nation's voice for community banks, represents 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. With nearly 5,000 members, representing more than 20,000 locations nationwide and employing nearly 300,000 Americans, ICBA members hold $1 trillion in assets, $800 billion in deposits, and $700 billion in loans to consumers, small businesses and the agricultural community.
[3] To view an executive summary of the 2007 ICBA Community Bank Payments Survey, please visit http://www.icba.org/publications/2007paymentssurvey.cfm?ItemNumber=38445

While we agree that a small number of issuers have engaged in practices that are harmful to consumers, any legislative remedy should more broadly focus on encouraging consumer choice, transparency, and disclosure. This measure, which instead attempts to prohibit specific practices, imposes additional costs and burdens on community bankers who did not contribute to the problems in the industry, and will result in fewer and more expensive sources of credit for all Americans.

ICBA has testified before this committee and others on the dangers of excessive concentration of deposits in the banking sector: It is not in the public interest to have so much power and concentrated wealth in the hands of so few. This same maxim applies to the credit card industry. Public policy should encourage banks of all sizes to offer credit cards.

Throughout my career, I have seen first-hand the implications of excessive regulation on small issuers: the costs become too much to justify continuing the program, the card portfolio is sold to a big bank, and consumers in smaller markets are left with fewer choices with less favorable terms. At a time when everyone agrees that government should be encouraging and supporting efforts by community banks to assist in the recovery of our economy, passing this legislation sends the wrong message to those who are actually in a position to help.

The most powerful force for change in a market as competitive as credit cards is the ability of an educated consumer to shop with his or her feet. Ensuring that consumers are informed on a card's terms and conditions through appropriate and comprehensible disclosures is the best means of combating unfair practices. In fact, community bankers feel they gain a competitive advantage over the competition when an educated consumer walks in the door, because that individual will be able to discern the better terms and conditions often found at a community bank.

ICBA remains very concerned about the efforts in this legislation to limit a community bank's ability to price and control for risk, which can lead to increased pricing for all customers regardless of risk. Risk-based pricing allows community banks to remain competitive, while being reasonable and flexible to their customers. Without risk-based pricing, community banks will have a difficult time helping people struggling on the margin to get back on sound financial footing. And if community banks aren't able to help, struggling consumers will be priced out of the market, forced to turn to payday lenders and others. While this legislation allows a limited set of circumstances in which an issuer may re-price a consumer's account, the implication will be a dramatic shift among community banks away from fixed-rate cards – which many consumers prefer – to variable-rate cards with limited flexibility.

I would also note that the deadlines set forth in this legislation for full compliance are completely unrealistic. For starters, the vast majority of community banks cannot afford to run their own credit card processing operation, and must rely on third parties. As we are seeing with the implementation of recent regulatory changes affecting credit cards, it takes months for the processor to reconfigure software and back-room operations, weeks of testing to work out the bugs, and more weeks to train employees and sales forces. Beyond that, once actually in the bank, the systems have to be reconfigured, and at least a full testing cycle must elapse before the system can be fully implemented. On top of this is training of bank employees and notifications to customers of the changes being made. All of this takes far more time than the bill allows.

Consequences for Consumers

As consumers, we all recognize the convenience that credit cards afford us in our daily transactions, since they are accepted at over 24 million locations worldwide.[4] Credit cards are open-ended credit plans, as opposed to installment plans like a mortgage or car payment. As a result, credit cards are the only loan or credit product that, generally, allows the consumer to control how much he will owe, and whether he will pay any finance charge or just be a convenience user.

The Credit Cardholders' Bill of Rights Act attempts to restrict what today are considered to be inappropriate practices. This approach could actually create an incentive for those intent on maximizing profits at all cost to simply find new ways to work around the system, while the regulatory and paperwork requirements imposed through this bill will disproportionately burden community banks, diminishing their profitability and their ability to attract capital. Just as importantly, community banks will struggle to meet the credit needs of their consumer and small business customers. No one benefits if community banks exit the marketplace.

In today's struggling economy, access to credit is vital to many families. Many hard-working households use credit cards to budget their cash and spending as well as to deal with emergency or unexpected expenses. Community bankers, with business models based on establishing long-term relationships through good and bad financial times, have remained a solid and cost-effective option for countless consumers when the alternative is often a payday lender. In fact, community banks often extend credit to consumers with imperfect credit scores because they work with people directly: they know the person's character and they

[4] See http://www.electronicpaymentscoalition.org/value/business-economy.html

value the overall relationship a customer has instead of just looking to exploit the maximum revenue from a single product. Whether a potential customer walks into a community bank with a credit score of 800 or 600, today they can feel confident they will be provided personal customer service without ulterior plans to trip them up with excessive fees and billing gimmicks.

But any competitive advantage a community bank may have today can be quickly erased through a legislative approach such as H.R. 627. Its restrictions take flexibility away from community bank lenders and make it nearly impossible to adapt to changing markets and new consumer demands. Moreover, I am concerned that this legislation will cause a transformation of the credit card industry into one that consumers will not like. Today, community banks can offer credit cards that are truly customized to the needs of individual customers. The litany of options a community bank customer has is long: basic cards with a fixed low annual percentage rate, cards with valuable rewards programs, flexible rates that drop with a good payment history, and credit limits designed to match the needs of the consumer are just a few of the choices that consumers have. All of these are possible because of the ability of lenders to innovate and develop new products and services to meet the needs of their customers. For community banks, this creativity allows them to differentiate themselves from the competition.

While the restrictions imposed through H.R. 627 are intended to protect consumers, issuers – especially smaller ones – will be so constrained in their ability to run a card program that balances the needs of consumers with safety and soundness requirements expected by regulators. As a result, cards as consumers have come to appreciate them today will be dramatically changed. I believe this legislation will lead to more homogenous cards, eliminating choices and options for consumers, fixed-rate cards will be replaced by variable-rate pricing, and interest rates across the industry will rise.

Credit Cards Benefit Small Businesses

The impact H.R. 627 could have on small businesses should not be overlooked. Community banks are incubators for small businesses, and play a vital role in providing the all-important access to capital that entrepreneurs need to succeed. While community banks only account for a small percentage of total domestic banking assets, they provide nearly a third (32.7%) of the total dollar amount of bank business loans under $100,000,[5] many in the form of small business credit card products. When a small business has no track record, access to funding through a credit card can be the key resource that helps get the business going.

The 2007 ICBA Community Bank Payments Survey[6] revealed that more than 60% of respondent banks offer small business credit cards, and data from a recent National Small Business Association survey showed that credit cards are a leading source of financing for fledgling businesses[7]. A community banker's ability to offer credit cards at competitive rates and terms to entrepreneurs in our local towns is critical to supporting the engine of small business that drives our economy. Community bankers know their customers and live and work in their neighborhoods. The community banker often knows the capabilities and needs of the principals of a small business and the local community, and can help them where help is needed. And should the small business find itself in a tough financial situation, both the

[5] U.S. Small Business Administration, Office of Advocacy. *Small Business and Micro Business Lending in the United States, for Data Years 2005-2006.* February, 2008.
[6] To view an executive summary, please visit http://www.icba.org/publications/2007paymentssurvey.cfm?ItemNumber=38445
[7] National Small Business Association. *2007 NSBA Survey of Small and Mid-Sized Businesses*. Accessed at http://www.nsba.biz/docs/surveynewfinal.pdf

banker and the owner have much more of a vested interest in making sure the business succeeds.

The negative consequences for consumers as a result of the restrictions prescribed in this legislation hold true for small businesses as well. Again, ICBA strongly urges this Committee to carefully consider whether this prohibitive and constraining legislative approach is appropriate when small businesses and community banks are both being asked to resurrect the economy.

H.R. 1456, the Consumer Overdraft Protection Fair Practices Act

Many community banks offer overdraft protection programs that are highly valued by their customers. These programs, which automatically cover transactions drawn against non-sufficient funds, have historically been implemented on an ad hoc basis. New technologies have allowed banks to automate these processes in certain instances and honor more overdrafts. This is a convenience for customers who would otherwise inadvertently overdraw their accounts.

ICBA supports ensuring consumers are fully informed about the terms and conditions of any overdraft protection program (ODP) and are made fully aware of choices available to them. However, the burdens imposed in H.R. 1456 would reduce community banks' ability to competitively offer overdraft protection programs. In particular, the provisions of this legislation present technical and practical difficulties that will reduce the availability of overdraft coverage to community bank customers.

First, mandating an opt-in requirement to participate in overdraft programs is not what community bank customers want. Generations of community bank customers have come to expect that their banker will ensure they have access to their accounts, even if granting that access means overextending temporarily. Community bank customers understand and appreciate that it is in their best interest to accept a reasonable overdraft fee in exchange for their banker clearing a check or allowing a point-of-sale transaction to be completed, rather than paying a non-sufficient fund fee, a bounced check fee, and facing the possibility of being late on a mortgage or other critical payment.

Furthermore, while the legislation mandates that consumers be allowed to decline overdraft coverage at a point-of-sale transaction, it is important to note that real-time balance information does not flow through our payments system. The system is not intended to carry this sort of information, and implementing these changes will not only carry significant cost, but will also disrupt the customer experience going forward by adding to the length of time required to complete a transaction, and also placing the customer at risk of embarrassment in the event a charge is declined. This sort of change will also require significant and costly upgrades to merchants' point-of-sale terminal equipment, another cost that likely will be passed on to consumers.

ICBA also believes overdraft protection programs should not be subject to the Truth in Lending Act (TILA). Regulation and disclosure under TILA is appropriate for open-ended accounts, such as credit cards, where a consumer is offered and extended credit and has certain rights and obligations regarding using and repaying it.[8] The discretionary nature of ODPs, which allows community banks to make overdraft protection available to more consumers while mitigating their own risk, does not fit the criteria for regulation under TILA. While overdraft *lines of credit* are properly addressed under TILA, other overdraft programs are more appropriately addressed under the Truth in Savings Act and Regulation DD. The disclosures provided under TILA are based on specific principal amounts and defined terms,

[8] See, *inter alia,* 12 C.F.R. §§ 226.1(c), 226.2(a)(14).

elements lacking when overdrafts occur since customers are charged a flat fee, not an interest rate. Also, generic disclosures are not meaningful for consumers but would be required if attempts were made to apply TILA to overdraft protection programs.

Overall, ICBA believes the compliance costs imposed by this legislation would reduce the ability of community banks to compete. Overdraft programs are not all created equal, a fact which gives community banks the ability to leverage the unique and close relationship they have with their customers to offer them competitively priced programs to best meet their needs. This competitive advantage is an important part of what allows community banks to serve their customers, many of whom are already at the margin.

If the burdens and costs of compliance become too great, many community banks will merely reject any transaction that would overdraw an account. Without overdraft coverage, many customers will pay a nearly identical fee for the declined transaction but will also face a merchant fee and the hassle of a returned check. Furthermore, the returned check will be reflected on their records and negatively affect their credit worthiness. In sum, allowing consumers to overdraw their accounts on occasion helps consumers avoid unnecessary fees, helps them avoid a blot on their credit records, ensures transactions are completed in an efficient and timely manner, and are generally welcomed by community bank customers.

Conclusion

Thank you again for the opportunity to testify today on behalf of ICBA and community banks across the country. Our concerns with these two pieces of legislation are straight-forward: overly restrictive approaches such as H.R. 627 and H.R. 1456, while serving well-intentioned purposes of addressing practices we agree are unfair to consumers, will create more difficulties than they cure. Community banks want to be able to offer competitive credit card products, and also want to be able to help their customers with reasonable overdraft programs.

Empowering consumers to make informed decisions is not only better for them, but is also to the benefit of community bankers who can highlight the strength of their business model. Setting rigid parameters under which a bank may operate a card business or overdraft protection program will discourage already burdened community bankers, pushing them to reduce the number of products and services they can currently offer their customers. Fewer community bank card issuers means less choice for consumers and more business for those larger institutions which, it could be argued, are the principal target of H.R. 627. Overly burdensome conditions on overdraft programs will force community banks to simply stop making the service available to consumers, causing them to reject consumer transactions that otherwise would have been covered. While the latter may seem like a reasonable outcome, community bank customers do not agree.

In today's economic environment, every source of capital, and every form of protection, needs to be an option for consumers and small businesses. Adding further regulatory costs to credit card and overdraft protection programs will make it increasingly difficult for community bankers to remain a viable choice to meet the needs of their communities. ICBA urges this Committee to consider the harmful consequences these two measures would have on community banks and their customers.

Again, on behalf of ICBA and our 5,000 community bank members, thank you for the invitation to testify on these important issues. I look forward to your questions.

STATEMENT OF
DOUGLAS FECHER
PRESIDENT AND CHIEF EXECUTIVE OFFICER
WRIGHT-PATT CREDIT UNION
ON BEHALF OF THE
CREDIT UNION NATIONAL ASSOCIATION (CUNA)
ON
H.R. 627, THE CREDIT CARDHOLDERS' BILL OF RIGHTS ACT
AND
H.R. 1456, THE CONSUMER OVERDRAFT PROTECTION FAIR PRACTICES ACT
BEFORE THE
HOUSE FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

MARCH 19, 2009

Good afternoon, Chairman Gutierrez, Ranking Member Hensarling, Members of the Committee.

Thank you very much for giving me the opportunity to testify today regarding H.R. 627, the Credit Card Holders' Bill of Rights Act and H.R. 1456, the Consumer Overdraft Protection Fair Practices Act on behalf of the Credit Union National Association. My name is Doug Fecher, and I am President and CEO of Wright-Patt Credit Union in Fairborn, Ohio.

Wright-Patt Credit Union serves 170,000 everyday Americans in the Miami Valley, Ohio (just outside Dayton), including the airmen and airwomen of Wright-Patterson Air Force Base and surrounding communities. Our philosophy is to help everyday people save more, smartly use credit, and improve their family's financial well being.

H.R. 1456 – Consumer Overdraft Protection Fair Practices Act

Mr. Chairman, I am a practical thinker and come from the perspective of "main street" Americans who are faced with making daily routine financial decisions that are best for their family, often with limited resources. To be honest, my members do not spend much time thinking about the laws and regulations that affect how they receive financial services. What they do think about, however, is how to make their paycheck last from payday to payday, how they are going to pay for the things they need, not to mention the emergencies they sometimes face, such as the car breaking down or the furnace going out.

The majority of people I serve do not tend to read disclosures, and if they do, it does not change their behavior. I am not against disclosures per se, but we must recognize they are of limited value.

Legislation that does not go far enough does not really help the consumer, and legislation that goes too far does not eliminate financial need, but instead will drive consumers away from credit unions and other legitimate service providers to those who will provide the types of "high cost" services that this legislation is intending to eliminate, making it impossible for credit unions such as mine to be of much help. Indeed, the ideal legislation will create an equitable balance between consumer protections and the needs of service providers to be fairly compensated for their services and not subjected to unnecessary burdens. To say it another way, the ideal legislation will not limit consumers' access to legitimate financial services, such as bounce protection, but it should prohibit financial service companies from engaging in abusive or predatory practices.

The bounce protection legislation being considered is well intentioned – I agree with what it is trying to do – but as a practical matter will limit consumers' access to legitimate financial services, and may be technically impossible to implement. It will not curb abusive or predatory practices and in fact will likely have the unintended consequence of driving consumers to unscrupulous high-cost providers.

Wright-Patt Credit Union Overdraft Practices

Wright-Patt Credit Union charges $25 for non-sufficient funds (NSF) checks that bounce, which is the same as the fee to process an overdraft. We do not charge more to process an overdraft than we do to bounce a check. Our NSF fee is in addition to any fees that might be charged by the receiver of the check.

Our overdraft protection service saves members the cost and embarrassment of bouncing a check. Most merchants charge $30 or more to process a bounced check, which is in addition to the embarrassment that members face. We try to help members in these situations, and think we are saving people money.

We do not knowingly allow transactions that will result in an NSF fee if we have the capability to deny it. For example, we will not authorize a debit transaction if we know there is not enough money in the account to support the debit. Nor will we allow an ATM withdrawal if the money is not in the account. We realize that some banks, and perhaps a few credit unions, may not follow this practice.

We do not allow accounts to run consistently negative. We will only process overdrafts for members on direct deposit so we know they have a way of bringing their account positive again. We limit how negative we will allow an account to get based on a member's average balance with us. Some are limited to no more than a $300 negative balance, although those with higher balances will be allowed up to a $1,000 negative balance.

We do not process overdrafts on accounts that remain negative for more than two weeks. And, we limit the number of times per month that members may use this service. We do not charge a daily negative balance fee.

We do not take any action to manipulate how checks are presented in order to increase fee income, instead clearing them in the order presented for payment, regardless of amount. Many banks will force-order checks from largest to smallest. This practice increases the number of checks that will bounce in an account. They say they do this to clear a customer's "most important" checks, such as the mortgage or car payment, but I believe that they do it to maximize fee income.

Finally, we offer free financial counseling and budget services to any member who wants to use it. Our goal is that members not ever pay an NSF fee. We do not do anything we believe is not in the best interests of members, and we do not make decisions for the sole purpose of generating additional income.

Wright-Patt Credit Union's overdraft program works for the majority of our members. Many come to the end of a pay period and they are out of money, but they still need to make a purchase. We clear the check, charge the same fee we would have charged if the check were returned, and take the account negative for a few days. These members will bring the account positive relatively quickly and go about their financial business. For these people we save them the cost and embarrassment of bouncing a check.

Then, there are members who have difficulty managing their money and are consistently writing checks that exceed their balances. To address this, we recently limited their use of our overdraft services, and we will close their account if this becomes excessive. This is a difficult decision because if we close their account we know they will go somewhere else for these types of services and pay higher fees. However, we see no other option if our financial counseling services are not successful.

Wright-Patt Credit Union is in the final stages of implementing an "opt-in" program on a trial basis in which members opening new checking accounts will be able to elect whether or not to use our overdraft services if they overdraw their accounts. At that time, we will disclose the cost of these services and the available options. We expect to have the program running in the next 60 days or so. We will assess the costs and benefits of the new program during this trial period before deciding whether to make this permanent.

Credit Unions' Concerns with H.R. 1456

Credit unions have four primary concerns with respect to H.R. 1456.

First, as introduced, the bill would classify overdraft protection products as lending products under the *Truth in Lending Act* (TILA) and include the service fee associated with the overdraft protection program within the APR calculation. CUNA opposes treating overdraft programs under the Truth in Lending Act because we do not believe that this service is a lending product. Rather, it is a service that credit unions provide their members which is associated with a savings product.

Second, if this bill were law, it would cause credit unions offering these programs to exceed the usury ceiling prescribed by the *Federal Credit Union Act* (presently at 18%), since even a modest fee would exceed this threshold. As a result, credit unions subject to the usury ceiling would no longer be able to offer these services, driving members of these credit unions to alternative – and perhaps more expensive – financial services providers. Moreover, we do not believe that the disclosure of an APR on an activity of this nature will be particularly helpful to the consumer. Rather, we would support language requiring more meaningful disclosures, such as the disclosure of the cost of using the overdraft protection program versus the cost of the institution's bounced check (NSF) fee and line of credit, similar to those required under recent rules that were issued under the *Truth in Savings Act.*

Third, H.R. 1456 has the potential to present significant operational issues for financial institutions by requiring a written agreement with the member prior to the extension of any overdraft coverage. Since overdraft protection programs are well established, it is unrealistic and unreasonable to require a written agreement from the consumer/member before continuing to provide him or her with overdraft protection. Therefore, CUNA suggests that the bill provide additional disclosures as a "change in terms" for the account where overdraft protection is offered and specifically require that a consumer can formally "opt out" of a depository institution's overdraft protection program if he or she so desires. New account-holders would be provided this information and ability to opt out upon opening a new checking account.

Finally, the requirement that consumers be notified at an ATM or point-of-sale that the transaction will cause an overdraft event represents a compliance burden that we do not believe can be met given current technology and the structure of the payment system. There are other ways to notify consumers that the transaction that they are about to complete may cause an overdraft event. A "sticker" on the side of any ATM – which has been used in the past for other warnings – or a first screen general notice alerting the consumer that a withdrawal from the ATM may trigger an overdraft fee by his own institution, may be appropriate notice for consumers. At some point, however, we do think the consumer has the responsibility to know how much money he has in his checking account. We are also mindful of the fact that there is no warning given when a consumer writes that check which puts him in an overdraft position.

We encourage the Subcommittee to consider whether the goal of this legislation can be met by requiring these types of disclosures as opposed to regulating this product under TILA and requiring an APR disclosure that consumers will find of little value. To address these practical concerns about H.R. 1456, CUNA recommends that the bill be amended as amendments to the *Truth in Savings Act*, rather than to the *Truth in Lending Act.* This approach would eliminate any calculation of APR and eliminate concerns about the impact of the bill on federal credit unions' usury ceiling. To the extent that the Subcommittee feels that real-time disclosure is critically important, we suggest limiting that type of requirement to disclosure on ATM networks that are controlled and operated by the financial institution to which the consumer is affiliated. As we have noted in previous testimony, few credit unions drive their own ATM networks.

Once again, credit unions support the spirit of this legislation, which seeks to prohibit predatory overdraft practices. While we oppose this legislation in its current form, we would like to work with supporters in an effort to craft legislation that eliminates predatory activity without making it impossible for the good actors to offer this service to their members/customers.

H.R. 627 – Credit Cardholders' Bill of Rights Act
Innovations in the financial services sector, such as the credit card, have made credit more available and more convenient to use than at any time in history. When used properly, the credit card is an important purchasing tool for consumers. Credit cards are rarely collateralized, which

means the risks associated with this convenient form of credit is generally higher than other lending products; and, financial institutions, including credit unions that offer credit cards to their members need to be able to price that risk appropriately.

CUNA recognizes that there are legitimate concerns about abusive credit card practices. We applaud efforts to end discriminatory, predatory, deceptive and abusive lending practices, noting that these efforts should be balanced to avoid unintended consequences which would ultimately be adverse to consumers, including making credit more expensive and less available for consumers.

Last year, the Federal Reserve Board of Governors (Federal Reserve), the Office of Thrift Supervision (OTS) and the National Credit Union Administration (NCUA) issued rules that restricted and prohibited a number of credit cards practices, pursuant to their authority under the Unfair and Deceptive Acts and Practices Act (UDAP) and the Federal Reserve issued separate rules under Regulation Z (Reg Z) which address several of the concerns raised in H.R. 627; these rules will become effective July 1, 2010. H.R. 627 would for the most part put into law the requirements that the agencies will require banks and credit unions to follow beginning next year.

Effective Date

Inasmuch as credit unions will be required to comply with the new UDAP and Reg Z requirements in just over fifteen months, our most significant concern with H.R. 627 is the effective date of the measure. Credit unions can appreciate the consumer benefit of having the regulation codified. However, were this bill to become law, credit unions would only have three months to comply with the same requirements with which they are currently adjusting their systems to comply in fifteen months time.

Credit unions are making a significant investment in both time and resources to update computer systems and train staff to be ready to comply with the UDAP and Reg Z changes next year. For credit unions, the cost of compliance is borne directly by their member-owners. If legislation were enacted requiring credit unions to be ready to implement the UDAP and Reg Z changes in only three months time as opposed to fifteen months time, it would require significantly more resources, which would have a direct impact on member service. This would come at a time when credit unions are struggling with enormous regulatory burdens resulting from a number of new and significant laws and rules that have been enacted over the past decade, including requirements in the area of privacy, internet gambling, the *Real Estate Settlement Procedures Act*, the *Fair Credit Reporting Act*, and the *Bank Secrecy Act*, among others.

Notwithstanding the concerns that we have with the provisions of this legislation that are not consistent with the new UDAP and Reg Z rules, we encourage the Subcommittee to modify the effective date of this legislation to be consistent with the implementation date of the UDAP and Reg Z changes.

Universal Default

Statement of Douglas Fecher on behalf of the
Credit Union National Association
March 19, 2009

H.R. 627 seeks to limit the practice of "universal default," by prohibiting creditors from using adverse information concerning a consumer, other than actions directly related to the credit card account, as the basis for increasing the annual percentage rate of interest on outstanding credit card balances. The bill would prohibit creditors from increasing the interest rate on an existing balance unless the increase is due to the expiration of a promotion rate; the increase is due to changes in an index; or the increase results from the cardholder's failure to make a payment during the 30-day grace period after the due date.

Credit unions do not want to raise interest rates to gouge their members. CUNA supports the concept of prohibiting universal default on outstanding balances. A consumer's action which is unrelated to the card should not affect the interest rate of a previously incurred debt. However, as we indicated in our comment letter to NCUA and the Federal Reserve, the implementation of this provision will likely raise asset/liability management issues, possibly resulting in an increase in the initial pricing of credit and other rates and fees.

Advance Notice of Rate Increases

H.R. 627 would entitle a cardholder to a 45-day notice of the rate increase and the opportunity to close the account and pay off the existing balance at the current rate. The joint rule includes a similar 45-day notice requirement. Currently, creditors are required to provide 15-day notice. We suggested last year during consideration of H.R. 5244 that a 30-day notice requirement would make more sense operationally and still provide adequate consumer protection because it would be more compatible to the typical 30-day billing cycle. In practice, many credit unions already provide their members with 30 days notice and usually send these notifications with their periodic statements.

Double Cycle Billing

H.R. 627 would prohibit a practice known as "double cycle billing," which occurs when a creditor calculates interest charges based on balances in a billing cycle that precedes the most recent cycle. Credit unions do not generally engage in this type of interest calculation. We agree that this is an unfair practice and support its prohibition either through regulation or legislation.

Limitations Relating to Account Balances Attributable Only to Accrued Interest

H.R. 627 would prohibit creditors from imposing or collecting any fee on an outstanding balance the amount of which is attributable only to accrued interest on previously repaid credit extended under the plan. CUNA supports this provision.

Access to Payoff Balance Information

H.R. 627 would require creditors to provide cardholders, in each periodic statement, a telephone number, Internet address, and website address at which the cardholder may request the payoff balance on the account. Most credit unions already provide a telephone number but should not be required to also provide an Internet address and website since not all credit unions have interactive Internet capabilities.

Consumer Right to Reject Card before Notice is Provided of Open Account

H.R. 627 also prohibits creditors from reporting any information to a consumer reporting agency concerning the establishment of a newly opened credit card account until the credit card has been used or activated by the consumer. We appreciate that the bill clarifies that this language should not be construed as prohibiting creditors from furnishing information about applications for credit card accounts to consumer reporting agencies. With this clarification, CUNA supports this provision.

Payment Allocations

H.R. 627 would require lenders to allocate payments for a credit card that includes balances subject to different interest rates, on a pro rata basis, except under certain circumstances. CUNA supports prohibiting creditors from applying payments to balances with the lowest interest rate before applying it to those subject to higher rates.

Statement Dates

H.R. 627 would prohibit creditors from considering a payment as late unless the consumer is provided with reasonable time to make payments. Specifically, the bill would require these statements to be mailed at least 25 days before the bill is due. It is worth noting that the joint rule would require lenders to mail periodic statements to cardholders at least 21 days before the bill is due.

CUNA supports a requirement that periodic statements be mailed 21 days before the bill is due. We are concerned that a 25-day requirement is too close to the end of the billing cycle and could create logistical problems for credit unions. We encourage the Subcommittee to address this issue.

Over-the-Limit Transactions

H.R. 627 includes language regarding fees that are triggered when a cardholder exceeds the credit limit on the account. Specifically, the bill permits the cardholder to opt-out of receiving an extension of credit in excess of the consumer's credit limit and would prohibit over-the-limit fees when the consumer opts-out; requires creditors to disclose annually the right to opt-out of this card feature, and provide cardholders with multiple methods of opting-out of the feature; places additional restrictions on the number of times an over-the-limit fee may be charged and under what conditions it may be charged in excess of the limit; and prohibits the imposition of an over-the-limit fee if the credit limit was exceeded due to a hold unless the actual amount of the transaction for which the hold was placed would have resulted in the consumer exceeding the credit limit.

CUNA agrees with the concept that an over-the-limit fee should not be imposed if it results from holds placed by merchants that exceed the amount of the transaction. However, such a standard with respect to holds may create processing issues for creditors since they have little control over the holds that are placed by merchants. We note that the Federal Reserve is considering a proposed rule under Reg E with regard to overdrafts in connection with debit holds.

Subprime Credit Card Accounts

H.R. 627 would require that all fees associated with opening a credit card account in excess of 25 percent of the credit extended to the consumer must be paid in full before the card may be issued to the consumer. We do not believe that credit unions offer cards under these circumstances and support these limitations.

Extensions of Credit to Underage Consumers

H.R. 627 prohibits the issuing of a credit card to a consumer under the age of 18 unless the consumer has been legally emancipated under State law. However, there may be legitimate reasons for underage consumers to have a credit card, including one that is co-signed by an adult. Rather than prohibit such cards, we believe that the regulators should develop guidelines specifically designed to protect younger consumers from abusive practices.

Additional Issues

In addition to the report to Congress already required in H.R. 627, we suggest that Congress request the Government Accountability Office (GAO) conduct a study on the impact of merchant data breaches on consumers and financial institutions. When merchants lose consumers' personal data, including credit card information, as a result of criminal intent or negligence, the cost of the breach is borne almost entirely on the consumer and his financial institution. Anecdotally, several of credit unions report that the cost per member of a merchant data breach is around $20 per member. Financial institutions are rarely made whole when breaches occur and this imbalance deserves additional scrutiny and study. We believe that this issue deserves to be studied by the GAO and considered by Congress.

Conclusion

Mr. Chairman, on behalf of the Credit Union National Association and Wright-Patt Credit Union, thank you very much for giving me the opportunity to express the association's views on these two bills. Credit unions look forward to working with the Subcommittee on these issues.

Statement of Douglas Fecher on behalf of the
Credit Union National Association
March 19, 2009

Credit Union National Association
Guidelines and Ethical Standards Related to Overdraft Protection Programs

CUNA's Board of Directors calls on every CUNA member credit union that offers overdraft protection services to adopt overdraft protection standards and ethical guidelines that will help emphasize credit unions' concern for consumers and further distinguish credit unions as institutions that care more about people than money.

