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CREDIT CARD PRACTICES: FEES, INTEREST CHARGES, AND GRACE PERIODS

HEARING

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON
HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

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MARCH 7, 2007

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CREDIT CARD PRACTICES: FEES, INTEREST CHARGES, AND GRACE PERIODS

WEDNESDAY, MARCH 7, 2007

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
OF THE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:03 a.m., in room 342, Dirksen Senate Office Building, Hon. Carl Levin, Chairman of the Subcommittee, presiding.

Present: Senators Levin, Carper, McCaskill, Coleman, Warner, and Sununu.

Staff Present: Elise J. Bean, Staff Director and Chief Counsel; Mary D. Robertson, Chief Clerk; Julie Davis, Counsel to Senator Levin; Kate Bittinger, Detailee, GAO; Zack Schram, Counsel; Teresa Meoni, Intern; Leslie Garthwaite, Law Clerk; Peggy Gustafson (Senator McCaskill); Christine Sharp, Derek Freeman, and Price Feland (Senator Pryor); Hilary Jochmans (Senator Carper); Mark L. Greenblatt, Staff Director and Chief Counsel to the Minority; Mark D. Nelson, Deputy Chief Counsel to the Minority; Timothy R. Terry, Counsel to the Minority; Michael P. Flowers, Counsel to the Minority; Sharon Beth Kristal, Counsel to the Minority; Clifford C. Stoddard, Jr., Counsel to the Minority; Emily T. Germain, Staff Assistant to the Minority; Robin Landauer (Senator Coburn); John Frierson and Hughes Bates (Senator Warner); Clark Irwin, Melvin Albritton (HSGAC); and Adam Hechavarria (Senator Sununu).

OPENING STATEMENT OF SENATOR LEVIN

Senator LEVIN. Good morning, everybody. In 2001 and 2002, Wesley Wannemacher, our first witness this morning, used a new credit card to pay for expenses mostly related to his wedding. He charged a total of about $3,200, which exceeded the card's limit by $200. He spent the next 6 years trying to pay off the debt, averaging payments of about $1,000 a year.

As of last month he had paid about $6,300 on his $3,200 debt, but his February billing statement showed that he still owed $4,400.

Now how is it possible that a man pays $6,300 on a $3,200 credit card debt, but still owes $4,400? Here is how. Take a look at Exhibit 1.[1]

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[1] See Exhibit 1 which appears in the Appendix on page 134.

On top of the $3,200 debt, Mr. Wannemacher was charged by the credit card issuer about $4,900 in interest, $1,100 in late fees, and $1,500 in over-the-limit fees. He was hit 47 times with over-the-limit fees, even though he went over-the-limit only three times and exceeded the limit by only $200. So for going over-the-limit by $200, he was hit with $1,500 in over-the-limit fees.

Altogether, these fees and the interest charges added up to $7,500 which, on top of the original $3,200 credit card debt, produced total charges to him of $10,700. In other words, the interest charges and fees more than tripled the original $3,200 credit card debt, despite payments by the cardholder averaging $1,000 per year.

Unfair? Clearly unfair, I think. But our investigation has shown that sky high interest charges and fees are not uncommon in the credit card industry.

While the Wannemacher account happened to be at Chase, penalty interest rates and fees are also employed by Bank of America, Citigroup, and other major credit card issuers. Last week Chase decided to forgive the remaining debt on the Wannemacher account. While that is good news for the Wannemacher family, that decision does not resolve the problem of excessive credit card fees and sky high interest rates that trap too many hard-working families into a downward spiral of debt.

Today we are focusing on industry practices affecting three fundamental aspects of credit cards: grace periods, interest rates, and fees.

After an investigation that required digging into the details of complex billing records, unfair, little known, and hidden industry practices emerged which squeezed not only the consumers struggling to repay debt but also hit those with accounts in good standing.

Start with grace periods. Many consumers think that credit cards provide them with a grace period before interest is charged. Not always true. If you owe money on your card from the prior month, there is no grace period on new purchases. Each of those purchases racks up interest charges from day one. And today, 50 percent to 60 percent of U.S. cardholders carry unpaid balances. They do not get a grace period on their purchases. I wonder how many working families understand that.

Interest is another key issue. Our investigation found that even accounts in good standing are socked unfairly by little known credit card industry practices that inflate interest rates for millions of consumers. Take a look at Exhibit 2.[1]

Suppose a consumer who usually pays their account in full and owes no money on December 1, makes a lot of purchases in December, and gets a January 1 credit card bill for $5,020. That bill is due on January 15. Suppose the consumer pays that bill on time, but pays $5,000 instead of the full amount owed, which was $5,020.

Now what do you think the consumer owes on the next bill? If you thought that the next bill would be the $20 past due plus interest on the $20 past due, you would be wrong. In fact, under industry practice today, the bill would likely be twice as much as that.

[1] See Exhibit 2 which appears in the Appendix on page 135.

And that is because the consumer would have to pay interest, not just on the $20 that was not paid on time, but also on the $5,000 that was paid on time.

In other words, the consumer would have to pay interest on the entire $5,020 from the first day of the billing month, January 1, until the day the bill was paid on January 15, and that interest is compounded daily. So much for the grace period.

In addition, the consumer would have to pay the $20 past due plus interest on the $20 from January 15 to January 31, again compounded daily. In our example, using an interest rate of 17.99 percent, the same rate used on Mr. Wannemacher's account before he got into trouble, the $20 debt would in one month rack up about $35 in interest charges and balloon into a debt of $55.21.

Now you might ask, hold on, why does a consumer have to pay any interest at all on the $5,000 that was paid on time? Why does anyone have to pay interest on a portion of a debt that was paid by the date specified in the bill, in other words on time? The answer is because that is how the credit card industry has operated for years, and they have gotten away with it.

There is more. You might think that once the consumer gets gouged in February, paying $55.21 on a $20 debt and pays that debt on time and in full, without making any new purchases, that would be the end of it. But you would be wrong again. It is not over. Look again at our example in Exhibit 2.[1]

Even though on February 15 the consumer paid the February bill in full and on time, all $55.21, the next bill has an additional interest charge on it for what we call trailing interest. In this case the trailing interest is the interest that accumulated on the $55.21 from February 1 to February 15, which is the time period from the day when the bill was sent to the day that it was paid. The total is 38 cents. While some issuers will waive trailing interest if the next month's bill is less than a dollar if a consumer makes a new purchase, which is typical, a common industry practice is to fold the 38 cents into the end-of-the-month bill reflecting the new purchase.

Now 38 cents is not much in the big scheme of things. That may be why many consumers do not notice these types of extra interest charges or try to fight them. Even if someone had questions about the amount of interest on a bill, most consumers would be hard pressed to understand how the amount was calculated, much less whether it was incorrect. But by nickel and diming tens of millions of consumer accounts, credit card issuers reap large profits.

Some of the questions then that we want to examine today are whether it is fair to make consumers pay interest on debt which they pay on time, whether it is fair to charge trailing interest when a bill is paid on time and in full, and whether it is fair to assess interest in such convoluted, opaque ways that make it nearly impossible for consumers to figure out what is happening to them.

In addition, it used to be that credit cards offered a single fixed interest rate. That is not true anymore. Recently the Government Accountability Office, the GAO, prepared a report examining the interest rates and fees being applied to 28 popular credit cards

[1] See Exhibit 2 which appears in the Appendix on page 135.

issued by the six largest credit card companies.[1] GAO found that today credit card issuers typically apply multiple interest rates to the same card.

For example, the credit card industry typically uses one interest rate for cash advances, another for regular purchases, and a third for balance transfers. And if a card holder pays late or exceeds a credit limit, they can substitute a so-called penalty interest rate that can exceed 30 percent. All of these interest rates can also vary with some frequency since many credit card issuers use interest rates that rise and fall with the prime rate.

The use of multiple interest rates that change over time makes it nearly impossible for consumers to track their finance charges or even know beforehand what interest rates will apply to their card in a specific month. Today most consumers find out their interest rates when they get their billing statements, after they have made their purchases or obtained a cash advance.

There is also a recent trend towards higher interest rates. When the GAO examined data provided by the six largest credit card issuers, it found a dramatic increase over 2 years in the number of credit card accounts with higher interest rates. For example, from 2003 to 2005, the number of accounts subject to interest rates greater than 25 percent doubled, from 5 percent to 11 percent of all accounts. The number of accounts subject to the three highest interest rates also doubled, going from 29 percent to 57 percent. That means that, in 2005, 57 percent of the accounts at the six largest credit card issuers had interest rates from 15 percent to more than 30 percent.

The bottom line is this, that the use of multiple and variable interest rates, together with anti-consumer payment allocation rules, confuse consumers about what interest rates apply to what debts when. The disclosures on calculating interest rates are so complicated that virtually no average consumer can understand them.

But the consequences of industry practice on industry rates go deeper than inadequate disclosure and consumer confusion. In some cases consumers become overwhelmed with penalty interest charges that can double or triple the size of their debt and make it nearly impossible for them to pay their bills. Equally disturbing are the interest charges that are quietly added to accounts in good standing, inflating the outstanding balances often without the credit card holder realizing it.

And finally, on the issue of fees, the GAO report identified a host of fees imposed by the credit card industry. The GAO found that late fees now average $34 per month, while over-the-limit fees average $31 per month. Some credit card issuers also have policies that allow them to impose over-the-limit fees repeatedly. In Mr. Wannemacher's case, although his purchases exceeded the limit just three times, for a total of $200, he was charged over-the-limit fees 47 times and paid $1,500 on his $200 over-the-limit amount. I think that is unfair gouging.

Another common fee which I call pay-to-pay is the $5 to $15 that issuers charge consumers to pay their credit card bill over the tele-

[1] See Exhibit 6 which appears in the Appendix on page 142.

phone. To me, charging folks a fee to pay their bills—again we are talking about people paying their bills on time—is a travesty.

Excessive and abusive fees are then made worse by the industry practice of including all fees in a consumer's outstanding balance so that they, too, incur added interest. In other words, the higher the fees, the higher the balances owed, and the higher the interest charges.

It is sometimes high penalty fees and interest charges rather than purchases that push a consumer over a credit limit, triggering more penalties and deeper debt.

Credit card issuers sometimes say that they are engaged in a risky business, lending unsecured debt to millions of consumers, and that is why they have to price their product so high. But the data shows that typically 95 percent to 97 percent of U.S. cardholders pay their bills, and it is clear that credit card issuers charge interest and fees in ways that produce enormous profit. For the last decade, credit card issuers have reported year after year of solid profits, maintained their position as the most profitable sector in the consumer lending field, and reported consistently higher rates of return than do commercial banks.

Credit card issuers make such a hefty profit that last year they sent out 8 billion pieces of mail soliciting people to sign up.

With profits like those, credit card issuers can afford to stop unfairly charging interest on debt that is paid on time, stop forcing consumers to pay for the balances with the lowest interest rates first, stop charging consumers a fee to pay their bills, and stop imposing abusive fees and excessive penalty interest rates.

As one Michigan businessman expressed it to the Subcommittee, "I don't blame the credit card issuers for putting me into debt, but I do blame them for keeping me there."

To examine these issues in greater detail, we are going to hear today from both consumers and the three largest issuers of credit cards in America. Together Bank of America, Chase, and Citigroup administer over 200 million credit card accounts. Each of these banks, as well as others that we have contacted, have cooperated with the Subcommittee's inquiry and we appreciate that cooperation.

Recently some banks have also taken steps to improve their credit card practices, including Chase's recent decision to stop collecting the added interest charges involved in double cycle billing. But much more needs to be done.

Finally, I want to thank the Subcommittee's Ranking Republican, Norm Coleman, and his staff, who have worked so hard to examine these issues with us. I now turn to Senator Coleman for an opening statement.

[The prepared statement of Senator Levin follows:]

PREPARED OPENING STATEMENT OF SENATOR LEVIN

In 2001 and 2002, Wesley Wannemacher, our first witness this morning, used a new credit card to pay for expenses mostly related to his wedding. He charged a total of about $3,200, which exceeded the card's credit limit by $200. He spent the next six years trying to pay off the debt, averaging payments of about $1,000 per year. As of last month, he'd paid about $6,300 on his $3,200 debt, but his February billing statement showed he still owed $4,400.

How is it possible that a man pays $6,300 on a $3,200 credit card debt, but still owes $4,400? Here's how. Take a look at this chart. On top of the $3,200 debt, Mr.

Wannemacher was charged by the credit card issuer about $4,900 in interest, $1,100 in late fees, and $1,500 in over-the-limit fees. He was hit 47 times with over-limit fees, even though he went over the limit only 3 times and exceeded the limit by only $200. Altogether, these fees and the interest charges added up to $7,500 which, on top of the original $3,200 credit card debt, produced total charges to him of $10,700.

In other words, the interest charges and fees more than tripled the original $3,200 credit card debt, despite payments by the cardholder averaging $1,000 per year. Unfair? Clearly, I think, but our investigation has shown that sky-high interest charges and fees are not uncommon in the credit card industry. While the Wannemacher account happened to be at Chase, penalty interest rates and fees are also employed by Bank of America, Citigroup, and other major credit card issuers. Last week, Chase decided to forgive the remaining debt on the Wannemacher account, and while that is good news for the Wannemacher family, that decision doesn't begin to resolve the problem of excessive credit card fees and sky-high interest rates that trap too many hard-working families into a downward spiral of debt.

Credit cards are more and more a fixture of U.S. economic life. People use them to buy groceries, rent a car, even pay their taxes. They use credit cards to buy goods on the Internet, and obtain capital for small business ventures. Credit cards provide individuals with a readily accepted payment mechanism, ready access to credit, and the means to manage their finances. In 2005, with an average of 5 cards per household, U.S. families used over 690 million credit cards to buy goods and services worth $1.8 trillion.

But credit cards have also brought problems. They have contributed to record amounts of household debt. They have made it common for working families to be hit with interest rates of 25 percent, 30 percent, or more. They have brought families to their knees with excessive late and over-limit fees, making it harder for them to climb out of debt. When I announced the Subcommittee investigation into credit card practices, my office began receiving hundreds of communications from Americans angry at how they'd been treated by their credit card issuers and identifying a host of practices they view as unfair.

Today we are focusing on industry practices affecting three fundamental aspects of credit cards—grace periods, interest rates, and fees. After an investigation that required digging into the details of complex billing methods, unfair, little known, and hidden industry practices emerged which squeeze not only the consumers struggling to repay debt, but also hit those with accounts in good standing.

Take grace periods. Many consumers think that credit cards provide them with a grace period before interest is charged. Not true. If you owe money on your card from the prior month, there is no grace period on new purchases—each of those purchases racks up interest charges from day one. Today, 50-60 percent of U.S. cardholders carry unpaid balances; they don't get a grace period on any of their purchases. I wonder how many working families understand that.

Interest is another key issue. Our investigation found that even accounts in good standing are socked unfairly by little known credit card industry practices that inflate interest charges for millions of consumers. Take a look at Chart No. 2. Suppose a consumer who usually pays their account in full, and owes no money on December 1st, makes a lot of purchases in December, and gets a January 1 credit card bill for $5,020. That bill is due January 15. Suppose the consumer pays that bill on time, but pays $5,000 instead of the full amount owed. What do you think the consumer owes on the next bill?

If you thought the bill would be the $20 past due plus interest on the $20, you would be wrong. In fact, under industry practice today, the bill would likely be twice as much. That's because the consumer would have to pay interest, not just on the $20 that wasn't paid on time, but also on the $5,000 that was paid on time. In other words, the consumer would have to pay interest on the entire $5,020 from the first day of the billing month, January 1, until the day the bill was paid on January 15, compounded daily. So much for a grace period. In addition, the consumer would have to pay the $20 past due, plus interest on the $20 from January 15 to January 31, again compounded daily. In our example, using an interest rate of 17.99 percent, the same rate used on Mr. Wannemacher's account before he got into trouble, the $20 debt would, in one month, rack up $35 in interest charges and balloon into a debt of $55.21.

You might ask why does the consumer have to pay any interest at all on the $5,000 that was paid on time? Why does anyone have to pay interest on the portion of a debt that was paid by the date specified in the bill—in other words, on time? The answer is, because that's how the credit card industry has operated for years, and they have gotten away with it.

There's more. You might think that once the consumer gets gouged in February, paying $55.21 on a $20 debt, and pays that bill on time and in full, without making any new purchases, that would be the end of it. But you would be wrong again. It's not over.

Look again at our example in Chart No. 2. Even though, on February 15, the consumer paid the February bill in full and on time—all $55.21—the next bill has an additional interest charge on it, for what we call "trailing interest." In this case, the trailing interest is the interest that accumulated on the $55.21 from February 1 to 15, which is time period from the day when the bill was sent to the day when it was paid. The total is 38 cents. While some issuers will waive trailing interest if the next month's bill is less than $1, if a consumer makes a new purchase, a common industry practice is to fold the 38 cents into the end-of-month bill reflecting the new purchase. Now 38 cents isn't much in the big scheme of things. That may be why many consumers don't notice these types of extra interest charges or try to fight them. Even if someone had questions about the amount of interest on a bill, most consumers would be hard pressed to understand how the amount was calculated, much less whether it was incorrect. But by nickel and diming tens of millions of consumer accounts, credit card issuers reap large profits. Some of the questions we want to examine today are whether it is fair to make consumers pay interest on debt which they pay on time, whether it is fair to charge trailing interest when a bill is paid on time and in full, and whether it is fair to assess interest in such convoluted, opaque ways that make it nearly impossible for consumers to figure out what is happening to them.

In addition, it used to be that credit cards offered a single fixed interest rate. That's not true anymore. Recently, the Government Accountability Office (GAO) prepared a report examining the interest rates and fees being applied to 28 popular credit cards issued by the six largest credit card issuers. GAO found that, today, credit card issuers typically apply multiple interest rates to the same card. For example, the credit card industry typically uses one interest rate for cash advances, another for regular purchases, a third for balance transfers, and if a cardholder pays late or exceeds a credit limit, may substitute a so-called penalty interest rate that can exceed 30 percent. All of these interest rates can also vary with some frequency, since many credit card issuers use interest rates that rise and fall with the prime rate.

The use of multiple interest rates that change over time makes it nearly impossible for consumers to track their finance charges or even to know beforehand what interest rates will apply to their card in a specific month. Today, most consumers find out their interest rates when they get their billing statements—after they've made their purchases or obtained a cash advance.

There is also a recent trend toward higher interest rates. When GAO examined data provided by the six largest credit card issuers, it found a dramatic increase over two years in the number of credit card accounts with higher interest rates. For example, from 2003 to 2005, the number of accounts subject to interest rates greater than 25 percent doubled, from 5 percent to 11 percent of all accounts. The number of accounts subject to the three highest interest rates also doubled, going from 29 percent to 57 percent. That means, in 2005, 57 percent of the accounts at the six largest credit card issuers had interest rates from 15 percent to more than 30 percent.

Credit card issuers like to point out that they often offer new customers very low introductory interest rates, such as 0 or 1 percent. But these rates are the "come on" rates, are usually limited to short time periods, and may apply only to a balance transferred from another card. If a cardholder pays late or exceeds the credit limit, the introductory rate may be immediately replaced with a much steeper rate. In some cases, if the cardholder makes new purchases, those purchases are charged a higher interest rate and can't be paid off until the entire balance at the lower rate is repaid. That's because there is an industry wide practice of requiring all consumer payments to be allocated first to the balances with the lowest interest rates.

The bottom line is that use of multiple and variable interest rates, together with anti-consumer payment allocation rules, confuse consumers about what interest rates apply to what debts when. The disclosures on calculating interest rates are so complicated that virtually no average consumer can understand them.

But the consequences of industry practice on interest rates go deeper than inadequate disclosure and consumer confusion. In some cases, consumers become overwhelmed with penalty interest charges that can double or triple the size of their debt, and make it nearly impossible for them to pay their bills. Equally disturbing are the interest charges that are quietly added to accounts in good standing, inflating the outstanding balances often without the cardholder realizing it. Finally, there is the issue of fees. GAO's report identified a host of fees imposed by the credit card industry. GAO found that late fees now average $34 per month, while over-limit fees average $31 per month. Some credit card issuers also have policies that allow them to impose over-limit fees repeatedly. In Mr. Wannemacher case, although his purchases exceeded the limit just three times for a total of $200, he was charged over-limit fees 47 times and paid $1,500. Talk about unfair gouging.

Another common fee, which I call pay to pay, is the $5-15 fee that issuers charge consumers to pay their credit card bill over the telephone. To me, charging folks a fee to pay their bills—again we're talking about people paying their bill on time—is a travesty. Excessive and abusive fees are then made worse by the industry practice of including all fees in a consumer's outstanding balance so that they incur added interest. In other words, the higher the fees, the higher the balances owed, and the higher the interest charges. It is sometimes high penalty fees and interest charges, rather than purchases, that push a consumer over a credit limit, triggering still more penalties and deeper debt.

Credit card issuers like to say that they are engaged in a risky business, lending unsecured debt to millions of consumers, and that's why they have to price their products so high. But the data shows that, typically, 95 to 97 percent of U.S. cardholders pay their bills. And it is clear that credit card issuers charge interest and fees in ways that produce enormous profit. For the last decade, credit card issuers have reported year after year of solid profits, maintained their position as the most profitable sector in the consumer lending field, and reported consistently higher rates of return than commercial banks. Credit card issuers make such a hefty profit that they sent out 8 billion pieces of mail last year soliciting people to sign up.

With profits like those, credit card issuers can afford to stop unfairly charging interest on debt that is paid on time, stop forcing consumers to pay for the balances with the lowest interest rates first, stop charging consumers a fee to pay their bills, and stop imposing abusive fees and excessive penalty interest rates. As one Michigan businessman expressed it to the Subcommittee, "I don't blame the credit card issuers for putting me into debt, but I do blame them for keeping me there."

To examine these issues in greater detail, we are going to hear from both consumers and the three largest issuers of credit cards in America today. Together, Bank of America, Chase, and Citigroup administer over 200 million credit card accounts. Each of these banks, as well as others we have contacted, has cooperated with the Subcommittee's inquiry, and we appreciate that cooperation. Recently, some banks have also taken steps to improve their credit card practices, including Chase's recent decision to stop collecting the added interest charges involved in double cycle billing. But more needs to be done.

Finally, I would like to thank the Subcommittee's Ranking Republican, Norm Coleman, and his staff, who have worked hard to examine these issues with us. I'd like to turn to him now for an opening statement.

Senator LEVIN. Senator Coleman.

OPENING STATEMENT OF SENATOR COLEMAN

Senator COLEMAN. Thank you, Mr. Chairman.

Mr. Chairman, let me start by thanking you not only for initiating this examination into certain credit card industry practices but also more broadly for your continued and tireless advocacy on behalf of the American consumer. You have a long and distinguished history of looking out for the little guy, and this hearing is an important part of that very laudable record. So I do want to say thank you.

Credit card debt is often seen as a very personal problem, but the burgeoning level of household debt in America has implications for the entire Nation. Over the past 25 years, U.S. debt has ballooned from a collective $59 billion in 1980 to approximately $830 billion in the year 2005.

Even more staggering, the number of consumers filing for bankruptcy has increased by 609 percent. These figures have far-reaching implications. Too many Americans across all economic strata are saddled with high interest payments on consumer debt, impeding them from accumulating wealth and achieving their financial goals, including sending children to college and saving money for retirement.

