Written Testimony

Of

Michael D. Donovan

Partner

Donovan Searles, LLC
Philadelphia, PA 19103

also on behalf of

The National Consumer Law Center and
The National Association of Consumer Advocates

Before the

SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

January 25, 2007

INTRODUCTION

Chairman and members of the Committee, thank you for the opportunity to speak about some of the current abuses in the credit card industry and to describe the problems and experiences of the everyday consumers I represent in Pennsylvania and elsewhere. This testimony also is presented on behalf of the low-income clients of the National Consumer Law Center and the National Association of Consumer Advocates.[1]

I started my career in 1984 as a trial and appellate attorney at the Securities and Exchange Commission here in Washington, D.C. After working at the Commission, I entered private practice at a firm in Philadelphia, PA. Since about 1993, I have concentrated my practice on consumer matters, which has included cases challenging credit card company practices, cases against debt collectors for violations of the Fair Debt Collection Practices Act, cases against predatory lenders for unfair and deceptive lending practices and cases against finance companies for bait and switch schemes and illegal loan packing.

[1]The National Consumer Law Center, Inc. (NCLC) is a non-profit Massachusetts 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 a series of sixteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending*, (5th ed. 2003) and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (3d ed. 2005) and *Foreclosures* (1st ed. 2005), 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 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 extensive comments to the federal agencies on the regulations under these laws. The National Association of Consumer Advocates (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers. This testimony was co-written by Alys Cohen, staff attorney at the National Consumer Law Center.

I argued before the U.S. Supreme Court in the case of *Smiley v. Citibank,* which concerned whether late fees are "interest" under the National Bank Act. I also obtained a landmark decision from the Third Circuit Court of Appeals in *Rossman v. Fleet Bank,* holding that the Truth in Lending Act prohibits bait and switch marketing schemes and does not allow a credit card issuer to change a "No Annual Fee" card to an annual fee card, at least within the first years after the card was issued. I am one of the co-chairs of the Consumer Law Subcommittee of the American Bar Association's Litigation Section and I am a former chair of the National Association of Consumer Advocates.

REAL WORLD CREDIT CARD NIGHTMARES

Penalty Fees/Default Accounts

Practically every week a client brings in a collection letter claiming that the client owes thousands for a delinquent credit card debt. The client typically describes facts that mimic those described by the Court in *Discover Bank v. Owens.* In that case, an Ohio court found that Ms. Owens, an elderly woman who depended on a monthly Social Security Disability ("SSD") check, had more than repaid the principal balance plus interest that she had borrowed on a Discover credit card. The court rejected Discover's attempt to collect an additional $5000 in late fees, penalty interest and credit protection costs, because those charges were, in the court's view, unconscionable.

Many of the clients I see every week are just like Ms. Owens. They usually depend on a monthly SSI or SSD check or are on very tight budgets because of job conditions, a recent divorce or a family catastrophe. An example is Ms. C., who lives in North Philadelphia and has received SSI payments of about $600 per month for the past 14 years.

Ms. C. started with a Providian card in 1997, with a $1,000 credit limit and an APR of about 15%. The Providian card has since become a Washington Mutual Card, because Washington Mutual purchased the Providian card portfolio. Every month, Ms. C's card had charged to it a "credit protection fee" of as much as $47.40. Ms. C. had no idea what the fee was for. Her multiple written attempts to eliminate the fee were ignored by the bank.

Ms. C. has attempted to keep up with the minimum payments on the WAMU card and three other cards she has, but she has fallen off the treadmill. Her last minimum payment for one card was $247; for another $67; and about $80 for the two others. By August 2006, nearly $400 per month was coming due on the cards, all of which Ms. C. attempted to pay from her monthly $600 SSI check. As of August, 2006, the APR on her WAMU card had increased to a penalty rate of 31.49%.