When offering overdraft protection services, credit unions adopting these guidelines and ethical standards recognize that the following practices are not consistent with the credit union philosophy and principles and publicly affirm that they will not engage in any of these practices:

- **Deceptive Advertisement**
  Advertising, representing, or implying that the member should expect that all overdrafts will be paid but then stating in other documents that the paying of overdrafts is discretionary, which is a standard feature of overdraft protection plans. Such advertising may lead members to rely on the service in expectation that all overdrafts will be paid, which would be detrimental if any overdrafts are not ultimately paid by the financial institution.
- **Enticing Members to Overdraw Accounts Repeatedly**
  Advertising or promoting the overdraft protection plan in a manner that encourages the member to overdraw repeatedly his or her share draft account, **as opposed to** such a plan being used as an occasional convenience for the member. The frequent overdraw of accounts is a practice that financial education programs, such as those offered by credit unions, generally discourage.
- **Structuring Programs that Mislead Members**
  Including a feature that records the amount of coverage being offered to cover overdrawn share drafts as part of the "available funds," such as on ATM receipts, online statements and telephone balance statements.
- **Failure to Inform Heavy Users of Overdraft Protection Programs of Alternatives**
  Overdraft protection programs may not be appropriate for members who heavily use and rely on overdraft protection programs as a means to pay a significant proportion of every day living expenses. For these members, credit unions may offer a number of other products and services that would be more appropriate. These may include transfers from a savings account to the share draft account, as well as other types of less expensive secured and unsecured loans that the credit union offers to all its members.
- **Failure to Provide Financial Counseling Information**
  Credit unions recognize that they have a role in helping their members use overdraft protection services in a responsible manner. In addition to providing adequate disclosures regarding the features and fees associated with the programs, credit unions should also provide information regarding counseling services provided by the credit union or other reputable counseling services.

WRITTEN STATEMENT

OF

OLIVER I. IRELAND

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

March 19, 2009

Good afternoon Chairman Gutierrez and Ranking Member Hensarling. I am a partner in the law firm of Morrison & Foerster LLP, and I practice in the firm's Washington, D.C. office. Prior to joining Morrison & Foerster, I was an Associate General Counsel in the Legal Division of the Board of Governors of the Federal Reserve System ("Board") for over 15 years. Prior to that, I worked at the Federal Reserve Banks of Boston and Chicago. In all, I have over 30 years of experience working in banking and financial services, including working on various issues relating to credit cards. During that time, I have had the opportunity to be intimately involved in both drafting and interpreting regulations as a regulator and in advising financial institutions on how to comply with regulations. I am pleased to appear before you today to discuss H.R. 627, the Credit Cardholders' Bill of Rights Act of 2009, and H.R. 1456, the Consumer Overdraft Protection Fair Practices Act.

Importance of Credit Cards to American Households

Today, credit cards are among the most popular and widely accepted forms of consumer payment in the world and have become a driving force behind the consumer spending upon which our national economy has come to rely. In light of the current economic crisis, however, credit cards are becoming even more important to American households.

American households are experiencing financial pressures that they have not experienced before in their working lives. The percentage of equity that households have in their homes was lower at the end of 2008 at 43% than it has ever been since World War II. In addition, the equity markets that hold many households' investment and retirement funds have declined by over 50% from their highs in 2007. Similarly, overall household net worth has fallen 20% since the third quarter of 2007. Moreover, unemployment in February of 2009 was 8.1%, the highest level since 1983. Needless to say, the future is at best uncertain. For example, information recently provided by the Department of the Treasury and the bank supervisory agencies for the purpose of stress testing the largest banks suggest that unemployment may continue to rise and homeowners' equity numbers will only continue to fall through 2010. In 2010, the more adverse assumptions in the stress tests provide for a 10.3% unemployment rate and a decline in home values that could leave overall household equity at as little as 21.4%.

As unemployment grows, affected households must rely increasingly on their savings and their investments (both of which are concentrated in the wealthiest households) and ultimately their ability to borrow against the equity in their homes and lines of credit in the form of credit cards to meet day-to-day expenses. As households' equity in their homes erodes, households may need to turn to credit cards in order to meet unanticipated needs for credit. As a result, any Congressional or regulatory efforts to modify credit card practices need to pay particular attention to the potential for such modifications to unnecessarily limit the availability of this source of credit for these households when they may need it most.

<u>H.R. 627 and H.R. 1456</u>

The Credit Cardholders' Bill of Rights Act of 2009 (H.R. 627) would limit credit card practices by credit card issuers, and the Consumer Overdraft Protection Fair Practices Act (H.R. 1456) would limit overdraft practices at banks holding consumer deposit accounts. In both cases, recent or pending Board rulewriting efforts would address the policy concerns raised by these bills. For example, in December of last year, the Board, working with the Office of Thrift Supervision and the National Credit Union Administration, adopted the most sweeping regulatory changes to credit card practices ever. First, the Board has overhauled the disclosure regime for credit cards based on consumer testing. Hundreds of pages of new rules laying out changes to Regulation Z, which implements the Truth in Lending Act, will require credit card issuers to change virtually all of their disclosures and to revamp their billing statements and advertising. This is an enormous undertaking that will be both extremely expensive and time consuming.

However, on top of this overhaul of the information provided to credit cardholders, the Board and the other agencies have adopted rules on unfair or deceptive acts or practices ("UDAP Rules") in five new areas that will change the fundamental structure of credit card pricing. These rules address the repricing of credit card accounts for both existing and new balances, payment allocations, balance computation methods, the time to make payments and fee-based accounts. Although credit card pricing, like the pricing of other consumer credit products, has increasingly focused on risk and credit card issuers have thereby been able to expand access to credit by underserved consumers, the UDAP Rules severely limit credit card issuers' ability to reprice credit card accounts based on a change in a cardholder's risk profile. The UDAP Rules will require substantial changes in credit card issuers' price structures that will socialize the risk of declines in cardholders' credit standing over time.

Although at an earlier stage, the Board also is in the process of addressing fees for overdrafts in consumer accounts. The Board has issued a carefully considered proposal to change Regulation E, which implements the Electronic Fund Transfer Act, to address overdraft practices. Overdraft issues are complex and are highly dependent on the state of account-holding depository institutions' technology and systems. This proposal addresses whether there should be an opt in or opt out for overdraft fees, the form of the notice to be given, the treatment of debit holds and related issues. The comment period for this proposal closes on March 30, 2009.

At this point in time, adopting either H.R. 627 or H.R. 1456 runs the risk, at best, of creating conflicting statutory and regulatory regimes designed to address the same issues. At the extreme, new legislation, with respect to credit card practices, could lead to a significant limitation on the availability of credit to American households at a time when they may need access to credit most. For example, a number of provisions of H.R. 627 appear to be based on the proposed version of the UDAP Rules rather than the final version. To the extent that the goal of H.R. 627 is to codify the agencies' actions to limit future regulatory changes, it should be based on the final UDAP Rules and Regulation Z changes. On the other hand, H.R. 627 departs from the final UDAP Rules and Regulation Z changes by calling for its provisions to become effective in three months, a time potentially well short of the July 1, 2010 effective date for the UDAP Rules and Regulation Z.

Similarly, the provisions of H.R. 1456 differ significantly from the Board's proposal. Overdrafts are a highly technical issue. Some aspects of H.R. 1456 are simply unworkable, such as the opt out at debit card point-of-sale transactions. Other aspects, such as the opt in, are likely to lead to a significant disruption in consumer payments, to the detriment and ire of both consumers and merchants. Further, the overall approach to addressing overdrafts as loans under the Truth in Lending Act conflicts with the Board's conclusions in other areas, based on consumer testing, that the effective annual percentage rate is not the best way to call consumers' attention to fees on their accounts.

Timing of Rules for Credit Card Pricing

H.R. 627 would strictly limit the repricing of new and existing credit card balances, prohibit double-cycle billing, limit payment allocation methods and increase cardholders' time to make payments, among other requirements. These same issues are addressed in the final UDAP Rules and the Board's new disclosure requirements. As discussed above, H.R. 627's repricing limitations are similar to the corresponding limitations under the proposed, but not the final, UDAP Rules. Presumably these provisions would be reconciled with the final UDAP Rules, which, in some respects, are even more stringent than the proposal. It is important to note that this would be no simple task. For example, my firm, Morrison & Foerster, operated an Internet list to gather issues requiring clarification in the final UDAP Rules and the Board's disclosure requirements and sent to Board staff over 85 questions for further clarification. Any attempted reconciliation between H.R. 627 and the UDAP Rules would need to consider these uncertainties. However, even if these provisions are conformed to the final UDAP Rules, a three-month effective date would present serious operational problems and could significantly curtail access to credit.

It would be difficult, if not impossible, to separate reconciled provisions of H.R. 627 from the rest of the UDAP Rules and disclosure requirements. In light of the fundamental changes to industry pricing practices that would be required, credit card issuers will be faced with enormous changes in the highly automated systems that have allowed credit cards to be made available widely and to be used for billions of transactions. From a systems standpoint, any effort to accelerate these automation changes may either simply fail or result in significantly higher levels of processing errors.

Perhaps more significantly, an empirical study estimated that the cost to credit card issuers of the UDAP Rules' repricing and payment allocation limitations and related provisions, as initially proposed, was approximately $12 billion a year. In order to recover this significant cost, credit card issuers only have two possible options. First, card issuers could raise their rates. Early implementation of the repricing limitations, however, would severely limit this option. Second, card issuers could reduce potential credit losses in their portfolios by reducing credit lines, closing existing accounts and tightening their underwriting standards.

In the current economic environment, an accelerated implementation date would limit price changes and, therefore, would almost inevitably lead to a sharp and immediate reduction in the availability of credit to households. Credit card issuers will have no cushion of profitability to absorb the increased costs. From August 2007 through December 2008, the percentage of credit card accounts becoming 90+ days past due in each month increased 54%. Similarly, the percentage of balances becoming 90+ days past due in each month increased 66%. The increase in losses coupled with the narrowing interest rate spread has had a significant impact on issuer profitability. As a result, from August 2007 through the end of November 2008, the average return on assets for a credit card portfolio decreased 48%, and the average return on equity decreased 52%. In response, credit card issuers have begun to reduce potential risk in their portfolios. From August 2007 through December of 2008, the percentage of accounts closed each month increased by 425%. During this same period, the percentage of accounts with a line reduction has increased by 185%.

In evaluating more current conditions, it is important to note that credit card accounts are typically not charged off until they are 180-days past due, and, therefore, credit card losses significantly trail other economic events, such as job losses. For example, the 90+ days past due statistics cited above only reflect job losses through September of 2008 when unemployment stood at 6.2%. As unemployment correlates highly with credit card losses and current unemployment exceeds the September number by 1.9 percentage points, the past due statistics can be expected to increase sharply as the current employment figures show up in households' inability to meet their credit card payments. The Treasury stress test scenarios would, if true, result in even more significant increases in credit card losses.

To date, account closures and line reductions have been limited because credit card issuers have had the option to reprice accounts. Accordingly, account closures have been most common in accounts that do not have current balances, including dormant accounts. Line reductions, however, have been applied to accounts that are carrying balances, as well as accounts that are paying the balance in full and dormant accounts. In each group, the focus of line reductions has been on account holders with lower FICO scores. Although the statistics indicate that credit card issuers have attempted to maintain credit to their customers who use and need it, these, and potential future, reductions threaten to remove a safety net from cardholders.

For example, job losses due to a deteriorating economy will force many households to look to credit to help them meet their day-to-day expenses until the economy begins to recover, especially in light of the sharp reduction in homeowners' equity. Current and future growth in unemployment would assuredly increase the level at which credit card issuers must reduce the amount of credit that they provide in order to maintain profitability. Accordingly, credit card issuers will have no choice but to take steps to reduce risks in their portfolios. These steps would reduce the amount of credit available to households significantly and hurt American households when they most need ready access to credit.

As a result of this process, credit card lines will tend to be concentrated in wealthier account holders with higher FICO scores, potentially leaving those who need credit the most with little or no access to credit. Given the potential loss of most households' ability to borrow against their home equity and the likelihood that reductions in credit card availability will fall most heavily on households with lower FICO scores, which in many cases will also be households without significant savings or liquid assets, early implementation of the new credit card limitations on repricing could significantly limit any remaining private resources that might be available to many households to address unemployment or other contingencies.

I appreciate the opportunity to appear before you today, and I would be pleased to answer any questions.

dc-552417

NSBA
National Small Business Association®

TESTIMONY OF TODD MCCRACKEN, PRESIDENT

NATIONAL SMALL BUSINESS ASSOCIATION

"H.R. 627, the Credit Cardholders' Bill of Rights Act of 2009; and H.R. 1456, the Consumer Overdraft Protection Fair Practices Act of 2009"

Before the U.S. House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

March 19, 2009

Good afternoon, Chairman Gutierrez, Ranking Member Hensarling, former Chair Maloney, and members of the subcommittee; thank you for inviting me here today to discuss the *Credit Cardholders' Bill of Rights Act* and the dire need for broad credit-card reform from the perspective of America's small-business community.

My name is Todd McCracken and I am the president of the National Small Business Association (NSBA), America's oldest small-business advocacy organization.

SMALL-BUSINESS CHALLENGES IN FINANCING

The United States in the midst of the worst financial crisis since the Great Depression and America's entrepreneurs—existent and aspiring—are suffering through a crippling credit crunch, yet they continue to be subjected to practices recognized as "unfair" and "deceptive" by the U.S Federal Reserve Board, the Office of Thrift Supervision at the U.S. Department of the Treasury, and the National Credit Union Administration. This should be troubling to all.

Historically, small businesses have led America's resurgence out of periods of economic distress and uncertainty. As *The Economist* recently pointed out, "Microsoft, Genentech, Gap, and The Limited were all founded during recessions. Hewlett-Packard, Geophysical Service (now Texas Instruments), United Technologies, Polaroid and Revlon started in the Depression."

The renowned economist Joseph Schumpeter explained that economic downturns could serve as a "good cold shower for the economic system," releasing capital and labor from dying sectors. While America certainly is languishing through an economic cold shower, the prospect of a refreshing revitalization remains foggy—and the egregiously anti-competitive and anti-market practices of the credit-card industry are playing no small role in this haziness.

Previous small-business led economic recoveries were based less on the sudden expansion of existing small businesses than they were on the creation of millions of new, small firms. Suddenly out-of-work employees—many of them laid-off from big businesses—identified a niche they thought they could fill, a product they thought they could improve, or a service they thought they could enhance and decided to start their own firms. During these troubled economic times, millions of other small businesses failed. In the aggregate, however, there were many more small businesses in existence after the recessions and Depression than there were before it.

How did these aspiring small-business owners do it? Besides possessing an entrepreneurial streak, they were able to finance their dreams through a number of means, most of which are currently unavailable: (1) they borrowed from themselves; (2) they borrowed from their friends and family; and/or (3) they borrowed from a bank.

Aspiring business owners would be hard pressed in the current environment to self-finance their entrepreneurial dreams. With the S&P/Case-Shiller U.S. National Home Price Index reporting the largest drop in its 21-year history, it is unlikely many aspiring small-business owners are in a position to take a second mortgage on their homes. And with the stock market flirting with lows not seen in over a decade, it also is unlikely that aspiring entrepreneurs will turn to their retirement savings. The aforementioned circumstances also make it improbable that many aspiring small-business owners will seek loans from their friends and family, who have suffered just as acutely from plummeting stock and home values. And banks simply are not lending right now.

In its January 2009 quarterly Senior Loan Officer Opinion Survey, the Federal Reserve reported that the number of banks reporting having tightened their lending policies in the past three months remained "very elevated." Nearly 70 percent of the domestic respondents to the survey reported that they had tightened their standards for commercial and industrial loans to small businesses.

In addition to tightening their lending standards, hundreds of banks have dropped out of the lending programs offered by the U.S. Small Business Administration (SBA) or have simply stopped making—at least as many—SBA loans. Between 2001 and 2007, there was a 47-percent decrease in the number of banks making at least one 7(a) loan. Meanwhile, there has been a massive decline in the amount of SBA lending. There were 57 percent fewer 7(a) loans in the first quarter of 2009 than during the same period in 2008 and 62 percent fewer than 2007. Additionally, total dollars loaned fell by 40 percent, to almost $2 billion. The number of loans made through the 504 program (which finance real estate and other fixed assets) was down 46 percent from 2008.

Even those banks on the receiving end of billions of dollars of taxpayer dollars have not increased their small-business lending. According to an analysis by the *Wall Street Journal*, lending by the nation's largest banks declined between the third and fourth quarters of 2008. During this time, 10 of the 13 biggest beneficiaries of the U.S Department of Treasury's Troubled Asset Relief Program (TARP) reduced their outstanding loan balances by an approximate total of $46 billion, or 1.4

percent—even as they received $148 billion in taxpayer capital that was intended to help the economy by making loans more readily available.

It should not be surprising then that the number of small-business owners who reported using traditional bank loans was at a 15-year low, according to NSBA's 2008 nationwide survey of small- and mid- sized business owners (henceforth: NSBA Survey)—and this number has, no doubt, deteriorated in the last year.

Where does this leave the aspiring entrepreneurs that will lead the nation out of its recession? Increasingly reliant on their credit cards.

SMALL BUSINESSES' RELIANCE ON CREDIT-CARD FINANCING

Credit cards are now the most common source of financing for America's small-business owners. According to the NSBA Survey, 44 percent of small-business owners identified credit cards as a source of financing that their company had used in the previous 12 months—more than any other source of financing, including business earnings. In 1993, only 16 percent of small-businesse owners identified credit cards as a source of funding they had used in the preceding 12 months.

This dramatic increase does not represent emergency or short-term usage either. Of the small-business owners who use credit cards as a source of funding, 71 percent report carrying a balance month-to-month. This is up from 64 percent in 2000. Twelve percent of small-business owners are carrying a balance of more than $25,000, and 33 percent are carrying a balance of more than $10,000. This suggests that credit cards have replaced term loans to fund expansion needs.

Many small-business owners first turned to credit cards as their primary source of working capital in the early years of this decade—when a multitude of banks last tightened their lending standards. Bank regulators require business borrowers to have either equity in hard assets or historic cash flow to support their loan requests. Rapidly-growing service or technology companies that are not traditional brick and mortar have neither and are forced to use bank credit lines which, if not secured with equity in a home, are increasingly credit-card accounts.

THE TROUBLE WITH SMALL-BUSINESSES' RELIANCE ON CREDIT-CARD FINANCING

Although they are increasingly turning to credit cards to finance their business ventures, more than two-thirds of surveyed small-business owners report that the terms of their cards are worsening.

This is not good news for America's economy, which is heavily reliant on a robust and thriving small-business community. Small businesses comprise 99.7 percent of all U.S. employer firms and more than half of all private-sector employees. Over the last 20 years, they have generated 93.5 percent of all net, new U.S. jobs. The billions of dollars generated from outlandish retroactive interest rates hikes, the escalating imposition of undisclosed fees, and unilateral and unforeseen interest-rate increases is money diverted from economic development.

America's small-business owners are not in the habit of advocating for the passage of increased federal regulations, preferring free enterprise and market solutions, but the current practices of the credit-card industry defy the principles of a free market.

One of the basic tenets of free-market capitalism is the sanctity and insolubility of contracts, but somehow the credit-card industry has managed to insulate itself from adherence to this principle, retaining the right to unilaterally change the conditions of their contracts at any time. For instance, the retroactive application of penalty interest rates effectively increases the purchase price of products and services for which consumers are already committed. This *ex post facto* application undermines business plans and easily can threaten many firms' very existence.

Imagine trying to run a business when one's carefully-constructed business plan is upended by a retroactive interest rate hike. How can a small-business owner be expected to maintain—let alone grow—her business when the capital she already has used is no longer subject to the 12 percent interest rate she agreed to but an egregiously punitive 32 percent?

A free-market system also relies on actual competition, but there is no longer real competition in the credit-card industry. In 2005, the top 10 U.S. banks controlled 83 percent of the small business credit-card market (understood as their proportion of outstanding credit-card debt), according to a report by research firm TowerGroup (which is owned by MasterCard). It is worth noting, by the way, that according to *BusinessWeek* these same banks were responsible for just 32 percent of the SBA loan market and only 14 percent of other small-business lending.

Free-market competition also is based on informed consumers, but the business practices of the credit-card industry appear geared more toward obfuscation than illumination. A recent Government Accountability Office report found that the required disclosures of credit cards "often were poorly organized, burying important information in text or scattering information about a single topic in numerous places. The design of the disclosures often made them hard to read, with large amounts of text in small, condensed typefaces and poor, ineffective headings to distinguish important topics from the surrounding text."

Improved disclosure—which must not be construed as simply *more* disclosure—is of paramount importance to the small-business community. America's small-business owners are capable of following the rules governing their credit cards but the rules must be clearly established, and they must be consistent and predictable.

Improved disclosure—which must not be construed as simply *more* disclosure—is of paramount importance to the small-business community. America's small-business owners are capable of following the rules governing their credit cards but the rules must be clearly established, and they must be consistent and predictable.

THE NEED TO CODIFY CREDIT-CARD REFORM NOW

While welcoming the recent voluntary discontinuation of certain practices by individual card issuers and the enactment of the "Unfair and Deceptive Acts or Practices" (UDAP) rule, NSBA believes that it is necessary to codify these rules and enact them well before July 2010. Accordingly, NSBA is pleased to support *H.R. 627, the Credit Cardholders' Bill of Rights Act of 2009.*

As the small-business owners who serve as the engine of America's economy and the backbone of its communities suffer, along with the rest of the country, through an economic crisis not witnessed in seventy years, it is unconscionable that Congress would allow issuers to perpetuate—with impunity—practices recognized as "unfair" and "deceptive" against them for 16 more months.

Additional Credit-Card Reforms Measures Needed

While NSBA unreservedly supports the enactment of *H.R. 627*, there are two major aspects of credit-card reform the bill does not address: (1) interchange fees and (2) the exemption of small-business cards. NSBA urges Congress to address both.

Interchange fees

Interchange is the fee paid by a merchant's bank every time a credit or debit card is used to pay for a good or service to the bank that issued the consumer's credit card. The fees—which vary depending on the type and size of the merchant's business, the way the transaction is processed, and the specific kind of card used—are set by Visa and MasterCard and the issuing banks and are not subject to negotiation. As much as $2 of every $100 in credit or debit card receipts goes to the card issuers, which inflates the cost of nearly everything consumers buy—since merchants are prohibited from surcharging the customers who use the most high-fee cards. It is important to note, especially as states across the U.S. raise their state sales taxes to meet budgetary shortfalls, that these interchange fees are based on the *total* transaction amount, including taxes.

As Professor Adam Levitin, of Georgetown University Law Center, has noted, since "interchange is transaction-based revenue; the issuer doesn't incur the consumer's credit risk. That means that issuers can risk greater credit losses because they've already made a nice bit of money via interchange with virtually no risk. Not surprisingly, interchange has increased over the last decade from being about 13 percent of card issuer revenue to being 20 percent." In total, Americans paid more than $42 billion in interchange fees in 2007—about twice as much as they paid in credit-card late fees.

Interchange fees originated in the 1960s as a way to cover the real cost of a credit-card transaction. Despite vast technological advancements, which have led to greatly diminished processing times and manpower requirements, interchange fees have more than doubled since 2001 alone. According to one recently study, Visa and MasterCard spend only 13 percent of the interchange fees they collect on the actual processing of credit-card transactions. Most of the rest of the collected fees is either profit or spent via the cards' rewards programs and mail solicitations.

Visa and MasterCard force merchants to sign a contract when they decide to accept credit cards, agreeing to all current and future operating rules. Merchants rarely have seen these rules and are prohibited from disclosing their terms to consumers, preventing merchants from alerting their customers to the true cost of accepting credit and debit cards. Many argue that Visa and MasterCard, which control roughly 80 percent of the credit-card market, and their card network function like "price-fixing cartels," operating in collusion and in violation of federal antirust laws by using their market power to impose non-negotiable rates and terms on merchants.

NSBA urges Congress to adopt legislation similar to *The Credit Card Fair Fee Act (H.R. 5546/S. 3086)* or *The Credit Card Interchange Fees Act of 2008* (*H.R. 6248*), which were introduced during the 110th Congress.

Business-card exemption

The largest loophole in *H.R. 627* is the absence of explicit protection for small-business owners who use their card(s) for business purposes. Since *H.R. 627* amends the *Truth in Lending Act* (*TILA*)—which, except for a few provisions, does not apply to business cards—its protections are limited to consumer credit cards. Although the credit cards of many—if not most—small-business owners are based on the individual owner's personal credit history, it is conceivable that issuers could legally consider them exempt from *H.R. 627*'s vital protections.

TILA defines a "consumer" as a "natural person who seeks or acquires goods, services, or money for personal, family, household use other than for the purchase of real property." While a small-business owner who opens a personal credit-card account and uses it occasionally for business should be covered under *TILA*, it is far from clear that this legislation would protect a small-business owner who used his card exclusively or even primarily for business purposes.

Although in the past, issuers appear largely to have kept most of their cards in compliance with *TILA*, there is no guarantee this convention will continue, especially when one considers that its basis appears to have been practicality and not legal obligation. Since issuers were able to subject consumer cards to the most egregious of practices, there was little incentive to distinguish between consumer and small-business cards. An unintended consequence of *H.R. 627*—if it remains un-amended—is that it could provide just such an incentive.

Accordingly, NSBA strongly urges Congress to correct this oversight and extend the protections of *TILA*, the UDAP rule, and *H.R. 627* to the small-business cards of employers with fewer than 500 employees. It is inconceivable that Congress would knowingly allow issuers to perpetuate practices recognized as "unfair" and "deceptive" against America's small businesses, especially given their essential role in the nation's economic recovery.

CONCLUSION

As President Barack Obama said this week while announcing his new small-business initiative:

> It's about our fundamental values. All across the country, there are people who are working hard and meeting their responsibilities every day, without the benefit of government bailouts or multi-million dollar bonuses. You've got a bunch of small business people here who are struggling just to keep their credit line open -- that they are foregoing pay, as one of our entrepreneurs talked about, they are in some cases mortgaging their homes, and doing a whole host of things just in order to keep things afloat. All they ask is that everyone, from Main Street to Wall Street to Washington, play by the same rules. And that is an ethic that we have to demand.

The small-business community is not opposed to the credit-card industry nor does it begrudge it the $109 billion in revenue it made in 2005. In fact, as I previously outlined, the small-business community is increasing reliant on credit cards for its very existence. Small business simply asks the credit-card industry play by the same rules as the rest of us.

I thank you for your time and welcome any questions.

ACORN	AMERICANS FOR FAIRNESS IN LENDING
CENTER FOR RESPONSIBLE LENDING	consumer action Education and advocacy since 1971
CFA	Consumers Union
Demos	NACA
NATIONAL CONSUMER LAW CENTER	NTIC Real People. Real Issues. Real Results.
Public Citizen 35 YEARS Protecting Health, Safety & Democracy	U.S. PIRG

Testimony Of
Travis B. Plunkett,
Legislative Director,
Consumer Federation of America
and
Edmund Mierzwinski,
Consumer Program Director,
U.S. Public Interest Research Group

On Behalf Of
ACORN, Americans For Fairness In Lending, The Consumer Federation Of America,
Center For Responsible Lending, Consumer Action, Consumers Union, Demos,
National Association of Consumer Advocates,
Consumer Law Center (On Behalf Of Its Low-Income Clients),
National Training and Information Center, Public Citizen and U.S. PIRG

Before The
Subcommittee On Financial Institutions And Consumer Credit
of the United States House of Representatives
Committee on Financial Services
The Honorable Luis Gutierrez, Chair

Legislative Hearing Regarding
H.R. 627, The Credit Cardholders' Bill Of Rights Of 2009 And
H.R. 1456, The Consumer Overdraft Protection Fair Practices Act Of 2009
March 19, 2009

Testimony of Twelve Consumer and Community Groups On HR 627 and HR 1456 Before the Subcommittee on Financial Institutions and Consumer Credit by Travis Plunkett of the Consumer Federation of America and Edmund Mierzwinski of U.S. PIRG

Chairman Gutierrez, Ranking Member Hensarling and members of the Subcommittee, we appreciate the opportunity to offer our comments on two crucial consumer protection bills introduced by Representative Maloney: the Credit Cardholders' Bill of Rights (H.R. 627) and the Consumer Overdraft Protection Fair Practices Act (H.R. 1456). We are testifying today on behalf of ACORN,[1] Americans For Fairness In Lending,[2] Consumer Federation of America (CFA),[3] the Center for Responsible Lending,[4] Consumer Action,[5] Consumers Union, the publisher of Consumer Reports,[6] Demos,[7] the National Association of Consumer Advocates,[8] the National Consumer Law Center,[9] on behalf of its low-income clients, Demos, the National

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[1] ACORN is the nation's largest grassroots community organization of low- and moderate-income people with over 400,000 member families organized into more than 1,200 neighborhood chapters in 110 cities across the country.

[2] **Americans for Fairness in Lending (AFFIL)** works to reform the lending industry to protect Americans' financial assets. AFFIL works with its national Partner organizations, local ally organizations, and individual members to advocate for reform of the lending industry.

[3] The **Consumer Federation of America** is a nonprofit association of over 280 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

[4] The **Center for Responsible Lending** (CRL) is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, which consists of a credit union and a non-profit loan fund focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to purchase homes. Self-Help has provided over $5 billion in financing to more than 60,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across the United States. Another affiliate, Self-Help Credit Union, offers a full range of retail products, and services over 3,500 checking accounts and approximately 20,000 other deposit accounts, and recently inaugurated a credit card program.

[5] **Consumer Action**, founded in 1971, is a San Francisco based nonprofit education and advocacy organization with offices in Los Angeles and Washington, DC. For more than two decades, Consumer Action has conducted a survey of credit card rates and charges to track trends in the industry and assist consumers in comparing cards.

[6] **Consumers Union** is a nonprofit membership organization chartered in 1936 under the laws of the state of New York to provide consumers with information, education and counsel about good, services, health and personal finance, and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports with more than 5 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[7] **Demos** is a New York City-based non-partisan public policy research and advocacy organization founded in 2000.A multi-issue national organization, Demos combines research, policy development, and advocacy to influence public debates and catalyze change.

[8] The **National Association of Consumer Advocates, Inc. (NACA)** is a nonprofit 501(c) (3) organization founded in 1994. NACA's mission is to provide legal assistance and education to victims of consumer abuse. NACA, through educational programs and outreach initiatives protects consumers, particularly low income consumers, from fraudulent, abusive and predatory business practices. NACA also trains and mentors a national network of over 1400 attorneys in representing consumers' rights.

[9] The **National Consumer Law Center**, Inc. (NCLC) is a non-profit corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes and regularly updates a series of sixteen

Training and Information Center,[10] Public Citizen[11] and U.S. PIRG.[12] Our written testimony is joint to address the concerns of all the organizations signed on; we will offer oral testimony today commenting on different important aspects of the bills.

SUMMARY:

Swift enactment of both of these bills is necessary to protect millions of consumers from unjustified and abusive loan practices that are putting them at financial risk and draining their income at a time of great economic uncertainty.