This inquiry today falls squarely in line with the Subcommittee's long tradition of investigations designed to protect the American consumer. During my tenure as Chairman, this Subcommittee conducted similar bipartisan, consumer protection inquiries that uncovered unconscionable, often criminal, schemes in the refund anticipation loan and credit counseling industries. Those investigations exposed how many low income Americans become mired in debt and pay usurious interest rates and exorbitant fees to unscrupulous lenders who exploit their lack of access to low-cost lending.

Although the practices at issue today are not criminal schemes, they clearly have had a devastating impact on the many families who are mired in debt. And credit opportunities that look like a helping hand actually become snares that sink the consumer into further depths of debt.

High interest rates, hefty fees, and crippling penalties impede more and more hard-working families from pursuing the American dream. This problem is only compounded by the often intractable and jargoned disclosures of credit card terms, which are impenetrable to the average consumer. Too many families, not surprisingly, feel that the credit system is rigged against them, and it is time the industry cleaned up its act.

It is not lost on me that over the past 20 years the credit card industry has created financial opportunities for countless Americans by extending credit to a far broader pool of borrowers than other lenders, including many high-risk borrowers who would not otherwise have access to credit. But with these increased opportunities have also come greater complexity and greater vulnerability.

Credit cards are no longer one-size-fits-all and not every borrower knows, or is even told, which is the best, most affordable card for their particular needs. Interest rates can increase in a moment's notice, interest charges grow by leaps and bounds, and the credit that once promised economic opportunity all too often portends financial ruin.

In light of these fundamental market changes and the growing complexity of credit card terms, we need to do more and take a closer look at certain industry practices, including the adequacy of disclosure, the application of high penalty interest rates to previous credit card balances, and the issue of trailing or residual interest which the Chairman has discussed.

The disclosures contained in credit card agreements are written by and for lawyers with an eye more toward staving off litigation rather than educating consumers. Too often consumers are caught unaware by important terms buried deep inside dense, fine-print contacts, replete with interminable sentences and complex jargon.

For example, one credit card disclosure offers us the following: "For each balance, the Balance Subject to Finance Charge on the statement is the average of the daily balances during the billing period. If you multiply this figure for each balance by the number of days in the billing period by the applicable daily periodic rate, the result is the periodic finance charges assessed for that balance, except for minor variations caused by rounding."

After wading through that morass, it should come as no surprise to learn that the GAO recently reported that disclosures are sometimes written at the 27th-grade level. I can only assume that one would need, after 12 years of grade school and 4 years of college, a 4-year medical degree, a 5-year Ph.D., and a 2-year MBA to fully grasp those particular provisions.

Former Supreme Court Justice Louis Brandeis got it right when he said "Sunlight is the best disinfectant." My fear is that the average credit card's complexity has vitiated the traditional disclosure's effectiveness, and consumers are being left in the dark. In many ways, the Schumer Box, which is the box that you see on the forms that is supposed to describe terms and conditions, has more accurately become or needs to become the Schumer Pamphlet. That does not make sense.

We must all work to ensure that disclosures are made in a user-friendly, common-sense, straight forward manner and are drafted not with an eye toward fending off litigation but toward educating consumers regarding their rights and obligations under the card.

Turning to the subject of finance charges, two practices in particular contribute to the public's impression that credit card companies design interest rates specifically to entangle the unsuspecting consumer. I'm talking first about the application of high penalty interest rates to previous credit card balances. For example, a consumer will make a series of purchases on a card with a 10 percent interest rate. Later, if the credit card company reprices his or her account, she may actually end up paying off that debt at a penalty rate of 30 percent. Many consumers think that imposing post hoc materially higher interest rates on prior balances is a misleading bait and switch.

A second practice—known as trailing or residual interest—which the Chairman has discussed and fully described, is also of concern. In other words, this is the practice where, even if the consumer did exactly as the bill instructed—paid off the entire balance, let's say, on March 20—she would still be responsible for the interest that accrued after she received her statement—that is, from March 1 through March 20. The interest charges would be compounding while her check was in the mail.

Better disclosure is one obvious answer here, perhaps even something as simple as a line on your bill that says, "In order to pay your balance in full, please remit the following sum by a certain date."

Regardless, something must be done. To be sure, credit card companies provide absolutely vital services for American consumers, employ over 100,000 Americans of all stripes, and are a sizeable component of the pension plans that many Americans rely on in retirement. But as one prominent industry insider recently remarked to me, "The industry has gone too far, pushed too far, and needs to clean up its act."

Fortunately, some of the work has begun. Several credit card companies have recognized the inadequacies of their disclosures and are eager to propose new formats. Moreover, the Federal Reserve plans to roll out new disclosure requirements later this year. I look forward to reviewing those regulations, and I urge the Fed to draft regulations that will provide some much-needed sunlight to credit card disclosures.

Moreover, at my direction, my staff has reached out to credit card companies to find common sense solutions to these challenges.

I'm happy to report that several issuers have assured us that they are reviewing certain policies and practices. I applaud Chase for its decision last month to eliminate the odious practice known as double-cycle billing. Also, just yesterday Chase announced a major overhaul of its over-the-limit fees, specifically that it will no longer charge such fees after 90 days.

Similarly, Citi deserves praise for its announcement last week that, in its words, "A deal is a deal"—as long as the cardholder upholds her end of the card's terms, Citi will not reprice her card more than once every 2 years.

These are all important steps. More must be done. Clearly, this hearing, I think, has played a major part in instigating change.

And again I thank the Chairman for his vision and his leadership, and I look forward to creating a more consumer friendly lending environment in the figure.

Thank you, Mr. Chairman.

[The prepared statement of Senator Coleman follows:]

OPENING STATEMENT OF SENATOR COLEMAN

Mr. Chairman, I'd like to start by thanking you not only for initiating this examination into certain credit card industry practices, but also—more broadly—for your continued and tireless advocacy on behalf of the American consumer. You have a long and distinguished history of looking out for the little guy, and this hearing is an important part of that laudable record.

Credit card debt is often seen as a very personal problem, but the burgeoning level of household debt in America has implications for the entire nation. Over the past 25 years, U.S. household debt has ballooned from a collective $59 billion in 1980 to approximately $830 billion in 2005. Even more staggering, the number of consumers filing for bankruptcy has increased by 609 percent. These figures have far-reaching implications. Too many Americans across all economic strata are saddled with high interest rate payments on consumer debt, impeding them from accumulating wealth and achieving their financial goals, including sending children to college and saving for retirement. This inquiry falls squarely in line with the Subcommittee's long tradition of investigations designed to protect American consumers. During my tenure as Chairman, this Subcommittee conducted similar bipartisan, consumer-protection inquiries that uncovered unconscionable, often criminal, schemes in the refund anticipation loan and credit counseling industries. Those investigations exposed how many low-income Americans become mired in debt and pay usurious interest rates and exorbitant fees to unscrupulous lenders who exploit their lack of access to low-cost lending. Although the practices at issue today are not criminal schemes, they clearly have a devastating impact on the many families who are mired in debt—and credit opportunities that look like a helping hand actually become snares that sink the consumer into further depths of debt. High interest rates, hefty fees, and crippling penalties impede more and more hard-working families from pursuing their American dream. And this problem is only compounded by the often-intractable and jargoned disclosures of credit card terms, which are impenetrable to the average consumer. Too many families find themselves ensnared in a seemingly inescapable web of credit card debt, and not surprisingly feel that the credit card system is rigged against them.

It is not lost on me that over the past 20 years, the credit card industry has created financial opportunities for countless Americans by extending credit to a far broader pool of borrowers than other lenders, including many high-risk borrowers who would not otherwise have obtained credit. But with these increased opportunities have also come greater complexity and greater vulnerability. Credit cards are no longer one-size-fits-all, and not every borrower knows, or is even told, which is the best, most affordable, card for their particular needs. Interest rates can increase in a moment's notice, interest charges grow by leaps and bounds, and the credit card that once promised economic opportunity all too often portends financial ruin.

In light of these fundamental market changes and the growing complexity of credit card terms, we need to do more and take a closer look at certain industry practices, including the adequacy of disclosure, the application of high, penalty interest rates to previous credit card balances, and the issue of trailing or residual interest.

The disclosures contained in card agreements are written by and for lawyers with an eye more toward staving off litigation rather than educating consumers. Too often, consumers are caught unaware by important terms buried deep inside dense, fine-print contracts, replete with interminable sentences and complex jargon. For example, one credit card disclosure offers us the following:"For each balance, the Balance Subject to Finance Charge on the statement is the average of the daily balances during the billing period. If you multiply this figure for each balance by the number of days in the billing period and by the applicable daily periodic rate, the result is the periodic finance charges assessed for that balance, except for minor variations caused by rounding."

After wading through that morass, it should come as no surprise to learn that the Government Accountability Office recently reported that disclosures are sometimes written at a"twenty-seventh-grade level." I can only assume that one would need—after twelve years of grade school and four years of college—a 4-year medical degree, a 5-year PhD, and a 2-year MBA to fully grasp those particular provisions.

Former Supreme Court Justice, Louis Brandeis, got it right when he said"Sunlight is the best disinfectant." My fear is that the average credit card's complexity has vitiated the traditional disclosure's effectiveness, and consumers are being left in the dark. In many ways, the Schumer Box has more accurately become the Schumer Pamphlet. We must all work to ensure that disclosures are made in a user-friendly, common-sense, straight-forward manner, and are drafted not with an eye toward fending off litigation, but toward educating customers regarding their rights and obligations under the card.

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A second practice—known as"trailing" or"residual" interest—also illustrates how consumers can get caught in a seemingly never-ending cycle of debt. Consider a cardholder who spent $1,000 on holiday gifts in December and carried that $1,000 balance through February. At the end of February, she would receive a bill for the $1,000 principal plus some interest charges, which would be due at some point in March, for instance March 20th. Even if she did exactly as the bill instructed—paying off the entire balance on March 20th—she would still be responsible for the interest that had accrued after she received her statement (that is, from March 1st through March 20th). The interest charges would be compounding while her check was in the mail. Better disclosure is one obvious answer here, perhaps even something as simple as a line on your bill that says:"In order to pay your balance in full, please remit the following sum by March 20th."

Regardless, something must be done. To be sure, credit card companies provide absolutely vital services for American consumers, employ over one hundred thousand Americans of all stripes, and are sizeable components of the pension plans that many Americans rely on in retirement. But as one prominent industry insider recently remarked to me,"The industry has gone too far, pushed too far, and needs to clean up its act."

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Moreover, at my direction, my staff has reached out to credit card companies to find common-sense solutions to these challenges. I am happy to report that several issuers have assured us that they are reviewing certain policies and practices. I applaud Chase for its decision last month to eliminate the odious practice known as double-cycle billing. Also, just yesterday Chase announced a major overhaul of its over-the-limit fees, specifically that it will no longer charge such fees after 90 days.

Similarly, Citi deserves praise for its announcement last week that, in its words,"A deal is a deal"—as long as a cardholder upholds her end of a card's terms, Citi will not"re-price" her card more than once every two years.

These are all important steps, and I look forward to working with our witnesses and with Chairman Levin to create a more consumer-friendly lending environment in the future.

Senator LEVIN. Thank you, Senator Coleman. Again thank you to you and your staff for the very effective role that you and they have played in this hearing.

I would now like to welcome our first panel of witnesses for today's hearing. Wesley Wannemacher, a consumer from Lima, Ohio; and Alys Cohen, a staff attorney with the National Consumer Law Center's Washington office.

Mr. Wannemacher is a husband and a father. In December he contacted the Subcommittee to tell his story of how high fees and penalty interest rates charged by his credit card company increased his $3,000 in wedding expenses into a $10,000 debt.

I want to thank you, Mr. Wannemacher, for traveling here today.

Ms. Cohen is here representing several consumer advocacy organizations as an expert in credit and lending issues. Ms. Cohen, I want to welcome you to today's hearing. We look forward to hearing your perspective on the impact of credit card practices on consumers throughout the country.

Pursuant to Rule 6, all witnesses who testify before this Subcommittee are required to be sworn, and at this time I would ask both of you to please stand and to raise your right hand.

Do you swear that the testimony that you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. WANNEMACHER. I do.

Ms. COHEN. I do.

Senator WARNER. Mr. Chairman, could I just make an unanimous consent request that I put an opening statement in to follow Senator Coleman?

Senator LEVIN. Of course.

OPENING STATEMENT OF SENATOR WARNER

Senator WARNER. He talked about firms that had made corrective practices. In my State, we have the Capital One, and they never got involved in the question of double cycle billing, and they were among the very first to discontinue the universal default practice.

I thank the Senator. I would like to expand those remarks for the record.

[The prepared statement of Senator Warner follows:]

OPENING STATEMENT OF SENATOR WARNER

Thank you Mr. Chairman for holding this hearing on credit card practices.

There are many concerns that people have raised about the credit card industry and its practices, and I think it is important that these concerns are given due consideration. We need to be sure consumers are protected. However, as we discuss these concerns, we should not forget about the many benefits that the credit card industry provides consumers, businesses, and our economy. Our financial system is the best in the world, and the financial institutions before us today have played a role in the growth of our economy. It is also worth noting that there is tremendous competition in the credit card industry, which can lead to more complex products as credit card companies adjust to remain competitive in the marketplace.

As we discuss the development of various practices in the industry, we must remember the convenience and flexibility credit cards offer consumers to purchase goods and services while allowing them to manage those purchases through monthly payments. You may recall that in the 1980's all credit cards looked very similar. Nearly all had an interest rate of around 20 percent and an annual fee of $30-$50. Most importantly, only about one-third of Americans could qualify for a credit card.

Today, interest rates are lower and many cards are available without an annual fee, saving consumers hundreds of millions of dollars. According to a 2005 GAO report, the average interest rate for credit card purchases was 12.3 percent. And now, the benefits of credit cards are available to a much larger segment of America. Once only offered to a select few, now approximately 75 percent of Americans have a credit card.

With these advancements, however, we must not lose sight of the fact that the increased complexity of credit cards can have negative effects on consumers. Unfortunately, as these products and technology have changed, many of the disclosures have not. As with the case of Wesley Wannemacher who we will hear from today, cardholders can find themselves in financial distress if they do not understand the consequences that late payments may have on increasing their interest rates or fees. I understand the Federal Reserve is in the process of re-writing the required disclosures for credit cards and that the industry is supportive of this effort. I hope that the Federal Reserve can act expeditiously to make the necessary changes.

While there are members of the credit card industry that may use questionable practices, I think it is important to recognize that not all companies are the same. Capital One based in McLean, Virginia, indicates that it has never engaged in a practice known as "double-cycle billing" and some time ago abandoned "universal default." I am happy to learn that recently other credit card companies have changed their practices to provide more clarity for their credit card products. The Federal Reserve and the credit card industry must continue to work together to better serve consumers.

In closing Mr. Chairman, thank you for raising these important issues to our attention.

Senator LEVIN. We would be happy, of course, to receive that and any other opening statements. We are sorry that time does not allow them now. This is, I guess, the tradition here for everyone to have an opening statement. But perhaps people can weave those into their time when they are recognized.

Mr. Wannemacher, we will have you go first, and you may proceed.

TESTIMONY OF WESLEY WANNEMACHER,[1] CONSUMER, LIMA, OHIO

Mr. WANNEMACHER. Mr. Chairman, and Members of the Subcommittee, thank you for having me here today.

Senator LEVIN. If you could try to limit your remarks, both of you, to 5 minutes, we will put your entire statements in the record.

Mr. WANNEMACHER. First of all, I would like to thank everyone, especially my wife and family, who have been so supportive the last few years. And I would also like to reach out to the millions of people who have gone through or are currently going through situations similar to my own.

My name is Wes Wannemacher. I am married and raising a small family. I wish I could come here and tell you that I have paid all my bills on time, but my goal is not to convince you that I am the most responsible adult in the United States.

Toward the end of 2001, my wedding was approaching. As a young adult, I really had no idea just how much a wedding would cost. I had applied for and received a credit card from Chase with a $3,000 limit. This was quickly reached after paying for flowers and a photographer. I charged a total of $3,200 on this card and never charged anything beyond that. I have been trying ever since to pay it off.

I could tell I was going to have problems paying these and other debts. Debt seems to invoke a feeling of hopelessness, unlike any

[1] The prepared statement of Mr. Wannemacher appears in the Appendix on page 62.

other problem I've encountered. When a creditor calls you on the phone and you make a minimum payment, you know that you have made no real progress and that in one more month they will call again.

From 2000 to 2004, I learned what many adults already know. As your pay increases, your expenses increase as well. During those 2 years I tried to make payments to Chase. I had not asked for a payment plan or any method to resolve the balance, but I made whatever minimum payment they would take when they called on the telephone. These payments were usually close to $200. With limited funds, you have to prioritize, and since Chase could not turn off my lights or kick us out of our home, there would be times that their payment would be the lowest priority.

In the last half of 2004, my wife left her job because of complications with her pregnancy and my father asked me to move home and help out with the family business.

As 2005 started, we had another baby and we had moved back to our hometown. I realized that my problems with Chase would only get worse unless I took action. Early in 2005, I called Chase and asked if they would take $3,000 to settle the debt which, by this point, was $4,600. I offered $3,000 because it was my original credit limit and I had never gone much past that.

Unfortunately, Chase was unwilling to settle for $3,000. I should not speculate why they declined my offer, but I would guess that the person on the other end of the phone had a goal to get as much money as possible.

This meant I was back to making payments and watching the balance rise. In 2006, my balance had exceeded $5,300 and I knew that I needed to make them work with me before I ended up in bankruptcy. I called and asked if there was something they could do to help me. Eventually, I was offered a payment plan. The premise of the plan was to pay off the $2,300 that was past the credit limit. However, the representative was very clear that once I got the balance down to $3,000 I would be taken off this plan and the interest rate would go back to normal.

While I was making regular payments of between $140 and $210 a month, my stepdaughter was enrolled in therapies that were not covered by our new insurance plan and she had her tonsils removed. Before I knew it, I had a very large medical debt as well. With these offices calling and asking for payment, we were quickly overwhelmed. In December 2006, I gathered up all the statements from the various companies I owed money to and took them to a credit counselor.

My credit counselor sent proposals to everyone. Chase was the only creditor who declined her offer. Despite filling out a power of attorney, Chase made many attempts to contact me directly. I would instruct representatives who called me on the phone that they needed to contact my credit counselor. Many times they would say things to try to pressure me into making more payments directly.

Around this time I saw a news article mentioning Senator Levin and his desire to look into cases like mine. The article mentioned that people who feel they have paid excessive fees and charges should contact his office, so I did.

Over the last few months, Chase representatives have tried to convince me to not enroll in debt management and asked for direct payments. Finally, in February 2007, my credit counselor offered Chase a payment plan of $130 a month for 47 more months, totaling $6,110. Chase accepted. At the same time I was working with Senator Levin's office which, after reviewing all of my account information, asked if I would testify here today.

I was asked on a Thursday to testify today. On the following Monday a representative of Chase called me on the telephone to let me know that they had reviewed my account and decided they are forgiving my balance. I asked the representative if my plan to testify today had anything to do with their change of heart. The representative assured me that their decision was based solely on a review of my account.

I agreed to come testify because my primary concern is for the future of my own children. I am only here to let people know what happened to me. From September 2001 to February 2007 I have paid Chase over $6,300. If they had not reviewed my account, I would have paid another $6,110 on a $3,200 debt.

Thanks for listening.

Senator LEVIN. Thank you, Mr. Wannemacher. Ms. Cohen.

TESTIMONY OF ALYS COHEN,[1] STAFF ATTORNEY, NATIONAL CONSUMER LAW CENTER

Ms. COHEN. Mr. Chairman, Ranking Member Coleman——

Senator LEVIN. He will be back. There is a joint session of Congress that we have at the moment, so he has a conflict, as a number of us do. But he will be back.

Ms. COHEN. Mr. Chairman, Ranking Member Coleman, and Members of the Subcommittee, thank you very much for inviting me.

I am testifying today on behalf of the low-income clients of the National Consumer Law Center, as well as Consumer Action, Demos, National Association of Consumer Advocates, and U.S. Public Interest Research Group.

We also thank Chairman Levin and Ranking Member Coleman for commissioning a landmark GAO report on credit cards.

We have a debt crisis in America and its source is the practices of the credit card industry. Credit card debt has caused consumers to file bankruptcy more often, reduce savings to a historical low point, and spend the equity in their homes to pay off credit card debt.

Credit cards are a tremendous convenience for consumers who are well off and can pay their balances every month. However revolvers, who do not have the means to pay off a credit card balance every month, make up 80 percent of issuer revenues. Revolvers are socked with penalty rates averaging 27 percent APR and fees averaging over $30. These fees stack up, making it difficult for borrowers to pay off their balances.

This squeeze on borrowers has been called the sweat box by Professor Ronald Mann. Such back-end pricing protects issuers from

[1] The prepared statement of Ms. Cohen appears with an attachment in the Appendix on page 64.

losses, but it does not protect borrowers' assets. Credit cards are issued without any real determination of the borrower's ability to repay and these fees only push the most vulnerable among us further into mountains of debt. In addition, high interest rates paid by everyone allow the convenience users to subsidize the revolvers to the extent the fees do not already take care of that.

It is essential to note that credit card debt primarily is incurred for basic expenses—medical bills, auto repairs, utilities, and groceries. They are a safety net for many Americans.

Demos and the Access Project report that 29 percent of revolvers have charged medical debt. According to the National Council of La Raza, almost 39 percent of Latinos reported basic living expenses as contributing to credit card debt.

Credit card companies were not always so free to engage in abusive behavior. Deregulation began in 1978 with the Supreme Court's decision in the *Marquette* case that gave national banks the green light to bring the pricing rules from their home States across State lines. In 1996, the Supreme Court's *Smiley* case uncapped the amount of fees that credit card banks can charge as long as their home States allow it.

The OCC's preemption of State laws that specifically regulate credit cards has further weakened consumer protections. Because agency funds for all the bank regulators come from the regulated banks, there is a race to the bottom so that agencies can court banks to choose them. States are left on the sidelines and Federal law primarily is limited to disclosure rules, which are inadequate.

Here are some real-world examples of credit card abuses. A service member opened a credit card account with First Premier Bank last November. The credit card had a $250 credit limit and the bank charged $178 in fees. As of January 25, she owed a balance of $379.45 for almost $85 worth of purchases.

Another client bought a baby crib for $158 just after coming out of bankruptcy and charged it to a Capital One card with a $200 limit. He has paid over $700 and is being sued for over $3,500 for just this one purchase.

Allocation of payments also is a problem. A client who was assessed a balance transfer fee of $250 was charged 18.9 percent on that purchase so that this balance continued to increase while payments were applied to pay off the lower rate portion of his account transferred from elsewhere.

Another classic example, very similar to Mr. Wannemacher's, is Josephine McCarthy's, where on one account she had over $5,300 in a balance on only $218 in purchases. On another card she owed over $2,600 for $203 in purchases.

Other practices about which I can provide more information include penalty rates and universal default, including where rates increase based only on credit score changes, unilateral changes in terms, and mandatory arbitration clauses.

We call on policymakers to take a stand against industry abuses. We need a fair and functioning market. People have the right to expect that.

We look forward to working with Chairman Levin, Ranking Member Coleman, and other Members of this Subcommittee on further examination of the credit card industry.

I look forward to your questions.

Senator LEVIN. Thank you very much, Ms. Cohen.

Mr. Wannemacher, you have accepted personal responsibility for getting into debt. You did that again today. You have been consistent in acknowledging that. You tried to pay the debt instead of going into bankruptcy, and over the next 6 years after you incurred that debt you made payments that roughly averaged about $1,000 per year.