Ms. C. has rarely used any of the credit cards for at least the past three years. From time to time, she has used them to buy gas or prescriptions, but for the most part they have been at or above their credit limits. On the original Providian card, Ms. C has repaid at least double what she actually borrowed, if you ignore the worthless "credit protection" fees she was charged over the years.

These facts are virtually identical to the facts in *Discover Bank v. Owens*, where the Court found that Ms. Owens had repaid over $3,400 on an original debt of $1,900 but was still assessed a monthly late fee and credit protection fee. Both borrowers – Ms. C in Philadelphia and Ms. Owens in Ohio – allegedly still owed the banks over $5,000 in penalty interest, fees and charges despite having repaid all principal borrowed plus a very handsome return to the banks.

Had Ms. C been less scrupulous and had just stopped paying years earlier, the penalty rates and fees probably would have stopped when the bank wrote off the debt. In fact, it has been my experience that it is the conscientious – those who earnestly try to keep up with their payments – that are most hurt and frustrated by the escalating fees and penalties.

Universal Default

Even consumers who always pay on time cannot avoid the pricing abuses. Mr. S, a consumer client from York, PA, is an example. He had two credit card accounts: one at U.S. Bank; the other at Chase. He always paid these accounts on time and diligently. Nonetheless, in March 2005, U.S. Bank increased the APR on his account from around 9.9% to about 21.9%. The Bank told Mr. S in writing that a review of his credit report indicated he had too much total credit outstanding and, therefore, his APR was being increased. At about the same time, Chase also increased the APR on his account, from about 11.9% to about 27.9%. But Chase went even further; it also lowered his available credit line. Like U.S. Bank, Chase told Mr. S that his lower FICO score caused the increase in his APR and the reduction in his credit line. Incredibly, Chase lowered the available line to the exact amount of the outstanding balance on Mr. S's credit card. So, when Chase added the daily finance charge to the account, it caused the account to go over the reduced credit limit, which then caused automatic over-limit fees to be charged as well. Mr. S did not learn of this bank-caused over-limit "default" until his statement arrived just days after the letter telling him about the reduced credit line.

What was even more frustrating for Mr. S is that the information that caused his credit report to change was itself incorrect. Apparently, one of the credit bureaus had reported an unpaid tax lien. But there was no tax lien. In fact, Mr. S was owed a municipal tax refund. The credit bureau evidently misread or overlooked one of the columns on the municipal tax lien records.

In sum, two separate credit card companies imposed default penalty rates on Mr. S even though he had never missed or been late with any payment on the cards. For Mr. S, the imposition of universal default was an indisputable mistake, but neither bank ever reimbursed him for the months of extra-contractual charges they collected.

Still another client, Ms. M. from Murraysville, PA, had a similar experience. She transferred a balance from another card to her MBNA card, which had a lower 8.9% rate. She always paid her MBNA bill on time and 90% of the time paid more than the monthly minimum. But a few months after the balance transfer MBNA increased the card's APR to 18.49%. Ms. M is sure she never received any change in terms notice from MBNA. When she called MBNA about the increase, they said they had reviewed her credit history and that the higher rate was imposed because of her high debt ratio. MBNA then offered to connect her to their home equity loan department. Ms. M believes she was deceived by MBNA's balance transfer offer because she would not have accepted it if she knew MBNA could or would impose an even higher rate than the other card did before she transferred the balance.

For Ms. M and many other clients we have seen, universal default amounts to a classic unfair and deceptive practice, because the banks go back on the very promises and commitments they made when the consumers agreed to accept the card or transfer the balance.