The **Credit Cardholders Bill of Rights, H.R. 627**, curbs some of the most arbitrary, abusive, and unfair credit card lending practices that trap consumers in a cycle of costly debt, such as sharply escalating "universal default" interest rates that can double some cardholders monthly payments overnight. It passed the House in 2008 on an overwhelming 312-112 vote. Although the Federal Reserve and other regulators agreed that action was needed and later in the year approved similar regulations, the agencies unwisely stayed compliance until July 2010.[13] Just as the economy needs a recovery now, consumers need protection from unfair credit card practices now. HR 627 would take effect just 90 days after passage and should be enacted immediately. In addition, In addition, the bill is more urgent than ever because taxpayers are now propping up major national credit card issuers through several enormously expensive government programs. If the government is going to invest in the credit card industry and attempt to spur the extension of credit, it is essential that it ensure that the loans that this industry is offering to Americans are fair and sustainable.[14] The problem, and the solution, enactment of HR 627, are explained in Part I of this testimony.

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practice treatises and annual supplements on consumer credit laws, including Truth In Lending, Cost of Credit, Consumer Banking and Payments Law, Foreclosures, and Consumer Bankruptcy Law and Practice, as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for tens of thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of the all federal laws affecting consumer credit since the 1970s, and regularly provide comprehensive comments to the federal agencies on the regulations under these laws.

[10] **National Training and Information Center (NTIC)** is a national organizing, policy, research, and training center for grassroots community organizations dedicated to building power to reclaim our democracy and advance a far-reaching racial and economic justice agenda.

[11] Public Citizen is a national non-profit organization that represents the interests of consumers and the public in matters before state legislatures, the courts, executive branch agencies, and Congress.

[12] The **U.S. Public Interest Research Group** serves as the federation of and federal advocacy office for the state PIRGs, which are non-profit, non-partisan public interest advocacy groups that take on powerful interests on behalf of their members.

[13] Federal Reserve System, 12 CFR Part 227 [Regulation AA; Docket No. R-1314]; Department of the Treasury, Office of Thrift Supervision, 12 CFR Part 535 [Docket ID. OTS-2008-0027] RIN 1550-AC17; National Credit Union Administration, 12 CFR Part 706, RIN 3133-AD47; Unfair or Deceptive Acts or Practices.

[14] In January, a number of the organizations signed onto this testimony sent Treasury Secretary Geithner a letter urging that any credit card bank receiving government support through the Term Asset Backed Loan Facility (TALF) program be required to comply immediately with the terms of those Federal Reserve rules and to also provide a program to swiftly reinstate fair interest rates on consumers paying penalty interest rates. According to

Similarly, the **Consumer Overdraft Protection Fair Practices Act, HR 1456**, addresses a separate set of largely unregulated unfair tricks and traps that also place a consumer's wallet at risk. Instead of deterring the practice of bouncing checks, as they did for decades, over the last five to ten years, more and more banks have encouraged consumers to bounce checks and other debits, replacing a beneficial back-up system for checking accounts with a system of high-cost, unsolicited overdraft loans that are in effect the banks' version of a usurious payday loan. The costly, and often multiple, fees charged for these overdraft loans drive their customers further into the red. The problem has grown worse as formerly small cash transactions have been substituted by small debit transactions that are approved at point-of-sale even when the bank knows the account shows a negative balance. The problem, and the solution, enactment of HR 1456, are explained in Part II of this testimony.

Part I: The Credit Card Problem.
Why The House Should Enact The Credit Cardholders Bill of Rights (HR 627).

The Credit Cardholders Bill of Rights (HR 627), as introduced by Representative Maloney and co-sponsored by over 75 others, curbs some of the most arbitrary, abusive, and unfair credit card lending practices that trap consumers in a cycle of costly debt, such as sharply escalating "universal default" interest rates that can double some cardholders monthly payments overnight. These tricks and traps have always been unfair, but now, at a time when consumers can least afford it, these practices produce devastating financial repercussions. Moderate-income families with little flexibility in their budgets are particularly hard hit if they have to pay more in unjustifiable fees and credit card interest. Signs that credit card delinquencies and defaults are rising sharply should be a further warning that these practices have helped make credit card loans unsustainable for many Americans. The meltdown of the subprime mortgage market demonstrates the importance of ending abusive lending practices when warning signs arise. Congress should take steps now to rein in these practices to forestall an even greater economic crisis.

A. CARDHOLDERS ARE SHOWING SERIOUS SIGNS OF ECONOMIC STRESS

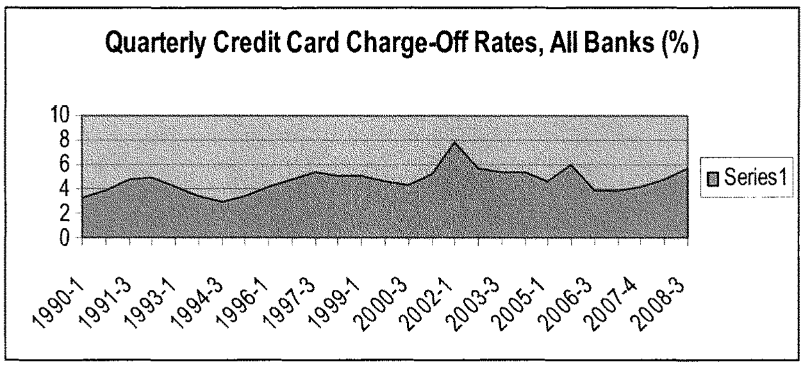
As the economy has worsened and home foreclosures have increased to record levels, consumers are increasingly having serious difficulty paying their credit card bills. One widely watched measure of financial health, the amount of credit card debt paid off by Americans monthly, is now at one of the lowest levels ever recorded.[15] Credit card charge-offs, the percentage of the value of credit card loans removed from the books (net of recoveries), or "written off," have been persistently high for most of the last thirteen years and are now approaching the highest levels on record. During the decade between the end of 1995 and the

Gail Hillebrand of Consumers Union, who led the letter, there has been no reply. The letter is available here http://static.uspirg.org/consumer/archives/TALF.pdf ,

[15] Chu, Kathy, "November Credit-Card Payoff Rate Fell Sharply," *USA Today*, February 8, 2009. The monthly payment rate fell by 2.5 percentage points to 16.1 percent in November 2008, according to CardTrak.com.

start of 2006, credit card charge-offs were not below 4 percent in a single quarter.[16] They increased to more than 4 percent in the fourth quarter of 2006 and broke 4 percent again during the later half of 2007. Since then, charge-offs have escalated sharply to 5.62 percent in the third quarter of 2008. There is a very good chance that charge-offs will keep rising because the number of delinquent credit card payments – an early sign of payment difficulty – are also approaching historically high levels. Thirty-day credit card delinquencies are now at their highest point in six years, since the last economic recession ended.[17] Moreover, a number of major issuers have reported fourth quarter charge-offs that indicate that borrower defaults and issuer losses will exceed those of the last two recessions.[18] The difficulty that many families are having affording their credit card bills has been exacerbated by the mortgage crisis. As home values have dropped sharply, Americans have been unable to use home equity loans and home refinancing to pay off their credit card debts.[19] Moreover, despite rising credit card delinquencies, there is evidence that some families are attempting to stay current on their credit card loans but not their mortgage payments, a shift in behavior from past economic crises.[20]

Quarterly Credit Card Charge-Off Rates, All Banks (%)[21]



Source: Federal Reserve.

[16] Federal Reserve Board, "Charge-Off and Delinquency Rates on Loans and Leases at All Commercial Banks," available at www.federalreserve.gov/release/chargeoff. Most experts attribute lower charge-offs in 2006 to the surge of bankruptcy filings (and corresponding increase in charge-offs) that occurred in the third and fourth quarters of 2005.

[17] 30-day credit card delinquencies during first three quarters of 2008 were between 4.79 and 4.88 percent, the highest levels since 2002. Federal Reserve Board, "Charge-Off and Delinquency Rates on Loans and Leases at 100 Largest Commercial Banks" "U.S. Credit Card Delinquencies at Record Highs – Fitch," *Reuters*, February 4, 2009.

[18] Terris, Harry, "Credit Card Losses Seen Surpassing Levels of Last Two Recessions," *American Banker*, January 28, 2009.

[19] Westrich, Tim and Weller, Christian E., "House of Cards, Consumers Turn to Credit Cards Amid the Mortgage Crisis, Delaying Inevitable Defaults," Center for American Progress, February 2008.

[20] Chu, Kathy, "More Americans Using Credit Cards to Stay Afloat," *USA Today*, February 28, 2008.

[21] Federal Reserve Board, "Charge-Off and Delinquency Rates on Loans and Leases at All Commercial Banks," available at www.federalreserve.gov/releases/chargeoff/chgallsa.htm , accessed April 14, 2008.

Although some issuers have suffered losses in the last year, over time the credit card industry has been the most profitable in the banking sector, earning a return on assets (ROA) from 1995 to 2008 that was more than three times greater than that for commercial banks overall.[22] Because of the high mortgage losses that many large banks experienced in 2007, there was more than a five-fold difference between bank and credit card profits.[23]

B. CONSUMERS HAVE SHOWN FAR MORE CAUTION IN TAKING ON CREDIT CARD DEBT THAN ISSUERS USED IN MARKETING AND EXTENDING CREDIT

It is conventional wisdom that consumer demand fueled the growth of revolving debt to about $964 billion.[24] However, a careful analysis of lending patterns by credit card companies shows that aggressive and even reckless lending by issuers played a huge role in pushing credit card debt to record levels. From 1999 through 2007, creditor marketing and credit extension increased about twice as fast as credit card debt taken on by consumers,[25] even though the rate of growth in credit card debt in 2007 was the highest it had been since 2000.[26]

The debt growth rate started slowing in the second quarter of 2008 and then experienced a rare decline in the fourth quarter.[27] This most significant reason for this drop was probably the decline in consumer spending brought on by the recession. Additionally, issuers significantly reduced their marketing of new credit and started reducing some existing credit lines in the latter half of 2008.[28]

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[22] "Card Profits 04," *CardTrak*, January 24, 2005; "Banner Year," *CardTrak*, February 2004; FDIC, *FDIC Quarterly Banking Profile*, Third Quarter 2006 at 5, Table I-A; FDIC, *FDIC Quarterly Banking Profile*, Fourth Quarter 2000 at 4, Table I-A. Commercial banks' average return on assets between 1995 and 2004 was 1.23 percent, less than one third the size of the credit card industry average return on assets of 3.73 percent over the same period, according to R.K. Hammer and Associates.

[23] ROA for credit card issuers in 2007 was 4.65%, R.K. Hammer and Associates, January 2008. ROA for commercial banks in 2007 was .86%, FDIC, "Banks and Thrifts Earned $105.5 billion in 2007," February 26, 2008.

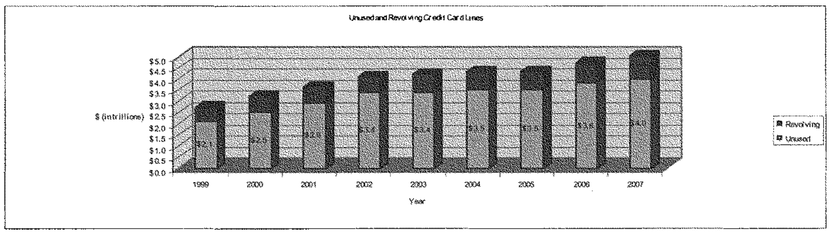
[24] As of December 2008, the amount of revolving debt held by Americans was $963.5 billion. Although this figure is often used as a proxy for credit card debt, most experts believe that outstanding credit card debt is slightly lower. First, approximately 5 percent of consumer revolving credit is not on credit cards. Second, between 4 to 9 percent of the debt does not truly revolve. It is repaid to the credit card issuer before the next billing cycle starts. Taking these two factors into account, outstanding credit card debt is likely to be between $829 and $877 billion.

[25] VERIBANC, Inc. (www.VERIBANC.com) and Federal Reserve Consumer Credit Outstanding. According to Federal Reserve figures, consumer revolving debt grew by 50 percent from $627.5 billion in December 1999 to $941.4 billion in December 2007. According to VERIBANC, unused lines of credit grew at almost double the rate (90.5 percent) that consumers increased their use of credit card lines, increasing from $2.1 trillion in 1999 to just under $4.0 trillion ($3,983,200,614) at the end of 2007.

[26] The amount of revolving debt increased by 7.8 percent in 2007, which was the sharpest increase since revolving debt grew by 11.6 percent in 2000. Federal Reserve, Statistical Release, "Consumer Credit Outstanding," Table G.19.

[27] The amount of credit card debt in the fourth quarter of 2008 dropped by 5.4 percent, from $976.7 billion to $963.5 billion. Federal Reserve, Statistical Release, "Consumer Credit Outstanding," Table G.19.

[28] Wolfe, Daniel, "Top Issuers, with Less Appetite for Risk, Slashing Credit Lines, *American Banker*, December 2, 2008. Banjo, Shelly, "Credit Card Companies Slash Credit Limits," *The Wall Street Journal*, January 5, 2009.



Source: VERIBANC, Federal Reserve.

A similar trend is evident when examining the consumer response to massive increases in marketing by creditors that started in 1990. The most significant form of marketing for creditors remains solicitation by mail. Over half of credit cards held by consumers are the result of mail solicitation.[29]

Issuers increased the number of mailed credit card offerings six-fold from 1990 to 2005, from just over 1.1 billion to a record 6.06 billion.[30] Since then, solicitations dropped to 5.8 billion in 2006, 5.2 billion in 2007, and 3.8 billion in 2008.[31] Wealthier families receive the highest number of credit card mailings, but low-income families are more likely to open the solicitations they receive.[32] The table at right indicates that issuer interest in marketing credit cards grew much faster than consumer interest in accepting new cards. The consumer response rate to mail solicitations declined seven-fold from 2.1 percent in 1990 to 0.3 percent in 2005, picking up slightly to 0.5 percent in 2006 and 2007. This means that for every 250 solicitations consumers receive, they reject more than 249. The tiny response rate demonstrates that the vast majority of consumers are being responsible when offered unsolicited credit.

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[29] Vertis Inc., press release, "Financial Direct Mail Readers Interested in Credit Card Offers," January 25, 2005; "Card Marketing 101," *CardTrack*, September 2002.
[30] Synovate Mail Monitor, press release, "Mail Monitor Reports Record Six Billion Credit Card Offers Mailed in U.S. during 2005," April 27, 2006.
[31] Synovate Mail Monitor, press release, "U.S. Credit Card Mail Volume Declined to 3.8 billion in 2008," January 30, 2009.
[32] Kidane, Amdetsion and Sandip Mukerji, Howard University School of Business, "Characteristics of Consumers Targeted and Neglected by Credit Card Companies," *Financial Services Review*, Vol. 13, No. 3, 2004 at 186.

C. ISSUERS ENCOURAGE THE LEAST SOPHISTICATED AND RISKIEST HOUSEHOLDS TO RUN UP UNSUSTAINABLE LEVELS OF DEBT

The growth of revolving debt in this country to $964 billion has obviously not affected all Americans equally. The extraordinary expansion of the credit card industry in the 1990s was fueled by the marketing of credit cards to populations that had not had widespread access to mainstream credit, including lower- and moderate-income households, consumers with seriously blemished credit histories, college students, older Americans and minorities.

	Solicitations (billions)[33]	Response Rate
1990	1.1	2.1%
1991	0.99	2.4%
1992	0.92	2.8%
1993	1.5	2.2%
1994	2.5	1.6%
1995	2.7	1.4%
1996	2.38	1.4%
1997	3.01	1.3%
1998	3.44	1.2%
1999	2.54	1.0%
2000	3.54	0.6%
2001	5.01	0.6%
2002	4.89	0.5%
2003	4.29	0.6%
2004	5.23	0.4%
2005	6.06	0.3%
2006	5.8	.5%
2007	5.2	.5%

In a practice widely known as risk-based pricing, creditors charged riskier consumers more to cover potential losses, usually in the form of higher interest rates. To make the assumption of debt more attractive to these households – and to entice them into carrying debt for longer periods – creditors lowered minimum payment balances from around five percent of principal to just over two percent. As a result, an estimated eighty percent of all households now have at least one card.[34] According to the Federal Reserve Board, about 42 percent of cardholding households pay their credit card bill in full every month,[35] which means that the remaining 50 million or so families that carry debt owe an average of about $17,000.[36]

Moderate and lower income households that are more financially vulnerable shoulder a higher level of debt relative to their incomes. In the current economic climate, these households are also under financial pressure from many external factors, such as flat wages, rising unemployment, skyrocketing home foreclosures and increasingly unaffordable health insurance. In other words, the "democratization of credit" has had serious negative consequences for many Americans, putting them one unexpected financial emergency away from bankruptcy.

[33] Synovate Mail Monitor
[34] Cardweb.com
[35] Bucks, Brian K., Arthur B. Kennickell and Kevin B. Moore, "Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances," Federal Reserve Bulletin, vol. 92, February 2006, pg. 31.
[36] CFA calculation based on estimated credit card (as opposed to revolving) debt of $850 billion. If a conservative estimate of 75 percent of 114.4 million households have credit cards, and only 58 percent of these households carry debt, then the remaining 49.7 million households have an average of $17,103 in debt.

Lower-Income and Minority Households

Close to half of all minority families in the U.S. carry credit card debt.[37] Although lower and moderate-income households are less likely to have bank credit cards than more affluent families, they are more likely to carry over debt from month-to-month. Sixty one percent of the lowest income households with a card carry balances, compared to 45 percent of higher income families.[38] Credit card debt also represents a significant portion of lower-income families' income. A 2004 Gallup poll found that families with credit card debt earning under $20,000 a year owed 14.3 percent of their income in credit card debts, those earning between $20,000 and $29,999 owed 13.3 percent and those earning between $30,000 and $39,999 owed 11.0 percent. Compare this to the 2.3 percent of their income owed by families earning over $100,000.[39] The increase in credit card debt has contributed to alarmingly high overall levels of debt for many of these lower and moderate-income families. More than one-quarter of the lowest income families spent over 40 percent of their income on debt repayment in 2001.[40]

Younger and Older Americans

Starting in the early 1990's, credit card issuers targeted massive marketing efforts at college campuses throughout the country, resulting in a sharp growth of credit card debt among college-age and younger Americans. CFA,[41] with Dr. Robert Manning, and U.S. PIRG[42] were among the first to document the serious consequences of this trend. Since Dr. Manning's report for CFA in 1999, this issue has been the subject of much public and media scrutiny. And yet, Americans under 35 years-of-age continue to show more signs of trouble managing credit card debt than any other age group. The amount of credit card debt held by students graduating from college more than doubled to $3,262 between the mid-1990s and 2004.[43] Americans under

[37] Bucks, Brian K., Arthur B. Kennickell and Kevin B. Moore, "Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances," *Federal Reserve Bulletin*, vol. 92, February 2006, pg. 24.

[38] Board of Governors of the Federal Reserve System, "Report to the Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and their Effects on Consumer Debt and Insolvency," submitted to the Congress pursuant to section 1229 of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, June 2006 at 9 Table 6.

[39] Gallup Poll News Service, "Average American Owes $2,900 in Credit Card Debt," April 16, 2004.

[40] Aizcorbe, Kennickell and Moore 2003 at 29, Table 14. In 2001, more than one in four (27.0%) families in the lowest income quintile spent more than 40% of their income on debt payments, compared to less than one in six (16.0%) of families in the second lowest income quintile and one in nine (11.0%) of all families who spent 40% or more of their income on debt payments.

[41] Manning, Robert, "Credit Cards on Campus: Costs and Consequences of Student Debt," June 8, 1999. CFA Press Release available at: http://www.consumerfed.org/ccstudent.pdf

[42] Mierzwinski, Edmund, "The Campus Credit Card Trap," April 1998, U.S. PIRG Education Fund; Mierzwinski, Edmund and Lindstrom, Christine, "The Campus Credit Card Trap: A Survey of College Students and Credit Card Marketing," March 2008, U.S. PIRG Education Fund; Mierzwinski, Edmund and Lindstrom, Christine, "Characteristics of a Fair Campus Credit Card," U.S. PIRG Education Fund, April 2008. Both of the 2008 reports are available at http://www.truthaboutcredit.org.

[43] Trigaux, Robert, "Generation Broke: New Grads Bear Heavy Load," *St. Petersburg Times*, November 22, 2004.

35 are less likely to pay off their credit card balances every month than average Americans,[44] are paying more for debt obligations than in the past and are increasingly likely to pay more than 40 percent of their incomes on credit card debt.[45] Not surprisingly, more young Americans are declaring bankruptcy than in the past.[46] Moreover, there is increasing evidence that issuers are now targeting high school students with credit card offers.[47] They are also marketing branded debit cards to adolescents, in part to encourage these young consumers to use similarly branded credit cards when they are older.[48] U.S. PIRG's most recent report also documented intense marketing of credit cards on college campuses and the growing use of contracts between colleges (sometimes through their alumni associations) and credit card companies for exclusive marketing of both credit and debit cards to college students.[49]

The growth of credit card debt among older households is also troubling. Although these households were long thought to be the most frugal and resistant to consumer debt, changing economic conditions – especially declining pension and investment income coupled with rising health care and prescription costs – have made credit card debt a more serious financial issue for older Americans. Between 1992 and 2001, Americans over age 65 saw their credit card debt nearly double from $2,143 to more than $4,000.[50] The number of seniors filing for bankruptcy more than tripled from 1991 to 2001.[51] Other warning signs are also evident. The proportion of income spent to pay off debts by households headed by individuals 65 to 74 years of age has risen steadily over the past decade[52] while about one in seven senior households paid more than 40 percent of their income towards their debts in 2001.[53]

Seniors have fewer credit cards than other age groups and are more likely to pay their credit cards in full every month, but a greater proportion of older Americans also have lower

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[44] Draut, Tamara, Director of Demos Economic Opportunity Program, Testimony Before the House Banking Committee Subcommittee on Financial Institutions and Consumer Credit, September 15, 2004, at 8. More than half (55%) of Americans carry revolving balances compared to 71% of borrowers aged 25-34.

[45] *Ibid.* at 4-5. In 1992, about one in thirteen (7.9%) Americans aged 25-34 had debt greater than 40% of their income; by 2001, about one in eight (13.3%) had these high debt burdens.

[46] Sullivan, Theresa A., Deborah Thorne and Elizabeth Warren, "Young, Old, and In Between: Who Files for Bankruptcy?" *Norton Bankruptcy Law Advisor*, Iss. No. 9A, September 2001.

[47] Mayer, Caroline E., "Girls Go From Hello Kitty To Hello Debit Card; Brand's Power Tapped to Reach Youth," *The Washington Post*, October 3, 2004.

[48] Ludden, Jennifer, "Credit Card Companies Target Kids," *All Things Considered*, National Public Radio, February 6, 2005.

[49] Testimony of Christine Lindstrom, Director U.S. PIRG Higher Education Program, at a hearing on "Problem Credit Card Practices Affecting Students: The Need for Legislative Action," before the Subcommittee on Financial Institutions, June 26, 2008 available at http://financialservices.house.gov/hearing110/hr0626084.shtml.

[50] Demos, "Retiring in the Red," January 19, 2004 at 3.

[51] Sullivan, Theresa A., Deborah Thorne and Elizabeth Warren, "Young, Old, and In Between: Who Files for Bankruptcy?" *Norton Bankruptcy Law Advisor*, Iss. No. 9A, September 2001, at 5. The number of older Americans declaring bankruptcy during this period rose from 23,890 to 82,207.

[52] Aizcorbe, Kennickell and Moore 2003 at 28, Table 14. According to the Federal Reserve Survey of Consumer Finances, the median debt services ratio of households aged 65-74 grew by 54% from 9.8% in 1992 to 15.1% in 2001 and the debt services ratio for households 75 and older grew 169% from 2.6% to 7.0% in 2001.

[53] *Ibid.* 13.9% of households aged 65-74 and 14.3% of households aged 75 and over spent more than 40 percent of their income on debt service.

incomes.[54] This means that credit card debt has a more severe impact on this age group. For example, credit card debt can threaten older homeowners, who stand to lose their home – and their most significant hedge against poverty – if they use home equity to pay off credit card debt.

The Downsizing of Minimum Payments

As credit card issuers dramatically expanded their marketing and extension of credit in the 1990s, they lowered monthly minimum payment amounts. By reducing the minimum payment, issuers could offer more credit, encourage consumers to take on more debt, and ensure that consumers would take far longer to pay off their debts, thus making them more profitable for the industry.[55] Monthly minimum payment rates were reduced from around 5 percent of principal owed in the 1970s to just over 2 percent by the turn of the century.[56] In 2005, 19 million credit card borrowers make only the minimum payments.[57]

The number of consumers paying just above the minimum rate is even larger. In a representative survey conducted for the Consumer Federation of America by Opinion Research Corporation in November of 2005, 34 percent of those questioned said that they usually pay the minimum rate or somewhat more. More than 40 percent of respondents earning less than $50,000 a year said they paid the minimum rate or somewhat more, while 45 percent of African Americans and 51 percent of Hispanics did so.[58] An examination by the Credit Research Center of 310,000 active credit card accounts over 12 consecutive months in 2000 and 2001 found similar results. Just under one-third of the accounts paid 5 percent or less per month of the total amount due.[59] Moreover, payment habits for many cardholders are not static over time. Depending on the economic circumstances of the cardholder involved, he or she could shift from fully paying outstanding balances every month to paying at or near the minimum rate.

However, paying only the minimum on credit cards can increase the length of time the debt is carried and significantly add to the interest cost of the credit card loan. Julie Williams, the First Senior Deputy Comptroller and Chief Counsel of the Office of the Comptroller of the Currency (OCC) has noted that reduced minimum payments "dig borrowers into an ever deeper hole, requiring increasingly more difficult measures" for consumers to get out of debt.[60] CFA

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[54] Hanway, Steve, "Do Credit Card Habits Improve with Age?" Gallup News Organization, May 18, 2004. Nearly half (48%) of households over 65 years old have incomes below $30,000, compared to 16% of those aged 30-49 and 18% of those aged 50-64.

[55] Interview with Andrew Kahr, credit card industry consultant, "The Secret History of the Credit Card," *Frontline*, November 2004.

[56] Kim, Jane J., "Minimums Due on Credit Cards are on the Increase," *Wall Street Journal*, March 24, 2005.

[57] Der Hovanesian, Mara "Tough Love for Debtors," *Business Week*, April 25, 2005.

[58] Opinion Research Corporation, "Consumer Financial Services Survey," November 3-7, 2005.

[59] Credit Research Center, McDonough School of Business, Georgetown University.

[60] OCC, Remarks by Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel before the Risk Management Association's Retail Risk Management Conference on Regulatory Concerns about Certain Retail Banking Practices, Chicago, June 3, 2003, in "Speeches and Congressional Testimony," *OCC Quarterly Journal*, Vol. 22, No. 3, September 2003 at 107.

has concluded that reduced minimum payments were a significant cause of increasing bankruptcies in the last decade.[61]

One way to alert consumers to the consequences of paying off credit card balances at the minimum rate is to offer each consumer a personalized notice on the billing statement about how long it would take to pay off the balance at the minimum rate, and what would be the total costs in interest and principal.[62] Such a personalized disclosure is, unfortunately, not included in the recent bankruptcy law, which requires consumers to call a toll-free number to get information about how long it would take to pay off their balances.[63] No specific information would be offered on the total cost of paying at the minimum rate. This bankruptcy law requirement will likely have no impact on the millions of consumers paying at or near the minimum rate who will not call a toll-free phone number.

One positive development regarding credit card minimum payments is that regulatory guidance issued by federal banking regulators in January 2003 directed credit card lenders to set minimum payments that "amortize the current balance over a reasonable period of time" and noted that prolonged negative amortization would be subject to bank examiner criticism.[64] Many major credit cards began increasing their minimum payments requirements in 2005, including Bank of America, Citibank, Discover and JP Morgan Chase,[65] in some cases to as high as 4 percent.[66] All issuers were required to fully phase in the changes by the end of 2006.[67]

The Office of the Comptroller of the Currency (OCC) has warned banks that increasing minimum payments may need to be accompanied by a reduction in Annual Percentage Rates (APRs) or eliminating fees to ensure that cardholders can actually reduce their balances and not just tread water with higher minimum bills.[68] Since the increases took effect, consumers with interest rates above 20 percent have had to cope with payments that have roughly doubled.[69]

Targeting Consumers on the Brink of Financial Distress

Nothing illustrates the perverse incentives (and dangers) of the credit card market better than the marketing of cards to consumers with tarnished credit histories, or even worse, to those

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[61] Consumer Federation of America, "Consumer Restraint Pressures Lenders to Reduce Credit Card Marketing and Credit Extension," January 18, 2000.
[62] Proposed in S. 1176 by Senators Akaka, Durbin, Leahy and Schumer.
[63] Public Law 109-8.
[64] Joint press release of Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency and Office of Thrift Supervision, "FFIEC Agencies Issue Guidance on Credit Card Account Management and Loss Allowance Practices," January 8, 2003, see attached "Account Management and Loss Allowance Guidance" at 3.
[65] American Financial Services Association, "Credit Card Minimum Payments Going Up," *Spotlight on Financial Services*, April 2005.
[66] Warnick, Melody, "Credit Card Minimum Payments Doubling," *Bankrate.com*, May 3, 2005. Citibank and Bank of America have announced they are doubling their minimum payment requirements from 2% to 4% of the balance.
[67] Day, Kathleen and Caroline E. Mayer, "Credit Card Penalties, Fees Bury Debtors," *Washington Post*, March 6, 2005.
[68] Der Hovanesian, Mara "Tough Love for Debtors," *Business Week*, April 25, 2005.
[69] "Minimum Payments," *CardTrack*, September 6, 2006.

who are literally on their way to or just coming out of bankruptcy. For example, in the first half of 2007, as home mortgage foreclosures shot up and signs of a serious economic slowdown started to appear, some of the nation's largest credit card issuers increased the number of solicitations they mailed to sub-prime consumers by 41 percent compared to the first half of 2006.[70]

Other major issuers and many smaller companies market high-cost, sub-prime cards to those with blemished credit histories. This population of cardholders can be profitable for the industry. Credit card industry consultant Andrew Kahr estimates that average sub-prime consumers will make two or three late payments a year, from which the industry can generate a separate fee, and that these fees can greatly exceed the interest payments on the small lines of credit themselves.[71]

Sub-prime consumers haven't just encountered high-cost offers of credit, but deceptive marketing practices. In 2000, Providian was required to pay more than $300 million in restitution to its sub-prime cardholders for unfair and deceptive practices.[72] Cross Country Bank, the sub-prime and secured credit card issuer that has been investigated by state and federal regulators for misleading consumers about the terms of its sub-prime credit card accounts and engaging in abusive collection practices, has advertised on late-night and daytime television when more unemployed potential sub-prime customers are more likely to be watching television.[73]

In December of 2008, sub-prime card marketer Compucredit reached a settlement with federal regulators to provide at least $114 million in consumer redress and pay a $2.4 million fine for deceptive marketing of high-fee, low-limit credit cards. Among other allegations, Compucredit was accused of marketing cards with a $300 limit, but failing to adequately disclose the $185 in fees that would be immediately charged to the card.[74]

Consumers exiting bankruptcy are often swamped with offers at prime terms – low interest rates and without annual fees.[75] Many bankruptcy attorneys believe these offers are being made because consumers leaving bankruptcy court cannot erase their debts for another six years. Under the new bankruptcy legislation consumers will not be able to wipe away any credit card debts for eight years. Some categories of credit card debt will not be "dischargeable" at all, no matter how long the consumer waits.[76]

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[70] Gavin, Robert, "Credit Card Companies Pursue Subprime Borrowers," *Boston Globe*, September 5, 2007.
[71] Interview with Andrew Kahr, credit card industry consultant, "The Secret History of the Credit Card," *Frontline*, November 2004.
[72] OCC, Statement of Comptroller of the Currency John D. Hawke J., June 28, 2000.
[73] Pacelle, Mitchell, "Pushing Plastic," *Wall Street Journal*, November 5, 2004.
[74] "Subprime Credit Card Marketer to Provide At Least $114 Million in Consumer Redress to Settle FTC Charges of Deceptive Conduct," Federal Trade Commission, Dec. 19, 2008, http://www.ftc.gov/opa/2008/12/compucredit.shtm.
[75] Mayer, Caroline E., "Bankrupt and Swamped with Credit Offers," *Washington Post*, April 15, 2005.
[76] *Ibid.*

D. ISSUERS HAVE PURSUED ABUSIVE INTEREST RATE, FEE AND RISK MANAGEMENT POLICIES THAT HAVE A HARMFUL IMPACT ON MANY HOUSEHOLDS

There is considerable evidence linking the rise in bankruptcy in recent years to the increase in consumer credit outstanding, and, in particular, to credit card debt. For example, research by Professor Ronald Mann of Columbia University has found that an increase in credit card spending in the U.S. and four other countries has resulted in higher credit card debt, which is strongly associated with an increase in bankruptcy filings.[77] To make matters worse, credit card companies have become far more aggressive in implementing questionable fees and interest rate practices in recent years. The upshot of these practices is that penalty interest rates, high and accumulating fees and interest on fees can push consumers with high debts over the financial brink into bankruptcy.[78] In fact, consumers in debt trouble sometimes owe as much or more in fees and penalty interest charges, as in principal.