Were you surprised that those payments you made never seemed to lower how much you owed on the card?

Mr. WANNEMACHER. Yes. At first I was very surprised and then sort of became immune to the effect probably 3 or 4 years in. There's a basic assumption that I had that there is protection against people treating you unfairly. It just really seemed like there was no end in sight.

I am glad we are here today to discuss it, but I think more needs to be done because I think there are plenty of people that have an example similar to mine, or worse.

Senator LEVIN. The records that you have given us show that, in 2005, your interest rate reached 30 percent. What is it like, once you are in debt, to try to pay that debt off when the interest on it is 30 percent annually?

Mr. WANNEMACHER. Making payments on a debt, it feels like every month you take one step forward but two steps back. You watch that 30 percent and the other fees just continue to grow your balance. It is a feeling similar to riding in a submarine when the water pressure is really high. Every time the phone would ring it gets hard to breathe and you are not sure whether you should even answer it or not.

Senator LEVIN. You have been charged $1,500 in over-limit fees. The records show that you went over your limit by $200. So on a $200 overage, you have been charged over seven times that amount in penalties. You never made another purchase after the beginning of 2002 but you were charged an over-limit fee almost every month for the next 4 years. And 47 times, again, you were charged with that fee.

In some months, such as July 2002, it was the over-limit fee that kept your account over the $3,000 limit, so that you would then be charged another over-limit fee.

Did you realize going in, when you took this credit card, and made a deal with them, that for going over the credit limit by $200 that you would be charged over-limit fees repeatedly, 47 times?

Mr. WANNEMACHER. No. To me I would view going over-the-limit as a singular event. Like you have described, doing it three times or having the fees or interest pushing my account over-the-limit were all things that I was unaware could happen.

And then once they did, I guess I was not surprised, because there really does not seem to be anywhere to go to complain. Chase is a large corporation and navigating through phone systems or trying to get a representative on the other end of the line who would be sympathetic to your situation when you owe them, or when the balance indicates an amount similar to what I had, is often difficult.

Senator LEVIN. On the fees that you were charged, both over-limit fees and late fees, they were added to your outstanding balance and then interest was charged on those fees. Were you aware of the fact that the fees that you were charged, the penalty fees, would increase your interest charges?

Mr. WANNEMACHER. No, I was not aware. It was surprising at first but, as I mentioned earlier, you become immune to it and you know that—there is times where it seems like no matter how much you pay, they have got you and you are going to continue to pay until they are happy somehow.

Senator LEVIN. To avoid a late fee you had to pay, like other credit card holders, a specified minimum on the bill. Some months that minimum was extremely high. For instance, in March 2005, the bill stated that you owed about $4,400 and you had to make a minimum payment of $1,600, a little more than a third of the bill. Did that high of a minimum mean that you were virtually always going to have a late fee?

Mr. WANNEMACHER. At the time I did not realize—to me, paying late would have meant the money came in afterwards, not that there was two conditions, that I not only had to pay on time but, as well, I had to pay the amount that they were asking for. So I was unaware that while I was paying or making payments over the phone that I would be assessed a late fee.

Senator LEVIN. Can you describe how your inability to pay off this growing credit card debt affected your business or your family?

Mr. WANNEMACHER. It affected probably my family more than anybody else. I have four children total, but they have to share two bedrooms between the four of them. We were homeowners in 2002 and 2004, but have been unable to get preapproved for a home loan while I have this debt. It is difficult. There are things, I know my oldest son needs braces, which an orthodontist would take a payment plan probably very close to what I am paying Chase or what I had been paying Chase.

So there are all kinds of more productive or positive ways I feel it could have been spending that money.

Senator LEVIN. You say Chase called and said that the debt was being dropped. That call was made to you within the last 2 weeks wasn't it? What did they tell you when you asked why it was dropped?

Mr. WANNEMACHER. I asked the representative if my agreeing to come here and testify today had anything to do with it, mostly out of curiosity. She assured me that was not the fact, that she had reviewed my account and that my offer of $3,000, when it was made, should have been taken. They had counter offered $3,500 which at the time I could not afford. Since I was unable to resolve the issue at that time, the balance stayed the same. I think I made a $300 or $400 payment at that time and then continued to make the minimum payments.

But she indicated that after reviewing my account, at that time they should have taken the $3,000 that I offered. And since they had not, that the payments and everything that I had made since that point would cover the balance.

Senator LEVIN. Do you think it is a coincidence?

Mr. WANNEMACHER. I cannot really speculate on what is going on inside the walls at Chase, but it is a very suspicious coincidence, in my mind.

Senator LEVIN. Ms. Cohen, is Mr. Wannemacher's experience an unusual example? Or has the National Consumer Law Center seen many other examples of this type of problem?

Ms. COHEN. Senator, we regularly see borrowers who have too much debt that they cannot afford. Credit cards are no different. And often, the fees and the penalties do outweigh the initial charges that were made.

Senator LEVIN. Is it reasonable to think that a consumer with financial difficulties could ever pay off a debt that grows at a 30 percent rate?

Ms. COHEN. I think it is very challenging, as you have heard from Mr. Wannemacher. His credit card debt is not his only debt. Let me give you one brief example.

If you have only one card at 18 percent APR and your debt is $4,500, and you make a minimum payment of 2 percent, it will take you 532 months to repay that debt and you will pay $12,431 in interest.

Senator LEVIN. Ms. Cohen, in your printed testimony, you refer to a case called *Discover v. Owens.*

Ms. COHEN. Yes.

Senator LEVIN. In that case a woman named Ruth Owens charged about $2,000 on her credit card that had a $1,900 limit. So she went $100 over the limit. Her credit card company began to charge her interest, over-limit fees, and late fees. And for 6 years, from 1997 until 2003, she got one cash advance for $300 but otherwise did not use the card.

So it is very similar to this case. By 2003, after 6 years of payments, she had paid a total of about $3,500 on her $2,000 debt but she still owed $5,600 on her $2,000 debt.

So, for her $2,000 debt, the credit card company charged her $6,000 in interest, $1,500 in over-limit fees, and $1,200 in late fees. The credit card company took her to court in Ohio to collect what they claimed she still owed.

The court said they were not going to find for the plaintiff, they were going to find for her. Here is what they said: "The Court finds that the repeated 6-year accumulation of over-limit fees to be manifestly unconscionable. The determination of unconscionability is to be made in light of a variety of factors, including the sheer harshness of the contractual terms together with unequal bargaining position which renders certain consumer contracts suspect and worthy of judicial revision."

The Court later said that, "The defendant, the credit card holder, has clearly been the victim of plaintiff's unreasonable, unconscionable, and unjust business practice."

The Court found, in other words, that over-limit fees of the type which are repeatedly imposed is unconscionable. But that practice has not ended, has it? Ms. Cohen, do you know?

Ms. COHEN. As I understand it, the practices continue, which is why we heard the recent announcement about the change in those practices from one issuer.

Senator LEVIN. One issuer has just announced within the last couple days?

Ms. COHEN. It was my understanding that Chase announced they were at least changing their practice with regard to over-limit fees, but no, the practice has not changed.

Senator LEVIN. My time is long gone.

The rules that apply, that are given to the credit card applicant, are incredibly complicated; are they not? Could you just give us a very brief description of just how murky, complicated, incomprehensible these rules are?

Ms. COHEN. I think we heard before that some of them are written at the 27th-grade level. Readability experts say that things need to be written at the eighth-grade level in order to be universally understandable. And so we have got a long way to go.

The other thing is that even if you understand your disclosures, the terms can be completely unfair and you have no way to change that with your credit card issuer.

Senator LEVIN. What is the 27th-grade level? What does that mean?

Ms. COHEN. It was all those graduate degrees we heard about from Senator Coleman.

Senator LEVIN. Thank you. Senator McCaskill.

Senator MCCASKILL. Thank you, Senator Levin.

Mr. Wannemacher, I think that the moral of your story is that for everyone out in America what you need to do if you are having a tough time is to call Senator Levin's office. It is like winning the lottery to call Senator Levin. That is what is called good constituent service, Senator.

Senator LEVIN. And he is not even my constituent.

Senator MCCASKILL. I do not know that I can get up to that standard.

A couple of things. First, Mr. Wannemacher, I want to ask you while you were struggling with all this, I am willing to bet a dollar to donuts that you were solicited for additional cards.

Mr. WANNEMACHER. I still receive at least one a week or more solicitations. But at the same time that I cut up the Chase card, my wife and I decided that we would not finance anything unless it were a house, education, or car and we have tried to stick to that rule as best we could since 2002.

Senator MCCASKILL. Were there times when you were struggling to pay all of these bills and the same companies that were calling you on the phone to pay the bills were sending you solicitations in the mail to take another card?

Mr. WANNEMACHER. Yes. I have struggled to pay all of my bills for quite a while now, but to me, I would see myself as a high risk. But at the same time, high risk also means high profit potential, high interest rates. So I cannot blame them but I do have the choice not to apply for any more cards and I choose not to.

Senator MCCASKILL. I have to be careful here today because I have incredible love and respect for my mother but I have lived through with my mother a lot of the things that you have talked about this morning. My dad had a debilitating brain injury and my mother had never worked outside of the house. And so all of us tried to rally around and help her. She is a very strong, independent woman.

The way that she thought she could see her way through this was to use credit cards.

Fast forward several years and my mother was in what I would term a debilitating depression about her inability to manage her personal finances because what had happened to her is very similar to what had happened to you, being solicited for credit cards.

Now keep in mind the entire time that they were sending her these credit cards, her credit rating had to have been not good because she was really struggling to make ends meet.

Once my sisters and I figured out how bad it was, we gathered everything together and took over, with her kicking and screaming the whole way about how she can do on her own, she can do it on her own. If you met her, you would understand what I was saying. She literally was kicking and screaming all the way.

We began trying to manage it.

The interesting thing is even after we began to try to manage it, it never ended. Just recently I had been paying on some of her bills for some time and, I will confess, had not been looking at the bills closely. And this was a card that I had torn up and written them this card will no longer be used. And I realized there was a recurring charge on it.

I figured out what happened. They had sent her one of those checks in the mail, cash this check, this is your money. And she had not read the fine print.

I am curious, Ms. Cohen, have you all seen very much of that, where you get one of these checks in the mail and somebody who is struggling financially and maybe not paying as close attention as they should, cashes one of these checks. And then they have a recurring charge on their credit card month after month after month. And getting it off there is not an easy task. It is a little bit like the man you talked about in your testimony that got the Diners Club membership, even though he said he did not want it. And they kept charging him for the Diners Club membership.

Can you speak a little bit about these checks that they send you in the mail that obligate you to something ongoing, even though it looks like they are giving you money?

Ms. COHEN. My understanding is that in some contexts those checks are called live checks. And you get them and you cash them and you have obligations associated with them.

It is also my understanding that credit card issuers, mortgage companies, and other lenders use them to get their foot in the door and they are the first step to increasing your debt through other kinds of loans through the company.

Senator MCCASKILL. As far as you know, at the Consumer Law Center, has there ever been any legal action concerning these checks that are sent as if they are giving you money, which are really you signing up for debt?

Ms. COHEN. I do not have any information about that but I would be happy to get back to you.

Senator MCCASKILL. I think it is just unconscionable that they are sending these checks to people that they know that are financially stressed. It is like sending a six pack of beer to somebody who is on their 30th day of sobriety and saying why don't you just have another drink?

I am looking forward to the testimony of the next panel.

On solicitation—and clearly, the irony of all of this is that I have done a lot of Internet shopping the last several years of my life because I have been campaigning and do not have time to go into a store. So I have spent more money than I would like to admit on my credit cards over the last couple of years and I pay the bill as quickly as I can figure what it is.

I have learned with one card company I need to go online and pay it because by the time I get the bill in the mail sometimes I do not have enough time left to pay without getting the penalty, even though I always pay in full. So I have learned to go on the Internet and find the bill before I get it in the mail just to make sure they do not get that money out of me.

That is a side issue but the irony is you would think I would be the customer they are soliciting. To this day I get very few solicitations for credit cards because I pay my bills every month. I bet my mother still gets two or three a week.

Thank you, Mr. Chairman.

Senator LEVIN. Thank you, Senator McCaskill, very much. Senator Warner.

Senator WARNER. Mr. Chairman, I think this is a very important hearing and I will join you and follow it in the subsequent sessions we have.

I guess this is what puzzles me a bit. I started my inauspicious career as a young lawyer in a firm and dealt with banks. I had quite a few experiences with a number of old-time bankers and so forth and got an insight into the loaning of money. Then oftentimes, not too often fortunately, I would have to go to the collection process for defaulted loans and so forth.

But I look at this whole credit system and drawing on that background, and it puzzles me why institutions, financial institutions, which have such a remarkable history of serving America, have gotten into this business and their names attached to it, and they either intentionally or otherwise set traps to snare these basically younger people and others who come in and struggle to pay off these situations.

I just find it so distasteful. I just wonder why they want to be involved in it. Can you touch on what the psychology is, Ms. Cohen?

Ms. COHEN. Thank you for your question, Senator.

Senator WARNER. The GAO, in its report, alludes to this. I presume you have seen that GAO report?

Ms. COHEN. I have seen the GAO report.

I cannot answer the psychology question but I can answer it from a business model perspective. I really think Mr. Wannemacher said it best when he said high risk is high profit potential.

If 80 percent of the profits, of the revenues, are coming from people like Mr. Wannemacher who cannot pay their bills, then the system is built like a house of cards where profit is made on one side and the borrower welfare on the other side is irrelevant to how much profit is made. They can squeeze and squeeze people.

So as long as the system is set up where that is permitted, there is no reason to not follow the incentives in that direction.

Senator WARNER. Well, I will pose the same question to the panels that follow hereafter. But there has got to be a human quotient in this thing. I would not want to be involved with any financial institution if that is the job they gave me. I would tell them to go packing, find somebody else. I could not do with it.

So we will have to look into that because I do believe these hearings, together with—as I understand—our colleagues in the Banking Committee, Congress is going to police this thing pretty severely and clean it up. So perhaps we can get some good help and guidance from the industry, because these institutions, major financial institutions, have a long history in corporate recognition. I just do not think they want to have this sort of thing persist.

Thank both of you for coming up here today.

Senator LEVIN. Thank you, Senator Warner, for your very accurate, thoughtful, heartfelt comments.

Just a couple more brief questions.

The billing statement that is used by the Bank of America explaining how these interest rates are reached is, I think, impossible for the average person to understand. I am tempted to read it. Maybe I will. It will take 30 seconds.[1]

"Average Daily Balance Method (including new transactions): We calculate separate balances subject to finance charge for Category C balances and Category D balances. We do this by calculating a daily balance for each day in the billing cycle, adding all of the daily balances together, and dividing the sum of the daily balances by the number of days in the billing cycle. To calculate the daily balance for each day in this statement's billing cycle, we take the beginning balance, add an amount equal to the applicable daily periodic rate multiplied by the previous day's daily balance, add new transactions, new account fees, and new transaction fees, and subtract applicable payments and credits. If any daily balance is less than zero, we treat it as zero."

That is the only clear thing so far.

"If the previous balance shown on this statement was paid in full in this statement's billing cycle, then on the day after that payment in full date we exclude from the beginning balance new transactions, new account fees, and new transaction fees which posted on or before the payment in full date, and we do not add new transactions, new account fees, or new transaction fees which post after that payment in full date."

Now do you think the average consumer can understand that, Ms. Cohen?

Ms. COHEN. Everyone laughed while you were reading it, which I think is a pretty good answer to that question.

Senator LEVIN. I understand that the credit card issuers have said that they would like to simplify and clarify the disclosure language, and apparently they support an ongoing Federal Reserve effort to revise the key credit card disclosure regulation known as Regulation Z, and to develop model disclosure language that everybody could use.

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[1] See Exhibit 3a. which appears in the Appendix on page 136.

If the Federal Reserve did improve credit card disclosures in your judgment, Ms. Cohen, would that be enough to cure the worst of the problems that we are discussing today? Or is there still a need to do more than just better disclosure?

Ms. COHEN. I do think that disclosure is a piece of the picture. The National Consumer Law Center submitted 80 pages of single spaced comments to the Federal Reserve on that. So it is true that improving the disclosures will help.

But the real question here is where is the burden? I have been here in Washington for almost 10 years and all I hear over and over again is let's improve disclosures. What that means is the entire burden is on the borrower to take apart the description you just gave, understand it for themselves, and make a choice in an unfair market.

So what we really need is better disclosure so people can shop, if they shop, and then protections so that unfair practices, abuses, destructive lending can be stopped.

If there were poisonous food or medication put on the shelves, no one would say read this and learn that it is poison and learn not to buy it. They would be taken off the shelves. We want the same thing for credit.

Senator LEVIN. Who needs to adopt those protections, in your judgment?

Ms. COHEN. The Federal Reserve Board has the authority to improve the disclosures. They are not in a position to change everything that we need. And so we look to Congress to pass strong legislation.

Senator LEVIN. Thank you. Senator McCaskill.

Senator MCCASKILL. Do you believe it would be practical, in fact this would be a good question to ask the next panel. I do not know this, but I have a feeling they may say that these disclosures are so complicated because their lawyers tell them that is what they have to say. And I bet the lawyers that helped them write those added significantly to their costs that fiscal year too, looking at the disclosures.

But do you think that it would be possible for Congress to, in any way, urge the Federal Reserve Board to go more quickly or to do this in more plain language? It does not seem that complicated to me. It seems that you say this is the interest rate we are going to charge you. If you do not pay at all by the date that it is due, you are going to have an interest rate. If you go over your credit limit, this is what you are going to pay. And by the way, you have to pay it every single month, maybe forever.

Ms. COHEN. Some of the points that you just made are not currently in a clear manner in the disclosure. How long it is going to take you to pay off your bill is not in your disclosure and it is something that we have recommended that the Federal Reserve Board can do. I know they have a process to make sure that all of their I's are dotted and their T's are crossed. But we are hoping at the end of it that a lot of the things you just described will be in. There are also bills that have been introduced in Congress that do similar things for disclosures.

I also want to respond to your comment earlier about live checks. Representative LaFalce proposed a bill to ban live checks earlier in the 2000s but no action was taken in either house on that bill

Senator MCCASKILL. I will have to find out if maybe we can get that started again.

The other question I had about the amount of interest, it seems to me the fees for the low income people where they are making a lot of money, the penalty fees, the going over-the-limit fees, the various fees and penalties, are getting into some serious money now as opposed to the interest rate for the low income people.

Has there been any effort made by your organization or others that I could look at that compare someone who is low income with what actually happens to them on say a $500 limit credit card versus a $500 payday loan? I mean, are these not very similar in terms of when we get to the bottom line as to how much is being charged? Are we not getting to 30 percent, something that a long time ago in law school that we would have called usurious?

Ms. COHEN. We do not hear that word very often in Washington anymore.

I imagine that we have done some analysis and I am happy to get back to you with the details. What I have seen with payday lending and credit cards is that the problem is similar. Someone borrows a small amount of money because they cannot pay a basic bill, and then they are stuck week after week, month after month, paying back small amounts and never really covering the total amount.

Senator MCCASKILL. Never getting to the principal.

Ms. COHEN. Correct.

Senator MCCASKILL. They never get to the principal.

And watching my mom, she has never even met the principal, God love her. She has always just been paying interest, always making minimum payments until we kind of took over. I look at the amount of money she has paid over the years and it is just mind-boggling how expensive this has been.

Having done some work on payday loans at the State level, I think it is time we begin talking about really what the real amount of money that these people are being charged and comparing them to the payday loan industry.

And that may be, Senator, maybe these institutions would feel a little more comfortable about what they are doing. Because I do not think that these are the kinds of names in banking that I do not think see themselves as a payday loan lender. But it appears that, in many aspects, they are.

Ms. COHEN. It is our view that the fees that are charged should be reasonably related to the cost incurred by the credit card issuer. And right now we do not see anything like that.

Senator MCCASKILL. There is no connection between what it is costing them to service it and the amount of fees they are charging.

Ms. COHEN. It is generally a flat fee. They might be able to explain better how that fee is derived.

Senator MCCASKILL. Thank you.

Senator LEVIN. Senator Warner.

Senator WARNER. No, Mr. Chairman, I think we should proceed to the next panel.

Mr. Chairman, I think for those following this hearing, we should advise that many of our colleagues are engaged in a very important joint session of Congress this morning and could not arrange to be here. But I commend the Chairman and the Ranking Member for going ahead. I decided this was a more important challenge for us here this morning in the Senate.

Senator LEVIN. Thank you, Senator Warner.

Ms. Cohen, you have made a number of recommendations on behalf of a number of organizations. These are going to be referred to the Banking Committee along with our work. The Banking Committee has the legislative jurisdiction. We are working very closely with them. They know of our hearings. I have talked to Senator Dodd, I know Senator Shelby. They have had hearings on this subject. We are trying to address different aspects of the same problem so we do not duplicate.

But this very valuable testimony of both of yours will be part of a recommendation and probably a bill which we will introduce, which would then be referred to the Banking Committee, as Senator Warner has mentioned, because they have the legislative jurisdiction.

We have oversight jurisdiction here, investigative jurisdiction, and we are going to make full use of your testimony as well as the testimony of the next panel.

So we thank you both for coming, and you are excused. We will now call the second panel.

Let me now welcome our second panel of witnesses for today's hearing. Bruce Hammonds, President of Card Services at Bank of America; Richard Srednicki, Chief Executive Officer of Chase Bank USA; and finally Mr. Vikram Atal, Chairman and Chief Executive Officer of Citi Cards.

I welcome you all to this hearing. I look forward to hearing your testimony on your banks' practices relating to fees, interest rates and grace periods, and anything else you might want to testify about relative to this subject.

We know that for some of you it has been a challenge to get here. We appreciate that. And again, we also appreciate the cooperation that your banks have shown to the Subcommittee.

Pursuant to Rule 6, all witnesses who testify before the Subcommittee are required to be sworn. So at this time I would ask each of you to please stand and raise your right hand.

Do you swear that the testimony that you give before this Subcommittee today will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. HAMMONDS. I do.

Mr. SREDNICKI. I do.

Mr. ATAL. I do.

Senator LEVIN. We will be using the timing system today. Again, we would ask that you would limit your testimony to no more then 5 minutes.

We will go in alphabetical order, I guess by bank name. I am trying to interpret this. I was going to say we go in alphabetical order so Mr. Hammonds goes first, but apparently it is bank name.

So the Bank of America, Mr. Hammonds, we will have you go first, followed by Chase which is represented by Mr. Srednicki, and follow up with Citigroup that is represented by Mr. Atal.

After we have heard all of your testimony, we will then turn to questions.

Mr. Hammonds, please proceed.

TESTIMONY OF BRUCE L. HAMMONDS,[1] PRESIDENT, BANK OF AMERICA CARD SERVICES, BANK OF AMERICA CORPORATION, WILMINGTON, DELAWARE

Mr. HAMMONDS. Good morning, Chairman Levin, Senator Coleman, and Members of the Subcommittee. My name is Bruce Hammonds and I am President of Bank of America Card Services.

Bank of America is one of the world's largest financial services institutions. In the United States, Bank of America serves more than 52 million customers, nearly half of all U.S. households. As you may know, we are one of the largest credit card companies in the United States.

I have personally been involved in consumer lending for over 35 years and was part of the management team that formed MBNA in 1982. During my career, I have been personal witness to extraordinary changes in the card industry, driving the product from its origins as a pay in full charge card with an annual fee to a far more versatile product offering seamless access to credit for millions of Americans.

