

Testimony of

Kenneth J. Clayton

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Committee on Banking, Housing and Urban Affairs

United States Senate



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Chairman Dodd, ranking member Shelby, and members of the Committee, 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 the new federal regulations for credit cards and proposed legislative changes. 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've 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 rule¹) 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, including Chairman Dodd and other members of this Committee. 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.

We understand that a difference of opinion still may exist on credit card 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 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 access to credit for their daily expenses.

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

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).

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 timeframe 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.

ABA, on behalf of our membership (which includes all the major credit card issuers), pledges to work with this committee, bank regulators, and other interested parties to address any concerns that may remain.

In my statement, I would like to focus on three 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 and the Economy.

² 74 Federal Register 5548

- The Federal Reserve Rule Should Be Allowed to Work and Provides a Framework for Future Changes.

I will address each of these points in turn. Following these, I will also provide some initial thoughts on the “Credit Card Accountability, Responsibility and Disclosure Act,” as you requested, Mr. Chairman, in your letter of invitation.

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. 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 non-payment and 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. 108 of the “Credit Card Accountability, Responsibility, and Disclosure Act of 2008” (the CARD Act).³

³ S. 3252, as introduced in the 110th Congress.

Practice Eliminated: Interest Rate Increases on Certain Future Balances. Interest rates may not increase on balances from transaction 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. 103 of the CARD Act.

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. 106 of the CARD Act.

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. 107 of the CARD Act includes this requirement.

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.

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. 101 of the CARD Act.

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.

²Please send billing inquiries and correspondence to:
³PO 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 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.”

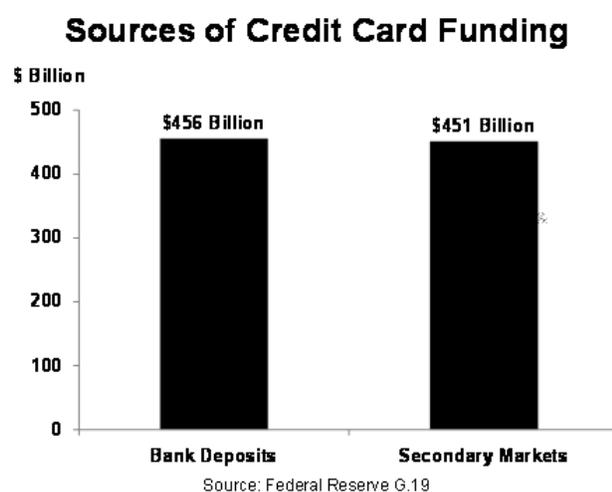
The impact on credit availability can be large. For example, Oppenheimer analyst Meredith Whitney estimated that card lines could decline by 45 percent (about \$2 trillion) because of economic and regulatory landscape. A study by Morrison & Foerster that covered 70 percent of card balances found that 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. 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 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 – or \$0.5 trillion dollars – of the total funding of card loans to

consumers (see chart at right). 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 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. 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. ***The integral part that investors play in helping fund consumer loans – and the broader economy – cannot be understated.*** 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.

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,

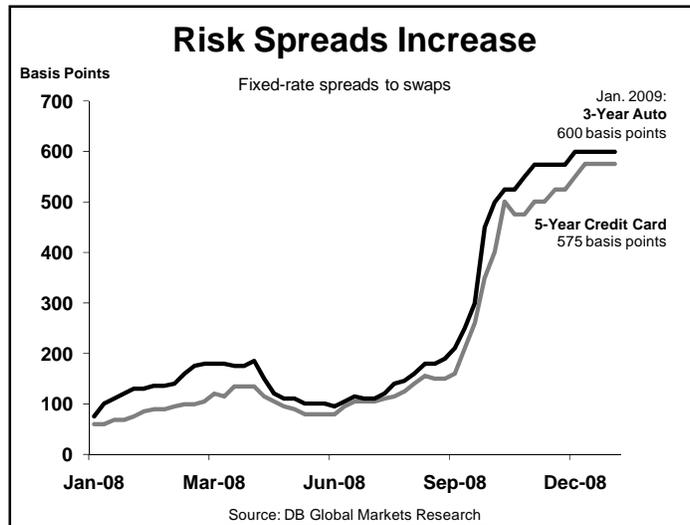
printing of new forms, training of customer service personnel, just to mention a few. For example, training for customer service personnel and modifications of call scripts could require hundreds of thousands of hours for each of the largest card issuers. The huge technological infrastructure that underpins 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.”⁴ 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.