High fees and interest rates can often result in negative amortization, where the principal owed on credit card debt continues to rise despite making payments. Negative amortization in effect traps credit card borrowers on a debt treadmill that keeps moving faster. Although they are making regular payments, their debts continue to mount. In 2004, a Cleveland judge ruled against Discover Card's efforts to collect debts from a cardholder whose balance nearly tripled from $1,900 to $5,564 without making additional purchases because of fees and penalties, including $1,158 in over-limit fees alone. [79]

In another case, a bankruptcy court in North Carolina ordered a credit card company to itemize the claims it files in chapter 13 bankruptcy cases.[80] In its findings in support of the Order, the bankruptcy judge listed claims filed in eighteen separate cases broken down between principal and interest and fees. On average, interest and fees consisted of more than half (57 percent) of the total amounts listed in the claims. In one case, the card company filed a claim in the amount of $943.58, of which $199.63 was listed as principal and $743.95 was listed as interest and fees. In another case, a claim of $1,011.97 consisted of $273.33 in principal and $738.64 in interest and fees. It is almost certain that pre-bankruptcy payments in these cases had more than paid off the real charges made by the consumers.[81]

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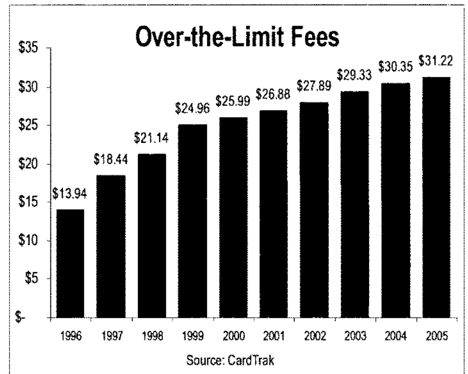
[77] Mann, Ronald J., "Credit Cards, Consumer Credit and Bankruptcy," Law and Economics Research Paper No. 44, The University of Texas School of Law, March 2006.
[78] Day, Kathleen and Caroline E. Mayer, "Credit Card Penalties, Fees Bury Debtors," *Washington Post*, March 6, 2005.
[79] National Consumer Law Center, "Responsible Consumers Driven into Default," February 22, 2005.
[80] *In re* Blair, No. 02-1140 (Bankrate. W.D.N.C. filed Feb. 10, 2004)
[81] National Consumer Law Center, "Responsible Consumers Driven into Default," February 22, 2005.

Penalty Fees

Traditionally, penalty fees were designed to deter irresponsible cardholder behavior, but in recent years these fees have become primarily a revenue enhancer for credit card issuers. An analysis by the United States Government Accountability Office (GAO) found that, "...typical cards today now include higher and more complex fees than they did in the past for making late payments, exceeding credit limits, and processing returned payments."[82] The GAO also identified several new fees that issuers have begun using in recent years, some of which they are not required to disclose to consumers in advance. One example of such a fee is for the payment of bills by telephone, which can range from 5 to 15 dollars.[83]



A substantial number of Americans are paying these fees. Thirty-five percent of the credit card accounts from the six largest issuers that the GAO examined had at least one late fee in 2005,[84] representing about 242 million credit cards.[85] Thirteen percent of all accounts – or about 90 million cards – were assessed over-limit fees in 2005.

Late fees have been steadily rising over the past decade and can easily exceed monthly payments for consumers paying low minimum balances.[86] In 1996, a Supreme Court decision prohibited states from setting limits on the fees credit card companies could charge their cardholders. Prior to this court ruling, credit card late fees were commonly around five to ten dollars, but have risen sharply since the decision.[87] The GAO analysis found that late fees jumped sharply after the court ruling. The GAO examined fee data collected by CardWeb.com and found that late fees jumped by 160 percent from $12.83 in 1995 to $33.64 in 2005. The GAO also found a sharp fee increase from data collected by Consumer Action, which showed a 119 percent increase from $12.53 in 1995 to $27.46 in 2005.[88] Even more striking, the GAO found that late fees paid by borrowers with typical balances were an average of $37 in 2005.[89] This is important to note as credit card issuers are increasingly assessing "tiered" fees based on the borrower's balance.

[82] "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, p. 18.
[83] *Ibid*, p. 23.
[84] *Ibid*, p. 1.
[85] CFA calculation based on 691 million credit cards, *Ibid*, p. 9.
[86] "The Ugly Issuer," *Credit Card Management*, September 2004.
[87] Bergman, Lowell and David Rummel, "Secret History of the Credit Card," *Frontline*, November 2004.
[88] "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, p. 18.
[89] *Ibid*, p. 20.

Credit card issuers used to reject transactions that exceeded a cardholder's credit limit, but it has become common for issuers to accept the transaction and then apply an over-limit fee on cardholders who exceed their credit limits.[90] These fees are often applied by issuers in addition to a higher "penalty" interest rate charge for exceeding the credit limit or carrying a high balance.[91] These monthly fees are charged every month a consumer carries a credit balance higher than their credit limit. According to the GAO report, data collected by Consumer Action shows a 114 percent increase in over-limit fees between 1995 and 2005.[92] Critics of this practice argue that issuers should not assess a penalty fee when they can simply enforce the credit limit if they wish to prevent consumers from exceeding it.

Penalty Interest Rates

The vast majority of credit card issuers also increase interest rates for credit card account holders who pay their bills late, even by a few hours. In 2005, Consumer Action found that 78.7 percent of issuers charged penalty rates for late payments on their cards.[93] For example, representatives for one large issuer told the GAO that they automatically increase a customer's interest rate if this person pays late or exceeds the credit limit. The GAO found that all but one of the 28 cards from the six largest issuers they reviewed charged default rates in 2005. By 2008, 94% of new credit card solicitations included a penalty rate.[94] The average default rate in 2008 is 28.6 percent, up from 23.7 percent in 2003.[95] Even more striking, the spread between the penalty rate and the standard purchase rate more than doubled between 2000 (8.1%) and 2008 (16.9%).[96]

Some consumers with low-rate cards could have their interest rates double overnight for being late on one payment to their credit card.[97] Some issuers also say that they will charge default interest rates for exceeding the credit limit on the card or for returned payments, or that they will increase interest rates for cash advances and balance transfers for violations of card terms.[98]

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[90] "The Ugly Issuer," *Credit Card Management*, September 2004.
[91] Bergman, Lowell and David Rummel, "Secret History of the Credit Card," *Frontline*, November 2004.
[92] "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, p. 20.
[93] Consumer Action, 2005 Credit Card Survey, "Card Companies Use Common 'Risk Factors' to Impose Unfair Rate Hikes, Finds CA," *Consumer Action News*, Summer 2005.
[94] Frank, Joshua M., *Priceless or Just Expensive? The Use of Penalty Rates in the Credit Card Industry*, p. 10, Center for Responsible Lending (December 16, 2008), hereafter Frank, *Priceless or Just Expensive.*, available at http://www.responsiblelending.org/pdfs/priceless-or-just-expensive.pdf.
[95] Id at 9. (The 2006 GAO report did find that some issuers do not assess default rates unless there are multiple violations of card terms. "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, pgs. 24, 25.)
[96] Frank, *Priceless or Just Expensive*, at 9-10.
[97] Bergman, Lowell and David Rummel, "Secret History of the Credit Card," *Frontline*, November 2004.
[98] "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, p. 25.

There is increasing evidence that those who can least afford these higher interest rates – financially vulnerable families – are most likely to be paying them. A study by the research organization Demos found that cardholders that carry debt who earn less than $50,000 a year are more than twice as likely to pay interest rates above 20 percent as the highest income Americans who carry debt. African-American and Latino credit card holders with balances are more likely than whites to pay interest rates higher than 20 percent.[99]

One recent study estimated that the cost of the penalty rate shock cost a revolver carrying the average $10,678 balance $1800 a year.[100] At a time when we are looking for ways to put money back in the hands of families, reducing this $150 a month surtax could have a real stimulative effect.

Retroactive Application of Penalty Rates

All issuers also apply penalty interest rates retroactively to prior purchases. This has the effect of increasing the price on purchases already made but not paid off.[101] Some cards even apply penalty rates to debts that were already paid at a lower rate.[102] There is simply no legal or economic justification for assessing a penalty interest rate to an existing balance. There is no other industry in the country that is allowed to increase the price of a product once it is purchased. Issuers have already assessed a consumer's risk of not repaying the loan and presumably offered an interest rate based on that risk. Issuers should be required to allow a consumer to pay off his or her existing balance at that interest rate.

Even for consumers who clearly are becoming higher risk, such as those who are a full thirty days late in paying a credit card bill, it is harmful to cardholders and, ultimately, lenders to impose a retroactive rate increase on the existing balance. These families are struggling and need help getting out of debt; they should not be shoved deeper underground. Retroactive penalty interest rate hikes for these cardholders only increases the likelihood that they will completely default, which is in no one's interest. The primary effect of a punitive retroactive rate increase appears to be to escalate the proportion of the consumer's debt owed to the card issuer and to put the card issuer at an advantage over the consumer's other creditors. This practice is unfair to creditors who do not escalate the debt owed by families having difficulty making ends meet.

[99] Wheary, Jennifer, and Tamara Draut, "Who Pays? The Winners and Losers of Credit Card Deregulation," Demos, August 1, 2007.
[100] Frank, *Priceless or Just Expensive*, at 1.
[101] Draut, Tamara, Director of the Economic Opportunity Program at Demos, Testimony Before the House Banking Committee Subcommittee on Financial Institutions and Consumer Credit, September 15, 2004, at 16-17.
[102] McGeehan, Patrick, "The Plastic Trap," *New York Times*, November 21, 2004. Discover disclosed to its customers that it had changed the terms of its interest rates from a low of zero to 19.99% for a single late payment, but it applied that rate increase for late payments from 11 months prior to the disclosure of the changing interest rate terms.

Universal Default

Universal default clauses in credit card contracts allow credit card companies to raise interest rates on debtors who have problems with other creditors or whose credit scores decline. The increases are triggered not just by a late mortgage or credit card payment to other lenders but also to payment disputes with other types of creditors, like utilities or book clubs.[103] A review of credit card disclosures issued in October 2006 by Consumer Action found five major issuers that said they reserved the right to assess universal default interest rates. Since that time, Citigroup and JP Morgan Chase have said that they will not use the practice, although Citigroup changed this policy in the fall of 2008.[104] On the other hand, representatives for Bank of America and Discover testified before the Senate late last year that they still use consumer credit scores, at least in part, to trigger higher default interest rates.[105]

It is fundamentally unfair to impose a penalty interest rate on a consumer who has not made a late payment or defaulted on an obligation, especially when this rate increase is applied retroactively. Another concern with using credit reports to trigger a penalty rate is the problems with inaccuracies in credit scoring and credit reporting that CFA and other organizations have documented.[106] Moreover, issuers who impose sharp interest rate increases on consumers who are meeting their obligations often fail to provide any rationale – much less a legitimate one -- for the increase. In January, Bank of America began increasing interest rates on some cardholders to as high as 28 percent but did not inform consumers the reason for the increase in the notification they mailed.[107]

Although credit card issuers contend that interest rate penalties that increase because of universal default are related to the credit risk of the borrower, the application by some issuers of these punitive rate hikes seems to belie that contention. One late payment can result in significant increases in interest rates in some cases, even though there is little evidence that a single late payment to one creditor increases the likelihood of default to all creditors. Moreover, increased fee and interest rate payments may have a similar or greater impact on the borrower's ability to repay than modest problems with another creditor.

Indiscriminate, Undisclosed Changes in Rates and Fees

Many credit card companies reserve the right to change the terms of their credit card contract at any time and for any, *or no*, reason. This allows credit card companies to arbitrarily raise interest rates even for cardholders in good standing and with perfect credit histories. Media reports of recent rate hikes by Bank of America demonstrate the unfairness of any-time/any-

[103] Burt, Bill, "Pay One Bill Late, Get Punished by Many," *Bankrate.com*, January 20, 2004.
[104] Dash, Eric, "Despite Pledge, Citigroup to Raise Credit Card Rates, Blaming 'Difficult' Environment," *New York Times*, November 15, 2008.
[105] Credit Card Practices: Unfair Interest Rate Increases, U.S. Senate Permanent Subcommittee on Investigation, December 4, 2007.
[106] Consumer Federation of America and National Credit Reporting Association, "Credit Score Accuracy and Implications for Consumers," December 17, 2002. CFA and NCRA reviewed over 500,000 credit files and found that 29 percent of consumers have credit scores that differ by at least 50 points between the credit bureaus.
[107] "A Credit Card You Want to Toss," *Business Week*, February 7, 2008.

reason changes: some consumers saw their interest rates triple without explanation.[108] The result of these unfair clauses is that consumers can't depend on the interest rate promised to them.

In the last few months, JP Morgan Chase has begun charging approximately 400,000 cardholders a $10 a month fee. It is also increasing the minimum payment amount for these consumers from 2 to 5 percent, a substantial amount. Many of these cardholders appear to have been promised a fixed interest rate for the life of the balance.[109]

Pricing Tricks: Double Cycle Billing and Manipulation of Payment Allocation

The GAO found that two of six major creditors are using a practice called double-cycle billing, which results in illegitimate interest charges on balances that have already been paid on time.[110] Since then, one of these issuers, JP Morgan Chase, has announced that it will no longer use double-cycle billing. With this practice, issuers consider two billing cycles in assessing interest. A consumer who begins with no balance and pays off most but not all of the purchases he or she makes in the first month would still be charged interest for the entire amount of the balance in the second month. A fair billing process would only result in an interest charge on the amount of the unpaid balance.

The GAO also determined that for 23 of the 28 large issuer cards they reviewed, cardholder payments were first allocated to the balance assessed at a lower rate of interest.[111] The actual proportion of large issuers who in effect use this policy is likely closer to 100 percent since the remaining five issuers applied payments "subject to their discretion". This practice is problematic for the many cardholders who now carry balances at different rates of interest, such as introductory "teaser" rates, cash advance rates, and balance transfer rates. The lower interest rate balances must first be paid off before the issuer will allocate payments to higher rate balances. Allocating payments to lower interest rate balances first unfairly extends the length of time it takes consumers to pay down their balances while increasing the finance charges that issuers earn. Furthermore, a recent study has shown this payment allocation policy and its impact to be very poorly understood by consumers.[112] The study also showed this issuer policy causes pricing to be less related to risk, the opposite of what issuers claim they wish to achieve.

Increases in Credit Card Fees and Interest Rates Significantly Affect Consumer Debt

Penalty fees and interest made up more than three-quarters of credit card issuers revenues throughout 2002 and 2003. Credit card issuers earned $65.4 billion in interest and $7.7 billion in penalty fees in 2003 or 75.7 percent of the total $96.5 billion in revenue.[113] In 2002, penalty fees

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[108] Ibid.
[109] Chu, Kathy, "Chase Adds Fee for Low-Rate Credit Cards," *USA Today*, February 9, 2009.
[110] "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, p. 27.
[111] *Ibid.*
[112] Frank, Joshua M., *What's Draining Your Wallet? The Real Cost of Credit Card Cash Advances*, Center for Responsible Lending (December 16, 2008), available at http://www.responsiblelending.org/pdfs/whats-draining-your-wallet.pdf.
[113] Daly, James J., "Smooth Sailing," *Credit Card Management*, May 2004 at 31.

and interest made up 76.8 percent of the industry's $97.1 billion in revenues. For the approximately 88 million credit cardholding households, penalty fees and interest on their credit card debt cost an average of $830 in 2003.[114]

Unsavory Credit Limit Practices

In its 2008 survey of credit card terms and conditions, Consumer Action identified some unsavory credit limit practices used by major credit card issuers. While reducing credit availability can be a responsible way for credit card issuers to manage growing financial risk during difficult economic times, these aggressive credit line policies can harm consumers. Each in its own way puts consumers at greater risk of being charged higher interest rates, falling deeper in debt, and causing a ripple effect among issuers. Consumers reported some credit limit practices to Consumer Action that are patently unfair.

- Following you down. As consumers pay off large balances, the credit limit is reduced so that the balance is always close to the credit limit.
- Sorry, you're over limit. Credit limits are reduced to levels lower than the current balance, triggering over limit fees and requiring a large "balloon" payment of the over-due amount. This practice also puts the consumer at risk of being hit with a penalty interest rate.
- Where's my credit limit? Cards are declined at the point of purchase, and only then do cardholders find out that their limits have been reduced with no warning.
- Ganging up on consumers. One credit card issuer lowers your credit limit, which lowers your credit score, which causes another of your cards to lower your credit limit.

The Combined Effect of Abusive Practices during the Recession

Although credit card issuers have curbed aggressive marketing and cut back on credit extension in the last year, they appear to be accelerating the use of many of the irresponsible and harmful practices detailed above to cut or mitigate their losses. For example, card issuers have used their ability to unilaterally change the terms of credit card contracts by raising interest rates even as the Federal Reserve has sharply reduced the federal funds rate.[115] They have also added new fees,[116] increased the amount of fees,[117] and, as detailed above, used harmful rather than responsible methods to lower credit lines. Citigroup back-peddled last fall on its promises not to increase interest rates "at any time for any reason."[118] As mentioned above, Chase has suddenly

[114] CFA calculation from Daly, James J. 2004 and Census Bureau figures.
[115] Trejos, Nancy, "Less Power to Purchase, Consumers' Credit Card Limits Slashed as Companies Try to Reduce Risk," *Washington Post*, November 16, 2008.
[116] Lieber, Ron, "Credit Card Companies Go to War Against Losses," *New York Times*, January 31, 2008.
[117] Trejos, Nancy, "Less Power to Purchase, Consumers' Credit Card Limits Slashed as Companies Try to Reduce Risk," *Washington Post*, November 16, 2008.
[118] Dash, Eric, "Despite Pledge, Citigroup to Raise Credit Card Rates, Blaming 'Difficult' Environment," *New York Times*, November 15, 2008.

started charging hundreds of thousands of cardholders fees of $120 a year, while sharply increasing the monthly amount that these cardholders owe each month. Bank of America and Capital One have used vague clauses in cardholder agreements to raise interest rates on cardholders because of "market conditions."[119] Issuers have every right to try and limit their losses during the current economic crisis if they act responsibly, but the use of these harmful, unjustified and sometimes arbitrary practices is contributing to the economic insecurity of millions of families who thought they were complying with their obligations.

When "Risk-Based" Pricing is Predatory

Credit card issuers often claim that their interest rate and fee policies are justifiable because they are necessary to compensate for the increased financial risk of lending to borrowers with blemished or limited credit histories. It is true that borrowers who pay their balance every month are receiving a valuable service at no cost in many cases. It is quite possible, in fact, that riskier borrowers who revolve their debt and pay higher interest rates and fees are subsidizing in-part the cost of services that these non-revolvers receive. It is important to note, though, that issuers still receive substantial fee income from merchant "interchange" fees and, in some cases, from annual fees.

The key question is whether interest rates and fees charged to riskier consumers are fair and can be legitimately related to the actual financial risk incurred by creditors. There is increasing evidence that the answer to this question is "no."[120] It is becoming more apparent that many of the most abusive fees and interest rates are assessed simply because it is what the market will bear.

The amount of fees and penalty interest rates do not appear to be proportional to the risk or cost incurred by issuers. For many years, issuers have justified "sticky" interest rates that rise faster than they decline by stating that these higher interest rates were necessary to compensate for increased risk. As issuers have increased the number and amount of fees and penalty interest rates they charge, it seems that higher baseline interest rates alone are not sufficient anymore to compensate for risk. There is very little evidence that relatively modest problems, like one or two late payments of a short duration – significantly increase a consumer's chances of default. It would appear to be impossible to justify charging a consumer with a reasonably good credit history with a late payment fee of $35 and a default interest rate of 29 percent on prior purchases, in addition to the finance charge the consumer would already pay on a fairly high interest rate, such as 17 percent. One sign that default rates may not be truly reflective of costs or risk incurred by issuers is that the "fixed amount" that issuers add to the index rate in setting default rates rises when the cost of funds declines. The GAO found that this fixed amount increased

[119] "Card Rates Rise 'Out of the Blue,'" *The Oregonian*, January 25, 2008. Kimes, Mina, "Card Companies Jacking Up Rates," *Cable News Network*, http://money.cnn.com/2008/09/26/news/economy/creditcards_kimes.fortune/.
[120] Testimony of Adam J. Levitin, Associate Professor of Law, Georgetown University Law Center, before the Subcommittee on Financial Institutions and Consumer Credit of the Financial Services Committee of the United States House of Representatives, March 13, 2008.

from about 19 percent in 2003 to 22 percent in 2005 on the 28 large issuer cards they evaluated.[121]

In response to these "tell-tale" signs of price gouging, it is time for issuers to provide more information to lawmakers and to the public about their real costs to demonstrate that their pricing practices are truly fair.

E. AMERICANS ARE HIGHLY CRITICAL OF MANY CURRENT CREDIT CARD PRACTICES

Our organizations regularly conduct public opinion surveys regarding consumer attitudes and behavior. We have rarely encountered the kind of broad, nearly universal condemnation that Americans have for many common practices used by credit card issuers regarding interest rates, fees and the extension of credit.

For example, a nationally representative poll of 1,005 adults conducted by the Opinion Research Corporation for the Consumer Federation of America from September 13 to September 16, 2007 found that:

- 82 percent of Americans think it is unfair to offer several credit cards to a student with little income. (62 percent believe it is very unfair.)
- 91 percent of Americans think it is unfair to raise interest rates or fees at any time for any reason. (76 percent believe it is very unfair.)
- 83 percent of Americans think it is unfair to increase the interest rate on one card because of a person's payment history on another card. (62 percent believe it is very unfair.)
- 84 percent of Americans think it is unfair to apply interest rate increases not only to new balances but also to past balances. (61 percent believe it is very unfair.)
- 85 percent of Americans think it is unfair to increase an interest rate to 30 percent for making two late payments. (64 percent believe it is very unfair.)
- 76 percent of Americans think it is very unfair to charge $30 for making a late payment. (51 percent believe it is very unfair.)
- 82 percent of Americans think it is unfair to charge a $30 fee each month if a balance is over the credit limit when a person is no longer using the card. (64 percent believe it is very unfair.)
- 90 percent of Americans think it is unfair to charge $10 for payment by phone. (72 percent believe it is very unfair.)
- 80 percent of Americans think it is unfair to not allow a person to pay off higher-interest rate debt first, such as on a cash advance, but instead applying payments first to lower-rate debt. (54 believe it is very unfair.)
- 81 percent of Americans think it is unfair to have only one week between the time a person receives a monthly statement and the time he or she must mail the payment. (54 percent believe that it is very unfair.)
- 93 percent of Americans think it is unfair to charge a late fee even though a person has mailed the payment a week or more in advance of the due date. (79 percent believe that it is very unfair.)
- 71 percent of Americans think it is unfair to require that disputes be settled by mandatory arbitration without being allowed to go to court. (45 percent believe that it is very unfair.)

[121] "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, p. 24.

F. FEDERAL RULE ON UNFAIR AND DECEPTIVE CREDIT CARD PRACTICES

On December 18, 2008, the Federal Reserve Board, the Office of Thrift Supervision and the National Credit Union Administration issued a final rule to curb unfair and deceptive practices by credit card issuers. The rules do not take effect until July 1, 2010.[122]

The new rule prohibits or restricts a number of abusive practices, including:

- **Interest rate increases on existing balances, unless the cardholder is more than 30 days delinquent.** The rule does not prohibit prospective "universal default" rate increases because of a supposed problem that the cardholder has with another creditor. It does eliminate the practice as applied retroactively, which has provided a major financial incentive for issuers to use it, though consumers struggling with their debt, who have missed a payment, could still be hit with large retroactive rate increases. The rule prohibits issuers from increasing interest rates on existing balances because a cardholder has made a minor mistake, such as paying late by a few days.

- **Payment allocation methods that cause debts to escalate**. The rule takes steps to require credit card issuers to more fairly apply the payments that cardholders make to balances with different interest rates. When consumers transfer balances with low, short-term "teaser" rates (that have higher rates for new purchases), or take out high-rate cash advances, issuers will be required to apply payments either to the higher rate debt or to both the higher and lower rate debt proportionately. Currently, credit card issuers apply payments only to the lower rate debt. Though the rule improves current payment allocation practices significantly, consumers would still be unable to completely pay off costly high rate balances by making extra payments unless the consumer pays off the lower rate balances at the same time.

- **Interest charges on debts that have already been paid**. The rule forbids "double cycle billing," which results in cardholders paying interest on debts paid off the previous month during the grace period.

- **Excessive fees for low-credit cards**. The rule forbids credit card companies that target consumers with poor credit histories from requiring consumers to pay fees that amount to more than half of the credit being offered, if those fees are charged to the card that is being issued. If the fees being charged to the card amount to more than one-quarter of the credit line, cardholders will be allowed to pay these fees off over a six-month period.

The rule is an important first step in stopping issuers from using some unfair and deceptive practices to increase the amount of debt consumers owe. However, it is not helpful to consumers struggling to pay off hefty debts in the middle of a recession to allow issuers to

[122] Federal Reserve System, 12 CFR Part 227 [Regulation AA; Docket No. R-1314]; Department of the Treasury, Office of Thrift Supervision, 12 CFR Part 535 [Docket ID. OTS-2008-0027] RIN 1550-AC17; National Credit Union Administration, 12 CFR Part 706, RIN 3133-AD47; Unfair or Deceptive Acts or Practices.

continue to use for another year and a half practices that federal regulators have deemed to be abusive. We urge this Subcommittee to provide consumers with more timely relief, and to address abusive practices that are not targeted or completely eliminated by the rule. The Credit Cardholders' Bill of Rights Act achieves both of these goals. (See Section H for discussion of this bill and how it compares to the regulators' rule.)

G. ENSURING THAT CREDIT CARD ISSUERS RECEIVING GOVERNMENT ASSISTANCE OFFER LOANS THAT ARE FAIR AND SUSTAINABLE

As part of the federal government's efforts to rescue the financial sector, credit card banks are receiving taxpayer assistance in several forms, including through the direct infusion of funds and the Troubled Assets Relief Program (TARP). On February 10th, Treasury Secretary Geithner announced that he would expand an additional program designed to make consumer credit more widely available. The Term Asset Backed Securities Loan Facility (TALF) would use the Federal Reserve Board's credit facility power, be operated by the Federal Reserve Bank of New York, and include a special purpose vehicle capitalized from TARP funds. Initially, the program was to use $20 billion to support a program for up to $200 billion in non-recourse loans to buyers of securities backed by non-mortgage debt, including consumer credit card debt. In other words, buyers of credit card securitizations would be able to borrow funds from the Federal Reserve Bank of New York to purchase these securitizations, with repayment from revenues from the securitized credit card debts. Secretary Geithner said he wants to expand the program to support between $500 billion and $1 trillion in lending.

A diverse coalition of more than twenty organizations led by Consumers Union has called on Secretary Geithner to require that any securitized debt whose purchase is financed through this program meet standards for fairness and truthfulness, including those standards were finalized in December 2008 by the Federal Reserve Board.[123] The groups sought this change to ensure that any consumer credit card debt facilitated through this taxpayer-backed program will promote, rather than damage, household economic stability.

Specifically, the organizations called on Secretary Geithner to impose two minimal eligibility conditions on all financing by the TALF for credit card securitization pools:

1. Immediate compliance with details of the rule against unfair or deceptive acts or practices for all consumer credit card debt in the pool; and

2. A specific program for cardholders to earn a reduction in penalty interest rates back to a lower standard rate after no more than six months of on-time payments for all consumer credit card debt in the pool.

Any government backed program to make capital available for credit card debt must be limited to that credit card debt which is not associated with practices that federal regulators have determined to be unfair or deceptive. Federal backing of credit card securitizations must also be

[123] https://mail.consumerfed.org/exchweb/bin/redir.asp?URL=http://www.consumersunion.org/pdf/TALF.pdf.

limited to credit card debt with a clear "road map" to non-penalty rates for households who pay on time while under a penalty rate.

A stated purpose for the Troubled Assets Relief Program (TARP) is to restore stability to the financial system. However, the first installment of TARP money did not even begin to promote financial stability for borrowers, homeowners, and communities in the face of the tide of foreclosures, onerous credit card practices, and the crying need for affordable, sustainable, systematic loan modifications. The new TALF program for non-mortgage debt should limit its offer of liquidity to avoid the type of credit card debt that detracts from sustainable lending and household financial stability.