Application of Payments

Similar problems occur with the application of payments by credit card issuers. Another consumer client, Mr. W, applied for a Capital One credit card advertising a 1.9% APR for balance transfers. Upon transferring over $7,000 to the new account, Mr. W was assessed a balance transfer fee of about $250. The balance transfer fee was recorded as a "purchase," and the standard APR of 18.9% for purchases was then applied to that fee. After Mr. W had made several payments, he noticed that the outstanding balance on the transfer fee was actually above $250. Apparently, only a tiny fraction of his monthly payment was being applied to the balance transfer fee, so the balance on that charge was actually increasing under the 18.9% APR while the balance on the transferred amount at the much lower APR was declining. Mr. W determined that if he had continued paying the amounts he was paying on the card, the Purchases balance would not have been paid off for over three years, and he could have paid nearly $250 in additional interest on the transfer fee of $250. The true cost of the balance transfer was far different from the 1.9% advertised by Capital One. The true cost of credit was about 7.9%, which was not all that different from the APR on the card from which he had transferred the balance. Even worse, after about ten months, Capital One sent a notice to Mr. W that it was increasing the APRs on all of its accounts and that Mr. W had to reject the proposed increase within 15 days. Mr. W missed the deadline for rejecting the change in terms because he was away on vacation and had assumed, incorrectly, that the envelope was just another one of the many solicitations he continued to receive for a Capital One credit card.

THE ESCALATING PROBLEMS WITH CREDIT CARD DEBTS

The Industry and its Abuses Keep Growing

As the above stories demonstrate, a significant amount of the debt load facing American households is caused not so much by consumer borrowing, but by the harsh – and exorbitantly expensive – tactics of the credit card industry. A significant contributor to the snowballing credit card debt of American consumers is the enormous increase in both the number and amount of non-periodic interest fees charged by credit card issuers. These "junk" fees include both fees considered to be finance charges (cash advance, balance transfer, wire transfer fees) and non-finance charge "other" fees. Most important among the latter are late payment and over-limit fees. Other abuses include penalty interest rates (where rates are raised due to late payments or exceeding credit limits on the card or simply if the consumer's credit score decreases below a certain number), deceptive marketing and establishing cut-off times for payment postings that cause borrowers to incur a late fee even if the payment arrives on its due date (for example, by posting all payments at 11 a.m. so that any payment received in the afternoon mail is considered late).

From 1978 to 1995, credit card debt increased six-fold to $378 billion.[2] In 1996, the Supreme Court paved the way for credit card banks to increase their income stream even more dramatically. In *Smiley v. Citibank (South Dakota), N.A.*, the court approved of the Office of Comptroller of Currency's definition of interest that included a number of credit card charges, such as late payment, over-limit, cash advance, returned check,

[2] *See* Fed. Res. Bull., *available at* http://www.federalreserve.gov/releases/g19/hist/cc_hist_mt.txt.

annual, and membership fees.[3] As a result, national banks and other depositories can charge fees in any amount to their customers as long as their home-state laws permit the fees and so long as the fees are "interest" under the Office of the Comptroller of the Currency ("OCC") definition. Uncapping the amount of fees that credit card banks can charge nationwide has resulted in the rapid growth of and reliance on fee income by credit card issuers.

After *Smiley*, banks rushed to increase late charges, over-limit fees, and other charges. The average late payment fee has soared from $14 in 1996 to over $32 in 2004.[4] Over-limit fees have similarly jumped from $14 in 1996 to over $30 in 2004.[5]

Now banks impose these fees, not as a way to curb undesirable behavior from consumers – which used to be the primary justification for imposing high penalties – but as a significant source of revenue for the bank. Since *Smiley*, penalty fee revenue has increased nearly nine-fold from $1.7 billion in 1996 to $14.8 billion in 2004.[6] The income from just three fees – penalty fees, cash advance fees and annual fees – reached $24.4 billion in 2004.[7] Fee income topped $30 billion if balance transfer fees, foreign exchange, and other fees are added to this total.[8] Concurrently, card issuer profits,

---

[3] Smiley v. Citibank (S.D.), Nat'l Assn., 517 U.S. 735, 116 S. Ct. 1730, 135 L. Ed. 2d 25 (1996). The OCC definition of interest is found in 12 C.F.R. § 7.4001(a).

[4] Cardweb.com, *Late Fees* (Jan. 28, 2005), *at* http://www.cardweb.com/cardtrak/news/2005/january/28a.html.