⁴ 74 Federal Register 5548

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 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. As Sandra Braunstein, the Director of Consumer and Community Affairs for the Federal Reserve noted that “18 months is a challenge in and of itself.” She stressed that “[i]n order to implement this, card issuers are going to need to rethink their entire business models...reprogram all their systems...redesign all the pieces of paper that they use...there needs to be adequate time allotted for that.” And, as there are 6,000 credit card issuers, it is unreasonable to assume that all could easily or simply change to be in compliance.

In fact, if the time period were shortened (particularly to as short as a few months as some have suggested), the impact could be devastating. There would not be time to evaluate the consequences for funding, pricing and allocation of credit. As a result, many issuers may not be willing or able to take the risk and would price and allocate credit accordingly. The Federal Reserve, which studied this in detail over the last several years, understood the enormity of the task and the implications for a shorter period.

III. The Federal Reserve Rule Should Be Allowed to Work and Provides a Framework for Future Changes

As I have described in detail above, the changes made in federal law affect every aspect of credit card lending. They will take a huge amount of bank resources to ensure that the new measures are fully implemented and effective. As the Federal Reserve recognized, the constraints on risk-based re-pricing and other limitations restricting the ability of issuers to act quickly in response to higher levels of default risk by borrowers will necessarily translate into less credit and/or higher-priced credit for some borrowers. The 18-month time period for implementation has the benefit of easing whatever adjustments might be made and the negative impact they may have on consumers. Time will be required to see how these new regulations will impact individual customers, small businesses and the broader economy. Before further regulating, it is important to gauge the full impact on the marketplace. Simply put, these new rules should be allowed to work.

The adjustments expected would need time even under the best of economic circumstances. Unfortunately, the economic recession adds additional concerns; changes in rules and business practices – and their implications for credit availability and pricing – will certainly be magnified in this recession. Secondary market funding is already in disarray; unemployment is rising; and delinquencies on credit cards are increasing. While credit card underwriting has been consistent and

did not follow the housing markets' foray into non-traditional affordability products, losses are increasing as individuals struggle to make ends meet. In fact, disruption in income – particularly from job losses – is by far the most significant predictor of delinquencies and losses on consumer loans. Credit card issuers are naturally concerned and want to be sure that credit remains available to their customers. Thus, on top of changes affecting all aspects of the business, they must also deal with the economic fallout that affects many of their customers. Fortunately, the 18-month time period provides time to cope with all these changes. If additional changes to the law or regulations were adopted and required to be implemented in a short period of time, it would disrupt an already fragile balance.

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.

IV. Comments on the “Credit Card Accountability Responsibility and Disclosure Act”

Many of the core issues included in the “Credit Card Accountability Responsibility and Disclosure Act” (S. 3252, the 110th Congress) are already addressed by the new credit card regulations. Like the bill, the regulations prohibit rate increases on existing balances with some exceptions, bans 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. While there are some differences in the details, ABA’s perspectives about the new card rules also apply to similar provisions in this bill and in other legislation. Taking a broad view, many of the significant concerns expressed by policymakers over card practices have been directly addressed by the final regulatory rules.

The bill also includes several provisions that go beyond the new rules. Please find below some of our initial thoughts with respect to these provisions. We would be happy to provide additional comments going forward.