Widespread access to credit cards has also played a significant role in our economy, allowing merchants, either at the point-of-sale or over the Internet, to accept payments quickly and securely.

Mr. Chairman, we were pleased to host Subcommittee staff as they visited our credit card operations in Wilmington and hope this experience helped the Subcommittee gain a deeper understanding of our operations and practices.

For years we have always been a leader in fair and transparent lending. Let me explain. Bank of America has never engaged in double cycle billing. Bank of America has never engaged in universal default. Bank of America already limits the frequency of risk-based repricing. Bank of America already has a program that lets customers know through e-alerts when they are approaching due dates and credit limits so they can avoid fees and repricing.

Bank of America already has a robust program to educate our customers about their credit. We have been testing a plain language brochure that advises our customers of steps they can take to keep the cost of credit lower.

I am proud to say that we arrived at these policies some time ago and by listening to our customers.

With that, let me return to the remainder of my remarks.

As Bank of America approaches the credit card market, that is, as we make our pricing terms and marketing decisions, our decisions are shaped primarily by four factors: Competition, risk, return, and regulation. Credit cards are now so ubiquitous that it is easy to forget a time not so long ago when access to credit was a

[1] The prepared statement of Mr. Hammonds with attachments appears in the Appendix on page 81.

privilege reserved for those on the higher end of the financial spectrum. Vigorous competition in this market has democratized access to credit and produced three primary benefits for consumers: lower prices, innovative products, and better customer service.

As the 2006 GAO report on credit rates and fees observed, consumers now pay lower interest rates than they did when credit cards were introduced in the 1950s. Over the past 15 years, in particular, issuers have competed for customers by offering attractive rates and expanding the availability of credit to a much larger segment of the population.

Credit cards have not only become cheaper for consumers but also, thanks to innovation, far more useful. A credit card now allows you to obtain instantaneous credit when purchasing at the point-of-sale or online, or to obtain a cash loan from an ATM, anywhere in the world in any currency. Credit cards also frequently come with other rewards, originally frequent flyer miles but now a wider and ever-expanding list of rewards.

The other way we compete is through superior service. If there is a problem, you can call us 24 hours a day, 7 days a week. And if your card is lost or stolen, we will replace it for free and you will not bear any costs from fraudulent use of the card.

Just as our approach to the market is shaped by competition, it also considers the risk of this unique type of unsecured lending. We manage risk in three primary ways. First, we issue cards only to those who have a credit history or an existing relationship with us that suggests an ability to repay. For this reason, we have not been active in marketing loans to the subprime market.

Second, we employ risk-based pricing, which allows us to continue lending to customers who failed to pay on time, go over limit, or exhibit other risky behavior.

Third, we identify and work with customers who are experiencing real financial difficulties. Frequently, that means lowering their interest rate and waiving fees, and working with consumer counseling agencies to ensure that credit problems with other lenders are made part of the plan.

I will focus on risk-based pricing, as the Subcommittee has expressed interest in it.

Risk-based pricing takes two general forms. First, our contract with the customer provides for default repricing, that is higher interest rates that apply in the event the customer makes payments late or exceeds their credit limit. This is how most of our repricing occurs.

As a matter of practice, we take this action only if a customer is late or over limit twice within a 12-month period, though some of our competitors are more aggressive and impose higher rates based only on one event and include using a bounced check as a trigger.

Additionally, in late 2007, Bank of America plans to further implement a feature that will provide for a cure to a lower rate if the customer has no late or over limit events for 6 consecutive months. This new lower rate will apply to both existing and new balances.

Second, when we see that a customer is exhibiting risky behavior, and this may include problems with other lenders, we may notify the customer of a proposed change in terms of the account, generally a higher interest rate for outstanding balances. This is known as risk-based repricing.

Risk-based repricing is necessary in credit card lending because credit card lending is open end credit. As such, a credit card relationship involves a series of loans of varying amounts over an indefinite period, whereas closed end credit, for example an auto loan, constitutes a single loan made for a specified maturity on terms fixed at the outset of the leading relationship.

Basically, if a deteriorating credit score causes us to question our initial decision to issue credit, we will inform the customer that in the future his or her account will have a higher rate.

I should stress that whenever we propose a higher interest rate, the customer has a right to simply say no. The customer is then entitled to repay any outstanding balance under the original terms, rather than the adjusted terms we are proposing. At that point, basically, we cannot charge a higher rate on loans the customer has outstanding but the customer can not continue taking out new loans at the old rate. That seems right to us.

This right to say no is a crucial distinction between risk-based pricing, which we and all of our competitors engage in, and universal default, which Bank of America has never engaged in. With universal default, a default to an unaffiliated creditor is treated as a default on every creditor and triggers repricing without any right to say no. As noted, Bank of America has never engaged in universal default.

I would also note that we have never engaged in two cycle billing, another practice I know is of concern to the Subcommittee.

I should also add that at Bank of America we do not propose a risk-based increase in rates to customers in the first year of the relationship. And once a proposed change in terms is accepted, will not propose another change for at least 6 months, even if the customer's credit score declines further.

Now let me turn to the reason we are in this business, which is to earn the maximum possible risk-adjusted return for our shareholders. Of course, the primary constraint on our returns is market competition. As the GAO report notes, the return on assets for large credit card issuers has generally been stable since 1999, with returns in the 3 percent to 3.5 percent range. Data from five of the six largest issuers showed that profitability between 2003 and 2005 has been stable, in the range from 3.6 to 4.1 percent.

On the regulatory front, we support the Fed's revision of Regulation Z and look forward to commenting further.

Thank you for the opportunity to share our story and our views with you, and I look forward to answering any questions you may have.

Senator LEVIN. Thank you, Mr. Hammonds. Mr. Srednicki.

TESTIMONY OF RICHARD J. SREDNICKI,[1] CHIEF EXECUTIVE OFFICER, CHASE BANK USA, N.A., WILMINGTON, DELAWARE

Mr. SREDNICKI. Mr. Chairman and Members of the Subcommittee, good morning. My name is Rich Srednicki. I am the Chief Executive Officer for Chase Bank USA, N.A.

I want to begin my remarks with a public apology to Mr. Wannemacher. We have policies and procedures in place at Chase to identify customers like him who have fallen into deep financial trouble and are finding it difficult to work their way out. In this case, we simply blew it. Our policies and procedures failed, and we deeply regret it. We took some action after hearing of his case from this Subcommittee. But we would have done the same with another customer who our procedures failed and who had contacted us.

We have reached out to Mr. Wannemacher personally and resolved the situation to his satisfaction, as we would do with anyone with whom we had made a mistake.

We believe this case is an exception and not the rule. It was caused by human error. However, we are reviewing our files and contacting all customers who are chronically over limit or have chronic late fees to let them know we have assistance programs that can and should help them, as we normally do.

We serve 100 million customers and, regrettably, mistakes can happen. We are committed to finding those errors and to fixing them.

We have decided to modify one practice we believe would have helped Mr. Wannemacher and we believe will help avoid future situations like this. We will now stop over-limit fees at 90 days. This change is in keeping with our overall efforts to continually review our policies and practices to find ways to improve customer service and satisfaction.

I assure you that Mr. Wannemacher is not an example of how we strive to do business. When our customers are facing serious financial distress it is both in our customer's interest and the bank's interest to work closely with them to help them find the right solution such as consumer credit counseling programs or a payment plan with no fees and/or low interest rates.

About .5 of 1 percent of our customers are in such programs today and more than two of three of those customers complete them successfully and get themselves back on their feet. That is what we should have done with Mr. Wannemacher. That is what we failed to do.

We are committed to dealing fairly and responsibly with customers who face financial difficulty, as we are with all of our customers.

Mr. Chairman, I want to also talk about Chase and the relationships we work hard to develop. The great majority of Chase's customers fall into the categories that our industry calls super-prime and prime. That means that regardless of income, they are among the most responsible and knowledgeable credit card customers in the country. They use their cards wisely to manage their purchases and receive the convenience, the protections, the instant access to

[1] The prepared statement of Mr. Srednicki with an attachment appears in the Appendix on page 115.

credit and flexibility payment cards bring while avoiding fees and maintaining very low interest rates, among the lowest in the country.

Fully 92 percent of Chase customers begin and end the year with the same or better contract interest rate because they manage their credit responsibly.

In order to build long-term relationships, we owe our customers clear and simple rules of the road so that they understand their fees, their interest rates, and know how to avoid late fees and over credit limit fees or have their interest rate increased. We provide account information in everyday language and want to help them meet this goal. We owe our customers, also, tools to help them manage their accounts and make on-time payments. We have free alerts that remind customers by e-mail, by telephone, or by text messaging when a payment due date is approaching or when their spending has reached their own self-determined limit.

We also allow customers to pick their own billing due date, one that best meets their budgeting needs. And we never change that due date unless they ask us to change it.

We owe all of our customers individual attention and we grant credit individually. Particularly when customers get into trouble, they need individual attention, and when their distress may be caused by factors like illness or job loss that are out of their control.

In cases like these, we owe our customers a process for helping them get out of debt through credit counseling and debt reduction plans.

The point that I want to underscore is that Chase is committed to working responsibly with our customers. Our core business model is based on responsibly providing excellent credit products to customers who use them responsibly. I believe that when we work with customers and treat them fairly we can be proud of a credit card system that is working extremely well for the vast majority of millions of Americans who use them every single day.

Mr. Chairman, we look forward to working with you and the Members of this Subcommittee.

Senator LEVIN. Thank you so much, Mr. Srednicki. Mr. Atal.

TESTIMONY OF VIKRAM A. ATAL,[1] CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CITI CARDS, GLOBAL CONSUMER GROUP, CITIGROUP, INC., NEW YORK, NEW YORK

Mr. ATAL. Thank you, Chairman Levin and Members of the Subcommittee. My name is Vikram Atal and I am the Chairman and Chief Executive Officer of Citi Cards.

Citi Cards is a large entity, employing over 32,000 employees at more than 30 sites across North America, and we do our very best to meet the needs of our customers with a broad range of financial products and services.

I appreciate the opportunity to appear before the Subcommittee today.

I understand that the Subcommittee's primary focus today is on issues relating to the transparency and fairness with which we

[1] The prepared statement of Mr. Atal appears in the Appendix on page 128.

treat our customers, and we welcome that conversation. At the outset though, I would like to step back and provide some context. Credit cards have become an integral part of our Nation's economy, providing real and significant benefits to our consumers and merchants alike. To understand this business, it is crucial to recognize that each and every time a person uses a credit card to buy something we are, in effect, making them an unsecured loan not backed up by any tangible security as mortgages, auto loans, or home equity lines of credit are. We are lending money based only on a customer's promise to repay.

Before the late 1980s, the credit card market was much narrower and more uniform. Customers were typically assessed a $20 annual fee and interest rates were nearly 20 percent across the board. In the last 15 years, this model has changed dramatically. Underwriting practices have become more refined, allowing banks both to offer lower-priced credit for people with solid credit histories and to extend credit to customers who previously had no access to unsecured credit.

The capacity for banks to consider risk is the key that makes this system work. Without that, less credit-worthy consumers would have fewer appropriate means of accessing credit, relatively risk-free consumers would face a higher cost of credit, and bank lending strategies would be significantly curtailed.

As a general matter, this democratization of credit has been a good thing. Average credit card rates have declined nearly 6 percentage points compared to the average rate prevailing in 1990, and overall credit card debt remains a small portion of household debt, down from 3.9 percent in 1995 to about 3 percent in 2004.

Finally, the lending model for credit cards is based on a relatively thin margin. Year after year we make roughly the same return of $2 to $2.50 for every $100 that we lend, which equates to about one dollar for every $100 of sales charged to credit cards.

We have taken many steps in recent years to improve the products and services we offer our customers. Let me start by outlining two very significant changes that we announced just last week. Taken together, these represent a sea change for the industry.

First, it has been standard practice for credit card issuers to consider raising a customer's interest rates based on behavior with respect to financial commitments to other companies. Even before last week, we gave customers notice and the right to opt out of any such proposed increase in their interest rate while still maintaining full use of their card until the expiration date.

But last week we eliminated the practice altogether for all customers during the term of their cards. Citi will consider increasing a customer's interest rate only on the basis of his or her behavior with us when the customer fails to pay on time, goes over the credit limit, or bounces a check.

Second, in order to be able to respond to general conditions in the financial markets the industry has traditionally kept the right to increase a card holder's rates and fees at any time for any reason. We are eliminating this practice. Effective next month, so long as a customer is meeting the terms of his agreement with us, we will not voluntarily increase the rates or fees of the account until a card expires and a new card is issued.

In tandem, these changes redefine our relationship with every single one of our customers.

In response to customer expectations, we have also developed online tools to make it easy for customers to avoid late fees and to manage their relationship with us. Our customers can choose a day of the month they would prefer to pay their bills and they can elect to be notified in advance about key dates and information. Under this program we send out some 5 million alerts each month and that number is increasing substantially over time.

Citi is an industry leader in financial education and literacy. The centerpiece of our education effort is our Use Credit Wisely program, a web-based program designed to assist consumers in understanding how credit works, budgeting, and how to work through difficult situations such as disability or living on a fixed income. As part of Use Credit Wisely, we developed the innovative Credit–ED program to provide support and the latest resource to help students manage their credit and money responsibly. Since 2000, the Credit–ED program has distributed more than 5 million credit education materials free to students, administrators, and parents.

Citi is also an industry leader in protecting customers from theft and fraud. In 1989, we offered consumers our fraud early warning feature. In 1992, we introduced the photo card to help deter unauthorized use of credit cards. And today, should our members become victims of identity theft or fraud, we offer, for free, Citi Identity Theft Solutions. Our service streamlines and simplifies the entire process of reestablishing a victim's identity and credit history, saving the customer significant time, money, and hassle even if the fraud happened on another credit card.

Credit card disclosures can be confusing, so our goal is to assure no surprises for our customers. This means that all of our written materials must describe our products clearly, accurately and fairly. The effective and simpler to read disclosures cited by GAO in its September 2006 report on credit cards were Citi disclosures.

We are also in the midst of a major redesign of our customer statement, working with some 2 million customers to understand how we might make them even better.

Mr. Chairman, at Citi we put our customers first. We want to make sure that our customers' Citi Card is a convenience that can make managing their financial affairs as easy and as stress-free as possible. This job is never finished and we know that there is always room for improvement.

I look forward to answering any questions that you and other Members of the Subcommittee may have.

Senator LEVIN. Thank you, Mr. Atal.

Mr. Wannemacher exceeded the $3,000 credit limit on his account by $200, and he was then charged an over-the-credit-limit fee—not three times when his purchases put him over-the-limit, but 47 times. And the fee increased over time from $29 a month to $39 a month. For the 5 years that this went on, the total over-limit fees charged him each year exceeded the $200 for which he was being penalized.

In 2006, he entered into a repayment plan to address this issue.

Now, until recently, Mr. Srednicki, was it standard practice at Chase to apply the over-limit fee not just to the month in which a consumer's purchases exceeded the card limit, but also every subsequent month, even if the consumer did not make any more purchases until your announcement here today?

Mr. SREDNICKI. Yes, Mr. Chairman, it was our policy and I believe an industry policy, to apply an over-limit fees for every month that the customer is over limit. But the most important thing for us is to try to prepare information and give information to our customers so that they do not get into an over limit or a late condition on the account. And the vast majority of our customers, the very vast majority, do not.

Senator LEVIN. When did you make the decision to eliminate this previous practice or this practice? You are announcing it here today but when was this decided? Yesterday? A week ago? When was this decided?

Mr. SREDNICKI. We decided this a few days ago, after actually getting information from this Subcommittee about Mr. Wannemacher and looking at his account.

Senator LEVIN. You have changed the practice across the board though, now?

Mr. SREDNICKI. Yes, sir, we are changing it.

Senator LEVIN. We understand from you, Mr. Hammonds, that the practice at Bank of America is not to charge these consecutive fees; is that correct?

Mr. HAMMONDS. Mr. Chairman, we charge three times, and then our practice is to stop at the third.

Senator LEVIN. How long has that been the case?

Mr. HAMMONDS. I am answering for two companies. I was involved in the merger, so I am answering for two separate companies.

Three years at MBNA. I am not exactly sure at Bank of America. After the two companies came together at January 1, 2006, I know that was put in place.

Senator LEVIN. We have an example. We have reviewed a Michigan constituent's Bank of America credit card account and found that he was charged seven over-the-limit fees, once each month from March 2006 to September 2006, even though he stopped using his card in April 2006.

So that would have violated the practice that you said was in place no later than early 2006; is that correct?

Mr. HAMMONDS. That is absolutely correct, Senator.

Senator LEVIN. We will show you that. Something is wrong with your computer.

Now, Mr. Atal, what is your practice on this issue?

Mr. ATAL. We charge over-limit fees only three times, Senator.

Senator LEVIN. How long has that been the case?

Mr. ATAL. I will have to get back with you, Senator, with the exact timeline. I don't have that but I believe it's been in place for a while.

Senator LEVIN. Still, I gather, many credit card companies charge the repeated over-limit fee; is that correct? You have now announced your change at Chase, and the other two banks represented here today say it has been the case for a year or more that three times is the most they charge.

Our understanding is that the common practice in the industry is still to charge these repeated fees. Is that your understanding? That it is common practice? Or don't you know?

Mr. HAMMONDS. Mr. Chairman, the OCC has encouraged the practice of no more than three times.

Senator LEVIN. You do not know how many credit cards companies comply with that?

Mr. HAMMONDS. I do not know how many.

Senator LEVIN. Do you know?

Mr. SREDNICKI. No, I do not.

Senator LEVIN. Do you know?

Mr. ATAL. I do not know, sir.

Senator LEVIN. I want to talk to you about the interest that is charged on money that is paid on time. In the example that we used in our opening statement, to make this point very clear, we just created a hypothetical bill of $5,020, no previous balance. They pay $5,000 on time. A $20 balance the next month with no additional purchases. They are hit with an interest charge of $55.21.

This may not be a typical payment approach, but nonetheless we are using this to clarify what we are talking about.

In that situation, interest is charged for the first 15 days on the $5,000 that is paid on time, not just on the $20 that was not paid. Now what is the justification for charging interest on debt that is paid on time?

Mr. Srednicki, do you want to start?

Mr. SREDNICKI. Senator, I believe that this practice really is as simple as charging interest for as long as the money is borrowed. And if the customer was statemented on the 15th of the month, he was statemented with interest through that date. When he makes his payment, from that date on, the original balance was still due.

We deduct the $5,000 from that payment and charge for the number of days that the customer has borrowed the money. I believe that is the same kind of interest rate that financial companies charge on things from mortgages to other financial loans.

Senator LEVIN. You folks, all the credit card companies, hold out that there is a grace period on purchases; is that correct? You talk about a grace period.

Mr. SREDNICKI. There is a grace period on purchases for customers who transact, that is, who pay their bills in full every month. And fully 30 percent of our customers never pay interest on their purchases.

Senator LEVIN. I understand that. Do you think most customers understand that the grace period only applies to people who pay their bill in full every month? Do you think most people understand that? Mr. Wannemacher sure did not.

Mr. SREDNICKI. I think that the large majority of our customers do understand that, sir.

Senator LEVIN. I disagree with that, by the way, and I think our expert here also disagreed with that. Because you tout, you advertise a grace period for purchases that are made. I would like to see in your advertisements where you say that grace period does not apply unless you pay the entire amount and you will be charged interest on money that you pay on time.

I do not think your advertisements say that. I do not think the ordinary consumer understands that or believes that it is fair. I do not believe it is fair. It is very clear to me that if you get a bill on January 1 that says $5,020 is owing, the due date is January 15, and there is a minimum payment, but that if you pay less than the full amount that you are still going to be charged interest on the amount that you paid on time. I do not believe that the average consumer understands it, believes it, thinks it is fair. And I do not either.

Now your explanation as to why you believe that is justified, to me, I did not understand your explanation. In simple terms, I did not. Maybe others did and I do not want to say that just because I did not does not mean it was not clear or comprehensible. But I did not understand your explanation.

Let me try Mr. Hammonds. Why should people who pay their bill on time or pay part of their bill on time be charged interest on the part that they pay on time?

Mr. HAMMONDS. Mr. Chairman, there are two ways that customers use a credit card. There are transactors, that is about 50 percent of our base, who pay their balance in full each month. So essentially, for that 30 days, we are supplying them with an interest free loan. We have costs with that loan. We have risks with that loan, but we are giving that loan to them for free.

Then there are other customers who borrow on their credit cards. Just as Mr. Srednicki said, the calculation for those is exactly the same as an automobile loan or a mortgage loan or anything else. You pay interest as long as the balance is out there. Once you pay the balance off, you can become a transactor again. And people come and go, and use it in both ways.

Senator LEVIN. Do you think that your advertisements and your solicitations and your bills make it clear to people that if there is a balance they are going to be charged interest on the money that they pay? I know that in some of your solicitations that is clear, but do you think that is the general understanding, even though some of your solicitations may have it, that the grace period only applies if there is no balance? Do you think that is the common understanding, Mr. Atal?

Mr. ATAL. Senator, I think that there is always an opportunity to continually inform consumers about the terms and conditions under which they are taking on credit. We try each and every day to enhance our interaction with consumers and we will continue to do that.

Senator LEVIN. I know that some banks do say that the grace period only applies if there is no balance. I do not think that is either commonly described or commonly understood, and I would think it is critically important because this is something that strikes me as being so fundamentally unfair that I would hope that you would all do what some banks do relative to the grace period to make it clear that it does not exist.

You should not even use the term, I believe, except for those people—making it clear that it is only available to those people who have no balance on their bills.

On the trailing interest issue. I do not know if you use the term trailing interest, but you heard me describe the trailing interest in that exhibit this morning. That even though in some cases, which we have outlined here, you pay in full, on time, that there still would be an interest charge the next month.

I do not know what you call that, but we are calling it trailing interest. Do you believe that is fair? That someone gets a bill on February 1, and the bill is $55.21, the due date is February 15. The person pays the entire amount on February 15. Shouldn't they then assume, assuming there's no more purchases, that is it? Mr. Hammonds.

Mr. HAMMONDS. Again, Mr. Chairman, I think we make it clear to our customers that to avoid finance charges, or to avoid borrowing charges, you have to pay the entire balance in full. Again, just like an automobile loan, if you do not pay the entire balance in full, the next month you will have interest from the previous month.

Senator LEVIN. But they did pay the balance in full. February 15, they paid the entire balance in full, $55.21.

Mr. HAMMONDS. I am not as current on that—I cannot comment on that particular example.

Senator LEVIN. Mr. Srednicki, do you know what we are saying?

Mr. SREDNICKI. I think I understand the example and this customer has been revolving, as we call it. I do not know the exact calculations in that particular example.

But I would agree with Mr. Atal that we could improve the disclosure to our customers and try to make sure that our customers really understand.

I would also comment, sir, that I think bank cards, in general, offer customers, for most part, extremely competitive rates. It is a very competitive industry. And customers who do pay their balances in full have extremely good rates, and we have particularly good ones.

Senator LEVIN. Thank you. Senator Warner.

Senator WARNER. Thank you, Mr. Chairman.

I find this testimony this morning very helpful and thank each of you because you represent institutions that I sort of grew up with. They are the institutions—Chase goes back to the early 1800s, does it not? Is that not right?

Mr. SREDNICKI. Yes, sir.