[5] Cardweb.com, *Over-limit Fees* (Feb. 2, 2005), *at* http://www.cardweb.com/cardtrak/news/2005/february/2a.html.

[6] Cardweb.com, *Fee Party* (Jan. 13, 2005), *at* http://www.cardweb.com/cardtrak/news/2005/january/13a.html.

[7] *Id.*

[8] *Id.* If merchant-paid fees are combined with consumer-paid fees, the total fee income is estimated at $50.8 billion.

though declining somewhat between 1995 to 1998, have steadily increased between 1999 and 2004. These profits rose from 3.1% in 1999 to 4.5% in 2004.[9]

Not only has the size of fee income for credit card issuers grown enormously, the types of fees have mushroomed as well. The Federal Reserve Board provides a list of fees to consumers in a brochure titled "Choosing a Credit Card."[10] The most common fees incurred in credit card transactions include:

NAME OF FEE	DESCRIPTION OF FEE
Annual fee (sometimes billed monthly).	Charged for having the card. Fees range from zero to $130.
Cash advance fee.	Charged when the card is used to obtain a cash advance; the fee is usually 3% of the advance, with a minimum of $5 and no maximum.
Balance-transfer fee.	Charged when the consumer transfers a balance from another credit card. Fees range from 2% to 3% of the amount transferred, with a minimum.
Late-payment fee.	Charged if the consumer's payment is received after the due date. Fees range from $10 to $49.
Over-the-credit-limit fee.	Charged if the consumer goes over the credit limit. Fees range from $10 to $39.
Credit-limit-increase fee.	Charged if the consumer asks for an increase in her/his credit limit.
Set-up fee.	One-time fee, charged when a new credit card account is opened.
Return-item fee.	Charged if the consumer pays the bill by check and the check is returned for non-sufficient funds.
Expedited payment fee.	Charged when the consumer makes a payment over the phone. Fees range from $10 to $14.95.
Expedited delivery fee.	Charged when the consumer requests an additional credit card and requests that it be delivered in an expedited way.

9 Cardweb.com, *Card Profits 04*, (Jan. 24, 2005), at http://www.cardweb.com/cardtrak/news/2005/january/24a.html.

10 Federal Reserve Board, *Choosing a Credit Card*, at http://www.federalreserve.gov/pubs/shop,

Replacement card fee.	Charged when the consumer's credit card is lost, stolen, damaged, or otherwise needs to be replaced.
Additional card fee.	Charged when the consumer requests a card for a family member or otherwise wishes an additional card.
Other fees.	Some credit card companies charge a fee to cover the costs of reporting to credit bureaus, reviewing the consumer's account, or providing other customer services.

The problem with these punitive charges, especially in combination with the penalty interest rates, is that they exacerbate the problems of consumers who have hit hard times. Too often these charges drive consumers into bankruptcy, resulting in cascading losses to individuals, families and neighborhoods—of lost savings, lost homes, forced moves, with all of the consequential financial and emotional tolls.

It is not just one or a handful of credit card companies that engage in abusive practices, but a great number of the top ten credit card issuers. [11] It is this pattern of heavy-handed and manipulative conduct by an entire industry that shows that credit card issuers have altered their fundamental treatment of consumers from a fair, respectful business relationship to an abusive, exploitative one.

Credit card companies were not always so free to engage in reprehensible behavior. Credit card deregulation, and the concomitant spiraling credit card debt of Americans, began in 1978, with the Supreme Court's decision in *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*[12] This case gave national banks

[11] For example, *see* information about the civil penalties assessed against Providian and other issuers, http://www.pirg.org/consumer/bankrupt/bankrupt2.htm; and the recent suit initiated against Capital One by the state of Minnesota, http://www.ag.state.mn.us/consumer/PR/PR_041230CapitalOneBank_FSB.htm

[12] Marquette Nat'l Bank of Minn. v. First of Omaha Serv. Corp., 439 U.S. 299, 99 S. Ct. 540, 58 L. Ed. 2d 534 (1978).