Credit bureau reporting. [Sec. 104] The bill would prohibit furnishing information about a “newly opened” account to a credit bureau before the card has been activated by the consumer, presumably dealing with concerns that consumers may have received a card with different terms than the one for which they applied. Unfortunately, this could expose issuers to unforeseen risk. Information that an individual has applied for an account, particularly where there are multiple applications, is a factor that bears on that person’s creditworthiness and default risk. The bill would deprive issuers of this critical risk assessment information in situations where a consumer obtains new credit lines but does not immediately activate them. It also opens the door wide for fraud and identity theft. For example, identity thieves could open several new accounts under one person’s name and each of

the lenders would not have any information about the other accounts. Importantly, the opening of several new accounts is often a strong indicator of identity theft, and reporting them to consumer reporting agencies is an important way of identifying when this is occurring and so that actions can be taken to protect consumers.

Prohibition on pay to pay. [Sec. 103] The bill prohibits any separate fee to pay a bill, regardless of whether payment is made by mail, electronic transfer, telephone, or by other means. Most credit card lenders offer their customers several ways to make payments – online, through the mail, by telephone or in person at a branch, and do not charge customers for payment processing other than by telephone. Telephone payments are expensive to provide because they require manual intervention. However, the fee associated with telephone payments is primarily meant to encourage consumers to use more efficient means of payment processing, while still allowing them the option of paying by telephone and avoiding late charges. An outright prohibition on such fees would more than likely cause lenders to stop telephone payments, which means fewer options for consumers. We believe that this provision will be counterproductive and lead to fewer choices for consumers.

Tying fees to costs.[Sec.103] The bill mandates that charges and fees for violations of card agreements (e.g., late fees, over-the-limit fees, and penalty interest increases) must be “reasonably related” to the cost of the violation to the card issuer. The ABA has serious concerns over price controls that attempt to regulate charges and fees in the private sector. These fees can be avoided altogether by careful management by consumers. Thus, in general, we believe that customers should be the ultimate arbiters regarding the appropriateness of any pricing structure and government efforts to intervene will inevitably distort the marketplace. Moreover, there are various reasons other than cost that may drive pricing. For example, just like a parking ticket may reflect fees well in excess of the cost of actually issuing the ticket for the purpose of affecting behavior (e.g., do not

park illegally), bank fees are often used to encourage appropriate behaviors, such as paying your bill on time or using more efficient services. While these fees may be in excess of costs, they serve other purposes, and again, *are easily avoided by consumers*.

Over-the-limit fee opt-out. [Sec. 103] The bill requires that consumers must be notified of their right to opt-out of over-the-limit (OTL) protection and no OTL fees can be charged for those that do. For consumers who do not opt-out, there are restrictions on when and how OTL fees may be imposed. Most consumers want over-the limit transactions to go forward – even though a fee will be charged for it. Research shows that customers value the ability to use more than their credit limit in certain situations because being declined can be both embarrassing and inconvenient.

In addition, this restriction presents operational problems. Because of technical limitations, neither the credit issuer nor the merchant may know whether an authorized transaction will cause an account to exceed its credit limit. Transactions are not real-time. At the time of a particular transaction, other, earlier transactions may have not yet posted. Some merchants do not seek authorization or process the transaction online. There may be intervening transactions, such as an automatic periodic payment. In addition, merchants such as hotels and car rental agencies may have requested an authorization amount that exceeds the amount of the actual transaction, temporarily inflating the balance. For these reasons, many card issuers create a “cushion” in deciding whether a balance has exceeded the limit. Card issuers also, as a matter of competition and good service, monitor customer habits and increase limits based on customer need and eligibility.

OTL fees and credit limits are clearly disclosed, so consumers can make appropriate decisions. If a consumer does exceed his or her credit limit, the issuer should be permitted to charge the consumer as a result of the consumer’s decision to exceed the credit limit.