Senator WARNER. These are the institutions that have built our Nation and I know you wanted to be in this business because the credit card is essential to our growing economy. There is no way in the world you could erect enough buildings to service everybody that would have to come in and borrow and look at a bank officer to make these, as Mr. Atal said, unsecured loans.

So you start with the premise it is an unsecured loan and, therefore, it has a higher degree of risk and you are entitled to a reasonable profit. And you have also got to remain competitive. I understand there is some 6,000 depository institutions which issue credit cards, but the majority of accounts apparently have gravitated to your institutions or institutions of a like nature.

So now we come along and it is obvious that we have to do something to help people manage their own lives and not fall into the traps that the credit card has the potential of doing.

Now let us talk a little bit about how the Federal Reserve is working to issue new regulations for disclosure requirements. Are you at liberty, any of you, to share with the Subcommittee today some of the ideas you are contributing in this process? I assume each of you or your subordinates are involved in working with the Federal Reserve on this; am I correct?

Why don't we just proceed as we have before. Mr. Hammonds.

Mr. HAMMONDS. Yes, Senator, we are. And we would be very happy to see some changes made there. We proposed some things that almost are like what you might see on a can of soup describing the ingredients, something that simple.

I will say to you, it is not the most simple process in the world. Our customers, and we know this from listening to them constantly, like a lot of flexibility in the product. So to try and describe everything that we might offer to a customer and do so across all institutions so they can compare products is not quite as easy as can be done on a can of soup. But we think, absolutely, there are many improvements that could be made and we should try and do so.

Senator WARNER. You mentioned—I caught the phrase and I wrote it down—a plain language brochure. Have you made a copy or would you make a copy or copies, plural, to the Subcommittee? I, personally, would like to read that over.

Mr. HAMMONDS. Absolutely, yes, sir. We will do so.

Senator WARNER. The Chase representative said you have—and I wrote this down—clear and simple rules of the road. I like that. And in every day language.

How is that put out, Mr. Srednicki? Is it a brochure?

Mr. SREDNICKI. It is a brochure that we send to our customers to make sure that they understand our billing practices, encouraging them to pay their bills on time, stay below their credit line, and better manage their credit. We also encourage customers, when they do have a problem that is intractable, to please call us because we would like to help them get on to a program that meets both their needs and our needs.

Senator WARNER. Now, would you make copies of those letters or however you call it, a brochure or whatever, available to the Subcommittee?

Mr. SREDNICKI. Yes, sir, I would be glad to.

Senator WARNER. With regard to the Federal Reserve, are you active participants in that process?

Mr. SREDNICKI. We are active participants, and we do support better, clearer, simpler disclosure for consumers, and we would be glad to work with them to get it done.

Senator WARNER. I recognize the antitrust complexities that you have to stay within your lanes and be careful, and I am sure that is being done. Where are we in the process with the Fed? Do you think we are making progress?

Mr. SREDNICKI. I think we have suggested things that we can do. We would work with them to improve anything that they come up with. And we would support having them gather folks under legal protection to make sure that we vet and improve disclosure to customers. We would all love to be on an equal playing field.

Senator WARNER. Are you at liberty to give this Subcommittee copies of your submissions to the Fed, the idea that you have provided?

Mr. SREDNICKI. I would be glad to give them. I do not know exactly where we are on it. I know that we have been working on new disclosure.

Senator WARNER. Mr. Hammonds, would you be willing to do that?

Mr. HAMMONDS. Yes, sir, we would.

Senator WARNER. I think, Mr. Chairman, that would be helpful to us.

As a wrap-up here in the few minutes I have left, Mr. Atal, what is your position on the Fed process? And would you be permitted to—

Mr. ATAL. Absolutely, Senator, yes, we would. We actually have already introduced to all of our customers, in addition to the highly complex and multi-page agreements that we send out that attempt to comply with the laws and regulations and inform them, but they are quite complex. We are already sending out a one-pager that is defined as similar to how Mr. Hammonds described the food labeling process.

But we will be absolutely willing to share with you what we are sharing with the Federal Reserve, and we are actively engaged in the process and looking forward to it.

Senator WARNER. I thank you for your contribution on that, too. Mr. Chairman, I thank you for this opportunity.

Senator LEVIN. Thank you. Senator Carper.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. Thanks, Mr. Chairman.

And to each of our witnesses here today, thank you for coming. Thanks for your prepared testimony and for your response to our questions. Thanks for working with the Fed and other regulators as we try to address some of the concerns that have been aired here today.

I missed most of the first panel's presentation. I was involved in another meeting. But we express our thanks to Mr. Wannemacher for coming.

I just want to say to Mr. Srednicki that I found it refreshing that you would issue a public apology on behalf of your bank to a customer who was wronged, unintentionally, but wronged. I do not know how many credit cards you have out, Mr. Atal, but I understand it is in excess of 100 million. I think I heard Mr. Srednicki say they have about 100 million out. Mr. Hammonds, would you have 100 million or so out?

With that many credit cards, you make mistakes. God knows we make mistakes in our business. Sometimes it is the way we vote, hopefully not often. Sometimes, we make mistakes in simply not returning calls or responding properly to people who e-mail or who write us. We get a lot of e-mails and phone calls, as you might imagine.

I always like to say everything that I do, I can do better. And we focus on our motto within our Senate office, is "if it is not perfect, make it better." It sounds like that is part of your DNA, as well.

Sometimes we have hearings here and they are on rather esoteric subjects. And it is difficult for us to identify the range of issues before us. That is not the case today. I am sure all of us have credit cards. I have several credit cards, one for my personal use, one for political campaign use, one for expenses that relate to my official business. And they are actually very helpful, enabling us to leave a paper trail, make sure that the proper charges are fixed and paid for in an appropriate way.

I am one of those customers that you probably do not like to have a lot, because I always pay my bill on time. I use every single day of that grace period and try to shop around for cards that provide the benefits that we want.

And it sounds like about half of your customers at Bank of America do that, and maybe a third or so of your customers at J.P. Morgan do that, as well.

I would comment, sitting here listening to this testimony—we had a previous hearing that you are familiar with that the Banking Committee held that Senator Sununu and I were part of.

I emerged from those hearings and this one today more firm than ever in the belief that if we could somehow harness market forces, harness competitive forces, inform consumers to make sure that our regulators are on the ball—not just soliciting input from consumers, from the industry and all—and holding, from time to time, hearings like this to put a spotlight on good practices. And I would argue that the folks before us today, Mr. Chairman and colleagues, are more arguably the white hats of the industry. The folks we really ought to have before us here are some of the folks that are traditionally lending to a subprime consumer base.

But those are not the folks that are here today. There is an old adage, people who write editorials are folks who come onto the battlefield when the shooting is over and shoot the wounded. That is not exactly what we are doing here today, but the folks that we ought to be shooting at are not necessarily the folks that are presented here.

When I first got my first credit cards, I looked at the amount of interest, I looked at the grace period, I looked at the annual fee. It was pretty easy. We did not have all these myriad fees that are in place today.

How do we go about harnessing competitive forces and market forces to provide consumers with the ability to actually shop and make informed decisions for themselves, better decisions? That was easy when I was young and it is not so easy today.

Mr. Hammonds, could we start with you, please?

Mr. HAMMONDS. As I said, Senator, it is not as easy as you might think because customers want a great deal of flexibility. Some customers want to use cash. Some customers want to use rewards programs. Some customers want discounts on other banking products as a result of the use of their credit card.

And so, describing simply all of those features while giving all of that flexibility is not as easy as someone might first think. It is not just thinking about only one way to use a credit card.

But we know from listening to our customers, that is what they want. They want that kind of flexibility. Many customers have three or four different credit cards and use them in three or four different ways. They might borrow on one, use one for a rewards program, and use one for business, as an example.

So I think there are things we can do to improve the process and again, I think working with the Federal Reserve, as well as trying more of these things like the brochures that I think we have all described—some clearer language to customers outside of Regulation Z—as well as all of the other educational efforts that we have going, whether it is with students or others, are the things that are needed in the industry to help make it easier for customers to understand more about their credit cards.

I will say, Senator, I spend a tremendous amount of time listening to customer calls and going out to banking centers talking to customers. I do think the vast majority of our customers do understand our products and do understand how to use them.

Is there some confusion? Absolutely. But I can tell you the vast majority of our customers do understand how to use the card.

Senator CARPER. Mr. Srednicki.

Mr. SREDNICKI. I would agree with everything that Mr. Hammonds has said, and say that I believe that we should have a uniform kind of disclosure and in very simple language. As simple as we can get it, recognizing that we do represent a lot of sophisticated products, different types of reward structures, different types of customers who use the product very differently.

But I think that we can do better at our disclosure and we would be willing to work on Regulation Z with the Fed.

Senator CARPER. Mr. Atal, before you speak, let me just say I am aware of the very good work that Citibank does with respect to financial literacy. You are active in our own State and some of our own schools. And I know that is true of your competitors here.

Go ahead, if you would just respond to my question.

Mr. ATAL. I would echo the comments of my colleagues here, Senator. As an example, we have over 300 products available through Citi Cards' business. So it is an option set that we have created for customers. On our Internet site, if you decide that you want a credit card from us, we ask you a number of questions. And you can self-select down into the products and features that you would like and reduce the level of optionality.

But it is a complex choice for customers to make amongst all the different credit cards that are available. Anything that we, as industry leaders, could do as well as supported by your Subcommittee and Senator Levin's focus on this would be positive to the industry.

Senator CARPER. Mr. Chairman, in closing, I would just say that looking back at the Banking Committee hearing that we had a month or so ago, and this hearing today, several of our witnesses here indicated they have changed practices that maybe did not stand up to the light of day. That is a very good thing. I think that is part of our responsibility, to invite them to appear before us and to hold out and question those practices as we are doing.

It is just unfortunate that a lot of the other thousands of issuers, or a number of the other thousands of issuers whose practices are far less defensible than the ones we are hearing about today, could not undergo a similar kind of scrutiny.

Senator LEVIN. Thank you, Senator Carper. Senator Coleman.

Senator COLEMAN. Thank you, Mr. Chairman.

I am the Ranking Member of the Near East Subcommittee of the Foreign Relations Committee, and King Abdullah of Jordan addressed the Joint Session of Congress, so I had to leave for that and did not get to hear the testimony. The staff has been briefing me.

I appreciate the discussion about disclosure. What we have here are complex choices with serious consequences for failing to understand those choices, very serious, burdensome, sometimes oppressive consequences.

Is it the sense, from what I heard from Senator Warner from Virginia, that you will be providing us some of the disclosure materials that you have been working on? Can you make this simple enough?

You cannot fit everything into the Schumer Box anymore. Two questions: First, do you think it is clear enough where we are today? And second, do you have a clear plan of where we go tomorrow to actually have the average consumer understand what they are getting into and what the consequences of not paying in full during a grace period are? Can you do that, Mr. Atal? We will just go from right to left.

Mr. ATAL. Yes, Senator, I believe we can.

I think that we will absolutely make that effort and I believe we will be successful at it.

Mr. SREDNICKI. I, too, believe we can do much better, Senator. I think our consumers, at least our consumers at Chase, are fairly sophisticated consumers. They do understand almost everything that we do. But I think we can make our disclosure better. I think we can make it more uniform. And I think we can improve the understandability of what we offer.

Senator COLEMAN. Thank you. Mr. Hammonds.

Mr. HAMMONDS. I agree with that. It is not good enough today, and we can make it better.

Senator COLEMAN. One area where I have continued concern is the application of penalty interest rates to previously existing loans. I understand the concept of reevaluating risk. People's circumstances change and these are ongoing loans.

The concern I have is a situation where after somebody purchases something at a certain interest rate and expects to repay that balance at that interest rate, the customer is sometimes repriced to a much higher interest rate. So now something that they had bought—understanding these are the terms and circumstances of the agreement—is repriced so that they suddenly have a higher interest rate applied to that prior balance.

I know that they often have the option of paying off their balance at that existing rate, but, for a lot of consumers, I do not know if they can—they have no real option to pay it off. That is probably why they borrowed, why they used the credit card in the first place.

So, in the end, they made purchases expecting a rate of, say, 10 percent and end up paying for those purchases at a rate of 20 percent. My question to you is do you think it is fair? And are there alternatives to this? Mr. Hammond.

Mr. HAMMONDS. Let me explain how we do it, Senator. We do evaluate risk. Where we see the risk change, we have to adjust price. As you said, these are open ended loans that theoretically never end.

We send a proposal out to the customer at that point to change the rate. The customer has the opportunity to opt out or just say no. If they decide to do that, they can pay the account off over time but we do not extend them future credit. And we think that is a fair way of doing it.

Senator COLEMAN. Mr. Srednicki.

Mr. SREDNICKI. Senator, we think and we believe that a repricing of a customer is an individualized decision. For example, for every 10 customers who are delinquent on their card, we do not reprice nine of them. We intentionally manage our risk by looking at the credit worthiness of that customer and how that customer behaves with us.

On the other hand, I do agree with Mr. Hammands that risk-based pricing is integral to our industry because 20 years ago everybody was at 19.8 percent. It is an extremely competitive industry, 20 years ago everybody was at $20 membership fee. Today, 75 percent of the cards do not even have fees.

And we do need risk-based pricing in order to manage our business.

Senator COLEMAN. Mr. Atal.

Mr. ATAL. While I would concur with the statements that my colleagues have made here regarding the ability of the industry to risk-based price because we are, after all, in the unsecured loan business, I would reiterate the point that I made in my testimony that we, at Citi, have moved a major step beyond that. We will be communicating to our customers that, during the term of their agreement with us, we will not reprice them over the terms we originally established as long as they are meeting the conditions that we stated up front. That is a sea change, we believe, in our interaction with our customers.

Senator COLEMAN. And I applauded that in my opening statement.

Mr. ATAL. Thank you, sir.

Senator COLEMAN. I think it is movement in the right direction, Mr. Atal.

Mr. Chairman, are we going to have another round?

Senator LEVIN. We will.

Senator COLEMAN. Thank you, Mr. Chairman.

Senator LEVIN. Thank you, Senator Coleman. Senator McCaskill.

Senator MCCASKILL. Thank you, Mr. Chairman.

First to all of you, do you all know the age of the customers you are soliciting? Mr. Hammonds, do you know the age of the customers you are soliciting?

Mr. HAMMONDS. In most cases we do, Senator. The majority of customers that we solicit are our customers that are coming into our banking centers. That is the way we get most of our customers. We certainly know the age prior to deciding whether we approve or decline their applications.

Senator MCCASKILL. In terms of the solicitations that you send out, though, do you know how old the people are that you are sending—you know 1.9 percent, get cash back, you are only going to pay 1.9 percent interest that is all over the envelope on the outside. Or even more that really seductive thing that looks like if you open it there is a check inside.

Mr. HAMMONDS. Senator, I am not sure that we do all of those things that you just described. When we solicit a customer, we do it one of two ways. We have a preapproved or pre-screened offer where we do know about the credit history of the customer and we know a lot of demographic information.

In some cases, we have affinity groups, for example, where we do not have that information. When we do send an application, the customer has to respond, and then a credit analyst makes the decision as to whether we will approve it or not. So with that solicitation, we may not know the age but we will know it before we make a credit decision.

Senator MCCASKILL. Do you have a cut off of age that you think is appropriate, either young or old, in terms of solicitation?

Mr. HAMMONDS. Well, I believe we cannot legally enter into a contract with anyone younger than 18 years old, but not on the upper end, no.

Senator MCCASKILL. So you would send solicitations potentially to somebody that is almost 79 years old that has a bad credit history on a frequent basis?

Mr. HAMMONDS. Senator, somebody with a bad credit history, whether they are 20 or 79, is not going to be approved by Bank of America.

Senator MCCASKILL. I will check with you later because I would disagree with that statement from personal experience.

And so if my 15-year-old daughter got a solicitation last week, that would have been just because you are sending out mass solicitations and you do not know how old she is?

Mr. HAMMONDS. It is possible but she would not have been approved had she responded.

Senator MCCASKILL. And what about college students that do not have a credit history? Are you one of the banks that send credit cards that do not have a credit history because they made it to college?

Mr. HAMMONDS. Senator, we have the endorsement, as a matter of fact, of about 800 college and college related groups that endorse our credit cards and we do approve credit card applications for college students after the same credit investigation that we do for any other customer.

Senator MCCASKILL. When you have the approval of those campuses, do they receive compensation for that?

Mr. HAMMONDS. Yes, they do.

Senator MCCASKILL. So they get paid, the universities, for allowing you to send credit cards to their students?

Mr. HAMMONDS. In many cases, they do.

Senator MCCASKILL. Is a list of the universities that allow you to do that, is that a public list? Is that something you would share with the Subcommittee?

Mr. HAMMONDS. I do not know. We have contracts with them. My guess would be that these are private contracts and we would not——

Senator MCCASKILL. I will go the other way. I will go to the universities and ask them because I think they would have to—I think if they are public universities that would be a public matter.

These college students, if they are 18 or older, I assume they get these credit cards without their parents ever knowing, even though they are in college full-time and do not have income?

Mr. HAMMONDS. First of all, you would find the vast majority of those that we approve would have income. They would have some kind of job. Some are done with their parents co-signing. Some are done on their own. In most cases, they have some credit already established. So we have credit criteria for students, just like anyone else.

Senator MCCASKILL. Is the credit criteria for a college student the same as a customer that would maybe apply for a credit card that was 30 or 40 years old?

Mr. HAMMONDS. It is, which also means that we look at income, debt to income, credit history and so forth. So if a college student was 40 years old and worked full time and was making money, they could get the same credit limit as someone else who was not.

Senator MCCASKILL. I meant the other way around. Most college students do not have a long credit history. They have just left home. And so most college students are going to have maybe a part-time job, maybe not. Most of them, there may be a few of them that have wealth because of wealth in their family. But the vast majority of them are not going to have a credit history and they are not going to have any kind of assets.

Frankly, I would have been shocked if somebody would have given me a credit card when I was in college, even though I worked as a waitress all through college. But it is very common now. I am curious how this came about. You may have explained it to me because I did not realize that the university campuses were getting paid for this.

Mr. HAMMONDS. Senator, a couple of things. First of all, our average credit line across our portfolio is about $8,500. You would find, probably, a college student would have more like a $500 credit line. So the credit lines are going to be different. We find they are very good customers.

Senator MCCASKILL. I bet.

Mr. HAMMONDS. Their loss rates are not significantly different than anybody else.

Senator MCCASKILL. They are not?

Mr. HAMMONDS. No, Senator, they are not. They handle their accounts very responsibly. They have a right to have credit as much as anyone else does.

I had two sons who went off to college in different parts of the country and, quite honestly, I would not have liked the thought of them being far away without having a credit card in their wallets. I think students need credit cards for all kinds of things, just like anyone else might need one, and just like everyone else, they need to handle it responsibly.

We have a lot more education for those college students than we would normally do with most other customers, including a handbook that we give them when we solicit them, as well as in the first statement is a brochure that explains how they should handle credit.

Senator MCCASKILL. I assume that the answers for the other two companies would be similar? You have agreements with college campuses that involve financial compensation in order to be able to send credit cards to their students?

Mr. SREDNICKI. It sounds like we do much less college solicitation than the Bank of America. We do have about 12 agreements with colleges. We also, though, find that college students are very responsible borrowers, payers, and they perform relatively well. The average age of our portfolio is in the upper end of 40. It is a very experienced credit portfolio.

We do not ever send out cards to someone who has had serious delinquencies. We never solicit them and we will not approve them, if they find us.

Mr. ATAL. Senator, we have no endorsements with any universities in North America. We have had 20 years of experience in marketing to students at college. Consistent with the statements of my colleagues, we do find that college students, if we provide them with credit in a responsible way, will behave responsibly. We do not see loss rates higher than we would see for the general population. Our credit lines for college students are, in general, about 20 percent of what we would provide to adults and they are able to handle that.

In addition to all of that, we take great care and great interest in making sure that they receive the materials to be able to use their credit wisely. We have actually introduced a program with Drexel University where they have got a Credit–ED program just for Drexel University students.

So we try very hard to inform them, to educate them, and provide them with products that would be suited to their needs.

Senator MCCASKILL. I want to ask all three of you, and if you can take as little time on this as possible, although I know we will have another round, how much time each of you give your customers to pay their bill to avoid interest and penalties? How many days do you give your customers to pay their bill in full if they are trying to pay in full? Mr. Hammonds.

Mr. HAMMONDS. It varies, but it is somewhere between 20 and 30 days.

Mr. SREDNICKI. It varies between 20 and 25 days.

Mr. ATAL. It is the same for us, it is 20 to 25 days, Senator.

Senator MCCASKILL. Why does it vary?

Mr. HAMMONDS. Different customers want different kinds of accounts and behave diffently with those accounts.

Senator MCCASKILL. And the customer has the control of that?

Mr. HAMMONDS. It is part of the customer selection of different accounts. I mean, Senator, we literally have thousands of different kinds of accounts that we offer customers. It is part of the feature of the account.

Senator MCCASKILL. I will not tell you which one of you I have. You may know. But I have one and I have struggled with getting this thing paid because there were times, particularly when I was building a home, that I was charging all of these things on this credit card through the Internet.

Of course, we wanted to review the bill in depth because there was a lot of charges on it. And it was incredibly difficult to get that thing paid on time because I found out it was 20 to 25 days but it was from the time that they sent the bill, not from the time you received the bill. Is that true with all three of you?

Mr. HAMMONDS. Yes.

Mr. SREDNICKI. Yes.

Mr. ATAL. Yes.

Senator MCCASKILL. So it's not from when you get the bill. It is 20 to 25 days from when you send it. So when the customer gets the bill, they do not know what date you sent it. How are they to know how much time they have?

Mr. HAMMONDS. There is a due date on the bill.

Senator MCCASKILL. So let us assume the due date is 5 days from when you got the bill. You have only 5 days—and that is why finally—you say the customer gets to pick. Well, I should not say that. I am not a good customer because I pay the bill every month. But I struggled because I called. And I am not the average layperson. I am pretty aggressive, as you can tell. And I got on the phone with this company and said why am I getting these late charges because I am turning this bill around—in my experience most Americans who pay bills, you get 30 days. And I was turning that bill around within a week and invariably I was getting interest and late charges on it

They said the only way—and then they finally told me well, on a certain day you can go on the Internet and see your bill.

Well, the average customer is never going to know that. It took me 14 phone calls to get there. I had to do this and ask for another person and do this and then finally ask for a supervisor. And I finally got to the point that I figured out I could do that. But I do not think most customers ever can figure that out.

Mr. SREDNICKI. Senator, we are spending a lot of time trying to inform our customers that they can go online, both to see their bills and to pay. I hope this customer, if we were your bank, we would have told you when you called in, you can pick the date for your payment, and it will never change once you do that.

Senator MCCASKILL. But I cannot pick the date because I do not know when you are going to get the bill to me because the date starts running when you send the bill, which is—it would be one thing if I always knew the bill was going to be around for a week before the bill was due. But there have been times I have had less than a week that the bill has been due.

Mr. SREDNICKI. You should never have less than a week to pay.

Senator MCCASKILL. I will show you guys.

My time is up. I am sorry.

Senator LEVIN. We will have another round.

Senator MCCASKILL. I am sorry. I got carried away.

Senator LEVIN. Thank you. Senator Sununu.

OPENING STATEMENT OF SENATOR SUNUNU

Senator SUNUNU. Thank you, Mr. Chairman. I was finding the line of questioning very interesting, if nothing else.

Gentlemen, I want to be sure that Senator McCaskill and Senator Carper are not driving you into bankruptcy. You are making money on interchange fees, aren't you, off of these terrible customers that pay these bills at the end of every month?