the green light to take the most favored lender status from their home state across state lines, and preempt the law of the borrower's home state. As a result, national banks and other depositories established their headquarters in states that eliminated or raised their usury limits, giving them free rein to charge whatever interest rate they wanted.[13] Therein lies the reason why so many of those credit card solicitations sent by mail every week come from Delaware or South Dakota: credit card issuers moved there to export those unregulated states' *lack* of consumer protections nationwide.[14] As of 1978, credit card debt had grown to $50 billion, up from just $5.3 billion when the Truth in Lending Act was passed.[15]

Industry executives also have recognized escalating pricing and advertising problems in the U.S. credit card market. In 2003, Duncan MacDonald, the former general counsel for Citigroup's North American and European credit card businesses, wrote about the credit card pricing mess in the American Banker.[16] Mr. MacDonald observed that the Office of the Comptroller of the Currency – the primary regulator of

---

[13] Other depository institutions obtained the same most favored lender status when Congress enacted § 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (codified at 12 U.S.C. § 1831d).

[14] South Dakota and Delaware, at the beginning of the explosive growth of the financial services industry around 1980, sought to attract that industry as part of their economic development strategy. They wanted to "provide [their] citizens with the jobs and benefits a large national credit card operation can provide (attracted by the ability to export limitless credit card rates to other states)," while, it should be noted, protecting their local banks from competition with the exporting banks. Indep. Cmty. Bankers' Ass'n of S.D. v. Board of Governors, Federal Reserve Sys., 838 F.2d 969, 975 (8th Cir. 1988). *Cf*. Richard Eckman, *Recent Usury Law Developments*: *The Delaware Consumer Credit Bank Act and Exporting Interest Under § 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980*, 39 Bus. Law. 1251, 1264 (1984).

It worked, too. South Dakota's tax revenue from banks went from $3.2 million in 1980 to almost $27.2 million in 1987, with the comparable figures for Delaware rising from $2.4 million to almost $40 million. The Economist, July 2, 1988, at 26.

[15] Diane Ellis, *The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-Offs, and in the Personal Bankruptcy Rate,* FDIC--Division of Insurance, Bank Trends, 98-05 (Mar. 1998), *available at* http://www.fdic.gov/bank/analytical/bank/bt_9805.html.

[16] *Comptroller Has Duty To Clean Up Card Pricing Mess*, Letter to the Editor, Duncan A. MacDonald, American Banker, Nov. 21, 2003.

national banks – had "turned a blind eye to [the] lawlessness" of certain credit card issuers. He described one particular issuer, Providian, as being "well known in the card industry as the poster child of abusive consumer practices."

Among Providian's more shocking abuses was its imposition a $29 per month charge for unrequested "credit protection" insurance that was worthless to the vast majority of cardholders. Even more shocking was Providian's use of bar-coded return payment envelopes that used the wrong zip code for the company's billing center. The payment envelopes practically guaranteed that cardholder payments would arrive late and, in turn, generate a late fee on the cardholder account.

Sadly, the abuses were not (and are not) limited to Providian. Mr. MacDonald also decried "The Frankenstein" (his word) that had been created by the Supreme Court's *Smiley* decision. He noted that credit card penalty fees were becoming a "substitute for APRs," and that the industry had devolved into "trip wire pricing," in which any cardholder misstep would set off a series of booby trap rates and penalty fees. He further observed that card pricing had become a massive subsidy for the rich. The penalty fees and rates charged to less well-off cardholders -- who usually revolve their balances -- were subsidizing the cash back and frequent flyer perks used to entice the super-creditworthy, who typically do not carry monthly balances.

Credit card debt has caught millions of households in a trap they simply cannot extricate themselves from without feeling the pressure to file bankruptcy. At the same time, credit card earnings have been consistently higher than returns on all commercial bank activities.[17] The problem is not the profits, it is simply that these profits are based

---

[17] Board of Governors of the Federal Reserve System, *The Profitability of Credit Card Operations of Depository Institutions* (June 2004), *available at*

on abusive practices, and resulting harm inflicted upon American households. The root of these problems is that credit card transactions in this nation are now completely unregulated – and this must change.