Providing more capital for credit card lending will not meet the national need for enhanced financial stability for households if the credit card debt that is facilitated under the TALF can continue until July 1, 2010 to contain the harmful terms and practices that the Federal Reserve Board and two other federal regulators have identified as unfair or deceptive. The challenges for the U.S. economy are great. Consumers cannot be the engine of economic recovery if they are burdened with high interest rate credit card debt that federal regulators have determined is not justified. Any further taxpayer assistance to credit card issuers must include conditions that will ensure that the credit provided will promote, or at least not be detrimental to, family economic stability.

H. H.R. 627

The "Credit Cardholders' Bill of Rights Act" helps restore fairness to the credit card marketplace. The bill would require credit card issuers to take a number of steps to treat consumers more fairly, including:

1. **Ending Bait and Switch Contract Clauses.** H.R. 627 invokes the basic tenet of fair dealing by prohibiting credit card companies from changing contract rules in the middle of the game through "any time, any reason" interest rate and fee hikes. Instead, they must disclose, up front, the specific, material reasons for which they will unilaterally change contract terms.

2. **Limiting Retroactive Application of Rate Hikes for Consumers in Good Standing.** H.R. 627 prohibits card issuers from applying "universal default" interest rate hikes retroactively to balances borrowed at a lower rate. As cited above, some issuers still use credit information not related to the account a consumer has with that company, such as a drop in a consumer's credit score, to raise interest rates. While consumers with a perfect payment history with their credit card company are understandably outraged when their interest rate rises for these reasons, the devastating consequences of retroactive application of these increases is equally egregious. Minimum monthly payments rise, sometimes dramatically. The time to pay-off the balance increases, sometimes by many years, while the total cost of the debt skyrockets. H.R. 627 limits these destabilizing impacts by prohibiting the retroactive application of rate hikes not related to the cardholder's credit card account.

3. **Preventing Credit Card Companies from Gaming Consumer Payments.** H.R. 627 reduces the ability of card companies to play costly games with consumer payments by requiring them to apply payments proportionately to card balances with different interest rates. As stated above, when consumers accept card offers for short-term teaser rates for balance transfers and cash advances and higher rates for other balances, credit card companies apply payments *first* to the lower-rate balance, preventing consumers from paying off higher interest balances and imposing unwarranted and costly finance charges. Issuers refuse to apply *any* portion of a consumer's payment to the higher interest rate balance, preventing consumers from paying down *any* portion of the high-cost balance until the lower interest rate balance is repaid. As a result, balances build up at the much costlier rate and finance charges accrue.

4. **Prohibiting Unfair and Hidden Interest Rate Charges on Balances Repaid During the Grace Period.** H.R. 627 prohibits credit card companies from using "double-cycle billing" to charge interest on balances repaid during the grace period. As mentioned above, this practice allows credit card issuers to sap unwarranted finance charges from the wallets of consumers who usually do not carry balances. Although some credit card issuers have disavowed this practice, some still engage in it. This legislation makes clear that a grace period is a grace period.

5. **Ending Unfair Late Fees for On-Time Payments**. H.R. 627 ends the classic late-fee gotcha. Consumers who mail their payments well in advance are often socked with a late fee of up to $40 because of card companies' own processing delays or arbitrary deadlines. The abuse has been exacerbated as credit card companies have shortened the time period in which consumers can make an on-time payment. Other consumers make electronic payments on the due-date, only to be hit with a late fee because they posted their payment five minutes after the issuer's arbitrary deadline on that day. The legislation provides that consumers demonstrating that they have paid their bill at least seven days before the due date are presumed to have paid on time and cannot be charged a late fee. It also sets a single uniform time of no earlier than 5 p.m. local time by which payments must be received on the due date to prevent companies from setting earlier and arbitrary deadlines that result in late fees. Issuers must also mail credit card bills 25 days before the bill is due, instead of the current rule requiring only 14 days, to help ensure that consumers will have enough time to pay.

These provisions largely track those required in the credit card rule finalized by federal regulators. There are a few significant differences, however. Most important is that H.R. 627 will take effect three months after enactment, while the regulators' rule does not take effect until July of 2010. Protections that are in H.R. 627 that are not included in the regulators' rule include:

- Consumers will be able to choose not to be allowed to exceed their credit limit
- Credit card companies will not be able to extend credit to borrowers younger than 18.

- Consumers who receive extraordinarily high-cost "subprime" cards would be better protected under H.R. 627. The Board rule permits fees to consume 50 percent of the consumer's credit line, whereas under H.R. 627 fees cannot be charged to more than 25 percent of the credit line.

Protections that are included in the regulators' rule that are not in H.R. 627 include:

- Prohibiting the practice of deferring interest rate payments. Deferred interest usually involves an advertised promise such as "no interest for one year," but the fine print calls for interest to be charged retroactively if the consumer does not fulfill a condition of the deferral agreement, such as paying in full before the end of the deferral period.
- Banning the hair-trigger loss of promotional interest rates. Issuers would not be able to use any reason they wanted to raise a promotional rate during the promotional period, but could only do so of a cardholder was thirty days or more late in paying a bill.
- Prohibiting "universal default" rate increases on future purchases for the year a card is issued. The rule primarily restricts interest rate increases on <u>existing</u> balances, but in this case the rule would prohibit interest rate increases <u>prospectively</u> for the first year a card is issued, because of a supposed problem the cardholder has with another creditor or a drop in the cardholder's credit score.

We recommend that the Subcommittee conform H.R. 627 to the additional requirements in the rule. We also recommend that the Subcommittee include in H.R. 627 several additional provisions that would enhance consumer protection not yet addressed by the bill, including: a ban on all universal default rate hikes, including prospective rate hikes before the card expires; a prohibition on retroactive application of *any* rate hike to prior balances; a requirement that the size of penalties charged by issuers be directly related to actual costs incurred; and a requirement that credit card issuers ensure that young consumers have the ability to repay the loans they are offered.

We also recommend that the Subcommittee eliminate a provision in H.R. 627 allowing issuers to charge over-limit fees for three consecutive months, even if the cardholder only exceeds the credit limit with a single transaction. Instead, H.R. 627 should prohibit issuers from charging over-limit fees if they choose to allow a cardholder to exceed the credit limit.

Taken together, the reforms offered in H.R. 627 would be an important first step in making the credit card marketplace fairer and more transparent. By prohibiting issuers from using questionable methods to sharply increase some "back end" interest charges, this bill would start to shift pricing in the industry to the "front end," especially the initial interest rate. It would encourage issuers to compete to attract consumers based on those initial charges, and to use responsible risk-management techniques to manage their financial exposure if the risk profile of the borrower declines over time. The bill would not stop issuers from using responsible risk-based pricing methods to establish initial interest rates or to change them prospectively if the borrower's credit worthiness declines.

PART 2. THE NEED FOR THE CONSUMER OVERDRAFT PROTECTION FAIR PRACTICES ACT

Similarly, the **Consumer Overdraft Protection Fair Practices Act, HR 1456**, addresses a separate set of largely unregulated unfair tricks and traps that also place a consumer's wallet at risk. Instead of deterring the practice of bouncing checks, as they did for decades, over the last 5-10 years, more and more banks have encouraged consumers to bounce checks and other debits, replacing a beneficial back-up system for checking accounts with a system of high-cost, unsolicited overdraft loans that are in effect the banks' version of a usurious payday loan. The costly, and often multiple, fees charged for these overdraft loans drive their customers further into the red. The problem has grown worse as formerly small cash transactions have been substituted by small debit transactions that are approved at point-of-sale even when the bank knows the account shows a negative balance. The costly, and often multiple, fees charged for these overdraft loans drive their customers further into the red.

A. INTRODUCTION

Without asking for their consent, banks and credit unions unilaterally permit most customers to borrow money from the bank by writing a check, withdrawing funds at an ATM, using a debit card at the point of sale, or preauthorizing an electronic payment that exceeds the funds available in a checking account. Instead of rejecting the debit card purchase or ATM withdrawal or returning the check unpaid, most institutions will now cover the overdraft and impose an expensive fee for each transaction.

Consumers do not apply for this form of credit, do not receive information on the cost to borrow bank funds via overdrafts, are not warned when a transaction is about to initiate an overdraft, and are not given the choice of whether to borrow the funds at an exorbitant price or simply cancel the transaction. Banks are permitted by the Federal Reserve to make cash advances through overdraft loans without complying with Truth in Lending cost disclosure rules, denying consumers the ability to make informed decisions about whether to access credit, as well as comparison shop for the lowest cost overdraft program.

Just as payday lenders use the borrower's personal check or debit authorization to insure priority payment, banks use their contractual right of set-off to collect the amount of the overdraft loan and the fee by taking money out of the next deposit into the borrower's checking account. Overdrafts are typically repaid within days, and the flat overdraft fees for very short-term extensions of credit result in outrageous interest rates.

Common banking practices, as confirmed by the FDIC's recent study of overdraft programs, now increase the number of overdrafts rather than minimize them—and can cost the account holder hundreds of dollars in a matter of hours, when they otherwise may have been overdrawn by just a few dollars for a few days or less.

Debit card overdrafts are now the single largest source of overdraft fees and are especially costly for account holders because they carry the same high flat fee but for much smaller loans.

Abusive overdraft loans are costly for everyone, but are most destructive to people who are struggling to meet their financial obligations. For example, the Center for Responsible Lending (CRL) recently found that seniors who depend primarily on Social Security income to cover living expenses pay over $1 billion in overdraft fees each year.[124] In a system hugely out of balance, our big financial institutions are collecting enormous fees from people who have nothing to spare, making them even less able to meet their obligations.

It has been disheartening to see wealth stripped away from American families by a variety of insidious predatory lending practices over the past decade, and now the very mainstream practice of abusive overdraft lending must be counted among them. Moreover, as the average overdraft fee continues to increase and as debit card transactions become increasingly common, the trend is toward more abuse, not less. Indeed, the most recent survey of the nation's sixteen largest banks found that overdraft fees continue their upward spiral, with the largest fee charged by banks ranging from $34 at Citibank (up from $30 just eight months ago) to a maximum $39 charged by Citizens Bank. The median maximum overdraft fee for the largest banks is now $35. Only two of the largest banks cap the number of overdraft fees imposed in a single day. Bank of America recently dropped its cap on fees. (See Appendix C, CFA Survey of Sixteen Large Banks' Overdraft Fees and Practices.)

This trend will no doubt continue unless this Committee takes strong action—the need for which has been dramatically underscored by the FDIC's recent survey of the institutions it regulates.

We strongly support HR 1456 as a strong solution to the problem of abusive overdraft lending. This legislation will help stop the abuse, without limiting the ability of financial institutions to provide genuine protection for their customers.

In this section of the testimony:

- We will describe the dysfunctional overdraft lending system that now dominates the market and how it has changed drastically from a model that was once truly just an occasional courtesy. We will report on a survey of the largest banks and their current overdraft fees and practices;

- We will explain that abusive overdraft lending costs $17.5 billion per year and that nearly half of these fees, $7.8 billion, come from overdrafts triggered by debit cards at the checkout counter or ATMs—overdrafts that could be prevented with a warning or if the transaction were simply declined;

- We will recommend that Congress pass HR 1456, a solution that will put real protection back into overdraft policy;

[124] *See* Leslie Parrish and Peter Smith, *Shredded Security: Overdraft practices drain fees from older Americans*, Center for Responsible Lending (June 18, 2008), *available at* http://www.responsiblelending.org/pdfs/shredded-security.pdf [hereinafter *Shredded Security*].

- And we will urge the Committee to encourage the Federal Reserve Board, currently considering limited new rules related to overdraft loans, to require institutions to obtain account holders' affirmative consent before enrolling them in fee-based overdraft programs for debit card purchases and ATM transactions.

Abusive Overdraft Lending Systematically Strips Funds from Checking Accounts

Abusive overdraft loans should not be confused with cheaper sources of back-up funds for checking accounts. Under traditional programs that link checking accounts to a savings account or line of credit, which are legitimate money management tools, funds are transferred in increments when the checking account is temporarily overdrawn. Financial institutions have offered such programs for decades. The largest banks charge a median $10 fee to transfer consumers' funds from savings accounts to cover overdrafts in their checking accounts.

Today, however, banks commonly enroll their checking account holders in a high-cost fee-based system automatically at the time they open a checking account. The FDIC reports that over three-fourths of the banks it surveyed automatically pay overdrafts for a fee and seventy-five percent of those banks automatically enroll their customers in overdraft programs without their permission.[125] If an account dips into a negative balance, the bank routinely covers the overdraft—a change from past practices—paying the shortfall with a loan from the banks' funds. When the account holder makes the next deposit, the bank debits the account in the amount of the loan plus a fee, which now averages $34.[126] At the largest banks, the median overdraft fee is $35.

Overdraft Loans Create a Vicious Cycle of Debt for the Most Vulnerable

The method in which overdraft loans are repaid contributes to the harm they cause consumers. Banks currently treat overdraft loan "fees" as checking account fees under the Truth in Savings Act. As a result, banks can and do use their right of set-off to pay themselves first out of the consumer's next direct deposit of pay or benefits. Consumers caught by overdraft loans do not get affordable installment repayment schedules. The full amount of the overdraft and the fees

[125] The FDIC Study found that 75 percent of banks surveyed automatically enrolled customers in automated overdraft programs. FDIC Study of Bank Overdraft Programs at iii (Nov. 2008) [hereinafter "FDIC Study"].

[126] Eric Halperin, Lisa James, and Peter Smith, *Debit Card Danger: Banks offer little warning and few choices as customers pay a high price for debit card overdrafts*, Center for Responsible Lending, at 8 (Jan. 25, 2007), *available at* http://www.responsiblelending.org/pdfs/Debit-Card-Danger-report.pdf [hereinafter *Debit Card Danger*]. The FDIC study found that the median fee *charged* by surveyed institutions was $27. Our research reflects the average *paid* by account holders. It is not surprising that it is larger since larger institutions with more customers generally charge higher fees. Government Accountability Office report on bank fees, *Bank Fees: Federal Banking Regulators Could Better Insure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts*, GAO Report 08-291 at 16 (Jan. 2008) (noting larger institutions' average NSF and overdraft fees were higher than smaller institutions').

are due and payable immediately and the bank reserves the right to deduct full payment out of the next deposit of funds into the account.

For low-income account holders who have no cushion of cash in their bank account, repayment of the overdraft and the average $34 charge is difficult to make up before another debit hits their account, sending them further into the red, triggering another $34 fee, and accelerating a downward spiral of debt. As discussed below, a small percentage of customers end up paying enormous amounts for overdraft loans, and these consumers tend to be lower-income and minority.

The example of Mary in Appendix B provides a real life illustration of how overdraft loans create a cycle of extremely costly debt. During two months in which she had overdrawn transactions, the fees totaling $448 themselves created more overdrafts because they were immediately deducted from her next deposit, leading to more fees. See Notes for examples of bank overdraft terms.[127]

Banks Speed Withdrawals but Not Deposits

In this age of fast-paced banking and electronic bill pay, anyone can temporarily slip into a negative balance. Check 21, passed in 2004, allows banks to debit accounts more quickly, while the rules for how long they can hold deposits before crediting accounts have not been updated in 20 years.

When banks hold deposited local checks until the permitted second business day, a paycheck drawn on a local bank and deposited on Friday afternoon can be held until Tuesday before money is available in the account to cover transactions. Fifth-day availability for deposited non-local checks means consumers may have to wait a whole week for deposits to become available, even when the check is drawn on the bank where it is deposited.

A spokesperson for a large national bank told the Atlanta Journal Constitution that the bank holds some deposits for as long as the law allows, unless the account holder calls and asks for a quicker credit.[128] By treating credits and deposits so differently, banks subject account holders to a heightened risk of overdrafting.

[127] Examples of bank terms and conditions provisions about repayment of overdrafts:

Bank of America: "If we overdraw your account, you agree to repay us immediately, without notice or demand from us. We may use deposits you or others make to your account to pay overdrafts, fees and other amounts you owe us."

Chase: "If we pay an item or honor your request that overdraws your Account, a deposited item has been returned unpaid, or for any other reason your Account has become overdrawn, you agree to pay the amount of the overdraft together with any fee and accrued interest identified in this Agreement immediately, whether or not you signed or requested the withdrawal or participated in the transaction creating the overdraft."

[128] Peralte C. Paul, *Whose Money is it? Checks Clear Faster than ever, but deposits tend to creep into accounts slowly. Watchdogs want banks to change.* Atlanta Journal Constitution, May 10, 2007.

Banks Manipulate the Order of Processing Withdrawals to Drive Up Fee Revenue

Financial institutions manipulate the order in which withdrawals are posted in order to trigger more fees. Institutions usually clear the largest transaction first, causing more transactions to overdraw the account. As the example scenarios in Appendix A demonstrates, this practice generates more in overdraft revenues because the institution can charge an overdraft fee for each transaction once the account is below zero. Using the same exact transactions, the bank in Scenario A, which processes transactions chronologically, only generates a single overdraft fee of $34. The bank in Scenario B, which manipulates transactions by posting larger debits first, generates eight overdraft fees, for a whopping $272 in fees.

Consumers do not know the order in which items drawn on their account will be presented to their bank and are not likely to know the order in which their bank pays items. Banks bury the disclosures about the order in which they process transactions, and these disclosures provide the banks the widest possible latitude to engage in this behavior.[129] Even the Federal Reserve noted in adopting Truth in Savings regulations in 2005 that consumers who are aware that their account may be overdrawn are not likely to know the number of items that will bounce or the total fees they will be charged.[130]

Banks claim they do customers a favor by paying the largest, and presumably most important, items first to ensure those items get paid. But this argument is disingenuous when a bank has an overdraft loan program, *because the bank pays all of the transactions*, regardless of the order in which they are posted. So no matter what order the transactions are cleared in, all items get paid, and the only difference is how much the customer pays in overdraft fees.

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[129] *See, e.g.*, US Bank's 26-page document, *Terms and Conditions for Deposit Accounts*, effective Feb. 1, 2005, *available at* https://fastapp.usbank.com/fastapp/en_us/termsAndConditions/TandC/LinkDepositAgreementCurrent.jsp (last visited Mar. 15, 2009): "If we get a batch of such items in a day (checks typically come in batches), and if one, some or all of them would overdraw the account if paid, we can pay or refuse to pay them, in any order, or no order . . . . We have all these options each time you might overdraw an account. What we do one time does not make that a rule you can rely on for the future"; Bank of America's 36-page document, *Deposit Agreement and Disclosures*, *available at* https://www1.bankofamerica.com/efulfillmentODAO/new_window_np.cfm?appURL=https://www1.bankofamerica.com/efulfillment/&showdaddoc=91-11-2000ED&daddoc2use=20081101&type=1&view=htm (last visited Mar. 15, 2009): "We may process and post items in any order we choose . . . . We may change categories and orders within categories at any time without notice. . . . [S]ome posting orders may result in more insufficient funds items and more fees than other orders. We may choose our processing and posting orders regardless of whether additional fees may result." Wachovia, *Deposit Agreement and Disclosures for Personal Accounts*, effective Feb. 8, 2008, *available at* http://www.wachovia.com/personal/online_services/disclosure/view/0,,7,00.html (last visited Mar. 15, 2009): "Although we generally pay larger items first, we are not obligated to do so and, without prior notice to you, we may change the order in which we generally pay items."

[130] Federal Reserve Board, Final Rule, Regulation DD, Docket No. R-1197, May 19, 2005, p. 4.

CFA's review of the largest banks' account agreements and customer information found that fifteen banks disclose that they pay the largest transactions first or reserve the right to pay withdrawals in the order the bank chooses. There was insufficient information to determine payment order at one bank surveyed. Bank customer agreements typically reserve the bank's right to change the order of processing withdrawals without notice or consent from account holders.

Indeed, the FDIC's recent study found that over half of the large banks surveyed process overdrafts from largest to smallest.[131] The survey further found, not surprisingly, that banks that engage in this abusive practice generate more overdraft fees than those who don't, but they also end up with more uncollectible debt related to overdraft loans.[132]

Consumer Views on Overdraft Practices

Consumers by a wide margin believe they are treated unfairly when banks permit them to overdraw at the ATM without warning. A 2004 survey poll of a representative sample of 1,000 adult Americans conducted for CFA by Opinion Research Corporation International found that an overwhelming majority (82 percent) of consumers thought permitting overdrafts without any notice at the ATM was unfair, while 63 percent said it was "very unfair." Fewer than one in five (17 percent) people thought it was fair. Consumers think they should be provided the opportunity to affirmatively opt in to overdraft provisions of their checking accounts. In CFA's 2004 ORCI poll, more than twice as many consumers thought it would be unfair for banks to permit overdrafts without obtaining their customers' consent (68 percent) rather than fair (29 percent).

A 2009 CRL survey found that 80 percent of consumers who wanted a choice about overdraft thought that their debit purchases and ATM withdrawals should only be covered for a fee if they affirmatively asked for overdraft coverage for those transactions. But the default arrangement for most institutions continues to be coverage—whether or not the account holder asked for it.

The *Consumer Reports* National Research Center 2009 poll of a nationally representative sample of 679 people found that two thirds of consumers prefer to expressly authorize overdraft coverage, so that there would be no overdraft loan – or fee – until they opted into the service. Likewise, two thirds of consumers said that banks should deny a debit card or ATM transaction if the checking account balance is too low.

Protecting consumers against unauthorized overdraft loans could also benefit banks. A 2006 study by Forrester Research Group documented that consumers are "irked" by overdraft fees. While 65 percent of consumers with no overdraft fees said they were very satisfied with their banks, only 53 percent of consumers charged overdraft fees in the last few months reported being

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[131] FDIC Study at iii (noting that 53.7% of large banks batched processed transactions by size, in order from largest to smallest).

[132] FDIC Study at 62.

very satisfied.[133] By offering contractual overdraft protection by linked savings accounts, low cost lines of credit, and transfers to credit cards, banks can provide real protection at lower cost to consumers and avoid angering a larger number of banking customers.

B. OVERDRAFT LOANS ARE A FORM OF INVOLUNTARY CREDIT

There is no question that overdrafts loans constitute a form of credit. Overdrafts are credit under the Truth in Lending Act (TILA), which defines "credit" as the right to "incur debt and defer its payment." See 15 U.S.C. §1602(e). When a bank permits a consumer to use the bank's funds to pay for an overdraft, and then requires the consumer to repay the bank, it is granting the right to incur a debt and defer its payment until the consumer's next deposit.

Overdraft or bounce loans are unique in that they are one of the few forms of *involuntary* credit. Banks essentially "cram" these loans on consumers, *i.e.*, they impose this form of credit on consumers who have not requested it. Furthermore, some consumers may not be aware until they overdraw their account that they are accessing a high-cost credit product. This is especially true in the ATM or debit card context, where transactions that would overdraw an account were previously declined and did not incur a fee. The *Consumer Reports* National Research Center poll also found that many consumers do not expect their bank to pay a debit card or ATM transaction that overdraws an account. Forty-eight percent of those polled thought an ATM card would not work if the account balance was too low and another ten percent through they would not be assessed a fee if the bank allowed the overdraft. Thirty-nine percent of people thought their bank would either deny a debit transaction or allow it to proceed without charging a fee.[134]

Indeed, we can recall only one time that consumers were sent loan products without their affirmative opt-in – when creditors sent unsolicited credit cards to consumers in the 1960s.[135] As a result of the outcry over this practice, Congress stepped in, amending TILA in 1970 to ban unsolicited credit cards.[136] According to the Senate report that accompanied this TILA amendment, unsolicited credit cards encouraged consumers to incur unmanageable debt, and many consumers found them an unwarranted intrusion into their personal life.[137] These same problems cited by this Senate report nearly 40 years ago hold true today for unsolicited overdraft loans – they cause severe financial distress and represent an intrusion on the lives of consumers.

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[133] CUNA News: "Consumers ignore ATM fees, get irked at overdraft fees," January 17, 2006.

[134] *Consumer Reports* National Research Center, Financial Regulation Poll, as filed with the Federal Reserve Board in Reg E Docket R-1343, March 12, 2009.

[135] Note that a "stickiness" of default options was observed with respect to unsolicited credit cards, which is the same with unsolicited overdraft loans. When unsolicited credit cards were permitted, very few consumers opted out – only 1% returned the card. However, when prospective customers were asked whether they wanted to receive a card, only 0.7% said they would. Jack Metcalfe, *Who Needs Money*, New York Sunday News, Nov. 24, 1968, *reprinted in* 115 Cong. Rec. 1947, 1951 (Jan. 23, 1969).

[136] Pub. L. No. 91-508, 84 Stat. 1126-27 (Oct. 26, 1970).

[137] S. Rep. No. 91-739, at 2-44 (1970).

Note that in the case of unsolicited credit cards, the consumer at least has to affirmatively and knowingly take action to *use* the credit card, by making a purchase or taking a cash advance. In the case of overdraft loans, the consumer not only receives credit without requesting it, the consumer often unknowingly and involuntarily *uses* that credit when she triggers an overdraft, especially in the debit card situation where many consumers don't realize they can overdraw their accounts.

Thus, overdraft loans represent an even worse problem than unsolicited credit cards did nearly 40 years ago. H.R. 1456 would prohibit this "cramming" of overdraft loans on consumers by requiring banks to obtain specific written consumer consent before adding this feature to a bank account.

C. THE FEDERAL RESERVE BOARD HAS FAILED TO PROTECT CONSUMERS FROM ABUSIVE OVERDRAFT LOANS

As discussed above, overdrafts are clearly "credit" under the federal Truth in Lending Act (TILA). The reason that overdraft loan programs do not require TILA disclosures is an exemption created by the Fed. Regulation Z, which implements TILA, excludes overdraft fees from the definition of a "finance charge." This exemption, written in 1969, was originally designed to exclude from TILA coverage the traditional banker's courtesy of occasionally paying overdrafts on an ad-hoc basis as a customer accommodation. However, banks exploited this exemption as a gaping loophole, creating and promoting predatory credit, extended on a routine basis without adequate disclosure – contrary to the clear statutory language and intent of TILA. As a result, H.R. 1456 would amend TILA itself to ensure that institutions no longer benefit from a loophole to exploit account holders.

In general, the fees for overdraft loans translate into APRs that are triple-digit or even higher. For example, consider a $100 overdraft loan that is repaid in two weeks, for which the bank charges a $20 fee. A comparable payday loan would have to disclose an APR of 520%. Furthermore, most overdraft loans are paid much more quickly than two weeks – sometimes in a matter of days or hours – and sometimes the loan is only for a few dollars.

Instead of requiring TILA disclosures, the Fed chose to regulate overdraft loans under the less effective Truth in Savings Act (TISA), simply requiring disclosure of the fee and a running tally. Regulation DD, 12 C.F.R. Part 230. TISA disclosures do not reduce or eliminate the most serious abuses of overdraft loans.

The failure of the Fed to require TILA disclosures for overdraft loans undermines the statute's key purpose of strengthening "competition among the various financial institutions and other firms engaged in the extension of consumer credit."[138] Without the uniform disclosure of the APR required by TILA, consumers have no way to compare overdraft loans to the cost of an overdraft line of credit or transfer from savings. Under the Fed's rules, the disclosed APR for a

[138] 15 U.S.C. § 1601(a)

typical payday loan is 391% to 443%[139] but for an overdraft loan program the lender may disclose under TISA that the account is actually earning interest! Without apples to apples comparisons, there is no competition to reduce the cost of any of these products.

If overdraft loans are to be permitted at all, banks must be required to make TILA disclosures. H.R. 1456 would fulfill that need by requiring banks to make the same APR disclosures required of credit card lenders under TILA. This includes a disclosure of the "effective" or fee-inclusive APR, which is an APR that includes the impact of fees on the price of credit.

However, in December 2008, the Fed eliminated the effective APR disclosure for credit cards and other forms of open-end credit. Among other problems, this change means that the sky high APRs for overdraft loans would not be disclosed even if overdraft loans are brought into TILA's scope of coverage. That is because the "periodic APR" for these loans is 0% – it's the flat fee for the overdraft that makes this form of lending so expensive. Only the effective or fee-inclusive APR that the Fed eliminated would include this type of flat fee in its calculation.

We recommend that H.R. 1456 be amended to require a special APR disclosure for overdraft loans. This APR will be calculated similarly to how an APR is calculated for a payday loan. The special overdraft APR will be included on any monthly statements in which an overdraft fee is assessed. In addition, we recommend that sample APRs be provided to consumers when they are being asked to opt-in to an overdraft loan program, so that consumers understand the exorbitant costs of using overdrafts as a source of credit before they sign on the dotted line.

D. OVERDRAFT LENDING COSTS AMERICANS $17.5 BILLION IN ABUSIVE AND LARGELY PREVENTABLE FEES

Marketed as "overdraft protection," in actuality, abusive overdraft lending protects only the banks' ability to maximize fees while jeopardizing the financial stability of many of its customers. Rather than competing by offering lower cost, truly beneficial overdraft products and services, many financial institutions are hiding behind a smokescreen of misleading terms and opaque practices that promote costly overdrafts.

Americans pay more in abusive overdraft loan fees than the amount of the loans themselves—$17.5 billion in fees for $15.8 billion in credit extended.[140] This makes crystal clear the degree to which the cost of this so-called service is out of line with any benefit.

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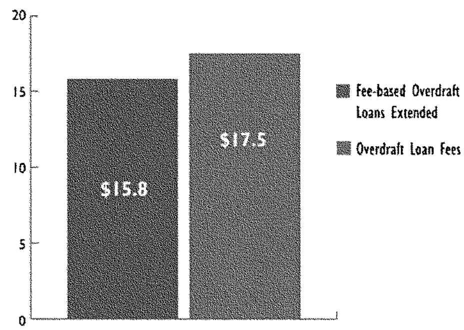
[139] Keith Ernst, et al., *Quantifying the Economic Cost of Predatory Payday Lending*, Center for Responsible Lending (December 18, 2003), at 3.
[140] Eric Halperin and Peter Smith, *Out of Balance: Consumers pay $17.5 billion per year in fees for abusive overdraft loans*, Center for Responsible Lending, at 9 (June 2007), *available at* http://www.responsiblelending.org/issues/overdraft/reports/page.jsp?itemID=33341925 [hereinafter *Out of Balance*]. CRL analyzed 18 months of bank account transactions from participants in Lightspeed Research's Ultimate Consumer Panel, from January 2005 to June 2006. For further discussion of CRL's database and methodology, *see Out of Balance* at 13-14.

High fees, coupled with small overdrafts, results in consumers paying more to borrow from banks than the banks extended as credit.

Figure 1. Consumers pay back more in overdraft fees than total loans extended



Overdraft loan fees now make up 69 percent of all overdraft-related fees, while traditional NSF fees—generated when the transaction is denied—make up only 31 percent.[141] Abusive overdraft loans, once the exception, are now the rule.