Mr. SREDNICKI. Yes.

Senator SUNUNU. Excellent. I just want to make sure that customers like that are not a problem for you.

I certainly appreciate the hearing and the testimony. I think it has been pretty direct and pretty frank. As Senator Carper said, we had a good hearing in the Banking Committee where some of these issues were discussed, and I want to say I appreciate the GAO report that was initiated by this Subcommittee. I had not read it in full until the last couple of days, but it has a lot of very good information, a lot of very interesting information about the trends in the industry, some very good, some that raise questions. But I think it is pretty thorough, pretty informative.

There are a number of findings, some that have been discussed here, such as the importance of disclosure. You have spoken about it, Members have spoken about it—good disclosure and increased competition—the market forces Senator Carper talked about have been driving interest rates down and improving competitiveness or expanding competition across the industry.

It is interesting to me that most customers avoid penalty and interest by paying off their cards. I think the GAO found it was close to 50 percent that pay off their card at the end of every month, a little bit higher than I would have thought. But obviously, if you then look at the disclosures that we have been talking about, they leave a lot to be desired. They are not always as clear as they could be or should be. There are some very important practices or key practices that you have talked about, that Chairman Levin has talked about, that obviously are questionable. And I think we appreciate the responsiveness in changing some of them.

In fact, that is where I want to begin because I know that most of you talked about recent changes that you have made in your testimony. I was here for some of your testimony. I saw others when I was back in my office at a meeting, watching on the television.

But I would like each of you to go through very briefly, I know you are repeating yourself, what practices have you changed recently and why? What is the simple most compelling reason for making those changes? Why don't we begin with you, Mr. Atal.

Mr. ATAL. Yes, Senator. The most important practice that we have changed recently has been the practice that I referred to earlier where we will, first, not change a customer's price with us or rate on loan with us if they are in conformance with the terms of the agreement we have established.

And second, we had, up until recently, the unilateral right to change the price for economic and financial conditions during the term of their contract.

We have voluntarily agreed and we will inform our customers of that, that we will not change that price.

What led up to that was obviously we have an ongoing dialogue with our customers. But quite frankly, the activities and the efforts of Senator Levin and this Subcommittee, as well as the Senate Banking Committee, has focused our minds and made us act quickly and in an important way and, I think, in a way that will be material to all of our customers.

Senator SUNUNU. Mr. Srednicki.

Mr. SREDNICKI. The most important practice that we just changed was eliminating over-limit fees for customers after 3 months over limit. And we did that, frankly, after review of the Mr. Wannemacher account.

Senator SUNUNU. Mr. Hammonds.

Mr. HAMMONDS. Senator, many of the practices that you have heard described we have never done so we have not made any recent changes.

We do have some programming going on right now where we are going to take customers who have been repriced up, and if they do not have a late charge or an over-limit fee in 6 months, reduce their rate down.

Senator SUNUNU. So you are looking at the repricing issue and your over-limit fees were capped at 3 months prior?

Mr. HAMMONDS. They were capped at 3 months already, yes.

Senator SUNUNU. For each of you, what percentage of credit card holders are assessed over-limit fees? How common is that particular problem, which has rightly really received a lot of attention because of Mr. Wannemacher's situation. Mr. Hammonds.

Mr. HAMMONDS. Well, I do not know that exact percentage. I know, like Mr. Srednicki mentioned, only about 4 percent of our customers last year were risk-based repriced. I can tell you, as a percentage of our income, only 12 percent of our income, our revenues, come from either over-limit or late fees.

Senator SUNUNU. Do you know what percentage of your customers have over-limit fees assessed?

Mr. SREDNICKI. Senator, I do not know off the top of my head.

Senator SUNUNU. Mr. Atal.

Mr. ATAL. I do not know the number for our business, Senator, but I do recall, I believe, that in the GAO report it quoted that about 87 percent of customers had not paid an over credit limit fee. And I would assume that as a large issuer, we would be in a parallel position.

Senator SUNUNU. Under 15 percent.

Mr. Atal, what does your company do when a customer gets into trouble?

Mr. ATAL. We have a very active program, Senator, to work with the customer. We would inform them about our different programs that are available. We invite them to call in and reach us on the statements we send to them. We will give them a number to call us. We would invite them to reach us via the Internet. And we send them separate mailings encouraging them to work with us in solving their issues.

So we believe we make every attempt to work with customers to make the right decisions for them.

Senator SUNUNU. Mr. Srednicki, have you changed the way that you approach customers who get into trouble over the last year?

Mr. SREDNICKI. Sir, we have had a very active program over the last many years to contact customers who are having financial difficulty and enroll them in programs, both help programs, temporary programs, long-term programs, consumer credit counseling programs.

A consumer credit counseling program would have been the right program, for example, to put Mr. Wannemacher in, had we handled the program correctly.

We do have inbound programs for the customers to reach us. We have outbound letters. We have online contact, ways for the customer to get hold of us. And we are always glad to work with the customer.

Senator SUNUNU. But the existence of a counseling program is not new for you?

Mr. SREDNICKI. No, sir, and we have always supported the accredited counseling programs in the country.

Senator SUNUNU. Mr. Hammonds, how many of your cards issued by your company are delinquent?

Mr. HAMMONDS. Well, about 5 percent of the balances are delinquent. The average delinquent customer has a higher balance than the average customer. So about 2 percent of our customers are delinquent at any given time.

Senator SUNUNU. So 2 percent of customers, 5 percent of balances?

Mr. HAMMONDS. That is correct.

Senator SUNUNU. Does that reflect industry norms?

Mr. HAMMONDS. You know, I do not know, Senator.

Senator SUNUNU. Why don't we ask Mr. Srednicki.

Mr. SREDNICKI. About 3 percent of our customers would be more than 30 days delinquent, and I believe that is below the industry norm.

Senator SUNUNU. Mr. Atal.

Mr. ATAL. Senator, we provide that information in our periodic financial reports. About 2 percent of our customers are over 90 days delinquent approximately at any particular point in time. I think it is relatively consistent with industry norms.

Senator SUNUNU. Let us talk briefly—the last question, Mr. Chairman—about these college students. Because I do not know whether to be alarmed now that my children are approaching college age or whether to see this as an opportunity.

Are college students' delinquency rates higher than the 2 percent that you say is typical for your company?

Mr. ATAL. It is very similar, Senator.

Senator SUNUNU. Any difference between their delinquency rates and the ones you just quoted, Mr. Srednicki?

Mr. SREDNICKI. I think it is basically the same, Senator. And I would point out that the average student goes to college with some credit experience. The important thing for us is to make sure when a college student is solicited and he or she applies, is that they get educational information that tells them how to responsibly use their card, do not go over the credit limit, and pay their bills on time.

Senator SUNUNU. Mr. Hammonds.

Mr. HAMMONDS. They have slightly higher delinquency but about the same loss rate as the rest of our customer base.

Senator SUNUNU. Thank you, very much. Thank you, Mr. Chairman.

Senator LEVIN. Thank you very much, Senator Sununu. Senator Carper.

Senator CARPER. Thanks, Mr. Chairman, for letting me go out of order here.

I have county officials from all over Delaware, all three counties, are waiting for me to treat them to lunch so I am not going to keeping them waiting too long. I appreciate you letting me go out of order and just take a minute, if I could.

I am going to submit a couple of questions for the record, if I may, Mr. Chairman.

I want to just state one question. I will not ask you to answer it here but I will ask you to answer it for the record.

I think you have all stated that your banks could improve the disclosure of your products and features of your products. I would just ask for the record, why don't you just go ahead and do that? And why do you have to wait for the Federal Reserve? That is one I will ask you to answer for the record.

Again, it goes back to the thought that if customers are well informed, they will make a decision and let those market forces and competitive forces work.

The other thing I would say to our Chairman and to my colleagues, these banks are profitable and sometimes extraordinarily profitable in these operations. It has not been mentioned today but they are also extraordinarily generous.

MBNA was one of the banks that Mr. Hammonds helped to start in our State. They are legendary in Delaware for their generosity.

The support that J.P. Morgan Chase and Citibank provided, and I suspect in the other States that are represented here, whether it is in the education of our students, adopting schools, providing mentors in our schools, supporting our affordable housing efforts, just all kinds of activities.

We are grateful for that.

Last, I would just say in my Clean Air Subcommittee we focused on climate change and global warning and trying to figure out how we can reduce the threat of global warming without screwing up our economy and costing consumers an arm and a leg.

I just learned that Bank of America has announced a $20 billion environmental initiative to support the efforts of a lot of businesses, a lot of people in this country and around the world. And we applaud you for that initiative, especially, and thank you for joining us today.

Thank you, Mr. Chairman.

Senator LEVIN. I think all three of your banks have a practice that requires that the payment by a consumer on a credit card account be applied first to the balance, which, as a matter of fact, has the lowest interest rate. Is that correct? Mr. Hammonds.

Mr. HAMMONDS. Yes, sir.

Mr. SREDNICKI. Yes, sir.

Mr. ATAL. Yes, sir.

Senator LEVIN. Why should you be in a position to decide which account a payment is made on? Why should that be exclusively your unilateral decision?

In other words, instead of applying a payment to the account that has the highest rate of interest, you apply it to the account that has the lowest rate of interest. Why shouldn't the customer have a voice in that? Mr. Hammonds.

Mr. HAMMONDS. Senator, that practice actually started when we started offering zero percentage promotional rates, which I think is much like a retail store offering a sale to a customer. We know our customers like the zero rate. We know that they take advantage of it and that they save money as a result.

However, we could not extend that zero rate without taking the payments to that balance first. If, for example, we extended a zero rate and then you paid first the other highest rate loans, you would never pay off the zero.

Senator LEVIN. But the rate of interest charged on purchases is a higher rate—excuse me, a lower rate than the interest that is charged on money that is borrowed; is that correct?

Mr. HAMMONDS. That is correct.

Senator LEVIN. Why then, when somebody sends you a payment and they have two types of loans in effect from you, why should it be your unilateral decision to apply that against the lower interest rate of interest instead of the higher? I am not talking zero rate of interest here.

Mr. HAMMONDS. That is the practice.

Senator LEVIN. I know, but why is that a fair practice? Why shouldn't we just say apply it to the rate of interest which is the higher rate of interest instead of the lower rate of interest?

Mr. HAMMONDS. It is clearly disclosed at the time we give that loan to the customer, Mr. Chairman. So the customer knows up front how we are going to apply their payments. That is why I think it is fair.

Senator LEVIN. Do you have anything to add to that, Mr. Srednicki?

Mr. SREDNICKI. Senator, I think that the zero rates or very low interest rates——

Senator LEVIN. Not the zero rates. We are talking about the regular rates on purchases compared to the rates that are charged on money that is borrowed, the advances: Those two rates. One of them is 15 percent, and one of them is whatever the other percent is. Why should it be applied, when I send you a check and I have two open lines with you, one is for my purchases which is a 12 percent account, let us say, and one is for my advances where you have advanced me money.

Why should I not be able to say I want to apply that to that account, which has got the higher rate of interest?

Mr. SREDNICKI. The payment hierarchy, as we call it, is created so that we can give better rates to customers on either transactions that they buy on the card or in loans that we extend the customers to pay off other credit cards or other bills. It is a great consumer benefit.

And if you make the right kind of disclosure and if you inform customers at point that they are giving you the direction to send a payment out to another issuer, to another retailer, or to a home furnishing store, it is a great consumer benefit. And we do believe our customers understand that pretty clearly and take advantage of it a lot.

Senator LEVIN. I would ask that each of you go back to your companies and take a look at this trailing interest issue because, to me, patently—it is absurd, frankly, that I would get a bill February 1 that says this is the total amount that I owe. And if I pay it by February 15, I think I would have a right to believe that it is, if I do not make any other purchases.

And the idea that then I get a bill on March 1, with no further purchases, for what is called trailing interest, it is 38 cents in our example here, which is obviously a small amount in that particular example.

But the point is not small. The point is there are probably hundreds of millions of dollars involved here, when you add up all of the small nickel and dime changes which are added like that.

I would ask each of you to go back. I do not think you are familiar with this issue, perhaps. At least, Mr. Hammonds, you indicated you were not. Mr. Srednicki, I do not think I asked you or Mr. Atal.

But whether you are familiar with it or not, it seems to me it is patently unfair. I would ask you to go back to your banks and see if you can get that thing dropped.

I think, Senator McCaskill, technically you would be next because he went out of order. Is that all right?

Senator COLEMAN. Actually, I have just two questions and I have a 12:30 meeting with——

Senator LEVIN. I am looking by my Ranking Member and Senator McCaskill and figuring out what the rules of the gavel are. I want to follow these disclosure rules very carefully.

Senator MCCASKILL. I would yield to Senator Coleman, no matter what the rule is.

Senator LEVIN. Thank you. That solves my problem. Senator Coleman.

Senator COLEMAN. Thank you.

Just two lines. First, a comment about the college kids. I have a son in college who has a credit card. Actually, he has been really good. I think he has an understanding of his obligation. He is really proud. He makes his payments. He is already negotiating lower interest rates. I think it is actually a good deal.

My concern, though, would be, apparently we put a lot of time into educating college kids. The average consumer does not have a college education. I would hope you would go back over what you are doing with average consumers and put the time and money into educating them as well. It would be very helpful and I would urge you to look at that.

I do have to say—and I hope I am pronouncing it correctly—is it Mr. Atal?

Mr. ATAL. That is right, Senator.

Senator COLEMAN. I think Citigroup has it right that terms of the deal should not change, customers should not be repriced unexpectedly.

I would ask Chase and Bank of America, are you considering doing the same thing? If not, why not?

Mr. SREDNICKI. Senator, we are always evaluating things that we can do to be more competitive. This is a very competitive industry.

But I would point out that we could reprice many more customers than we do. But we use individualized credit decisions in order to handle our customers. So that if your son were one of our customers and he was delinquent on our card, only one in 10 customers like that would be repriced by us. We take into account the credit performance of the individual customer and his experience. And every student that we get with limited credit experience, we do give credit education to.

Senator COLEMAN. Mr. Hammonds.

Mr. HAMMONDS. Senator, I would echo what Mr. Srednicki said about this being a very competitive market. And so with this new announcement by Citi, we certainly will look at that. But we will look at it compared to all of the other things we do in pricing compared to Citi. We always take those things into consideration as well. So, absolutely.

Senator COLEMAN. I appreciate it.

Thank you, Mr. Chairman. And thank you, Senator McCaskill.

Senator LEVIN. Thank you. Senator McCaskill.

Senator MCCASKILL. First, I want to thank all three of you for being here, sincerely. I think it is helpful. And to whatever extent my personal frustrations have spilled over today, I apologize to the three of you.

It is interesting because you all talk about how competitive your businesses is. And it is interesting to me, because I really believe there is a lot of American consumers that are very frustrated with your businesses and frustrated with what they do not understand and what they do not know.

It seems to me there is such a marketing opportunity there. And I think Citi has happened upon something that I bet will help, something that says to the consumer we are not going to change the rules on you. We are going to make sure you understand the fine print.

I think you all—and I know you all do focus groups all the time. But I would be really interested, if any of you did a focus group, how someone would feel if you advertised we are going to send you a disclosure that you understand. It may not be something that looks like anybody else's disclosure. But you are going to understand it. You are going to understand what happens if you do not pay the bill by the date it says. You understand what happens if you go over your limit. We are going to let you charge it in the store, because I think a lot of people believe that if they are going to charge something that goes over their limit, the machine is going to stop it, the machine is not going to let it go through. But you do, because that, I think, probably embraces some other monies that may come into your companies.

I just think that in some ways I think sometimes you get so caught up in competing in the business like you have always competed that you do not maybe think that there might be an opportunity out there to really make it simple and be really upfront about everything that you are doing and what it means. And I think you might be surprised how many people would flock to your companies.

Let me ask the three of you, on your promotions, what is the current promotion you are running? Is it 1.9 percent or is it zero percent? What are the current promotions you are running at the front end? Is there one?

Mr. ATAL. At any one time we have many promotions running to different sets of customers.

Senator MCCASKILL. Could you give any kind of average as to what the promotional interest rate is that you may be—it seems on the envelopes I am seeing all the time is 1.9 percent. Is my mother just in a certain set that she is getting 1.9 percent? or is that a common promotional right now?

Mr. SREDNICKI. Senator, I would say that there are literally hundreds of different types of promotions out there. Some of them have no promotional rates but we are selling, for example, an airline miles program or a rewards program for a hotel chain, etc.

And then there are some programs that go out with a zero APR for a length of time or a 1.9 percent and then a go to rate that is sometimes fixed, sometimes variable.

With our company, we solicit the most credit worthy customers and credit experienced customers so the rates are quite low.

Senator MCCASKILL. The interesting thing about your promotions, I got the analogy you gave, that it is like a retail store offering a promotion. Except when they give you a cheap price on hamburger, it is because they think when you are there buying the hamburger, you might buy a steak. With your companies, it is completely a different kind of promotion because once they are in, they are in. Once you get them that card and they have the ability to use that card, then I am assuming that the goal of your promotion is to get them in the door and then to have them as a long-term loan customer.

Mr. SREDNICKI. Absolutely.

Senator MCCASKILL. That is why I think that the disclosures are so important. This is not about buying a steak. This is about them signing up long-term for a financial obligation. It is so important they understand.

Late penalties, can you all give me what your late penalty is? What is your late penalty, Mr. Hammonds?

Mr. HAMMONDS. I believe we assess it one day after the due date and it is tiered up from $15 to $39.

Senator MCCASKILL. Mr. Srednicki.

Mr. SREDNICKI. We generally assess it one day after the due date and it is tiered based on balance and it goes up to $39.

Senator MCCASKILL. Mr. Atal.

Mr. ATAL. At the high end we have a $39 late fee rate that is applied after the due date.

Senator MCCASKILL. Let me just make an observation here. I know that there is a lot of times, throwing up the worry of antitrust is something that I think is used selectively sometimes. And I might point out that all three of you have the identical late fee. Is that because it is set by law or you just have followed each other, when one goes up the other two go up?

Mr. HAMMONDS. I think, Senator, it comes back to this being a very competitive business and you have to be aware of what your competitors are doing. And that is probably the result of that competitions.

Senator MCCASKILL. Finally, the last question I have, and I do not mean to pick on Chase. I tried to read through all of your disclosures that we have in our book, Bank of America and Chase and Citigroup.

I know that lost and stolen credit cards are the liability of your companies, as opposed to the cardholders; correct?

Mr. SREDNICKI. Yes.

Senator MCCASKILL. I do not think most cardholders know that. Now I am not sure that you should tell them because I think everybody should be careful with their cards and keep track of them. But I think a lot of consumers assume that if they lose their card or it gets stolen, somehow they are going to be responsible for the charges.

I am curious, Mr. Srednicki, why, when you look at your billing statement disclosures, the very first one is lost or stolen, which is the only one that really would impose a liability on your company. That is the first disclosure on your disclosure statement. And it is the only one that you tell the consumer how to get a live adviser.

All the other disclosures on this sheet, if your customer wants to get a hold of someone, you actually spell out you can reach an adviser by pressing zero after you enter your account number.

In other words, you are making it, in the very first paragraph, very simple for a consumer to let you know when you are going to have a liability. But when you get down here to your billing rights or any of that, there is not that information about you can get an adviser.

Do any of you put in your disclosures anywhere how you can get a live adviser, other than in the section that has to do with liability your companies will, in fact, have?

Mr. SREDNICKI. Ours is on every statement. We tell the customer on every statement, it is on the back of their card, how they can get a hold of us for virtually any type of a problem.

Senator MCCASKILL. Do you explain you can hit zero for an adviser after you enter your account number?

Mr. SREDNICKI. I do not know the answer to that.

Senator MCCASKILL. I would be interested in that, because that is part of the battle here, is getting a hold of a live person who you can talk to and they can explain things to you. I just thought it was fascinating that the only place I found, in any of this, that you could get a hold—whether the consumer is told how you can get a hold of a live adviser, is in the area where you are going to have the financial liability instead of the customer.

Mr. SREDNICKI. I never thought about it that way but when any one of our customers wants to call us, we have live advisors available on the phone 24 hours, 7 days a week. I think both of my competitors do, too.

Senator MCCASKILL. Thank you, Mr. Chairman.

Senator LEVIN. Thank you, Senator McCaskill.

There has been some discussion here today about the profitability of the credit card industry, and I pointed out in my opening statement that I believe it is the most profitable part of the commercial banking world. It is very profitable for many years consistently. Obviously, there is some risk involved. You talk about this is an unsecured loan.

But you folks send out 8 billion pieces of mail a year—not the three of you, and not your companies, but the entire industry, 8 billion pieces of mail. I do not know if there is any other industry which comes close. I doubt it.

There is obviously a significant profit in this industry or else you would not be soliciting so often, so repeatedly. I do not know how many pieces of mail that averages per household. My wife, I think, would say that she thinks she gets most of the 8 billion solicitations, just over and over and over again.

But there are already 640 million credit cards out there. I think it attests both to the competitiveness in the industry, which you focused on, but it also attests to the profitability of the credit card industry. 60 to 70 percent of the people who have credit cards, I think by your statistics here today, do not pay in full on time so that they run balances. For those folks—I think that is about an average figure.

For those folks, they are the ones that get hit with the over-the-limit fees, the late fees, the high interest rates after they have paid their zero percent for whatever number of months that is, after they sign on. These are the folks that frequently get into real financial trouble, as Mr. Wannemacher did.

But I think we have to, first of all, welcome the reforms that you folks make when the spotlight is on you. Those are welcome.

And it is necessary that we keep the spotlight on you, obviously. That is the role of oversight. That is the role of Congress.

But we cannot have hearings here every day. We cannot get every Mr. Wannemacher out there in front of us every day to have his debt forgiven. I wish we could, but we cannot.

We have done some good just with this process you have announced in the last couple of days, in which Chase has changed the terms of these multiple over-the-limit fees, and that is welcome.

As Senator Carper points out, however, there are I do not know how many thousands of companies out there that are not going to put limits on how many over-the-limit fees they charge. Mr. Wannemacher was hit 47 times for a $200 over-the-limit fee. He was charged $1,500 in fees for a $200 over-the-limit amount.

I think your three companies are now intending, with Chase's addition today, to stop that. But all those other companies that Senator Carper referred to are out there. And the question is how do we get them to stop that abuse? We cannot have a hearing with a thousand companies here, put the spotlight on them. And so you have to have some regulation and you have to have legislation. That is the line that we have to figure out where to stop and where to cross.

Some of these practices are not fair. We have talked about the trailing interest. We have talked about these multiple over-limit fees on consumers. We have talked about piling penalty interest on top of penalty fees because people, as Mr. Wannemacher says, are charged interest when those penalty fees are added to the amount that is owing.

I believe it is wrong for people to pay interest on debt which they pay on time. I think most people do not believe it. In fact, it is counterintuitive when I ask colleagues of mine, are you aware of the fact that if you pay a big chunk of your credit card bill on time that you are still going to be charged interest on the amount that you paid on time next month? And they all look at me like are you kidding?

So maybe it is in the fine print somewhere in the disclosure, but I think it is wrong.

I do not think we ought to charge consumers a fee to pay their bills. And I did not have a chance to ask you all about this but apparently it is the practice that if you pay your bill by phone that you are going to be charged a fee even if that bill is paid on time. That does not strike me as being fair. If you pay by computer there is no fee. If you pay by mail, someone has got to open an envelope, there is no fee. But if you place a call to the company and transfer money from another account or a bank to pay that credit card bill, you are charged a fee. And that is troubling, as well.