Mandatory Arbitrations Clauses Limit Access To Justice

Additionally, many credit card companies are now using mandatory arbitration clauses to circumvent basic due process protections and to obtain default judgments against consumers in distant forums. In Pennsylvania, for example, several credit card issuers obtained default arbitration awards against dozens of consumers from a Minnesota arbitration company, the National Arbitration Forum, that they attempted to have enforced by the Pennsylvania courts. The courts found that the method of service for the arbitrations and the distant forum did not comply with basic due process rules, analogizing the arbitrations to long-outlawed confessions of judgment. The courts then proposed and adopted a rule requiring such collection matters to first be filed in court.

Other courts have concluded that the prohibition of class actions is unconscionable. In truth and in economic reality, few if any consumers can take on an allegedly deceptive credit card practice individually. The stakes are just not high enough for any one consumer, and the time commitment alone far outweighs any potential economic award. No lawyer can handle an individual consumer credit card complaint, because his or her factual investigation will nearly always exceed in time and money the amount that could be recovered for the individual consumer.

---

http://www.federalreserve.gov/boarddocs/rptcongress/creditcard/2004/ccprofit.pdf. While the profitability of the credit card industry as a whole has fluctuated somewhat over these years, this is largely due to the changeability of the group of banks included in the sample. *Id.* at 2.

Credit Card Debt Pushes Borrowers Into Bankruptcy

Almost two years ago, Congress enacted draconian and unbalanced bankruptcy legislation. As a result of this new law, bankruptcy relief is now more complicated and more expensive for everyone who needs it. Despite the breathtaking scope of the new law, it did not place a single constraint on abusive practices by creditors. Yet, a large body of evidence links the rise in consumer bankruptcies over the last 20 years or so to a direct increase in consumer debt. And, as the examples in this statement demonstrate, a substantial portion of that consumer debt can be attributed to sky high interest rates, penalties and fees that credit card companies tack on to the bills of consumers each month.

Regrettably, all too often it is the growing interest, penalties and fees that force struggling families into bankruptcy. Just this week, a front-page article in USA Today[18] on debt and retirees made the link between credit card fees and bankruptcy. A woman from Palm Beach, FL who lives on $1,100 a month from a pension and Social Security said that she was struggling to pay off $6,000 in medical expenses charged to her credit card when it occurred to her that she may never pay off the debt because of the monthly interest charges. She is being charged nearly 30 percent interest, and despite not using the card for any other purchases, she cannot make a dent in the principal because her monthly payment gets eaten up by interest charges.

After a year of experience with the new bankruptcy law, Congress should consider eliminating some of the unnecessary and costly burdens it has placed on financially struggling families seeking relief from debts they cannot pay.

---

18 Kathy Chu, *Retirees Up Against Debt,* USA Today (Jan. 23, 2007) at A1.

PROPOSED SOLUTIONS

More Disclosure Is Not the Answer

Because of the deregulation of bank credit, virtually no state regulation on creditor conduct applies to the practices of the credit card industry.[19] While there are some – very few – limits placed on the most outrageous abuses of consumers by banks by the federal banking regulators, the Truth in Lending Act ("TILA) is the primary regulatory structure applicable to the relationship between credit card issuers and their customers. The TILA was intended to be – and remains – primarily a disclosure statute. Through its enactment and enforcement, Congress intended to enable consumers to compare the costs of credit.[20] However, the TILA was never intended to stand on its own – to be the sole and primary means of regulating and limiting a powerful industry vis-à-vis the individual consumers who borrow money for personal, family or household purposes. Indeed, when the TILA passed in 1968, state usury and fee caps applied to credit card transactions.