<u>Small Dollar Overdrafts Trigger Steep Fees</u>

The FDIC's ground-breaking report on bank overdraft loan programs, fees and practices was based on a detailed study of 462 FDIC-supervised banks and data on overdraft transactions from 39 banks. The typical debit card purchase overdraft was only $20 but cost an average $27 fee at FDIC banks. If repaid in two weeks, that overdraft costs 3,520 percent APR. The typical $60 ATM withdrawal on insufficient funds costs 1,173 percent APR. The median size check that overdraws an account is $66, an APR of 1,067 percent.[142] If the bank adds a "sustained overdraft fee" or requires repayment in less than two weeks, the APRs on these loans are even higher. Furthermore, because consumers often use their debit cards several times per day, multiple fees will be charged when an account is overdrawn.

A recent survey of the nation's largest banks confirms that not only are overdraft fees becoming more common, but the fee per transaction is getting larger. The maximum overdraft fee at this sample of banks is now $39, while the median fee is $35. Half of the largest banks use tiered fee schedules, with fees rapidly escalating when consumers incur more than a few overdrafts over a one-year period. US Bank charges $19 for the first overdraft, $35 for the second through fourth, and $37.50 thereafter. Fifth Third Bank switched to tiered fees in the last year, now charging from $25 to $37 per overdraft. Bank of America terminated its tiered fee structure and now charges $35 for each incidence.

Eight of the sixteen largest banks add sustained overdraft fees when consumers are unable to pay the overdraft and fee within a few days. On top of already high initial overdraft fees, Citizens Bank and SunTrust add a $35 fee while Chase charges another $12.50 to Arizona consumers

[141] *Out of Balance* at 10.

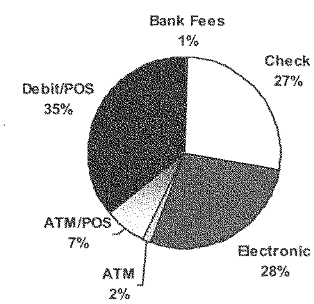
[142] FDIC Study at v.

when an overdraft goes unpaid five days. When initial overdraft fees and sustained overdraft fees are combined for overdrafts unpaid after seven days, consumers can be charged as much as $74 at Citizens Bank for a single overdraft. The combined cost at SunTrust is $70 and at National City $68. Only two of the largest banks limit the number of overdraft fees imposed in one day. Bank of America limited overdraft fees to seven per day but removed its cap in February 2009.

Banks Turn Debit Cards into High Cost "Credit Cards" When Overdrafts Permitted

Today, banks swipe a large portion of these fees when their account holders swipe debit cards at ATMs and checkout counters. A 2007 CRL report found, and the FDIC study recently confirmed, that debit card purchases are the most common trigger of overdraft fees.[143]

Figure 2. Identified Overdraft Fee Triggers



When debit cards first came into common use, they promised the convenience of a credit card without the cost, because debit card users were required to have the funds in their account to cover their purchase or withdraw cash. As recently as 2004, 80 percent of banks still declined ATM and debit card transactions without charging a fee when account holders did not have sufficient funds in their account.[144] But banks now routinely authorize payments or cash withdrawals when customers do not have enough money in their account to cover the transaction, so debit cards end up being very costly for many account holders.

In addition to being the most common trigger, these debit card overdrafts are more costly than overdrafts caused by paper checks or ACH electronic payments. The average overdraft loan triggered by a debit card purchase is less than $17 and is paid back in fewer than five days.[145]

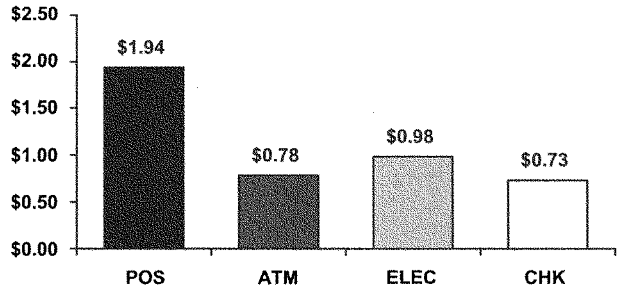
[143] *Debit Card Danger. See also* FDIC Study of Bank Overdraft Programs (Nov. 2008) (finding 41 percent of NSF-related transactions were triggered by point-of-sale/debit and another 7.8 percent by ATM transactions).

[144] Mark Fusaro, *Are "Bounced Check Loans" Really Loans?*, note 4, at 6 (Feb. 2007), *available at* http://personal.ecu.edu/fusarom/fusarobpintentional.pdf (last visited Mar. 15, 2009). *See also* Sujit Chakravorti and Timothy McHugh, *Why Do We Use So Many Checks?* Economic Perspectives, 3rd Quarter 2002, Federal Reserve Bank of Chicago, 44, 48 ("When using debit cards, consumers cannot overdraw their accounts unless previous credit lines have been established.")).

[145] *Debit Card Danger* at 8.

Given the average $34 fee, this means account holders pay $1.94 in fees for every one dollar borrowed to cover a debit card point-of-sale overdraft.[146]

Figure 3: Fees paid per dollar borrowed for overdraft loans, by trigger type



Taken as a whole, debit card and ATM swipes, which could easily be denied for no fee, cost Americans $7.8 billion per year in abusive overdraft lending fees.[147]

Banks and credit unions could prevent every dollar of these debit card overdraft fee charges by simply notifying account holders when they are about to overdraw their accounts or by declining a transaction when there are insufficient funds available, as they did in the past. Indeed, consumers would appreciate the warning: 80 percent of consumers surveyed would rather have their debit transaction denied than covered for a fee, whether that transaction is $5 or $40.[148] Institutions often claim that denial at the point of sale or ATM is not feasible, but it would be

Median values by type of overdraft:

	Fee Amount	Txn Amount	Loan Amount	Days	Fee per Dollar Borrowed
POS	$34.00	$20.00	$16.46	5	$1.94
ATM	$34.00	$40.00	$40.00	3	$0.78
ELEC	$34.00	$29.14	$27.95	4	$0.98
CHK	$34.00	$60.00	$41.38	2	$0.73

[146] *Id.*

[147] *See Out of Balance.*

[148] Leslie Parrish, *Consumers Want Informed Choice on Overdraft Fees and Banking Options*, CRL Research Brief (Apr. 16, 2008), *available at* http://www.responsiblelending.org/pdfs/final-caravan-survey-4-16-08.pdf [hereinafter CRL Research Brief].

surprising—shocking, in fact—if banks couldn't accomplish now technologically what they could in 2004.[149]

Furthermore, 7.9 percent of banks in the FDIC survey reported that they did inform customers at a debit card point of sale that funds were insufficient before transactions were completed, offering the customers an opportunity to cancel and avoid a fee, and 23.5 percent did the same at ATMs. It's difficult to believe that these banks have some sort of advanced technology unavailable to other banks.

Absent meaningful regulatory reform, banks will only increase their profits from overdraft fees as debit card transactions continue to skyrocket.[150] Debit card transactions will not only continue to grow as a percentage of all bank transactions, but they will continue to provide banks more transactions *overall* as more account holders use them in place of cash for small transactions.

Consumers Trapped in Overdraft Loans Can Least Afford Astronomical Fees

The FDIC examined individual transaction information from 39 banks to provide a snapshot of customers who overdrew their accounts on 22.5 million transactions. Nine percent of customers had ten or more insufficient fund transactions in one year. Consumers who overdrew ten to nineteen times in one year paid $451 in fees, while consumers who overdrew twenty times or more paid $1,610 in fees per year.[151]

Unfortunately, abusive overdraft fees have the greatest impact on those who can least afford them. Two CRL surveys, conducted in 2006 and 2008, found that account holders who are repeatedly charged abusive overdraft loan fees were more likely to be lower income, single, and non-white.[152] The FDIC study also found that customers living in low-income areas carry the brunt of overdraft fees.[153] CFA conducted a national opinion poll in 2004 which found that 28 percent of consumers say they overdraw their accounts. Consumers who stated they overdraw their accounts and are most likely to pay overdraft and bounced check fees were moderate-income consumers with household incomes of $25,000 to $50,000 (37 percent). Those 25 to 44

[149] In fact, CRL's affiliate, Self-Help Credit Union, denies all debit and ATM transactions it processes real-time if the account holder lacks sufficient funds and charges no fee even if the transaction is inadvertently paid.

[150] Debit card transactions are increasing at a rate of 17.5 percent per year, while check payments are decreasing 6.4 percent annually. 2007 Federal Reserve Payments Study, Financial Services Policy Committee, *Federal Reserve Study Shows That More Than Two-Thirds of Noncash Payments Are Now Electronic* (Dec. 10, 2007), *available at* http://www.federalreserve.gov/newsevents/press/other/20071210a.htm (last visited Mar. 15, 2009).

[151] FDIC Study. *Id.*

[152] CRL Research Brief.

[153] FDIC Study at v. It further found that account holders who overdrew their accounts more than four times per year paid 93.4 percent of all overdraft fees. *Id.*

years of age (36 percent) and African Americans (45 percent) were most likely to have bounced checks.[154]

Overdraft fees strip funds from Americans of all ages, but research indicates they hit America's oldest and youngest checking account holders—often the least financially stable—especially hard. Older Americans aged 55 and over pay $4.5 billion of the $17.5 billion total overdraft fees paid annually,[155] an especially alarming figure given that one in four retirees has no savings of any kind.[156] Those heavily dependent on Social Security pay nearly $1 billion,[157] while those entirely dependent on Social Security pay over $500 million.[158]

Appendix B illustrates a real-life case study of one Social Security recipient's checking account activity. Tracking two months of activity, the study demonstrates how much better off she would have been with an overdraft line of credit – or even no overdraft coverage at all – than with the fee-based overdraft coverage she was subjected to. Her account balance was $18 at the end of the two months; with an overdraft line of credit, it would have been $420.

At the other end of the age spectrum, young adults who earn relatively little as students or new members of the workforce pay nearly $1 billion per year in overdraft fees.[159] Because they are far more likely to use a debit card for small transactions than older adults,[160] they pay $3 in fees for every $1 borrowed for debit card overdrafts.[161] The situation is exacerbated by deals banks make with universities to provide school ID cards that double as debit cards. Banks pay the

[154] ORCI Poll for Consumer Federation of America, 2004.

[155] *See Shredded Security.*

[156] *Id.* at 4 (citing 2008 Retirement Confidence Survey, Employee Benefit Research Institute (April 2008) finding that 28 percent of retirees have no savings). *Shredded Security* also notes that even those who do have savings are increasingly spending it on rising healthcare costs (citing Paul Fronstin, *Savings Needed to Fund Health Insurance and Health Care Expenses in Retirement*, Employee Benefit Research Institute (July 2006), projecting that retired couples will need between $300,000 and $550,000 to cover health expenses such as long-term care).

[157] *Shredded Security* at 6, Table 1. "Heavily dependent" was defined as recipients who depended on Social Security for at least 50 percent of their total income.

[158] *Id.*

[159] *See* Leslie Parrish and Peter Smith, *Billion Dollar Deal: Banks swipe fees as young adults swipe debit cards, colleges play along*, Center for Responsible Lending, at 1 (Sept. 24, 2007) [hereinafter *Billion Dollar Deal*], *available at* http://www.responsiblelending.org/pdfs/billion-dollar-deal.pdf.

[160] Seven out of ten young adults would use a debit card for purchases costing less than $2. *Id.* (citing Visa USA Generation P Survey, conducted July 24-27, 2006. Findings and discussion at http://corporate.visa.com/md/nr/press638.jsp (last visited Mar. 15, 2009)).

[161] *Billion Dollar Deal.*

partner school for exclusive access to the student population and sometimes even split the fee revenue they collect on debit card transactions with the university.[162]

Unemployment Benefit Prepaid Debit Cards Permit Overdrafts

Most recently, our nation's growing unemployed population is being subjected to overdraft fees without their consent through the very cards to which their unemployment benefits are issued. We were appalled to learn that the debit cards to which many states' unemployment benefits are issued come with automatic fee-based overdraft coverage that costs the unemployed user as much as $17 or more per overdraft transaction.[163] The result, of course, is that the next benefit payment they receive from the government will be automatically reduced by the amount by which they have already overdrawn the card, plus $17 for each overdraft transaction. The absurdity of this arrangement and its impact on the most vulnerable—an arrangement effectively blessed by the states that forge these agreements with the banks issuing the cards—goes beyond what even our most cynical imaginations could have composed.

E. HR 1456: PUTTING THE PROTECTION BACK INTO OVERDRAFT POLICY

HR 1456, the Consumer Overdraft Protection Fair Practices Act, would not affect the real overdraft protection programs at banks. It would only prevent abuses created by the relatively new system of unauthorized usurious lending that is premised on generating fee revenue rather than protecting the funds of account holders.

HR 1456 would put the protection back into overdraft policy by requiring financial institutions to fully inform account holders of the costs of fee-based overdraft systems, including their astronomical interest rates. Account holders would have to give specific written consent in order for financial institutions to enroll them in such a costly and problematic system. Banks and credit unions would have to warn account holders before making them a high-cost loan for an electronic transaction and permit them to choose another payment option that will not cause an overdraft.

The bill would also prohibit manipulation of account activity if the result is to increase overdrafts. This would mean no debiting accounts with the highest dollar charge first in order to

[162] *Id.* at 7 (citing *U.S. Bank Pays Campus for Access to Students*, Milwaukee Journal Sentinel, June 18, 2007 (noting the agreement between US Bank and the University of Wisconsin at Oshkosh prohibits all financial institutions other than US Bank and the college's own credit union from locating ATMs on campus); Amy Milshtein, *In the Cards*, College Planning & Management (Dec. 2005) (noting the fee-sharing deal Higher One has with partner universities)).

[163] *See* AP Impact: Jobless Hit with Bank Fees on Benefits, Christopher Leonard, AP Business Writer (Feb. 20, 2009) *available at* http://news.yahoo.com/s/ap/20090220/ap_on_bi_ge/bank_fees_jobless_benefits; *see* disclosure of the $17 overdraft fee at Oregon.gov, http://www.oregon.gov/EMPLOY/UI/ui_payment_options.shtml, and in a fact sheet issued by Ohio Job and Family Services promoting the card at http://jfs.ohio.gov/ouc/ReliaCard_FactSheet.pdf.

increase the number of overdraft fees an account holder is charged. No holding deposits before crediting accounts in order to create a negative balance and charge an overdraft fee. And no authorizing debit and ATM transactions without allowing an account holder to cancel the transaction—itself another manipulation that increases overdrafts.

HR 1456 would also make sure that consumers understand how expensive overdraft loans are as a source of credit by requiring Truth in Lending disclosures. With the simple fix discussed above, the bill will allow consumers to compare the high cost of overdraft loans with other sources of short term credit.

HR 1456 does not cap bank overdraft fees. While it is reasonable to expect banks to lower fees if they have to give clear cost disclosures and persuade consumers to sign up for this credit product, consumers would benefit from limiting the cost of these high cost loans as proposed in S. 500 to a 36 percent FAIR annual cap. Bank overdraft loans are parallel to payday lending in that the high interest rates and short repayment time often trap consumers in a cycle of debt. Consumers should not have to pay triple digit interest rates for either form of credit.

Banks should also be required to provide overdraft loans subject to a contract that clearly spells out the types of transactions that will be covered, limits on the amount of overdraft coverage provided, the repayment schedule for extensions of credit via overdraft, and other terms and conditions that apply to this transaction. Banks currently include account agreement fine print that leave consumers in a quandary over when and if a particular transaction will be covered. Some bank account terms and conditions state that an overdraft and its fee are due and payable without notice or demand from the bank.

The protections in HR 1456 should apply to prepaid debit cards, such as the cards used to deliver unemployment benefits or cards that function as "bank accounts" for the unbanked. Failure to protect all consumers from unauthorized and unfair overdrafts adds to the two-track financial services market, where banked consumers and unbanked (usually lower-income) consumers do not benefit from the same set of rules.[164]

These protections are a simple matter of fairness and common sense. Current practices defeat the ability of consumers to assert meaningful control over their financial affairs and must be stopped. Banks and credit unions must be required to compete fairly, based not on smokescreens and manipulation, but on offering beneficial products and services at a reasonable price and with fair repayment terms.

[164] SVC overdraft loan fees are extremely expensive. See Testimony, Jean Ann Fox, CFA, Subcommittee on Social Security, Ways and Means Committee, "Hearing on Protecting Social Security Beneficiaries from Predatory Lending and Other Harmful Financial Institution Practices," June 24, 2008. http://www.consumerfed.org/pdfs/Jean_Ann_Fox_Testimony_Ways_and_Means_Social_Security_6-24-08.pdf

F. THE FED'S PROPOSED RULES: ONLY REQUIRING "OPT-IN" WILL CHANGE THE STATUS QUO

The Federal Reserve has proposed new rules that put forth two very different alternatives for addressing overdraft practices on debit card purchases and ATM withdrawals—

a. The first alternative would require institutions to allow account holders to opt out of overdraft coverage for these types of transactions.

b. The second, **far stronger alternative** would require institutions to obtain account holders' affirmative consent, or opt-in, before covering their debit card purchases and ATM transactions in exchange for an overdraft fee.

Only the second alternative would mark significant process toward curbing abusive overdraft practices.

With either alternative the Fed chooses, it will effectively be determining what the default arrangement will be. If it chooses only to require the opt-out alternative, the default will be that account holders continue to be enrolled in the most expensive overdraft option that their bank or credit union offers. If the Fed chooses the opt-in alternative, the default will be that debit card purchases and ATM transactions will be denied, and no overdraft fee incurred, when the customer lacks sufficient funds.

Because scores of behavioral economics research has shown that individuals do not tend to change the default, **it is critical that the Federal Reserve get the default right.**[165] The default arrangement should be the one that does not cause account holders more harm than benefit and that best reflects consumer preferences.

As the facts presented in this testimony have unequivocally demonstrated, fee-based overdraft coverage causes account holders more harm than benefit, and they would prefer that their debit card transaction be denied rather than covered for an overdraft fee. The right arrangement, then, is **opt-in** – no fee-based overdraft coverage for debit card purchases and ATM transactions unless the account holder affirmatively chooses it.

The Federal Reserve's proposed rule, regardless of which alternative it chooses, is already substantially weaker than the provisions of H.R. 1456. Not only does the Fed proposal address only debit card purchases and ATM transactions instead of all transactions, but it also does not recognize that overdrafts are extensions of credit that should require Truth in Lending disclosures, nor does it prohibit manipulating the clearing of transactions to maximize overdraft fees.

[165] For more on why opt-in is the right default arrangement, *see* Comments of the Center for Responsible Lending to the Federal Reserve System, OTS and NCUA on Proposed Rule Regarding Unfair or Deceptive Acts or Practices – Overdraft Practices, Docket No. R-1314, at 10 and following (Aug. 4, 2008), *available at* http://www.responsiblelending.org/pdfs/overdraft-comments-udap-final-as-submitted-w-appendices-080408-2.pdf.

In reality, an opt-out regime could even make the current situation worse—it could create the impression that account holders have been given a fair choice about overdraft, when in reality there is little possibility that account holders will receive a meaningful opportunity to get out of these abusive and expensive programs.

We urge the members of this Committee to weigh in with the Fed and urge it to select the only alternative that would provide additional meaningful protections to account holders – **opt-in**.

CONCLUSION

The **Credit Cardholders Bill of Rights, H.R. 627**, curbs some of the most arbitrary, abusive, and unfair credit card lending practices that trap consumers in a cycle of costly debt, such as sharply escalating "universal default" interest rates that can double some cardholders monthly payments overnight. It passed the House in 2008 on an overwhelming 312-112 vote. Although the Federal Reserve and other regulators agreed that action was needed and later in the year approved similar regulations, the agencies unwisely stayed compliance until July 2010. Enact HR 627 now.

Today, as many American families struggle to meet daily obligations, the last thing they need is to be surprised by high-cost credit to which they never expressly consented. HR 1456 would address at least three central problems with fee-based overdraft loans: (i) institutions are not required to provide with any *clarity* the terms under which they are extended; (ii) institutions are not required to obtain account holders' *consent* before extending them; and (iii) institutions maximize their *cost* to account holders by employing an array of unfair practices. We urge this Committee to reverse the current trend toward even greater overdraft abuses by supporting HR 1456.

Swift enactment of both of these bills is necessary to protect millions of consumers from unjustified and abusive loan practices that are putting them at financial risk and draining their income at a time of great economic uncertainty. We look forward to your questions.

Attached: Appendices A, B and C

APPENDIX A

For an illustration of how the practice of clearing checks and debits from the largest dollar amount to the smallest could play out, assume an account holder has $750 in her checking account. Before she realizes she is not covered, she pays some bills and makes some small dollar purchases, putting her $143 in the negative.

The order in which these payments clear her checking account makes a big difference in the cost of that shortfall. If the payments were presented to the financial institution on the same day, in the order in Scenario A below, and if they were cleared in the order they were presented, she would be charged like this:

Scenario A: Chronological Ordering of Charges

Transaction	*Charge*	*Account Balance*	*Average Overdraft Fee*
		750	
Credit card payment – ACH	90	660	
Water bill - check	30	630	
Groceries purchase – debit card	65	565	
Gas purchase – debit card	25	540	
Lunch purchase – debit card	10	530	
Drugstore purchase – debit card	15	515	
Family gym fees– check	40	475	
Coffee purchase - debit	8	467	
Bookstore purchase – debit card	10	457	
Rent – check	600	(143)	$34
TOTAL OVERDRAFT LOANS		**$(143)**	
TOTAL OVERDRAFT FEES			**$34**
Balance with fees deducted		**$(177)**	

On the other hand, if the payments were cleared from the largest to the smallest, the amount by which her account was overdrawn would remain the same, but the charges would be significantly higher.

Scenario B: High-dollar Ordering of Charges

Transaction	*Charge*	*Account Balance*	*Average Overdraft Fee*
		750	
Rent – check	600	150	
Credit card payment – ACH	90	60	
Groceries purchase – debit card	65	(5)	34
Family gym fees – check	40	(45)	34
Water bill – check	30	(75)	34
Gas purchase – debit card	25	(100)	34
Drugstore purchase – debit card	15	(115)	34
Lunch purchase – debit card	10	(125)	34
Bookstore purchase – debit card	10	(135)	34
Coffee purchase – debit card	8	(143)	34
TOTAL OVERDRAFT LOANS		**$(143)**	
TOTAL OVERDRAFT FEES			**$272**
Balance with fees deducted		**$(415)**	

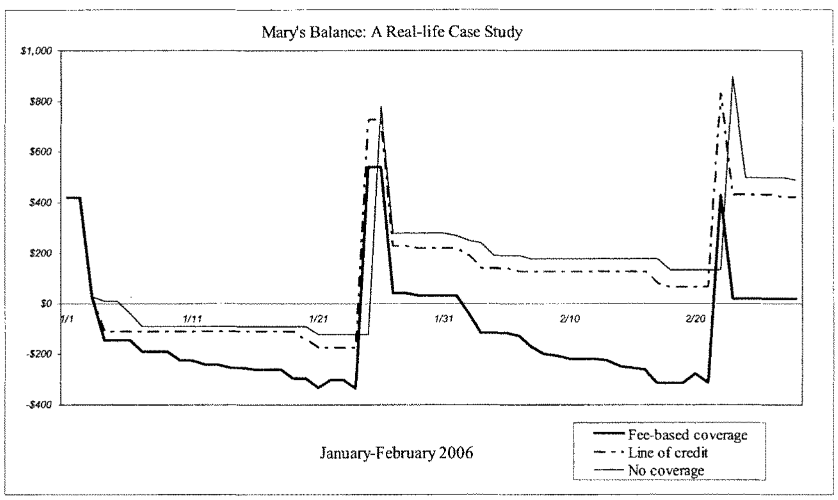
Banks and credit unions claim that their overdraft programs are providing customers a service—protection from returned check fees. But this argument is disingenuous, because in either scenario above, all the transactions are paid. The only difference is that in Scenario B, the bank or credit union increases their fee income by manipulating the order in which they clear the payments.

Of course, if the bank customer had no overdraft program in place at all, her rent would likely be paid late. But even if her landlord charged her a late fee of $30 (five percent of the rent) and her bank charged an NSF of $20, for a total of $50, she would still come out better than she would under Scenario B, which cost her $272.

APPENDIX B

REAL-LIFE CASE STUDY: A Social Security Recipient's Experience with Overdraft Fees

The harm of fee-based overdraft programs dramatically outweighs their potential benefits—a point well illustrated by the following case study. In CRL's recent report on the impact of overdraft fees on older Americans, it graphed two months of actual checking account activity of one panelist from its database, whom the report calls Mary. Mary is an older American entirely dependent on Social Security for her income. It also graphed what her activity would have been with an overdraft line of credit. It later added a third scenario to the graph: no fee-based coverage at all, reflected in the following graph:



During January and February of 2006, Mary overdrew her account several times and was charged $448 in overdraft fees. At the end of February, she had $18.48 in her account. She was trapped in a destructive cycle, using the bulk of her monthly income to repay costly overdraft fees.

With an overdraft line of credit at 18 percent, after two months, Mary would have paid about $1 in total fees for her overdrafts and would have had $420 in the bank.[166]

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[166] *Shredded Security* at 9-10.

Critically, *even if Mary had had no overdraft coverage at all*, she would have been better off than she was with fee-based overdraft. Five of her transactions, totaling $242, would have been denied—two point-of-sale transactions and three electronic transactions. She would have been charged no fee for the two point-of-sale transactions. She may or may not have been charged an NSF fee for each of the three denied electronic transactions. She also may have been charged late fees if any of the electronic transactions were bills. Assuming, conservatively, that she was charged an NSF fee and a late fee for each of the three transactions, as the chart illustrates, her ending balance still would have been $489—plenty enough to cover the value of the denied transactions.

Industry's common defense of fee-based overdraft is that it protects account holders from having important payments, like utility bills, bounce. But with fee-based coverage, Mary's utility payments in both January and February were denied *anyway* because she had already overdrawn her account by more than $300 each time—*largely due to overdraft fees*. With no overdraft coverage at all, while her January utility payment would have been denied, she would have had the money to pay her entire outstanding utility balance in February.

Mary's case demonstrates that while struggling account holders with no overdraft coverage may pay some bills late, they are still better able to pay bills eventually than they would be with fee-based coverage. And late fees they may incur from routine vendors, like utility and phone companies, do not have significant consequences so long as the bills due not remain unpaid for a substantial period of time. Furthermore, with the exception of credit card lenders, many companies do not even charge late fees unless a consumer is over 15 or 30 days late. Typically, then, the potential consequences of late fees are rarely as destructive as the repeat overdraft fees charged to those who pay the majority of these fees.

In addition, Mary's situation illustrates a problem common among the repeat overdrafters who pay the vast majority of the fees: Overdraft fees simply beget more overdraft fees. Not only is there no benefit to the account holder from covering certain types of transactions (debit point-of-sale and ATM), but even when there may be benefit from having a single transaction covered, policymakers must balance this benefit against the subsequent costs to account holders beyond that one transaction—specifically against the increased likelihood that the account holder will pay additional overdraft fees for transactions that carry no cost when denied, and be unable to meet future obligations.

Ultimately, fee-based overdraft coverage prevents account holders from being able to meet obligations they otherwise would have been able to meet. This reality makes it impossible to justify fee-based overdraft as a program that causes account holders more benefit than harm.

APPENDIX C

CFA Survey of Sixteen Large Banks' Overdraft Fees and Practices

Consumer Federation of America surveyed the sixteen largest banks providing customer deposit accounts to determine overdraft fees and practices. This review updates a survey for CFA's comments filed with the Federal Reserve Board in a regulatory docket in August 2008.[167] The surveyors searched bank websites, requested information from customer service personnel, and visited bank branches when information was not available.

Key Findings:

- All of the largest banks unilaterally pay overdrafts at the bank's discretion and charge per overdraft fees without advance consent from their customers.

- The median top fee for overdrafts is $35 per incidence, with the top fee ranging from $34 at CitiBank to $39 at Citizens Bank. Nine of the sixteen banks charged $35 for repeat overdrafts. Since August, CitiBank raised its $30 fee to $34.

- Half of the surveyed banks tiered overdraft fees, charging escalating fees for more than one overdraft over a rolling thirteen month time period. For example, Regions Bank charges $25 for the first overdraft in a year, $33 for the next three overdrafts, and $35 each for four or more. US Bank charges $19 the first time, $35 for the second to fourth overdraft, and $37.50 thereafter. Fifth Third Bank switched to tiered fees in the last year, previously charging a flat $33 per overdraft. Fifth Third now charges $25 for the first overdraft, $33 for the second to fourth, and $37 for five or more. In 2005, only three major banks used tiered fees. Bank of America terminated its tiered fees ($25 for first overdraft in a year), now charging $35 for each overdraft.

- Nine banks also charge sustained overdraft fees, imposed when overdrafts are not repaid within a few days. These ranged from an extra $35 charged by Citizens Bank and SunTrust, $30 charged by BB&T after seven days, $12.50 added by Chase to Arizona consumers after five days, and per day fees of $5 to $8 at other banks. PNC recently raised its sustained overdraft fee from $6 to $7 for a maximum of $35 over five days.

- Only two large banks cap the number of overdraft fees it will levy in one day. CitiBank caps fees at four per day ($136) while WAMU limits its charges to seven per day ($238). Bank of America has discontinued its limit of seven overdraft fees per day, permitting unlimited overdrafts effective February 9, 2009.

- Fifteen of the largest banks process withdrawals largest first (or disclose that they pay withdrawals in any order the bank chooses), which results in additional fees when smaller subsequent transactions overdraw an account. This information is generally

[167] Consumer Federation of America, Comments to the Federal Reserve, August 4, 2008, http://www.consumerfed.org/pdfs/OD_FRB_comments.pdf

buried in account agreement fine print. CFA did not have sufficient information from one bank to determine processing order.

- The total cost of a single overdraft at the bank's highest fee that is unpaid after seven days ranges from $74 at Citizens Bank to $47.50 at Chase in Arizona for the banks that charge a sustained overdraft fee. The combined cost at SunTrust is $70, with National City imposing $68 in total fees. Eight months ago, the most expensive seven day overdraft combined fee was $70 at SunTrust.

- Almost all of the largest banks offer an overdraft line of credit at moderate cost, with fees including a per transfer fee, monthly or annual service charges, or interest only on amount transferred to the line of credit.

- Banks that offer overdraft protection via transfer from savings accounts charge a median fee of $10 per day funds are transferred. TD Bank does not charge a transfer fee while Fifth Third Bank charges $20 after twenty-one transfers in a year. PNC doubled its transfer from savings fee in March 2009, from $5 to $10. Citizens, HSBC, and National City all charge $15 per transfer.

See next 5 pages for accompanying chart to Appendix C.