We are going to keep the spotlight on. This oversight hearing has been very valuable to us in terms of the road that we are going to walk. Hopefully not needing too much legislation. But I think at least for all those other companies that are not put right under the microscope as you folks have been today, that those companies have got to be reined in as well. And I do not know how to do it, except through regulation or through legislation or through the industry adopting some kind of a code of practices which everybody signs up to.

But there clearly are excesses out there. There are abuses out there. We appreciate not only the steps that you have taken, in a number of instances, to correct some of those abuses and very honestly and openly saying, in a number of cases, it is because of these oversight hearings and the Banking Committee's hearings. But also the fact that you have been very cooperative with the Subcommittee.

You have always provided us the information which we have sought. You have been helpful in that regard. And we appreciate that. And we will keep the spotlight on, the one that you faced today.

We appreciate your being here.

Thank you so much and we will stand adjourned.

[Whereupon, at 12:50 p.m., the Subcommittee was adjourned.]

APPENDIX

PREPARED STATEMENT OF SENATOR COLLINS

Mr. Chairman, I commend and share your long-standing interest in consumer protection and fair play.

Within the lifetimes of many of us in this room, credit cards have grown from a novelty for the affluent, to an essential element of daily life for many Americans. A recent Government Accountability Office (GAO) report cited evidence that Americans hold nearly 700 million credit cards, use them more than 2 billion times a month, and charge nearly 2 trillion dollars a year.

The GAO report noted that nearly half of cardholders pay off their balances month to month, and that competition among card issuers has brought interest rates below 20 percent for four-fifths of card users. For most people, credit cards are a clear boon.

Unfortunately, as the GAO report, our own observations, and our constituent mail can testify, many people find themselves shocked—and their budgets strained—by fees, penalties, or rate changes that were not explained well, or that defy our basic sense of fair dealing.

The GAO found, for example, that some credit-card disclosure text is written at third-year college level, even though about half of the population reads at eighth-grade level or below. Complicated explanations in tiny type may explain why over half of cardholders surveyed said they didn't read disclosures closely—or at all.

Informed consumers are key to reaping the advantages of competition and choice that help our people and our nation to prosper. Making sure that credit-card users can understand their choices among differing rate and fee structures will help them avoid unsuitable choices and will sharpen competition among card issuers.

Improved disclosure—which ideally includes simpler language and clearer displays—will also call attention to practices like double-cycle billing, through which a card holder paying off even a large part of a balance during the grace period gets charged interest on the entire amount in the next bill.

Mr. Chairman, I look forward to studying the views of the Subcommittee's witnesses today. I am sure that card issuers and users can help us identify improvements in practices and disclosures that will make credit cards an even more useful and beneficial part of our national commerce.

Thank you.

Wesley Wannemacher
Lima, Ohio

March 7, 2007

TESTIMONY BEFORE U.S. SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Mr. Chairman & Members of the Subcommittee, thank you for having me here today.

First of all I would like to thank everyone especially my wife and family who have been so supportive the last few years. And, I would like to reach out to the millions of people who have gone through or are currently going through a similar situation.

My name is Wes Wannemacher, and I come from Lima, Ohio. I am married and raising a small family. I wish I could come here and tell you that I've always paid my bills on time, but my goal isn't to convince you that I'm the most responsible adult in the US. Despite these and other faults, I am well liked and respected in my community.

Toward the end of 2001, I had just accepted a higher paying job, and my wedding was approaching. My wife and I wanted to show everyone a good time and have a memorable experience. As a young adult, I really had no idea just how much my wedding would cost. I had applied for and received a credit card from Chase with a $3,000 credit limit. This was quickly reached after paying for flowers and a photographer. I charged a total of $3,200 on this card and never charged anything beyond that, I have been trying ever since to pay it off.

Although I was working a new job, living in Columbus was more expensive than Lima. Right away, I could tell I was going to have problems paying this and other debts. Debt seems to invoke a feeling of hopelessness unlike any other problem I've encountered. When a debtor calls you on the phone and you make a minimum payment, you know that you've made no real progress and that in a month, they will be calling again.

From 2002 to 2004, I was able to increase my income. Although big raises and promotions are exciting, in that time period I learned what many adults already know. As your pay increases, your expenses increase as well.

During those two years, I tried to make payments to Chase. I had not asked for a payment plan or any method to resolve the balance, but I made whatever minimum payment they would take when they called. These payments were usually close to $200. With limited funds in your checking account, you have to prioritize. Since Chase couldn't turn off my lights or kick us out of our home, there were times that their payment would be the lowest priority.

In the last half of 2004, a few events changed my plans for the future. First, my wife left her job because of complications with her pregnancy. Second, my father asked me to move home and help out with the family business.

As 2005 started, we had another baby and we had moved back to our hometown. I realized that my problems with Chase would only get worse unless I took action. Early in 2005, I called Chase and asked if they would take $3,000 to settle the debt, which, by this point was $4,600. I offered $3,000 because it was my original credit limit and I had never gone much past that. Unfortunately, Chase was not willing to settle for $3,000. I shouldn't speculate why they declined my offer, but I'd guess that the person on the other end of the phone had a goal to get as much money as possible.

This meant I was back to making payments and watching the balance rise. In 2006, my balance had exceeded $5,300 and I knew that I needed to make them work with me before I ended up in bankruptcy. I called and asked if there was something they could do to help me. Eventually I was offered a payment plan. The premise of the plan was to payoff the $2,300 that was past the credit limit. The representative was very clear that once I got the balance down to $3,000, I would be taken off this plan and the interest rate would go back to normal. At the time, it seemed like a gift. Finally, I could see the balance go down rather than up.

While I was making regular payments between $140 and $210 a month, my stepdaughter was enrolled in therapies that were not covered by our new insurance plan and she had her tonsils removed. Before I knew it, I had a very large medical debt. With these offices calling asking for payment, we were quickly overwhelmed. This time, we decided to enroll in a debt management program. In December of 2006, I had gathered up all of the statements from the various companies I owed money to and took them to a credit counselor.

My credit counselor sent proposals to everyone and curiously, Chase was the only creditor who declined her offer. Despite filling out a Power of Attorney, Chase made many attempts to contact me directly. I would instruct representatives who called me on the phone that they needed to contact my credit counselor. Many times they would say things to try to pressure me into making extra payments directly.

Around this time, I saw a news article mentioning Senator Levin and his desire to look into cases like mine. The article mentioned that people who feel they've paid excessive fees and charges should contact his office, so I did.

Over the last few months, I've been contacted by Chase representatives who tried to convince me not to enroll in debt management and asked for direct payments. Finally, in February of 2007, my credit counselor offered Chase a payment plan of $130 a month for 47 months, totaling $6,110. Chase accepted. At the same time, I was working with Senator Levin's office, which, after reviewing all of my account information, asked if I would testify here today.

I was asked on a Thursday to testify today, and the following Monday, a representative of Chase called me on the telephone to let me know that they've reviewed my account and decided that they are forgiving my balance. I asked the representative if my plan to testify today had anything to do with their change of heart. The representative told me that their decision was solely based on a review of my account.

I had agreed to come testify because my primary concern is for the future of my own children. I am only here to let people know what happened to me. From September of 2001 to February of 2007, I've paid Chase over $6,300. If they hadn't *reviewed* my account, I would have paid another $6,110 on a $3,200 debt. Thanks again for listening.

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Testimony before the

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

regarding

Credit Card Practices: Fees, Interest Rates, and Grace Periods

March 7, 2007

Alys Cohen
Staff Attorney
National Consumer Law Center
1001 Connecticut Ave., NW, Suite 510
Washington, DC 20036
202-452-6252
acohen@nclcdc.org

also on behalf of:

Consumer Action
Demos
National Association of Consumer Advocates
U.S. Public Interest Research Group

Testimony before the
COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
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Credit Card Practices: Fees, Interest Rates, and Grace Periods
March 7, 2007

Mr. Chairman, Senator Coleman, and Members of the Subcommittee, thank you very much for inviting me here to talk about the practices of the credit card industry. I am testifying today on behalf of the low income clients of the National Consumer Law Center,[1] as well as Consumer Action,[2] Demos,[3] National Association of Consumer Advocates,[4] and U.S. Public Interest Research Group[5]. We also thank Chairman Levin for commissioning the landmark Government Accountability Office report on credit cards.[6] This GAO Credit Card Report documents the numerous credit card practices that have been unfair and sometimes abusive toward consumers, confirming the experiences of consumers and their advocates.

I. Credit Card Abuses Squeeze the Vulnerable

We have a debt crisis in America and its source is the practices of the credit card industry. This debt crisis causes consumers to file bankruptcy more often, to reduce their savings to a historic low point, to spend the equity in their homes to pay off credit card debt by refinancing and putting homes at risk of foreclosure – all precipitated by unaffordable credit card debt. It is not generally the *amount borrowed* by these consumers that causes the swelling of unaffordable debt leading to these personal catastrophes for millions of families. It is the practices of the credit card industry that cause the most trouble. The exorbitant interest rates and multiple fees charged to already overburdened consumers are breaking the proverbial backs of American families. Make no mistake - the tremendous profits of credit card companies come off the backs of the most vulnerable, financially distressed consumers.

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[1] The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations, from all states who represent low-income and elderly individuals on consumer issues. As a result of our daily contact with these advocates, we have seen many examples of credit card abuses. It is from this vantage point –years of observing the oppressive credit card practices against the less sophisticated and less powerful in our communities – that we supply these comments. This testimony was written by Alys Cohen and Chi Chi Wu, both attorneys with the National Consumer Law Center.

[2] Consumer Action (www.consumer-action.org), founded in 1971, is a national nonprofit consumer education and advocacy organization based in San Francisco, CA, with offices in Los Angeles and Washington, DC. Consumer Action's advocacy work centers on credit, banking and housing issues. The organization's free multilingual educational materials and pricing surveys are distributed online and through its network of 8,500 community-based organizations across the country.

[3] Demos is a non-partisan, national public policy organization based in New York. Our work centers on expanding economic opportunity and creating a more robust democracy.

[4] 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.

[5] The U.S. Public Interest Research Group is the national lobbying office for state PIRGs, which are non-profit, non-partisan consumer advocacy groups with half a million citizen members around the country.

[6] Government Accountability Office, *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*, GAO-06-929, September 2006. [Hereinafter "GAO Credit Card Report."]

A. An Incomplete List of Abuses

The abusive practices by credit card lenders are well documented, including by the GAO Credit Card Report. We discuss some of the most burdensome and egregious. This is by no means a complete list of credit card abuses-- the possibility of a new abusive practice is only limited by the human imagination.

Junk Fees. A significant contributor to snowballing credit card debt is the enormous increase in both the number and amount of "junk" fees, such as fees for cash advance, balance transfer, wire transfer, currency conversion, and more. Most prominent among these fees are late payment and over-limit fees.

Credit card lenders have made these fees higher in amount, imposed them more quickly, and assessed them more often. Banks now 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. According to the GAO Credit Card Report, over one third of credit card consumers were assessed a late fee in 2005.[7]

Penalty Rates. A penalty rate is an increase in a credit card's APR triggered by the occurrence of a specific event, such as the consumer's making a late payment or exceeding the credit limit. Penalty APRs average 27.3% according to the GAO Credit Card Report, and can be as high as 30% to 40%.[8] The new terms apply to the old balance – leaving consumers stuck to pay often high balances at interest rates far higher than was originally agreed, with devastating consequences.

Raising an APR from the mid-teens to 27% or higher, simply on the basis of a single transgression, itself is unjustified and unfair. After all, the card issuer has already collected a one-time charge for that late payment or over-limit transaction, which probably more than covers its costs. This practice is especially outrageous when applied retroactively. There is simply no legal or economic justification for assessing a penalty interest rate to an existing balance; the terms of a loan are being changed *after* the loan has already been made.

Universal Default. Even worse is universal default, in which credit card lenders impose penalty rates -- not for late payments or any behavior with respect to the consumer's account with that particular issuer -- but for late payments to any of the consumer's other creditors. In some cases, lenders will impose penalties simply if the card holder's credit score drops below a certain number, whether or not the drop was due to a late payment or another factor. Consumer Action's 2005 survey of credit card lenders found that 45% of banks surveyed had a universal default policy.[9] According to Consumer Action's survey

[7] *See* GAO Credit Card Report at 13.
[8] *Id.* at 24-25.
[9] Linda Sherry, *2005 Credit Card Survey*, Consumer Action (Summer 2005), *available at*: www.consumer-action.org/archives/English/CANews/2005_Credit_Card_Survey/index.php.

of credit card customer representatives, the following circumstances could trigger a penalty rate hike: credit score drops (90%); late payment to any creditor (86%); going over limit (57%); bouncing a payment check (52%); too much debt (43%); too much available credit (33%); getting a new credit card (33%); inquiring about car loan or mortgage (24%).[10] Among other concerns, using credit reports to trigger penalty rates is connected to the enormous problem of inaccuracies in credit scoring and credit reporting.

Allocation of Payments. Many credit card companies heavily advertise low APRs in their solicitations that are only applicable to one category of transactions. They then allocate payments first to the balances with lower APRs. The disclosure of payment allocation order has been very minimal,[11] or nonexistent.[12] As shown by our example below, payment allocation abuses are a form of bait & switch, depriving consumers of the benefit of the credit card lenders' highly promoted "0% APR" or other teaser rates for balance transfers. Consumers find all of their payments applied to their 0% balance, eliminating that amount quickly, while purchases at higher APRs accrue significant finance charges since they are not being paid down.

Late Payment Triggers. Not only are late fees higher, credit card lenders have been quicker to impose them, often using hair trigger tactics. Previously, credit card lenders gave consumers a leniency period of a few days before imposing late fees.[13] Now, card lenders will impose late fees if the consumer is even one day over the due date. Some lenders impose late fees for payments received on the payment due date but after a certain cut-off time, such as 1 P.M. And until consumer advocates and lawyers began to complaint and file lawsuits, these lenders set ridiculously early times like 9 or 10 A.M. deliberately to result in the imposition of late-payment fees -- well before the U.S. Postal Service delivers the mail. Furthermore, when due dates sometimes fell on a weekend or holiday, lenders considered the payment late if not received on the prior business day.

Unilateral Change-in-Terms. The nature of credit cards is that the borrower signs an agreement at one point in time, but continues to draw upon the credit line thereafter. Creditors likely need some flexibility to respond to changes in consumer circumstances. The problem is that they are allowed to change any term of a credit card virtually at will with only a 15 day notice under the Truth in Lending Act.

There are two problems with these unilateral changes-in-terms. First, they deprive consumers of any "benefit of the bargain," making a mockery of both federal disclosure laws and contract law, because the terms of the contract are illusory. A savvy consumer can select a credit card after reviewing Truth in Lending disclosures, comparing terms, reading articles about picking a credit card – in other words, be a smart shopper – then be

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[10] *Id.*
[11] Broder v. MBNA Corp., 722 N.Y.S.2d 524 (N.Y. Sup. Ct. 2001) (promotional material ambiguously disclosed in small print footnote that card issuer "may" allocate payments to promotional balances first).
[12] *See* Johnson v. Chase Manhattan Bank USA, 784 N.Y.S.2d 921 (N.Y. Sup. Ct. 2004).
[13] The *Role of FCRA in the Credit Granting Process: Hearing before the subcommittee on Financial Institutions and Consumer Credit*, at 7 (June 12, 2003) (statement of Dr. Robert D. Manning, Caroline Werner Gannett Professor of Humanities, Rochester Institute of Technology), *available at* http://www.creditcardnation.com/pdfs/061203rm.pdf.

faced with a change-in-terms notice that totally changes the APR and other terms of the credit card. One court has described change-in-terms provisions as "an Orwellian nightmare, trapped in agreements that can be amended unilaterally in ways they never envisioned."[14] Second, the vast majority of consumers probably do not read or understand change-in-terms notices. Credit card lenders have admitted that very few consumers opt out of changes.[15] Evidence uncovered from a case involving similar change in terms notices (albeit from cell phone contracts) found that very few customers actually read these notices.[16]

In any case, consumers have few options to switch to other companies even if they do figure out that the terms of their card are changing. In addition, when creditors change terms, they apply the new terms to previously incurred charges. In fact, the GAO Credit Card Report documented that creditors are now using change-in-terms notices to achieve universal default repricing.[17] In some ways, this is even worse, since it means the lenders don't need to disclose their penalty rate practices in the initial Truth in Lending disclosures.

Subprime credit cards. There are a number of credit card products targeted at the "subprime market," which generally means consumers with lower credit scores and/or impaired credit histories. The limited number of consumer protection actions taken by the federal banking regulators have primarily focused on subprime credit cards and have targeted practices such as:

- "Downselling" consumers by prominently marketing one package of credit card terms, but then approving consumers only for accounts with less favorable terms.
- Issuing credit cards with low credit limits, then adding mandatory fees or "security deposits" resulting in little or no available credit when the consumer receives the card.
- Deceptively marketing credit "protection" products.

While these cases shed light on the particular abuses in the subprime industry, they are in some ways an extension of the harsh practices of "mainstream" credit card lenders. A "prime" credit card can quickly become "subprime" with a change-in-terms notice, the imposition of a penalty rate, or one of the other abusive practices discussed above. A single late payment on a "prime" credit card account may result in the imposition of a $35 fee and an increase in the APR from a reasonable 10% to a sky-high 28%. This account now bears the hallmarks of a subprime credit card --- high rates and high fees.

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[14] Perry v. FleetBoston Financial Corp., 2004 WL 1508518 at *4 n.5 (E.D. Pa. Jul. 6, 2004). This court went on to say that it was "reminded of George Orwell's 1946 work, Animal Farm, in which the pigs assume power and change the terms of the animals' social contract, reducing the original Seven Commandments, which included 'All animals are equal,' to one—'All animals are equal, but some animals are more equal than others.'"
[15] GAO Credit Card Report at 26.
[16] Ting v. AT&T, 319 F.3d 1126 (9th Cir. 2003). An article by Bill Burt at Bankrate.com reports similar data, from a survey by Auriemma Consulting Group finding that only one-third of consumers who received change-in-terms notices were aware of the changed terms. Bill Burt, *Ignoring Credit Changes Can Cost You* (Jan. 30, 2004) *at* http://www.bankrate.com/brm/news/cc/20040129a1.asp.
[17] GAO Credit Card Report at 26.

Mandatory Arbitration Clauses. The use of arbitration provisions in credit card agreements has been a tremendous barrier for consumers seeking relief for credit card abuses. Consumers who complain about deceptive disclosures, late posting of payments, payment allocation abuses, and failure to follow federally required billing procedures have lost their day in court due to arbitration provisions (often added using change-in-terms notices).[18]

Card issuers are now using arbitration provisions offensively as well, as a lopsided method to obtain judgments against unsuspecting consumers. Some of these consumers include victims of unauthorized use and identity theft. A report issued by NCLC documents how credit card debt buyers use arbitration proceedings to obtain judgments for thousands of dollars against identity theft victims.[19]

B. Real World Examples of Abuses

The following are just a sampling of consumers who have been victimized by credit card abuses. Their cases are far from isolated, and each probably represents thousands of consumers with a similar story.

1. Low Balance Credit Cards

Our first example is a young Navy sailor who opened a credit card account with First Premier Bank on November 21, 2006. The credit card had a $250.00 credit limit and a 9.9% APR for purchases. The same day that the sailor opened the account, he was assessed two fees - a "Program Fee" of $95.00 and an "Account Set-Up" Fee of $29.00. The next day (November 22), he was assessed a Participation Fee of $6.00. Three days later (November 24), he was assessed an Annual Fee of $48.00. When this young sailor received his first month bill, which had a closing date of November 24, 2006, he had already accrued a balance of $178.00, *without making a single purchase.*

The next week, the young sailor used the credit card for four transactions totaling $84.85. On December 22, 2006, he was assessed a participation fee of $6.00. With all these fees, the young sailor was already over his credit limit, despite making less than $85 in purchases on a card with a $250 limit. He was assessed an over-limit fee of $25.00 and a late fee of $25.00, plus a finance charge of $1.96, on December 26. He now owed a balance of $320.81.

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[18] *See, e.g.,* Lawrence v. Household Bank, 343 F.Supp.2d 1101 (M.D. Ala. 2004) (compelling arbitration of Truth in Lending Act and Fair Credit Billing Act claims challenging a 9 A.M. cut-off for payment posting); Kurz v. Chase Manhattan Bank, 319 F. Supp.2d 457 (S.D.N.Y. 2004) (compelling arbitration of Fair Credit Billing Act claims as well as retaliation under the ECOA). *Cf.* Johnson v. Chase Manhattan Bank USA, 784 N.Y.S.2d 921, 2004 WL 413213 (N.Y. Sup. Ct. 2004) (compelling arbitration of state law claims challenging payment allocation abuse); Providian v. Screws, 2003 WL 22272861 (Ala. Oct. 3, 2003) (compelling arbitration of state law claims challenging bait & switch APRs, billing errors, and late fees).

[19] National Consumer Law Center & Trial Lawyers for Public Justice, *New Trap Door for Consumers: Card Issuers Use Rubber-Stamp Arbitration to Rush Debts Into Default Judgments* (Feb. 27, 2005), *available at* http://www.consumerlaw.org/initiatives/model/content/ArbitrationNAF.pdf.

In January 2007, the young sailor did not make any purchases with the credit card. He was again assessed a participation fee of $6.00, an overlimit fee of $25, a late fee of $25, and $2.64 in finance charges. As of January 25, 2007, the sailor owed a balance of $379.45 for $84.85 worth of purchases!

Another example for a low balance credit card comes from a summary by a consumer attorney defending a client against a Capital One collection lawsuit:

> Capital One is suing my client for over $3500 for a defaulted credit card. The client had just come out of bankruptcy and received a solicitation for a Capital One Mastercard with a $200 credit limit. He signed up for the credit card because he and his wife just had a baby and needed a crib. They charged a baby crib (total cost $158) on the credit card. The next week, the client received a call from Capital One trying to sell him a membership in a diner's club. He declined. The client then received his first monthly statement showing charges for the crib ($158), annual fee ($39), and the diner's club membership ($99). Capital One added a $25 over limit fee and finance charges. The client called Capital One and explained that he had declined the diner's club, and asked Capital One to please remove the charge for the diner's club and the overlimit charge. Capital One agreed to do so, but never did, despite follow up calls from the client. The account spiraled out of control with Cap One adding late fees, over limit fees, and finance charges each month. The client has paid over $700 to Capitol One, yet the company is suing him for over $3500. The only charge he ever made was for the baby crib.

Business Week recently documented how Capitol One offers *multiple* low-limit credit cards to overextended borrowers in order to maximize over-limit and other fees.[20]

2. Allocation of Payments[21]

Similar problems occur with the application of payments by credit card lenders. 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

[20] Robert Berner, *Cap One's Credit Trap*, Business Week, November 6, 2006.

Note that the Minnesota Attorney General's sued Capital One in 2004 over abusive practices. Some of the allegations in that lawsuit included: (1) deceptive practices in heavily promoting low "fixed" rates, then engaging in aggressive penalty rate repricing or even raising rates for no reason at all; and (2) lowering a consumer's credit limit without notice, then charging an over-limit fee and imposing a penalty rate. Complaint, State of Minnesota v. Capital One Bank, *available at* http://www.ag.state.mn.us/consumer/PDF/PR/CapitalOneComplaint.pdf.