Uniform and accurate disclosures *are* useful for consumers, but they cannot substitute for real regulation. The best proof of this is the unbalanced and dangerous situation that the American consumers find themselves in with the open-end credit industry today.

Disclosures are only useful for consumers when all of the following conditions exist –

---

[19] For example, when the state of California tried to address the issue of tiny minimum payments by requiring creditors to provide information to each consumer on how long it would take to pay off a sample credit card balance if only the minimum payment was paid each month, a federal district held the statute was preempted by federal banking statutes. American Bankers Association v. Lockyer, 239 F. Supp.2d 1000 (E.D. Cal 2002).

[20] 15 U.S.C. § 1601(a).

- The consumer has the opportunity to read the disclosures fully;
- The disclosures are unambiguous and understandable;
- The disclosures are true and apply to the entire term of the contract;
- The consumer has the knowledge and sophistication to understand the meaning of the information provided in the disclosures;
- The consumer has the opportunity to make choices based on the information gained through the disclosures.

Moreover, disclosures alone are not sufficient to protect consumers from over-reaching creditors. This is because --

- Consumers lack equal access to information – most consumers will not have the knowledge to understand the legal consequences of the terms of credit.
- Consumers lack equal bargaining power – no consumer has the market power to call up a credit card company and negotiate either the basic terms or those in the adhesion contract.
- The credit card market does not provide real choices. With the increasing consolidation of credit card providers, the industry guarantees *less* meaningful competition. There is generally competition only on the surface, on a few prominently-advertised terms such as the periodic rate and annual fee. Consumers have little or no meaningful choices on the terms that create the bulk of the cost of open-end credit.
- Without some basic substantive regulation, there will continue to be competition between industry players only as to which can garner the most profit from the most consumers – regardless of the fairness, or the effects on consumers.

<u>Recommendations for Statutory Reform</u>

The credit card market in the U.S. is now very mature. To increase market share, industry participants must be more aggressive in their pricing strategies. Because the APR is the primary measure of competitiveness, back-end penalty fees will continue to increase to offset the risks in credit card marketing plans. Consumers do not, however, shop for credit cards based on their penalty fees, and no real competition will ever exist to damper the escalation of those fees. To restore real competition based on the APR, all bank penalties should be controlled by the longstanding common law rules on penalties – the fees are capped by the actual or reasonably expected cost to the bank from a cardholder's breach. This is the principles-based standard reiterated for such fees by the Office of Fair Trading in the United Kingdom and Europe, and it should be applied here as well. Without such an approach, we will continue to see a race to the bottom for backend penalties while the banks deceptively tout unrealistically low APRs.

Accordingly, it is time for the re-regulation of credit card transactions. Real, substantive limits on the terms of credit, and the cost of the credit, including the interest rate and all fees and charges, must be re-imposed. These include:

- A cap on all periodic interest rates, for example, prime plus 10%.
- A cap on all other charges, whether considered a finance charge or not, to an amount the card issuer can show is reasonably related to cost.
- No unilateral change-in-terms allowed.
- No retroactive interest rate increases allowed.
- No penalties allowed for behavior not directly linked to the specific card account at issue.
- No over limit fees allowed if issuer permits credit limit to be exceeded.
- No improvident extensions of credit–require real underwriting of the consumer's ability to pay.
- No mandatory arbitration, either for consumers' claims, or for collection actions against consumers.
- Meaningful penalties for violating any substantive or disclosure requirement that provide real incentives to obey the rules.
- A private right of action to enforce section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive practices by businesses, including banks.

It is no longer a question of balancing the appropriate regulation with the need to assure access to credit. The increasing mountain of debt held by American consumers, coupled with the growing number of abusive practices by the credit card companies, illustrate amply de-regulation has not worked. Since biblical times government has recognized that consumers need strong, enforceable limits placed on the power of lenders to exert their far greater bargaining power in the marketplace. The age old protection of borrowers from over-reaching lenders needs to be reinstituted. We look forward to working with Chairman Dodd and other members of this committee to develop strong, effective credit card legislation.