5 Page Chart accompanying Appendix C: CFA Survey of Sixteen Large Banks' Overdraft Fees and Practices

FIRM	Fee Schedule On Web	TRADITIONAL OVERDRAFT PROTECTION						Clearance Policy	"COURTESY" OVERDRAFT LOANS			
		Line of Credit transfer fee	Annual Savings Transfer Fee	Savings Transfer Fee	Credit Card	Home Equity	Opt-In Contract		Unpaid NSF/ Overdraft Fee	Paid Overdraft Fee	Sustaine d Overdraft Fee	After Number of Days
Bank of America	Yes	$10; in increments of $100		$10; in increments of $100	see card agreement; varies		Yes	Any; usually high to low	$35 per item; no limit per day	$35 per item; no limit per day	No	
BB&T	no	$10		$10	$10	yes		high to low	$35 per item; no limit per day	$35 per item; no limit per day	$30	7
Chase	No	Yes	None	$10	13.99% APR	Yes	Yes	High to low, can change order w/out notice	$25-1st time, $32-2nd,3rd,4th time, $35 thereafter	$25-1st time, $32-2nd,3rd,4t h time, $35 thereafter	$5 to $25 per day dependin g on your location	$12.50 in AZ after 5 consec. Bus. Days
Citibank	Yes	Yes; Checking Plus, 16.5% variable APR in most states, $5 annual membership fee	No	$10			Yes	Electronic debits first then usually high to low	$34; not more than 4 fees per day; fees may also cause an overdraft	$34; not more than 4 fees per day; fees may also cause an overdraft	No	

5 Page Chart accompanying Appendix C: CFA Survey of Sixteen Large Banks' Overdraft Fees and Practices

FIRM	Fee Schedule On Web	TRADITIONAL OVERDRAFT PROTECTION						Clearance Policy	"COURTESY" OVERDRAFT LOANS			
		Line of Credit transfer fee	Annual Savings Transfer Fee	Savings Transfer Fee	Credit Card	Home Equity	Opt-In Contract		Unpaid NSF/ Overdraft Fee	Paid Overdraft Fee	Sustained Overdraft Fee	After Number of Days
Citizens Bank	No	$15 per day plus $25 line of credit annual fee		$15 per day					$25 per item 1st day; $37 2 OD days, $39 3 or more OD days	$25 per item 1st day; $37 2 OD days, $39 3 or more OD days	$35	Per account agreement
Fifth Third Bank	Yes	Yes	No	$9 for 1-10 uses; $15 for 11-20 uses; $20 for 21+ uses	$9-1-10 times; $15 11-20 times; $20 21 or more + APR	Info not found	Yes	High to low.	$25 for 1st time; $33 for 2nd-4th time; $37 thereafter per item	$25 for 1st time; $33 for 2nd-4th time; $37 thereafter per item	$6 per day	3 days
HSBC	no	$15		$15	$15			high to low	$35 per item; no limit per day	$35 per item; no limit per day	No	
National City Bank	Yes	$3 mo. Service fee; 24.8% APR		$15			Yes	High to low (2005)	$30-36; based on NSF activity and balances	$30-36; based on NSF activity and balances	$8.00	3 days

5 Page Chart accompanying Appendix C: CFA Survey of Sixteen Large Banks' Overdraft Fees and Practices

FIRM	Fee Schedule On Web	TRADITIONAL OVERDRAFT PROTECTION						Clearance Policy	"COURTESY" OVERDRAFT LOANS			
		Line of Credit transfer fee	Annual Savings Transfer Fee	Savings Transfer Fee	Credit Card	Home Equity	Opt-In Contract		Unpaid NSF/ Overdraft Fee	Paid Overdraft Fee	Sustained Overdraft Fee	After Number of Days
PNC Bank	Yes	Yes	No	Yes, $5 transfer fee, $50 minimum transfer ($10 transfer fee effective March 6, 2009)	Yes, $5 transfer fee, $50 minimum transfer ($10 transfer fee effective March 6, 2009)		Yes; w/ set up fee of $15 for Free Checking, $5 for Foundation Checking, and free for all other checking accounts	High to low (2008)	1-3 items = $31/item 4-6 items = $34/item 7+ = $36/item	1-3 items = $31/item 4-6 items = $34/item 7+ = $36/item	$6 per day ($7 per day effective March 6, 2009)	4 (for up to 5 days = $30 max total) ($35 max effective March 6, 2009)
Regions	No	Yes, $10 transfer fee per day, $7.50 per day for Preferred Plus Banking, revised February 2009	No	Yes, $10 transfer fee per day, $7.50 per day for Preferred Plus Banking, revised February, 2009	Yes, $10 fee per day, $7.50 for Preferred Plus Banking.. February 2009		Yes, subject to credit approval. Transfers in $100 increments.	Any order, reserve right to pay largest first, to change order without notice	1 item = $25 2-3 items = $33 4+ items = $35	1 item = $25 2-3 items = $33 4+ items = $35	No	

5 Page Chart accompanying Appendix C: CFA Survey of Sixteen Large Banks' Overdraft Fees and Practices

FIRM	Fee Schedule On Web	TRADITIONAL OVERDRAFT PROTECTION						Clearance Policy	"COURTESY" OVERDRAFT LOANS			
		Line of Credit transfer fee	Annual Savings Transfer Fee	Savings Transfer Fee	Credit Card	Home Equity	Opt-In Contract		Unpaid NSF/ Overdraft Fee	Paid Overdraft Fee	Sustaine d Overdraft Fee	After Number of Days
SunTrust	Yes	Yes	No	$10 transfer fee (max one per day) $100 transfer increments	Yes		Yes	Any; usually high to low	$35	$35	$35	7
TD Bank	No			no transfer fee	no transfer fee			any order	$35 per item; no limit per day	$35 per item; no limit per day	No	
US Bank	Yes	Yes, three different lines of credit are offered		$5 fee on deposit account per item covered for all overdrafts, auto increments of $200 or avail balance	Yes, $10 fee, payments are 3% of balance or $10, auto increments of $25 up to credit limit	Yes	Yes	Any; bank has total discretion	$19 1st time, $35 2nd-4th time, $37.50 5th time and thereafter	$19 1st time, $35 2nd-4th time, $37.50 5th time and thereafter	$8	3 days

5 Page Chart accompanying Appendix C: CFA Survey of Sixteen Large Banks' Overdraft Fees and Practices

FIRM	Fee Schedule On Web	TRADITIONAL OVERDRAFT PROTECTION						Clearance Policy	"COURTESY" OVERDRAFT LOANS			
		Line of Credit transfer fee	Annual Savings Transfer Fee	Savings Transfer Fee	Credit Card	Home Equity	Opt-In Contract		Unpaid NSF/ Overdraft Fee	Paid Overdraft Fee	Sustained Overdraft Fee	After Number of Days
Wachovia	No	Yes, $10 transfer fee	No	Yes, $10 transfer fee	Yes, $5 transfer fee + APR		Yes	Any; usually high to low	$22 1st time and $35 each additional time	$22 1st time and $35 each additional time	No	
Washington Mutual	No			$12 if balance under $10,000			"Overdraft Limits" program is automatic, other programs are opt-in	Any. Preference given to WAMU payments	$34 each, max 7 per day or $238 CA	$34 each, max 7 per day or $238 CA	No	
Wells Fargo	some info online	$10		$10 per day	$10-$20 depending on $ amount of advance; one fee per day			high to low	$22 - 1st time; $35 - thereafter; no limit to how many fees per day	$22 - 1st time; $35 - thereafter; no limit to how many fees per day	$5 per business day, CA	3 days

Embargoed until 2:30pm
March 19, 2009

Statement of

Montrice Godard Yakimov
Managing Director for Compliance and Consumer Protection
Office of Thrift Supervision

concerning

The Credit Cardholders' Bill of Rights Act of 2009
and
The Consumer Overdraft Protection Fair Practices Act of 2009

before the

Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit
United States House of Representatives

March 19, 2009

Office of Thrift Supervision
Department of the Treasury

1700 G Street, N.W.
Washington, DC 20552
202-906-6288

Statement required by 12 U.S.C. 250: The views expressed herein are those of the Office of Thrift Supervision and do not necessarily represent those of the President.

Testimony on
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before the
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of the Committee on Financial Services
United States House of Representatives

March 19, 2009

Montrice Godard Yakimov
Managing Director for Compliance and Consumer Protection
Office of Thrift Supervision

I. Introduction

Good afternoon Chairman Gutierrez, Ranking Member Hensarling and members of the Subcommittee. Thank you for the opportunity to present the views of the Office of Thrift Supervision (OTS) on the Credit Cardholders' Bill of Rights Act of 2009 (H.R. 627), the Consumer Overdraft Protection Fair Practices Act (H.R. 1456) and issues related to credit card lending and overdraft protection. Thank you also for your interest and leadership on these important aspects of the financial services market. We share your commitment to protecting consumers from abusive practices.

I would like to take this opportunity to update the Subcommittee on OTS efforts to curb such practices. On August 6, 2007, the OTS issued an Advance Notice of Proposed Rulemaking (ANPR) that started the process of determining whether new rules to prevent unfair or deceptive acts or practices (UDAPs) should be issued.[1] The notice solicited comment on a wide range of practices that could be banned under the Federal Trade Commission (FTC) Act, including practices related to the marketing, origination, and servicing of credit cards and practices relating to overdraft protection.

Based on our review of comments from consumer advocates, industry representatives, members of Congress and the general public, we worked with the Federal Reserve Board (FRB) and National Credit Union Administration (NCUA) (collectively, the Agencies) to propose a rule in May 2008 to address unfair practices. The proposal sought comment on both credit card and overdraft protection practices that have been the subject of public debate. The final rule, issued in January 2009, is intended to provide consumers with a reasonable time to pay credit card bills,

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[1] See Unfair or Deceptive Acts or Practices: Advance Notice of Proposed Rulemaking, 72 FR 43570 (August 6, 2007).

fairly allocate payments to balances with different interest rates, establish certain restrictions on increasing interest rates, ban double-cycle billing and limit the fees charged for opening an account. As I will explain in more detail below, the final rule accomplishes the key goals of H.R. 627.

I will also address our concern about certain overdraft protection practices and summarize steps already taken to address some of these concerns. Finally, I will discuss our willingness to adopt rules in this area and our support for a related rulemaking undertaken by the FRB.

II. Development of the Final UDAP Rule

A. Robust Public Comment

The Agencies collectively received more than 66,000 comments on the May 2008 UDAP proposal, one of the largest responses to a rulemaking proposal that we have ever received. Comments were submitted from a wide range of stakeholders. These included four letters signed by 74 members of Congress, as well as 64 letters from members of state and local governments. The Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) commented. In addition, we received hundreds of comments from depository institutions and other participants in the financial services industry, as well as 23 comments from trade associations. Most notably, we received written comments from tens of thousands of individual consumers and eight consumer advocacy organizations.

Virtually all comments from members of government and consumers voiced strong support for the proposal, particularly the proposed prohibition against interest rate increases on outstanding credit card balances. As the Ohio Treasurer observed in his letter, the thousands of comments from Ohio citizens show the magnitude of support for "reform" of credit card practices.

Among industry comments, common points included: (1) the cost and potential burden of implementation; (2) the possibility that some of the rules would reduce access to credit and increase its cost for consumers; and (3) the concern that labeling certain practices as "unfair or deceptive" at the federal level would prompt litigation against the industry at the state level, especially if the rules applied retroactively.

B. Policy Underlying the Final UDAP Rule

The Agencies finalized the UDAP Rule in December 2008 and published it in January 2009. To put the rule in perspective, it is necessary to understand its policy underpinnings.

First, in response to comments, the OTS worked with the other federal agencies with rulemaking authority under the FTC Act – the FRB, the NCUA and the FTC – to produce consistent interagency standards and a level playing field across the credit card industry. The final rule was issued jointly by the three federal agencies that have jurisdiction over virtually all credit card issuers.[2] Consequently, essentially all consumers who hold such cards will benefit from the rules. Issuers will experience little, if any, competitive disadvantage from compliance.

Second, the practices determined to be "unfair" were measured against well-established legal standards codified in the FTC Act.[3] Consequently, each practice was analyzed to assess:

- Whether it causes or is likely to cause substantial harm;
- Whether consumers can reasonably avoid the harm; and
- Whether the harm is outweighed by benefits to consumers or the market.[4]

Under the FTC Act, "unfairness" has a technical meaning. Congress has more latitude to ban practices of concern because the FTC Act only gives the Agencies authority to ban practices that meet the legal standards for unfairness or deception. Only the OTS has the authority to ban other practices under the Home Owners' Loan Act (HOLA).

Finally, the UDAP Rule requires the industry to change its business practices, rather than simply disclose them more effectively. This is a fundamental change from the past. Consumer research shows better disclosure does not address concerns raised by a number of these practices. In fact, testing showed that consumers simply could not understand some of the practices that the Agencies prohibited.[5] Even when consumers understood how a practice worked, they were not always able to use disclosures to make economically rational choices.[6] The results of this research contributed to the Agencies' decision to restrict certain practices, rather than merely require that they be better disclosed.

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2 Because the FTC must use special rulemaking procedures that it has described as "cumbersome and time-consuming," see FTC testimony before House Subcommittee on Commerce, Trade and Consumer Protection of the Committee on Energy and Commerce delivered October 23, 2007, it did not join the other agencies in issuing the UDAP rule. As a result, consumers that do business with FTC-regulated entities such as state chartered credit unions will not receive the protections afforded consumers under the rule. Although these credit unions account for only a small share of the credit card market, there is no rational public policy for exempting them from the rule.

To address concerns about FTC rulemaking authority, the House of Representatives passed H.R. 3526 on December 5, 2007. One provision in that bill would allow the FTC to use the same rulemaking procedures as the other agencies use when promulgating a rule to address unfair or deceptive acts or practices. OTS supports this approach.

3 See 15 U.S.C. § 45(n).

4 See Unfair or Deceptive Acts or Practices (UDAP) Rule, 74 FR 5498, 5502-5504 (January 29, 2009).

5 See, e.g., 74 FR at 5536 (testing shows that disclosure is not successful in helping consumers understand balance computation methods such as double-cycle billing).

6 74 FR at 5514 (testing shows that disclosure was not effective in helping consumers avoid the practice of allocating payments first to the balance with the lowest rate).

C. How the Final UDAP Rule Accomplishes Key Goals of *The Cardholders' Bill of Rights Act of 2009* (H.R. 627)

If enacted, H.R. 627 would provide consumers who hold credit cards with a number of additional protections. We share many of the concerns that prompted Congresswoman Maloney to introduce this bill and we see the benefit of many of its provisions. However, OTS sees benefit in addressing the underlying abuses through regulation. The advantage of a regulatory approach is agility. It enables agencies to respond to unfairness or deception as it emerges.

1. Unfair Time to Make Payment.

Like H.R. 627, the UDAP Rule is intended to ensure that consumers have enough time to pay their credit card bills. Under the UDAP Rule, an institution may not treat a payment as late unless the institution provides a reasonable amount of time for the consumer to make payment. The rule provides a safe harbor for an institution that sends periodic statements at least 21 days prior to the payment due date.[7] The Agencies considered this sufficient time for a statement to travel from an issuer to a consumer, for a consumer to review the bill and for payment to travel from the consumer to the issuer.

2. Unfair Increases in Annual Percentage Rates (APRs).

Like H.R. 627, the UDAP Rule is intended to address pricing practices that are harmful to consumers. These range from "any time/any reason" repricing, in which an issuer retains sole discretion to raise APRs, to "universal default," in which a consumer's APR is raised for failure to pay an unrelated account on time. In either case, a cardholder's APR is increased for reasons other than the cardholder's performance on the account.

The UDAP Rule addresses these problems by focusing on price transparency. To put it simply: no "gotchas." We have taken this tack because research shows that rate is what consumers view as the most important feature of credit cards.[8] It is what they shop for. Consequently, the UDAP Rule is intended to ensure that consumers can rely on the rates that they are promised.

To accomplish this, the UDAP Rule requires institutions to disclose at account opening all interest rates that will apply to the account. It then prohibits institutions from increasing those rates, except in the circumstances outlined below:

- Account-Opening Exception. If a rate disclosed at account opening expires after a specified period of time, institutions may apply an increased rate that was also disclosed at account opening.

7 H.R. 627 would require an institution to mail a periodic statement 25 days before payment is due.

8 74 FR at 5521.

- Variable Rate Exception. Institutions may increase a rate due to the operation of an index (in other words, the rate is a variable rate).

- Delinquency Exception. Institutions may increase a rate if the minimum payment is received more than 30 days after the due date.

- Workout Exception. If a workout arrangement does not succeed, institutions may return a consumer to the rate in effect before the workout arrangement.

After the first year, institutions may also take advantage of an additional exception. They may increase the rate applicable to new transactions after providing cardholders with the 45-day advance notice now required by Regulation Z.[9]

Although H.R. 627 addresses pricing issues in a manner that is broadly similar to the approach taken by the UDAP Rule, there are some important differences. First, H.R. 627 only prohibits issuers from increasing APRs that apply to *existing* balances. As explained above, the UDAP Rule goes further. During the first year in which an account is open, the UDAP Rule prohibits rate increases on *new* balances unless one of the exceptions applies.

Another example is how promotional rates can be repriced. Under H.R. 627, an issuer may raise a rate when a promotional rate is lost for a reason specified in the account agreement, such as paying late by even a day. Although the Agencies proposed permitting such an approach, commenters persuaded us that doing so would foster the very practices that we intended to prevent. For example, an institution might attempt to attract new customers by offering a promotional rate that is lower than its competitors' rates. In order to make this strategy profitable, such an institution might set conditions on retaining the rate that are intended to generate revenue through repricing. This type of practice distorts competition and undermines consumers' ability to evaluate the true cost of using credit.[10] The Agencies concluded that, absent a material default, a consumer should be able to rely on a rate for the period specified in advance by the institution. Therefore, the final UDAP Rule does not permit repricing of outstanding balances prior to the end of the specified period unless a consumer is more than 30 days delinquent.[11]

The treatment of deferred interest plans under the UDAP Rule also offers consumers more protection than H.R. 627. Such plans are typically marketed as being "interest free" for a specified period and are often offered to promote large purchases such as furniture or appliances. However, although interest is not charged to the account during that period, interest accrues at a specified rate. If the consumer violates the account terms, for example, pays one day late, or fails to pay the purchase balance in full before expiration of the period, the institution retroactively charges all of the interest that has accrued from the date of purchase. Consequently, many consumers fail to receive the "interest free" benefit that they are initially

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9 See Truth in Lending; Final Rule, 74 FR 5244, 5413-14 (January 29, 2009).
10 See 74 FR at 5525.
11 Id.

promised. This is precisely the type of surprise increase in the cost of completed transactions that the UDAP Rule is intended to prevent.[12] Based on the comments received and our own analysis, the Agencies therefore concluded that the assessment of deferred interest is unfair.[13]

Workout arrangements represent a final area in which the UDAP Rule goes further in protecting consumers than H.R. 627. As originally proposed, the UDAP Rule would have prohibited an institution that reduced an APR pursuant to a workout arrangement from increasing the rate if the consumer failed to comply with the terms of the arrangement. However, such arrangements can provide important benefits to consumers in material default. Consequently, the Agencies adopted an exception to the prohibition against retroactive repricing that provides that when a consumer fails to comply with the terms of a workout arrangement, the institution may increase the APR to return the consumer to the rate that applied prior to the arrangement.[14] Because H.R. 627 does not contain a similar provision, it may discourage issuers from entering into workout arrangements that temporarily lower interest rates for consumers who are severely delinquent.

3. Unfair Allocation of Payments.

Like H.R. 627, the UDAP Rule is intended to respond to concern about payment allocation practices. Most notably, concern has arisen when different APRs apply to different balances on a credit card account. This may occur when different rates apply to balances associated with purchases, balance transfers and cash advances. In such situations, most issuers have allocated payments first to the balance with the lowest interest rate. This maximizes issuer returns, but is costly for consumers. Moreover, because cardholders have difficulty understanding how issuers allocate payments, it is hard for them to use their cards in a manner that minimizes their costs.[15]

H.R. 627 would respond to these concerns by requiring that issuers allocate payments on either a pro-rata basis or to the balance with the highest rate first. The Agencies agree that payment allocation practices can be abusive. Consequently, the UDAP Rule imposes the same requirement.[16]

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[12] The Agencies note, however, that the final rule does not preclude institutions from offering consumers interest-free promotional plans. Institutions may still offer 0 percent promotional rates for specified periods so long as they disclose the rate that will apply thereafter. Furthermore, an institution could offer a plan in which interest is assessed on purchases at a disclosed rate for a period of time but is waived or refunded if the principal is paid in full by the end of the period.

[13] See 74 FR at 5527.

[14] 74 FR at 5532.

[15] See ftnt. 6, above.

[16] H.R. 627 would apply to a consumer's entire payment. However, the UDAP Rule focuses on payments in excess of the required minimum. The Agencies took this approach in order to strike a balance between providing institutions flexibility to determine the minimum payment necessary to meet their business needs and ensuring that when consumers pay more than the minimum, payments are not allocated in a way that maximizes interest charges. See 74 FR at 5518. However, the Agencies clarified that institutions are free to apply the entire payment consistent with the payment allocation rule as a means of simplifying their operations. Id. and Comment 535.23-1, 74 FR at 5570.

H.R. 627 also includes special allocation rules for promotional rate balances and deferred interest rate balances. Specifically, H.R. 627 permits issuers to allocate the amount paid in excess of the required minimum to a deferred interest plan during the last two billing cycles before the deferred interest offer expires. This portion of the bill may therefore be viewed as a Congressional endorsement of such plans. However, as explained previously, the Agencies have concluded that deferred interest plans are unfair.

In addition, H.R. 627 requires issuers to allocate payments to promotional rate balances last. Although the Agencies had proposed such a requirement to ensure that consumers received the benefit of a promotional rate, we did not retain it in the final UDAP Rule. Based on our review of data submitted as part of the public comment process, the Agencies concluded that discounted promotional rates offer significant benefits to many consumers.[17] This, combined with industry comment demonstrating that finalizing this part of the proposal would likely have caused issuers to significantly reduce promotional rate offers due to lost revenue, caused the Agencies to conclude that no special rule for promotional rate balances should be applied.[18]

4. Unfair Balance Computation Methods.

Like H.R.627, the final rule prohibits institutions from calculating interest using a method referred to as "double-cycle billing." Under this method, when a consumer pays the entire account balance one month, but does not do so the following month, the institution calculates interest for the second month using the account balance for days in the previous billing cycle as well as the current cycle.[19] Not surprisingly, testing showed that consumers simply could not understand this practice.[20]

5. Unfair Financing of Fees/Deposits for the Issuance of Credit

Like H.R. 627, the UDAP Rule is designed to address credit cards with high account opening charges that erode most of the credit provided. Thus, on an account with a $400 credit limit, a consumer might have to pay $300 (plus interest charges) to obtain $100 of available credit. Such products are typically offered in the subprime market.[21] When consumers are charged security deposits and fees for issuing credit or making it available, they are harmed financially by the charges themselves and by the interest on those charges.

In response to the proposed rule, the Agencies received thousands of comments from consumers who had high-fee subprime credit cards. Many of these consumers said their credit

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17 See 74 FR 5519.

18 Id.

19 H.R. 627 includes an exception to the prohibition against double-cycle billing to facilitate the use of deferred interest rate plans. However, as explained above, the Agencies have concluded that offering deferred interest plans is unfair. As a result, we have concluded that no exception to the ban on double-cycle billing is warranted for these plans. The provisions of H.R. 627 that provide such an exception may not be necessary.

20 See ftnt. 5, above.

21 See 74 FR at 5538.

problems and limited incomes made high-fee subprime credit cards the only type of credit card they could obtain. Many of these consumers described themselves as elderly, living on limited incomes, or having serious health problems. Accordingly, because high-fee subprime credit cards are marketed to financially vulnerable consumers who generally cannot obtain credit card products with less onerous terms, the Agencies concluded that – even with improved disclosures – those consumers could not, as a general matter, reasonably avoid high upfront fees and low initial credit availability.[22]

Finally, as noted above, many subprime credit card issuers assess fees that consume 75 percent or more of the credit line at account opening. The benefit of receiving this relatively small amount of available credit does not outweigh its high cost.[23]

As a result of these findings, the UDAP Rule restricts high fee subprime credit cards in the following ways:[24]

- Institutions are prohibited from charging consumers for issuing credit if, during the first year after account opening, such charges consume the majority of the available credit;

- Institutions are prohibited from charging more than 25 percent of the credit limit during the first billing cycle; and

- Institutions must spread charges that exceed 25 percent of the credit limit over at least the next five billing cycles.[25]

Notably, although these products are often marketed as "credit repair" vehicles, data submitted by the industry showed that most consumers who use these cards become delinquent and further erode their credit scores.[26] Because the "credit repair" marketing appears unsubstantiated, the Agencies warned issuers about the risk of violating the FTC Act prohibition against deception and the OTS Advertising Rule.[27]

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22 74 FR at 5539-40.

23 74 FR at 5540.

24 74 FR at 5542 and 5569 (rule text applicable to institutions supervised by OTS).

25 H.R. 627 limits fees/deposits to 25 percent of the credit line, but does not require institutions to spread any of the fees/deposits over a series of billing cycles. Based on the comments received in response to the UDAP proposal, this strategy may not provide issuers with enough flexibility to continue offering credit cards in the subprime market. See 74 FR at 5541.

26 74 FR at 5541.

27 74 FR at 5543.

D. Implementation of the UDAP Rule.

When the Agencies proposed the UDAP Rule in May 2008, we sought comment on whether a one year implementation period was appropriate. Due to the substantial operational changes required by both the UDAP Rule and the FRB overhaul of the aspects of Regulation Z that apply to open-end credit,[28] most industry commenters urged the Agencies to allow a longer period of time.[29] Many asked for at least two years. Nevertheless, the Agencies provided issuers with 18 months to bring their operations into compliance with both rules. Both are effective on July 1, 2010.

In choosing this timeframe, the Agencies sought to ensure that compliance would not be so onerous that issuers – particularly smaller ones – would be driven out of the credit card business.[30] We also wanted to avoid forcing issuers to incur excessive expenses that would likely be passed on to consumers.[31] Even more importantly, we intended to foster an orderly compliance process that would not inconvenience or confuse consumers.

To move this process along, we strongly encouraged institutions to use their best efforts to conform to the final rule before July 1, 2010.[32] At the OTS, we have written to all of the institutions under our supervision to encourage them to comply as soon as possible.[33] OTS also organized a conference call on February 24, 2009 to answer implementation questions. More than 700 callers joined us, so we believe many institutions have already begun the compliance process.

III. Rulemaking Process Under H.R. 627

H.R. 627 anticipates that the FRB, in consultation with a broader group of agencies than those that wrote the UDAP Rule, would write new rules to implement the law. If H.R. 627 is enacted, its implementing rules would likely necessitate revisions to the UDAP Rule. Consequently, we respectfully request that H.R. 627 be amended to provide that its implementing rules be issued jointly by the Agencies. This approach would provide OTS the same rulemaking authority as the FRB. The history of the UDAP Rule demonstrates OTS's leadership in initiating the process to use the FTC Act rulemaking power to address abusive credit card practices. Simply being consulted as the FRB develops new rules that would likely require changes in the UDAP Rule would prevent the OTS from providing the kind of policy perspectives that significantly shaped the UDAP Rule and the important consumer protections it contains.

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28 See ftnt. 9, above. Pursuant to the amendments to Regulation Z, issuers will have to revise all of their communications with consumers, including their advertising, account opening materials, cardholder agreements and periodic statements.
29 See 74 FR at 5548.
30 Id.
31 Id.
32 Id.
33 See Letter to Thrift Chief Executive Officers dated December 18, 2008, available at: http://files.ots.treas.gov/25287.pdf.

IV. Accomplishing Key Goals of the *Overdraft Protection Fair Practices Act*

Overdraft protection programs have become ubiquitous.[34] If enacted, H.R. 1456 would protect consumers from a number of troubling practices associated with these programs. As with the credit card legislation discussed previously, we share many of the concerns that prompted this legislation and we see the benefit of many of its provisions.

As discussed in more detail below, we have issued Guidance on Overdraft Protection Programs (OTS Overdraft Guidance)[35] that focuses on some of these practices. To strengthen it, OTS may expand the guidance into rules.[36] Moreover, we support the FRB effort to strengthen Regulation E[37] to provide consumers with the opportunity to choose whether to participate in overdraft protection. Finally, OTS enforces Regulation DD,[38] which includes restrictions on consumer communications about overdraft protection. One advantage that regulatory approaches have over legislation is the flexibility for the agencies to address practices of concern as they emerge.

A. Transaction Clearing

Much like H.R. 1456, OTS Guidance on Overdraft Protection Programs (OTS Overdraft Guidance) states, "Do not manipulate transaction-clearing rules." The guidance goes on to explain that, "Transaction-clearing rules (including check-clearing and batch debit processing) should not be administered unfairly or manipulated to inflate fees."[39] Moreover, the OTS Overdraft Guidance strongly encourages associations to clearly disclose rules for processing and clearing transactions.[40] In other words, we have asked institutions to disclose the actual processing order that they use.

B. Consumer Choice

H.R. 1456 would require that a consumer affirmatively consent – or opt in – before an institution could charge a fee for paying an overdraft.[41] Because many institutions automatically enroll consumers in their overdraft protection programs,[42] the federal financial institution

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34 See FDIC Study of Bank Overdraft Programs at p 5 (Nov. 2008) (FDIC Overdraft Study), available at: http://www.fdic.gov/bank/analytical/overdraft/FDIC138_Report_FinalTOC.pdf (confirming that 89.5 percent of institutions studied have some form of overdraft protection program).

35 See 70 FR 8428 (February 18, 2005).

36 Such rules could be issued either pursuant to the HOLA, 12 U.S.C. §§ 1463(a) and 1464(a), which permits the OTS to issue comprehensive rules to govern the operations of savings associations or pursuant to the FTC Act prohibition against UDAPs.

37 Regulation E implements the Electronic Funds Transfer Act, 15 U.S.C. § 1693 et seq.

38 Regulation DD implements the Truth in Savings Act, 12 U.S.C. § 4301 et.seq.

39 See 70 FR at 8431.

40 Id.

41 Under H.R. 1456, consent is not required for the first three fees charged for paying overdrafts each year.

42 See FDIC Overdraft Study at p.5 (75.1 percent of studied institutions automatically enroll customers in automated overdraft programs).

regulatory agencies have long been concerned about the lack of consumer choice in this area. As early as 2005, all of these agencies recommended that institutions provide consumers with the opportunity to opt out of overdraft protection programs.[43] The OTS Overdraft Guidance went further by specifying that if it is not feasible for an association to notify consumers about overdraft fees in time for them to cancel certain kinds of transactions, the association should permit consumers to limit access to overdraft protection by transaction type.[44]

When the Agencies proposed the UDAP Rule in May 2008, we anticipated formalizing our opt-out guidance into a rule.[45] However, consumer testing revealed that most consumers would not choose to opt out of overdraft protection if that meant that their checks would be returned unpaid.[46] However, when asked if they would opt out if the choice was limited to opting out of overdrafts in connection with ATM withdrawals and debit card purchases, half of the participants indicated that they would consider doing so.[47]

The Agencies did not take action in the final UDAP rule on the overdraft protection opt-out provisions that we had proposed. However, the FRB proposed amendments to Regulation E that would provide consumers with the opportunity to avoid the payment of overdrafts through ATM withdrawals and one-time debits at point-of-sale (POS) terminals.[48] The FRB has solicited comment on whether consumers should be permitted to opt-out of the payment of overdrafts paid for such transactions, or whether institutions should be prevented from paying overdrafts unless consumers "opt-in."