Five-star rating system. [Sec. 502] The GAO is required to determine whether the establishment of a five-star rating system to reflect the safety of card terms, marketing, customer service practices and product features would be beneficial to consumers. The credit card market is highly competitive and products are constantly being refined to meet consumer demands. In fact, there is no set standard on what makes a card “five stars” – one customer may want a high rewards program while not caring about interest rates; another may just focus on the interest rate. Thus, at best, any new rating system would be flawed because it cannot take into account customer priorities, making such a rating system misleading and uninformative. Further, the new Federal Reserve disclosures rules will allow customers to more easily compare different cards and chose the one that meets their needs the best, making such a rating system unnecessary. Moreover, private sector evaluations can, and do, ensure that third-party assistance to consumers on various card offerings is available, further making the creation of an expensive government bureaucracy in this area unnecessary.

Under Age 21 Restrictions. [Sec. 301-303] The bill prohibits issuing a credit card to anyone under age 21 unless the parents cosign, ability to repay is demonstrated or a financial literacy course is completed. There are also restrictions on affinity cards and prescreened offers to those under age 21. Before marketing to students or other young adults, credit card issuers undertake a thorough credit review similar to that of their general customer base. As a result, the credit performance of this portfolio is quite good. The proposed restrictions in the bill are not necessary for sound credit management and might preclude credit to numbers of young adults who in fact can handle it, and who benefit from a credit card not only for their daily transactions but also to establish a credit history. Rather than restricting their access to credit, we believe it more appropriate to teach young people how to use credit wisely and that is why ABA and our member banks strongly support financial literacy programs.

Fed Reports on Profitability and Rates. [Sec. 110] The bill amends Section 136(b) of TILA by adding several new data collection and reporting requirements for the Federal Reserve concerning credit cards. For example, the Federal Reserve must list each type of transaction for which card issuers have charged a separate interest rate. For each type of transaction, the Federal Reserve must show each distinct interest rate charged to a card holder, the number of cardholders to whom each such rate was applied and the total amount of interest charged to such cardholders. Similar data collection requirements are put in place for each type of fee charged to card holders. In addition, the Federal Reserve must report to Congress annually on the profitability of credit card operations of depository institutions, which is to include estimates of interest rates of less than 25 percent APR, equal to or more than 25 percent APR, fees on cardholders, fees on merchants and any other “material” source of income.

The bill will add unnecessary regulatory burden with little, if any, benefit, and seeks to establish a precursor to a price control system that will have government decide prices in the marketplace. This will stifle innovation and provide little benefit to consumers. We believe consumers should be the final arbiters regarding the appropriateness of any fees or interest charges in the marketplace.

Interchange Study. [Sec. 501] The GAO is required to conduct a study on interchange fees and the effect on consumers and merchants. This is an unbalanced approach that would produce questionable results. For instance, GAO is not asked to study how government interference in the market by artificially setting fees could harm consumers. There has already been some experience in this area. In Australia, the Reserve Bank of Australia (“RBA”) arbitrarily capped interchange rates. As a result, Australian merchants now pay less for payment card acceptance, but there is no evidence

that they have passed these savings on to consumers. In fact, Australian consumers now pay more for payment cards and receive fewer benefits as a result of the RBA's action.

In addition, the bill does not require GAO to study the benefits merchants receive from using the payment systems. The price that merchants pay to use these systems through the interchange fee is far below the value they receive in return. For example, it is card issuers and not merchants that absorb losses from fraud and non-payment in credit card transactions. It is important that these and other issues are included if Congress directs GAO to provide a fair and balanced study on this issue. We again caution that government intervention in price-setting in the marketplace is likely to have serious unintended consequences for consumers. This should not be taken lightly.

Conclusion

Mr. Chairman and members of the committee, ABA believes that credit cards provide an invaluable service to consumer and small businesses, and have become integral to our economic system. Any additional actions must be carefully considered so as to not further limit the availability of credit at reasonable rates to all creditworthy borrowers. This is particularly important given the current weak economy and the need for consumers to have access to credit to meet their daily needs. We stand ready to work with this committee as it continues to review the pros and cons of any further changes.