OTS supports requiring that a consumer affirmatively consent, or opt-in, before an institution may charge a fee for paying an overdraft, particularly for electronic transactions. Among the institutions that participated in a recent FDIC study, POS and debit transactions accounted for the largest share of overdraft transactions: 41 percent.[49] Moreover, as noted above, many institutions automatically enroll their customers in overdraft protection programs. Studies have shown that this strategy uses the power of inertia and lack of attention on the part of consumers to create high participation in these programs.[50] However, half of the consumers tested in connection with the UDAP Rule said they would consider removing overdraft protection from their electronic transactions. Consumers should be given that choice up front.

The need for an opt-in is particularly acute among young adults. A recent study found that although they held only 7.6 percent of the accounts offered by the institutions participating

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43 See OTS Overdraft Guidance, 70 FR at 8431 and OCC, FRB, FDIC and NCUA Joint Guidance on Overdraft Protection Programs, 70 FR 9127, 9132 (February 24, 2005).

44 See 70 FR at 8431.

45 See Unfair or Deceptive Acts or Practices; Proposed Rule, 73 FR 28904, 28929-31 (May 19, 2008).

46 See 74 FR at 5546.

47 Id.

48 See Electronic Funds Transfer; Proposed Rule, 74 FR 5212 (January 29, 2009).

49 See FDIC Overdraft Study at p.78.

50 Madrian, Brigitte C., and Shea, Dennis F., The Power of Suggestion: Inertia in 401(K) Participation and Savings Behavior, Working Paper 7682, National Bureau of Economic Research, Cambridge, MA, May 2000 (available at: http://www.nber.org/papers/w7682).

in the study, these consumers paid 61.5 percent of the overdraft fees originated at POS and debit terminals.[51] Among participating institutions, 46 percent of young adult customers had overdrafts and 25 percent had more than four overdrafts.[52] Because ATM and POS transactions are generally small – around $20.00 – the typical $27 fee often exceeds the cost of the transaction.[53]

C. Prohibition Against Misrepresentations

H.R. 1456 would prohibit institutions from misrepresenting the circumstances under which they will pay overdrafts. This prohibition would be consistent with existing OTS standards. If a savings association misrepresented these circumstances, it would likely violate the OTS Advertising Rule.[54] This rule, which is unique to OTS, prohibits a savings association from misrepresenting its services in any way. However, all of the federal financial institution regulatory agencies have previously stated that such misrepresentations should not occur, particularly when they involve the discretionary nature of many overdraft protection programs. For example, the OTS Overdraft Guidance states:

> ***Clearly explain the discretionary nature of [the] program.*** *If payment of an overdraft is discretionary, make this clear. Savings associations should not represent that the payment of overdrafts is guaranteed or assured if the savings association retains discretion not to pay an overdraft.*[55]

In fact, such a misrepresentation would violate 2005 amendments to Regulation DD. Under this rule, institutions that promote the payment of overdrafts in an advertisement must disclose in a clear and conspicuous manner the circumstances under which they will not pay overdrafts.[56] Such a misrepresentation might also be a violation of the FTC Act prohibition against deceptive practices.[57]

D. Advertising Restrictions.

When overdraft protection is offered for a fee, H.R. 1456 would prohibit the following representations in advertisements or promotions:

(1) Any representation or statement describing a transaction account as free or no cost if the account includes, or is promoted as including, overdraft protection services that involve the payment of overdraft protection fees.

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51 FDIC Overdraft Study at p.80.
52 Id.
53 Id. at p.79.
54 12 C.F.R. § 563.27.
55 See 70 FR at 8431.
56 12 C.F.R. § 230.11(b)(1)(iv).
57 15 U.S.C. § 45(a).

(2) Any representation or statement encouraging use of the account as a service to meet short-term credit needs or to obtain advances on a consumer's next payment of salary, wages, benefits, or other income.
(3) Any representation or statement that the financial institution will honor all checks or other debits presented against the account, if the institution retains discretion at any time not to honor any check or other debit presented.

Notably, the commentary to Regulation DD addresses the first point.[58] The provisions of Regulation DD discussed above address the third point. In addition, with respect to free or no cost advertising, the OTS Overdraft Guidance states:

> ***Distinguish overdraft protection services from "free" account features.*** *Savings associations should not promote free accounts and overdraft protection services in the same advertisement in a manner that suggests the overdraft protection services is free of charges.*[59]

With respect to the use of the service, the OTS Overdraft Guidance states:

> ***Avoid promoting poor account management.*** *Savings associations should not market the program in a manner that encourages routine or intentional overdrafts; rather present the program as a customer service that may cover inadvertent consumer overdrafts.*[60]

Finally, as noted above, the OTS Guidance addresses representations about the discretionary nature of many programs.[61] Also as previously noted, misrepresentations about the payment discretion retained by many institutions could violate the OTS Advertising Rule and the FTC Act prohibition against deceptive practices.

V. Rulemaking Process Under H.R. 1456

H.R. 1456 directs the FRB, under authority provided in the FTC Act, to write new rules to implement the law. This approach is at odds with the existing structure of the FTC Act, which assigns the FRB authority to issue regulations that define unfair or deceptive acts or practices by banks, but provides the OTS and NCUA authority to issue comparable regulations for savings associations and federal credit unions, respectively. Consequently, we respectfully request that H.R. 1456 be amended to provide that its implementing rules be issued jointly by the Agencies. Because all depository institutions offer overdraft protection, all three agencies should have authority to write rules in this area. This approach would ensure that virtually all deposit customers receive the same protection and that virtually all depository institutions are provided with a level playing field to do business.[62] The history of the UDAP Rule demonstrates OTS's

58 12 C.F.R. part 230, Supp. I, Comment 230.8(a)-10(v) and 230.11(b)-8.
59 See 70 FR at 8431.
60 Id.
61 Id.
62 See ftnt. 2 above regarding FTC rulemaking authority.

leadership in initiating the process to use the FTC Act rulemaking power to address abusive practices. For the FRB to have sole authority to develop new rules would prevent the OTS from providing the kind of policy perspectives that significantly shaped the UDAP Rule and the important consumer protections it contains.

At the same time, OTS would respectfully note that the additional rulemaking authority contemplated by H.R. 1456 may not be necessary at all. As observed above, the FTC Act already provides the FRB, OTS and NCUA with authority to issues rules that define unfair or deceptive practices for virtually all depository institutions. This authority should be sufficient for the agencies to address the specific practices covered by H.R. 1456.

VI. Conclusion

Thank you again for the opportunity to testify, Mr. Chairman. The OTS commends your efforts to ensure that consumers are treated fairly when they use credit cards and overdraft protection programs. For our part, we are actively working to address these issues as they emerge. We have issued guidance and rules, and remain committed to employing all of our supervisory tools. We look forward to continuing to work with Congress to enhance consumer protection.

First Data.

March 18, 2009

The Honorable Luis V. Gutierrez
Chairman
House Subcommittee on Financial Institutions and Consumer Credit
2129 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Jeb Hensarling
Ranking Member
House Subcommittee on Financial Institutions and Consumer Credit
2129 Rayburn House Office Building
Washington, D.C. 20515

RE: Opposition to H.R. 1456, the Consumer Overdraft Protection Fair Practices Act

Dear Chairman Gutierrez and Ranking Member Hensarling:

On behalf of First Data Corporation, I am writing to express our opposition to H.R. 1456, which is currently scheduled for a hearing on Thursday, March 19, 2009. While we understand the intent of the bill, the operational and technical realties of payment processing would make compliance all but impossible in many circumstances.

By way of background, First Data is a Fortune 350 company that is one of the largest payments processors in the world. Our merchant acquiring and processing services facilitate the ability of merchants to accept consumer payment card transactions (e.g. credit, debit, stored value, and loyalty cards) at the point of sale, whether those transactions occur at a physical merchant location, over the Internet, or at an ATM. We process over 30 billion payment transactions annually, including approximately half of all Visa and MasterCard credit and debit card transactions in the United States. Additionally, we own and operate the STAR PIN debit network, one of the leading nationwide electronic funds transfer (EFT) networks, as well as the Instant Cash ATM debit network.

We do not oppose the idea of allowing customers to opt out of their financial institution's overdraft protection programs. However, the current construct of the payments system makes the requirements of H.R. 1456 – real-time opt-out at either the point of sale (POS) or ATM – highly impractical. Here are some key reasons why the bill is impractical:

- **Cost of New POS Terminals**

A variety of PIN POS terminal configurations are available for retail businesses to purchase, but generally the display screen will not support balance information with the balance type (current, available, etc). For those POS terminals with screens that are too small to support the number of characters that would be necessary to convey an overdraft message, replacement would be the only option. In addition, software applications would need to be developed and deployed to enable the POS systems to manage this new data. Further, interoperable data and messaging formats would need to be developed, tested, and implemented by all entities in the payments stream to accomplish what is contemplated in the bill.

Such a measure would come at considerable cost. For example, First Data processes for over four million retail business locations in the U.S. If, on average, each of these merchant locations has three to five POS terminals in use, then approximately 12 million to 20 million terminals would need to be replaced in order to support this proposed mandate from a purely hardware perspective. The cost of POS terminals varies and can exceed $1,000 per device. Using these numbers, replacement costs could range from $12 to $20 billion that just the retail businesses First Data process would incur in the midst of an economic crisis.

- **Privacy Concerns at the POS**

Some of the bill's unintended consequences would result in consumers experiencing diminished privacy when conducting electronic payment transactions. For example, by requiring POS devices to displaying consumer balance information or reasons for a transactional denial (e.g. insufficient funds), store clerks and others in line at the retail location would likely be privy to the cardholder's personal financial account information. In other words, consumers would experience a diminution in privacy if such information were to be transmitted on a screen of sufficient size to transmit the information since these messages would be viewable by others in line at the retail location or by the store clerk. Further, faced with potential embarrassment, rejected transactions, or lengthier time to process due to the additional messaging, consumers may reject electronic transactions in favor of other payment methods that would (as a result of the bill) help protect their privacy. Separately, retailers would likely find such a mandate anathema to their ongoing efforts to reduce the time it takes to get consumers through checkout lanes.

- **Real-Time Processing at an ATM**

Providing consumers with overdraft fee notifications at ATMs is also much more difficult (and in many cases impossible) in reality than in concept, particularly for financial institutions and non-bank ATM operators that utilize the services of third party payment processors such as First Data to operate their ATM systems.

For example, available account balances are only as current as the account balance file that is being used, and the balances only reflect transactions that have been processed by the third party processor. Therefore, those balances would not reflect teller deposits, withdrawals, or transactions processed by another third party processor. The following scenarios further illustrate the difficulties in providing overdraft fee notification at ATMs:

- There are over 300,000 ATMs in operation in the U.S. today. Many of these ATMs are older model machines that are not bank-owned and that are limited in the information they can display due to the way there were manufactured and the type of software they use that does not allow for significant software upgrades. These upgrades would be necessary to reprogram the machines in order to comply with the intent of the bill.
- The financial institution could be authorizing their own transactions against their own Demand Deposit Account (e.g. checking account) system, but the account balances are not available when an entity is providing stand-in processing for that financial institution. Stand-in processing refers to processing that occurs when a telecommunications network is inoperable or other IT problems occur. Financial institutions pre-authorize their processors to approve transactions from their cardholders up to a certain limit. In these instances, the processor and the bank cannot communicate with one another, so there is no way to provide an available account balance from which to determine if a consumer's transaction would cause them to enter into an overdraft situation.
- The financial institution may have a third party authorize transactions on their behalf against a positive balance file, but the account balances would not be available during stand-in processing.
- The financial institution may have a third party authorize transactions on their behalf against a card file and daily limits, but the balances are never available at an ATM.

- **Federal Banking Regulators Acknowledge Difficulty with Real Time Overdraft**

In the staff commentary released as part of the proposed revisions to Regulation AA by federal regulators late last year, the agencies acknowledged the significant hurdles associated with providing real-time overdraft notification. Specifically, on page 28930, the Agencies wrote the following:

> *"The Agencies considered, but are not proposing, an exception that would allow an institution to impose an overdraft fee despite a consumer's opt out election as long as the institution did not 'knowingly' authorize a transaction that resulted in an overdraft. The Agencies are concerned, however, that given the difficulty in determining a consumer's 'real-time' account balance at any given time, such an exception would undercut the protections provided by a consumer's election to opt out.*
>
> *At the same time, the Agencies recognize that a rule that generally prohibits institutions from imposing an overdraft fee if the consumer has opted out could adversely impact small institutions that use a daily batch balance method for authorizing transactions. Because such institutions do not update the balance during the day to reflect other authorizations or settlements for transactions that occurred before the authorization request, their authorization decisions would be based upon the same dollar amount throughout the day.*
>
> *Accordingly, it would be infeasible for these institutions to determine at any given point in time whether the consumer in fact has a sufficient balance to cover the requested transaction.*

> *Similarly, institutions that use a stand-in processor because, for example, the ATM network is temporarily off-line, would also be unable to determine at the time of the transaction whether the consumer's balance is sufficient to cover a requested transaction."*

The Government Accountability Office also recognized these challenges in Appendix II of its January 2008 report entitled *Bank Fees - Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts.*

Ultimately, there are a number of factors that make overdraft decisions at the POS or at an ATM nearly impossible. Balance information may represent only a certain portion of the transactions that the consumer has performed during the current cycle. Mandating real-time overdraft decisions at the POS or ATM would be extremely expensive for retail businesses, banks, and payment processors, and would anger consumers because it would diminish their privacy when conducting electronic payment transactions. Finally, a mandate such as what is contemplated in H.R. 1456 would require a complete re-engineering of the payments system. Thus, in many cases, it would be all but impossible to comply with the bill.

Therefore, we oppose H.R. 1456 and urge the Committee to thoughtfully and judiciously weigh the perceived benefit to consumers against the true negative impact to consumers and retail businesses, and significant operational challenges and costs that would be imposed on other parties within the payments system.

Thank you in advance for your consideration. Please feel free to contact me with any questions or comments.

Sincerely,

Joe Samuel

Joe Samuel
Senior Vice President of Public Policy
303.967.7195
Joe.samuel@firstdata.com

Submitted for the record by:

The Honorable Emanuel Cleaver

Hello,

I don't know if you will remember me or not. I called about a week ago because I was upset and I wanted to let Congressman Cleaver know why. You had asked me if I would mind sending you an email about it and I said I would. I'm sorry that it has taken me so long to get this sent to you. I really appreciated you taking the time to talk with me and listen to my complaints.

I will try to keep this as short and to the point as possible. Basically, I called because I was upset about what the credit card companies are doing now as a result of the economic crisis. Right before I talked to you, I had received my third notice from a credit card company saying that because of the economy they were going to raise my interest rates. I was upset because these credit card companies are owned by the banks and financial institutes that were "bailed out" by the government with taxpayer money. And this is how they were repaying the taxpayers by raising their interest rates.

I have been blessed with steady work since 1995 and I was able to pay my bills and establish good credit. I have had all of these credit cards for quite a few years now and my interest rates were very low. My parents and my brother weren't quite as fortunate and had debts on credit cards with high interest rates. Because most of their payments went toward the interest their balances weren't going down very fast. I had helped them out by transferring their balances over to my credit cards since I had very low interest rates. I make the payments and they pay me back each month. Now the credit card companies are raising my rates so that doesn't really help any of us out. My parents have also received similar notices about the credit cards that they still have.

American Express was the first credit card company to raise my interest rates. They sent me a notice late last fall and raised my interest rate from 12.99% fixed to 15.99% fixed. Next, I received a notice in January from Chase saying that they were raising my interest rate from 7.6% fixed to 12.24% fixed. The day I called you, I received a notice from Capital One saying that they were raising my interest rate from 9.99% fixed to 17.9% variable. They all sighted the economy as the main reason for the changes. I closed my account with American Express and I will be closing my account with Capital One too. Fortunately, Capital One will let me keep my existing interest rate after the account is closed while I pay off the balance.

I have been out of work for about a year now and I have been able to continue to pay all my bills on time, but I know that there are many families who struggle to pay their bills each month because they are also unemployed. I'm sure that many of them have been using a credit card to up pay for things and now they are facing the same problem. The interest rates on their credit cards are going up making it harder to pay the balances down and if their payments go up they might not be able to pay the bills.

It is just so upsetting because I worked hard to establish good credit and now because of the economic crisis we are in they are doing this. I understand that they are businesses and they have to make money to stay in business, but they are to blame for part of the mess that we are in. They received taxpayer money to help bail them out and now (pardon the expression) they are sticking it to the taxpayers again! The president is trying to stop the downward spiral the economy is in by getting people to spend which will in turn create jobs, but the banks/credit card companies seem to be doing the opposite. Instead of extending credit, they will cause people to spend less and/or close their accounts. People will only buy what they have cash for and if they don't have the money they will do without.

That's why I was so upset the day that I called Congressman Cleaver's office. I didn't know if he or the president knew what these banks/credit card companies were doing after receiving the bailout money or not. I just felt that something needed to be done about this.

I'm sorry this email isn't quite as short as I was hoping it would be, but I do appreciate your time and thank you again for listening. If you could please pass this along to Congressman Cleaver, I would really appreciate it. It may not do any good, but it can't hurt.

Sincerely,

Lee's Summit, MO resident
Constituent of MO's Fifth District

Ms. Sandra Braunstein subsequently submitted the following in response to a written question received from Representative McHenry in connection with the March 19, 2009 hearing before the House Financial Institutions and Consumer Credit Subcommittee of the Financial Services Committee.

1. **Ms. Braunstein, Lowes, the home repair store, is headquartered in my district, and they have joined with many in the retail business over their concern that the UDAP rule may go too far in the area of "deferred interest" (or no interest) financing. Millions of consumers have benefitted from this type of financing in being able to better afford important "big ticket" items from retailers like computers, appliances, home repairs, etc. These are difficult times, and any restriction on these lines of credit could hurt Lowes, companies like them, and their consumers even further. Could you give me your position on this issue?**

In the final rule addressing unfair and deceptive credit card practices, the Board, the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA) (collectively, the Agencies) expressed concern regarding deferred interest programs that are marketed as "no interest" but charge the consumer interest if purchases made under the program are not paid in full by a specified date or if the consumer violates the account terms prior to that date (which could include a "hair trigger" violation such as paying one day late). In particular, the Agencies noted that, although these programs provide substantial benefits to consumers who pay the purchases in full prior to the specified date, the "no interest" marketing claims may cause other consumers to be unfairly surprised by the increase in the cost of those purchases. Accordingly, the Agencies concluded that prohibiting deferred interest programs as they are currently marketed and structured would improve transparency and enable consumers to make more informed decisions regarding the cost of using credit.

The Agencies specifically stated, however, that the final rule does not prohibit institutions from offering promotional programs that provide similar benefits to consumers, but do not raise concerns about unfair surprise. For example, the Agencies noted that an institution could offer a program where interest is assessed on purchases at a disclosed rate for a period of time, but the interest charged is waived or refunded if the principal is paid in full by the end of that period.

We understand that the distinction in the final rule between "deferred interest" and "waived or refunded interest" has caused confusion regarding how institutions should structure these types of promotional programs where the consumer will not be obligated to pay interest that accrues on purchases if those purchases are paid in full by a specified date. For this reason, we are consulting with the OTS and NCUA regarding the need to clarify that the focus of the final rule is not on the technical aspects of these promotional programs (such as whether interest is deferred or waived), but instead on whether the programs are disclosed and structured in a way that consumers will not be unfairly surprised by the cost of using the programs.

If the Agencies determine that clarifications to the final rule are necessary, then those changes will assist institutions in understanding and complying with the new rules and should not reduce protections for consumers.

Ms. Sandra Braunstein subsequently submitted the following in response to a written question received from Representative Meeks in connection with the March 19, 2009 hearing before the House Financial Institutions and Consumer Credit Subcommittee of the Financial Services Committee.

<u>Question # 1</u>: Do you have a view on what impact the new UDAP rules will have on: (a) the availability of credit for lower income or higher risk consumers; and (b) on the cost of credit overall?

The final credit card rules are intended to allow consumers to access credit on terms that are fair and more easily understood. The rules seek to promote responsible use of credit cards through greater transparency in credit card pricing, including the elimination of pricing practices that are deceptive or unfair. Greater transparency will enhance competition in the marketplace and improve consumers' ability to find products that meet their needs. From the perspective of credit card issuers, reduced reliance on penalty rate increases should spur efforts to improve upfront underwriting. While the Board cannot predict how issuers will respond, it is possible that some consumers will receive less credit or pay higher upfront costs than they do today. However, these rules will benefit consumers overall because they will be able to rely on the rates stated by the issuer and can therefore make informed decisions regarding the use of credit.

<u>Question # 2</u>: I see that the Federal Reserve has set an effective date for the new regulations of July 1, 2010. Why so long? Would an accelerated date for implementation pose significant challenges for overall effectiveness of the rules?

<u>Question # 3</u>: What will the issuers need to do to satisfy the new regulations? What would be the impact of accelerating that implementation period to three months? Could the Fed even make that deadline, given that the legislation (H.R. 627) would require the Fed to issue new regulations that are slightly different than the existing regulations?

The final rules represent the most comprehensive and sweeping reforms ever adopted by the Board for credit card accounts and will apply to more than 1 billion accounts.

- To comply with the final rules, card issuers must adopt different business models and pricing strategies and then develop new credit products. Depending on how business models evolve, card issuers may need to restructure their funding mechanisms.
- In addition to these operational changes, issuers must revise their marketing materials, application and solicitation disclosures, credit agreements, and periodic statements so that the documents reflect the new products and conform to the rules.
- Changes to the issuers' business practices and disclosures will involve extensive reprogramming of automated systems which subsequently must be tested for compliance, and personnel must receive appropriate training.

Given the breadth of the changes, which affect most aspects of credit card lending, card issuers must be afforded ample time for implementation to allow for an orderly transition. Although the Board has encouraged card issuers to make the necessary changes as soon as practicable, an 18-month compliance period is consistent with the nature and scope of the required changes. A shorter time period (such as three months) could lead to unintended consequences, compliance difficulties, and potential liabilities.

In addition, a three-month compliance period would make it difficult if not impossible for the Board to issue implementing regulations. Prior to adopting final rules, the Board must:

- Revise the existing rules for consistency with the final version of the legislation;
- Consult with the other agencies regarding those rules;
- Propose the rules for public comment and provide a period of time for comments to be submitted;
- Review and analyze all comments received (which exceeded 60,000 in the previous rulemaking);
- Revise the proposed rules based on the comments and the Board's own analysis; and
- Consult with the other agencies regarding the final rules.

Question # 4: Issuers have expressed concerns about the effect on the secondary markets should changes be required sooner (faster than the effective date of July 2010). Do you have an understanding of those concerns and what the risks are if acceleration of the new rules were mandated by the Congress?

As discussed above, the final rules will require card issuers to develop new credit products. H.R. 627 would have a similar effect. Depending on how business models evolve, card issuers may need to restructure their funding mechanisms, including funding obtained through securitization. If secondary market investors do not have sufficient time to evaluate the new credit products and ensure that those products comply with the new legal requirements, they may choose to invest elsewhere, reducing the amount of funds available to credit card issuers for new lending.

<u>Question # 5</u>: **There is an urge by many in Congress to do something regarding credit card practices. If Congress overshoots and places too many restrictions on how the industry manages its business by establishing controls over pricing, fees and other practices, do you have a view of what such restrictions could do to the availability of credit for consumers?**

<u>Question # 6</u>: **The Federal Reserve has spent years developing rules that balance the needs of consumers with the need to ensure that banks operate in a safe and sound manner and that the availability of consumer credit is sustained in the marketplace. In preparing these new regulations, the Fed has also had the benefit of more than 60,000 comments from consumers, legislators, advocates, and the industry regarding the proposed regulations. Do you think Congress should be adding additional rules or insisting on a faster timeline for implementation? What risks do you see in taking such an approach?**

As discussed above with respect to the final credit card rules, it is difficult to predict how credit card issuers will respond to new restrictions. The rules adopted by the Board are based on a comprehensive rulemaking process that included extensive consumer testing, a review of tens of thousands of comments, and a careful analysis of benefits and costs of particular credit card practices. Based on this process, the Board believes that, by making the costs of using credit cards more transparent, the restrictions in its final rules will benefit consumers overall, although it is possible that some consumers will receive less credit than they do today. To the extent that Congress determines that additional restrictions are necessary, it is possible that the impact on available credit will be greater than under the Board's rules.

ICBA BANCARD &TCM BANK

April 29, 2009

The Honorable Gregory W. Meeks
2342 Rayburn HOB
Washington, DC 20515

Dear Congressman Meeks:

Thank you for the opportunity to respond to your additional questions stemming from my March 19 testimony before the Subcommittee on Financial Institutions and Consumer Credit's hearing on the Credit Cardholders' Bill of Rights Act and the Consumer Overdraft Protection Fair Practices Act of 2009.

First, you asked about my views on proposals to create a Financial Products Safety Commission. As I testified, I firmly believe priority should be placed on arming a consumer with the information and tools they need to select the best options for their particular situation. That will do more to weed out the bad actors in the credit card marketplace than any other legislation Congress can enact. Setting the boundaries of what can and can not be done is like "giving a man a fish," while educating consumers on what to look for is like "teaching a man to fish."

The notion of an independent commission to review consumer financial products might sound plausible in concept, but would be tremendously problematic for community banks. I am very concerned these far-reaching proposals would significantly harm small credit card issuers.

Community banks know their customers because they live and work along side them in the same small communities. They do not engage in deceptive practices to dupe consumers, or saddle them with unfair terms that pile on excessive fees. And they are able to meet the credit needs of their customers of all socio-economic means thanks in large part to risk-based pricing, a concept that many have – and I believe in a very unfair and unwarranted way – vilified.

Not every consumer qualifies for the "Platinum" credit card with the lowest possible rate. That is not unfair: an issuer must strike the right balance between its legal requirement to maintain a safe and sound portfolio, and finding the smartest way to meet the needs of a specific customer. Community bankers work with all borrowers in the fairest way possible to meet that balance.

Proposals to create a Financial Products Safety Commission would, among other things, give that entity power to in many instances supersede actions by the federal banking regulators by prohibiting financial products it determines to be harmful to consumers, and enforcing its decisions on all banks. In my opinion, community bankers and their customers are the best judge of what products are best for their needs. At least under current practice, the federal banking agencies write consumer protection regulations under specific Congressional direction, informed by experience from their own safety and soundness and consumer compliance examinations. These agencies are better equipped to determine what products are helpful or harmful for consumers because of their technical expertise and knowledge that comes from firsthand observations from bank examinations in the field.

Community banks face a constant struggle, in the shadows of their larger counterparts, to ensure that policymakers and regulators take their unique business model and close customer relationships into account before tarring an entire industry with the same broad brush. Nothing in these new legislative proposals distinguishes between a community bank working to meet the credit needs of its local customer base, and a megabank beholden to millions of shareholders and driven to maximize short-term profit.

The new financial products safety regulator created by these proposals would be granted significant enforcement authority over community banks, in lieu of a bank's regulator, and would expose banks to the threat of litigation (frivolous or otherwise) by not only federal and state officials, but also private citizens. I believe it unwise for Congress to grant this new agency the power to make decisions affecting the financial well-being of millions of Americans without adequate direction and debate. Today, consumer regulations are imposed only after Congressional hearings and markups, regulatory comment periods, and vibrant discussion among the agencies. In contrast, a super-agency such as the one being proposed would have the power to act unilaterally without Congressional direction and interagency debate.

Community banks are conservative lenders, and are fairly risk-averse. That said, when a local entrepreneur turns to his or her community banker for capital to start up or maintain a business, community banks want to be able to innovate and be creative. But with the threat of litigation, scrutiny, and civil penalties looming large in the form of this new commission, local banks will be discouraged from finding ways to help their local economies. Perhaps even more significantly, many community bankers will raise the bar for determining who should be extended credit, which will only serve to harm those at the margin.

Throughout my nearly three decades working with community bank credit card programs, I have seen the consequences of increased regulatory burden on small issuers: the costs become too much to justify continuing a card program, the portfolio is sold to a big bank, and consumers in smaller markets are left with fewer choices with less favorable terms. I can confidently tell you that the burdens imposed by the creation of this new entity will harm community banks and the customers they serve, which would be counterproductive given today's economic climate.

Second, you asked my opinion on the utilization of TALF resources to fund credit card loans, and if there should be limits on credit card practices on those companies that utilize

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TALF funds. In general, community banks support efforts to free up consumer credit by creating a secondary market for securitized pools of credit card loans. Ultimately, a program like the TALF can benefit consumers and small businesses by creating liquidity in the tightening consumer credit market. Any such program should be open to community banks of all sizes and charter types.

I would note that I am not aware of a single community bank that securitizes and sells its credit card debt. That said, ICBA Bancard and our subsidiary, TCM Bank, can act as an aggregator for community banks and may be able to participate in a program like TALF in the future.

To the second part of your question, I believe the recent experience with the TARP program is proof that as more conditions are added by the government, fewer institutions that are actually in a position to help will choose to participate. While I know these new conditions and restrictions are targeted to the largest participants that should be held accountable, unless the conditions are carefully crafted, they will force community banks to the sidelines.

As I testified and described previously, community bankers can't afford to engage in practices that harm their customers. In fact, community banks support the portions of new federal regulations that prohibit double-cycle billing and universal default. To that end, if conditions are imposed on TALF participants in a very narrow way – i.e. limited to prohibiting participation if an institution is engaged in these two practices or ones like them – I believe that is reasonable.

However, I would be very concerned if TALF is used to accelerate the implementation deadline for all portions of the final credit card regulations. As was discussed at length during the hearing, such a change would be unworkable for community banks. Should this be the outcome, I am certain that no community bank would be able to participate in the TALF.

Again, on behalf of the thousands of community banks in our country, thank you for the opportunity to respond to your questions.

Sincerely,

Linda F. Echard

Linda Echard
President and CEO

CC: Terrie Allison, Document Clerk/Editor, Committee on Financial Services

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