[21] Taken from Testimony of Michael D. Donovan Before the Senate Committee on Banking, Housing, and Urban Affairs, January 25, 2007.

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.

3. Consumers Overwhelmed by Fees and Penalty Rates

The leading example of abusive credit card practices has been the case of *Discover Bank v. Ruth Owens* which the GAO Credit Card Report cites.[22] In that case, an Ohio court found that Ms. Owens, an elderly woman who depended on a monthly Social Security Disability check, had paid $3,492 on $2,000 principal that she had borrowed on a Discover credit card. The court rejected Discover's attempt to collect an additional $5,000 in late fees, penalty interest and credit protection costs, because those charges were, in the court's view, unconscionable.

Another classic example is the bankruptcy case of Josephine McCarthy.[23] On one account, Ms. McCarthy had made $3,058 in payments over a two year period during which her balance on the account increased from $4,888 to $5,357. She had made only $218.16 (net of store credit) in purchases during this time. On the other card, she made $2,008 in payments over the same period and the account balance increased from $2,020.90 to $2,607.66. This time she made all of $203.06 in purchases.

II. A Broken Market

A. Cross Subsidies in the Credit Card Marketplace.

Credit cards work well for some consumers. Credit cards are a tremendous convenience for consumers who are well off and can pay their balances every month, those known as "convenience users." Those consumers, as the GAO Credit Card Report notes, enjoy lower APRs and fewer annual fees. Convenience users collect airline miles, reward points, or even cash back, plus they enjoy an interest-free one month loan from the credit card lenders and the protections of federal law against theft or loss. The consumers who can pay off their balances every month generate such lower profitability for credit card lenders that they are sometimes referred to as "deadbeats" by the industry.[24]

Somebody, however, needs to pay for the deadbeat's great deal, and that person is the consumer who does not have the means to pay off a credit card balance every month - the

[22] Discover Bank v. Owens, 822 N.E.2d 869 (Ohio Mun. 2004).
[23] *In re* McCarthy, No. 04-10493-SSM (Bankr. E.D. Va. filed July 14, 2004).
[24] These users still represent a source of substantial income to the lenders, through the charging of "interchange" or the merchant fees.

"revolver." The revolvers make up most of the profits for the credit card industry, about 80%.[25] The revolver who makes the tiniest misstep – a day late on a minimum payment, a few dollars over the limit – becomes a profitable borrower. The revolver will be socked with penalty rates averaging 27% APR and fees averaging over $30. Even if the revolver merely pays late to another creditor or the credit score drops, the effect will be exorbitant penalty rates on the credit card.

Why do credit card lenders stick so many consumers who make the smallest misstep (or even no misstep) with rates averaging 27% APR, sometimes even after the lenders have collected $25 or $30 for their troubles? The reason is that card companies have figured out how to make money by lending to people without any determination of their ability to repay. There is no real evaluation of the consumer's ability to take on new debt – an evaluation that would involve not just obtaining a credit score but also determining whether the consumer can afford the credit given her income and other debts. Instead, credit card lenders engage in "back end" underwriting. *After* the consumer has received the credit card and run up a debt, and after facing trouble making the payments on the debt, the credit card lender hikes up the interest rate for the consumer and justifies the increase in rate based on the "newly discovered" high risk of non-payment.

However, when they realize a consumer is a risk, the card issuers don't simply cut off these consumers who it turns out can't afford the credit handed to them. Instead, lenders raise the interest rates for these consumers to sky high levels and assess exorbitant fees on a monthly basis. The lenders use the extension of risky credit to justify the higher interest rates, but that simply exacerbates the riskiness (or likelihood of default) of those borrowers. Enough high risk customers pay these exorbitant amounts to subsidize any losses that actually result from customers who do not repay their debt.

Thus, the industry has found a way to use risky lending to their benefit. These tactics have proven to be immensely profitable. One of the most startling facts uncovered by the GAO Credit Card Report is that an enormous amount of credit card revenues come from financially vulnerable or distressed consumers.[26]

These abusive practices also permit credit card lenders to "hide the ball" on the real price of a credit card. Consumers will shop for credit cards based on sales pitches in the solicitation - points and rewards, and if pricing is something they focus on, APR and annual fee. Consumers never shop on "what is the penalty APR or late fee" because they never expect to be that consumer who is late, or loses a job and can't pay off the bill.

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[25] GAO Credit Card Report at 69-72 (approximately 70% of revenues from interest charges, with a growing portion attributable to penalty interest, and 10% from penalty fees).

[26] The GAO Credit Card Report noted that about 11% of credit card consumers are assessed an interest rate of 25% or more, which is probably a penalty rate. However, only about half of cardholders are revolvers. That means about a quarter of revolvers have a penalty rate. These penalty rate revolvers probably make up for more than 25% of profits from interest rates, since as the GAO noted they pay higher prices and also may carry larger balances. Interest makes up about 70% of credit card lenders profits, and penalty fees account for another 10%. GAO Credit Card Report at 67-72.

Once the consumer has racked up the debt, a consumer is beholden to the credit card lender, and has few choices in the marketplace. Consumers who are homeowners are often able to tap home equity, but if their credit score is poor, they now face the risk of abusive subprime home equity lending. Otherwise, the best that a distressed consumer might be able to do is file for bankruptcy, or try to walk away (stop paying). Therein also lies part of the reason credit card lenders use such draconian tactics when a consumer stumbles even a little - lenders often can squeeze enough out of distressed consumers to make the account profitable, even if ultimately the consumer files for bankruptcy or the debt is written off.

It is important to understand that the industry often does NOT lose money on borrowers who don't fully repay their credit card debt. Generally, before a borrower defaults, the creditor has already received multiple fees and payments of interest from that borrower – often equal to or in excess of the actual amount borrowed. Some examples of this tactic, which has been called the "sweat box" by Professor Ronald Mann,[27] are shown in our real world cases discussed above.

Altogether, the abusive practices, the back end underwriting, and the attempts to "sweat out" consumers have created a form of credit card economic Darwinism. As the GAO Credit Card Report documents, the credit card market has improved over the last several decades for the financially secure who do not carry a credit card balance or can manage not to stumble even a little – lower interest rates, reward programs, fewer annual fees, and convenience. For Americans who have a tougher time, the market has become much worse with high penalty rates and excessive penalty fees for strapped consumers who cannot escape by paying off their balance.[28] The financially vulnerable consumer is subsidizing the financially secure. Moreover, the increasing securitization of credit card debt[29] will only magnify this problem because a profitable business model sells on Wall Street whether or not working Americans benefit.

Even many of the borrowers who routinely pay off their balances are at risk of becoming forced "revolvers. Many households live paycheck to paycheck, with only small savings to buttress them against financial catastrophe. A recent study from Demos and the Access Project documents that medical bills are responsible in part for credit card debts for 29% of the families that are revolvers.[30] An earlier report by Demos and the Center for Responsible Lending found that credit card debtors often incur ongoing debt as a result of automobile repairs, medical bills

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[27] Ronald Mann, *Bankruptcy Reform and the "Sweat Box" of Credit Card Debt*, 2007.1 Ill. L. Rev. 375 (2007), *available at* http://works.bepress.com/ronald_mann/14.
[28] In the GAO's own words:

> the increased revenues gained from penalty interest and fees may be offsetting the generally lower amounts of interest that card issuers collect from the majority of their cardholders. These results appear to indicate that while most cardholders likely are better off, a smaller number of cardholders paying penalty interest and fees are accounting for more of issuer revenues than they did in the past.

GAO Credit Card Report at 79.
[29] The GAO noted that more than 50% of credit card debt is securitized. GAO Credit Card Report at 68.
[30] Cindy Zeldin and Mark Rukavina, *Borrowing to Stay Healthy: How Credit Card Debt Relates to Medical Expenses*, Demos and the Access Project (January 2007).

and just to buy groceries.[31] Professor Elizabeth Warren's research documents how consumers end up in unmanageable debt due to divorce, illness or other financial disasters.[32] It's not plasma screen televisions or luxury handbags - it's the medical bills, the groceries, the car repairs and the gas bill that pulls families into the quagmire of high credit card balances, higher interest rates and fees.

B. Deregulated Interest Rates Cause Extensions of Unaffordable Credit

The credit card industry has used the deregulation of interest rates as a justification to make these unaffordable extensions of credit to people who cannot afford to repay that debt. Rather than evaluate the borrower's ability to repay and then charge a rate of return based simply on the cost of extending that credit, plus a reasonable margin to cover profit and a small risk of loss from non-payment, the industry charges high margins of interest to cover *anticipated losses from borrowers whose ability to repay has never been determined.* The high rates of return are charged to whole classes of borrowers, regardless of whether they can afford to repay. These returns provide ample income to cover losses for those who default and to provide huge profit margins. The high interest rates thus facilitate lending to borrowers who cannot afford the credit, and whose lives are significantly damaged by their attempts to pay high cost credit which no underwriter would have anticipated they could repay. Moreover, the riskiness of the credit is used as the excuse for charging exorbitant rates of interest – thereby making the credit more unaffordable and more risky.

This approach is backwards. The market should not provide an incentive for making loans to consumers who can not repay. The industry should be evaluating a borrower's ability to repay and only extending credit to those who can afford the credit provided to them. If interest rates were limited, the industry's profits would come from paying borrowers (who would sometimes default due to life events). There would not be sufficient excess profit from those who could pay to allow for making predictably unaffordable loans to borrowers who were never in a reasonable position to repay the debt.

III. History of Credit Card Regulation: How Did We Get Here?

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.*[33] This case gave national banks 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

[31] Tamara Draut, Ansel Brown, Lisa James, Kathleen Keest, Jabrina Robinson and Ellen Schloemer, *The Plastic Safety Net: The Reality Behind Debt in America,* Demos and Center for Responsible Lending) (Oct. 2005), *available at* www.demos.org/pubs/PSN_low.pdf.

[32] Warren, Elizabeth et al. "Illness and Injury as Contributors to Bankruptcy," *Health Affairs*, February 2, 2005; Elizabeth Warren, et al., *Illness and Injury as Contributors to Bankruptcy*, Health Affairs (Feb. 2, 2005); Elizabeth Warren, *Families Alone: The Changing Economics of Rearing Children*, 58 University of Oklahoma Law Review 551(2005); Elizabeth Warren & Amelia Warren Tyagi, *The Two-Income Trap* (Basic Books 2003).

[33] 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).

states that eliminated or raised their usury limits, giving them free rein to charge whatever interest rate they wanted.[34] From 1978 to 1996, credit card debt grew from $50 billion to $378 billion, multiplying six-fold.[35]

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 a definition of interest that included a number of credit card charges, such as late payment, over-limit, cash advance, returned check, annual, and membership fees.[36] 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. 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 lenders.

After *Smiley*, banks rushed to increase late charges, over-limit fees, and other charges. As the GAO noted, the average late payment fee has soared from $12.83 in 1995 to over $33 in 2005, an increase of 115% adjusted for inflation.[37] Over-limit fees have similarly jumped from $12.95 in 1995 to over $30 in 2005, an increase of 95% adjusted for inflation.[38] Since *Smiley*, penalty fee revenue has increased nearly nine-fold from $1.7 billion in 1996 to $14.8 billion in 2004.[39] The income from just three fees – penalty fees, cash advance fees and annual fees – reached $24.4 billion in 2004,[40] Concurrently, card issuer profits, 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.[41]

It is this complete deregulation of interest rates, and the resulting escalation in interest rates and fees charged to many consumers, that has directly caused the industry's deliberate decision to extend credit to consumers in amounts far in excess of what they can afford to repay.

IV. Restoring a Fair and Functioning Credit Card Market

The industry's practice of deliberately making unaffordable loans, and then charging these borrowers an arm and a leg when they don't repay, must stop. This damages everyone, and is a contributing factor to the boom in risky mortgage refinancing, reduced savings and foreclosures.

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[34] 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).
[35] *See* Fed. Res. Bull., *available at* http://www.federalreserve.gov/releases/g19/hist/cc_hist_mt.txt. 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.
[36] 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).
[37] GAO Credit Card Report at 20.
[38] *Id.* at 21.
[39] Cardweb.com, *Fee Party* (Jan. 13, 2005), *available at* http://www.cardweb.com/cardtrak/news/2005/january/13a.html.
[40] *Id.*
[41] Cardweb.com, *Card Profits 04*, (Jan. 24, 2005), *available at* http://www.cardweb.com/cardtrak/news/2005/january/24a.html.

Because of the deregulation of bank credit, virtually no state regulation on creditor conduct applies to the practices of the credit card industry. 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 lenders and their customers. The TILA was intended to be – and remains – primarily a disclosure statute. It 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 American consumers face today with the credit card industry. Disclosures alone are not sufficient 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 credit card debt.
- 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.

Furthermore, many consumers lack the ability to make effective use of even straightforward and uncomplicated disclosures. One example of this inability is the failure of many consumers to derive information from FDA food nutrition labels, considered by many to be the gold standard in disclosures. A recent study found that 40% of consumers could not answer the simple question of "how many carbohydrates were in half a bagel" when the label stated information about the amount of carbohydrates for a whole bagel.[42] What chance do these consumers have of figuring out credit card disclosures?

For the past two decades, substantive credit regulation has been steadily whittled away, with no discernable benefits for consumers. The twin justifications for this diminution in credit regulation have been that too much regulation limits access to credit, and that consumers can adequately protect themselves so long as they are armed with full information about the costs of the credit. The pendulum has swung too far – there is no lack of available credit; indeed for many families there is far too much dangerous credit available to them.

[42] Eric Nagourney, *Nutritional Information Leaves Many Uninformed*, New York Times, Sept. 26, 2006, at D6.

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. We recommend substantive regulation along the following lines. Most of these reforms are also discussed in the Joint Recommendations of Consumer Groups on Credit Cards, attached.

- **Meaningful underwriting of the consumer's ability to pay.**

- **A cap on all other charges to an amount the card issuer can show is reasonably related to cost.** Penalty fees should be based on the lender's cost for a default; they should not be a profit center. This is the longstanding common law doctrine on penalties in contracts. It is also the principles-based standard reiterated for such fees by the Office of Fair Trading in the United Kingdom and Europe.[43]

- **No unilateral change-in-terms allowed.** Credit card lenders should not be able to change the terms of a contract mid-stream. If a credit card lender wants to change the terms of a contract, they should be required to close the old account (and permit the balance to be repaid on the pre-existing terms) and offer the consumer a new deal with respect to future credit.

- **No retroactive interest rate increases allowed.**

- **No universal default.**

- **Penalties should not be allowed for behavior not directly linked to the specific card account at issue.**

- **No over limit fees allowed if issuer permits a credit limit to be exceeded.**

- **A cap on all periodic interest rates.**
  The time has come to consider reinstituting the historic prohibition against usury in this country. A new usury cap could be designed to "float" with the prime rate, so that lenders can still make a *reasonable* profit in a high interest rate environment. A cap on interest rates would have the important result of forcing the industry to limit their profits from too-risky loans.

- **No mandatory arbitration, either for consumers' claims, or for collection actions against consumers.**

- **Meaningful penalties for violating any substantive or disclosure requirements 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.**

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[43] *Calculating Fair Default Charges in Credit Card Contracts*, United Kingdom Office of Fair Trading, April 2006.

We need a standard of fairness on credit card companies when they deal with consumers. Fundamentally, the abuses of the credit card industry represent a simple breakdown of the concept "treat the consumer right." A fairness standard is also important, because a flexible standard is necessary to restrain the industry from responding to reforms by creating new and innovative techniques designed to squeeze consumers. Alternatively, credit card lenders should be subject to the old common law contract doctrine of good faith and fair dealing. This is another standard reiterated by the Office of Fair Trading in the United Kingdom.[44] Basic fairness is a baseline standard; it is something people have the right to expect.

The increasing mountain of debt held by American consumers coupled with the growing number of abusive practices by the credit card companies, illustrate amply that 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 Levin and other members of this committee on further examination of the credit card industry.

[44] *Calculating Fair Default Charges in Credit Card Contracts*, United Kingdom Office of Fair Trading, April 2006, at 10.

ACORN * Center for Consumer Finances * Consumer Action * Consumers Union Consumer Federation of America * Demos * National Association of Consumer Advocates * National Consumer Law Center • U.S. PIRG

Joint Recommendations of Consumer Groups on Credit Cards

Eliminate reckless and abusive lending by credit card companies

No unsound loans: Make issuers offer credit the old fashioned way, using sound underwriting principles based on the ability of consumers to pay and that ensure the cardholder is not overextending financially by taking on more debt.

Restrict lending to youth without conditions. Young people deserve credit, but only if they qualify. Yet right now, young people are the only group that can obtain a credit card without either a positive credit report, a job, or other evidence of ability to pay, or, barring any of these, a co-signer. No other adult can get a credit card without meeting at least one of these conditions. Young people should have the same safeguards.

No abuse of consumers in bankruptcy. Credit card issuers drive consumers into bankruptcy with abusive terms and collection practices. Stop issuers from collecting on these abusive loans in bankruptcy.

End deceptive and unjust terms, interest rates and fees

Ban retroactive rate increases. Stop issuers from changing the rules in the middle of the game by raising interest rates on past purchases.

No unilateral adverse changes in terms for no reason: Credit card company contracts currently claim the right to change terms for any reason, including no reason. Any change in terms during the course of the contract should require knowing affirmative consumer consent and reasonable notice.

Ban universal default in all its forms. Prohibit punitive "universal default" interest rates based on alleged missteps with another issuer but involving no missed payments to the credit card company itself. It is unfair to impose a penalty rate on a consumer who has not made a late payment to that creditor. Stop card companies from using a change in terms clause to impose penalty rates.

Stop late fees for payments mailed on time. Require credit card companies to follow the Internal Revenue Service (IRS) and accept the postmarked date as proof of on-time payments. This will also eliminate the tawdry practice of assessing late payment fees when payment is received on the due date, because it did not arrive by a specific time (such as 11 a.m.).

Relate fees to cost. Ensure that all fees and other charges closely match the true cost borne by the card issuer.

End roll-over or repeat late and over-limit fees. Ban fees that are charged in consecutive months based on a previous late or over the limit transaction, not on a new or additional transaction offense, even if the consumer remains over the previous limit.

No fees for creditor approved transactions. Don't let the credit card company charge a fee for a transaction it has approved. Ban over-limit fees when the issuer approves the over limit transaction.

Empower consumers with more detailed information.

Ban deceptive credit card offers. Solicitations and "invitation to apply" solicitations that do not make a truly firm offer of credit are deceptive because they lead consumers to believe that they are pre-approved for or have a good chance of getting certain interest rates. Most consumers instead receive cards at much less favorable interest rates and terms.

Simplify pricing. Reduce the number and types of fees so consumers can compare cards and understand the real cost of using the card.

Real minimum payment warning. Give each consumer a personalized warning on his or her monthly statement calculating the length of time—in months and years—and the total interest costs that will accrue, if the consumer makes only the requested minimum payment.

Ban unfair teasers. Stop issuers from downplaying permanent interest rates in advertisements and solicitations and from trumpeting temporary rates as "fixed rates."

Enhance 'Schumer Box' disclosures. Include a "Schumer box" disclosure table in all cardholder agreements containing personalized information about the terms of the card granted. The box should include the APR, the credit limit, and the amount of all fees, such as late charges, cash advance fees, over limit fees and any other applicable miscellaneous fees.

Give consumers strong protections to deter illegal acts

Ban pre-dispute binding mandatory arbitration. No consumer should be forced to waive his or her right to a court trial as a condition of using a credit card. Prohibit binding mandatory arbitration for consumers' claims *and* for collection actions against consumers.

Toughen Truth In Lending Act (TILA) penalties. TILA penalties have stagnated since 1968.

Give aggrieved consumers a private right of action to enforce the Federal Trade Commission Act to challenge unfair or deceptive practices by businesses, including banks.

Bank of America

Statement of Bruce Hammonds
President of Card Services
Bank of America

Submitted to
U.S. Senate Committee on
Homeland Security and Governmental Affairs
Permanent Subcommittee on Investigations
March 7, 2007

INTRODUCTION

Good morning, Chairman Levin, Senator Coleman and members of the subcommittee. My name is Bruce Hammonds and I am President of Bank of America Card Services. Thank you for this opportunity to discuss Bank of America's credit card business. I have been in the financial services industry for more than 35 years.

Mr. Chairman, please know that it was a pleasure to work closely with your staff and especially have them tour our card operations in Delaware and spend some time with line experts in the areas they visited. I hope the committee found the experience useful, and we appreciate the working relationship our respective staffs have.

BANK OF AMERICA

Before turning to our credit card operations, I would like to introduce you all briefly to Bank of America.

Our Business

Bank of America is one of the world's largest financial services institutions. We provide a full range of financial services to individual consumers, small- and middle-market businesses, large corporations and government entities.

In the retail world, Bank of America serves more than 52 million consumer relationships — nearly half of all U.S. households. We operate more than 5,700 local banking centers and 17,000 ATMs, in 30 states and the District of Columbia. Our Web site, Bankofamerica.com, is America's leading financial services Web site and the 14th busiest site overall, including Google, Amazon, Yahoo and eBay. Our site attracts 37% of total online banking customers and 65% of online bill payment customers. We are the second largest payment processing provider for small businesses. And, as you may know, we are one of the largest credit card companies in the United States

We have succeeded, we believe, by offering our customers quality products at reasonable prices, coupled with extraordinary service. Each year, our 3,500 associates who work in Customer Satisfaction within our Card business handle more than 100 million personal contacts with our customers who call in for credit card service. Our more than 33,600 front-line teller associates engage our customers face-to-face more than 1 billion times per year. During every interaction, we listen to our customers, and we hear what kinds of products, services and features they want and we deliver.

Our Commitment to Corporate Responsibility

With our success and our scale comes an obligation to support the communities in which we operate — an obligation we take very seriously.

Building communities

In 2005, Bank of America pledged to invest $750 billion for community development nationwide over 10 years. This goal is one of the largest such programs in the history of U.S. commercial banking and underscores the company's commitment to strengthening and revitalizing local communities across the country. In 2005, the first year of the program, Bank of America invested and loaned $85.1 billion for community development nationwide.

We are fulfilling this pledge, by building stronger and healthier neighborhoods, especially in low- and moderate-income communities. The financial resources of Bank of America help build and preserve affordable housing, improve education and create jobs, thereby transforming under-served and long-neglected blocks into vibrant neighborhoods. We provide financing, make equity investments and develop real estate. In addition, we deliver other innovative financial products in low- and moderate-income areas across the country, working with individuals, government, non-profit organizations and business.

Under our community development investment goal, we also intend to invest $10 billion in rural communities. We are providing:

- Affordable housing loans for low- and moderate-income renters in rural areas who want to become homeowners.
- Special loans to small businesses and small farms, which are vital to the economic sustainability of rural areas.
- Equity investments in projects that benefit low- and moderate-income individuals, families and small businesses in rural areas.
- Loans to and investment in low- and moderate-income Native Americans in Indian Country communities.

Philanthropy

Just as community development is part of the company's business model, corporate philanthropy is a part of who we are. In 2004, the Bank of America Charitable Foundation announced a $1.5 billion 10-year goal for philanthropic giving, and we donated over $200 million to non-profits around the country in 2006. This figure included $24.6 million awarded to important nationally based organizations such as Habitat for Humanity, National Urban League, and National Council of La Raza.

As an example of the programs we operate, our Neighborhood Excellence Initiative strengthens communities by working with local leaders to identify critical issues facing neighborhoods, by partnering with the leaders of nonprofit organizations and by giving grant recipients the funding flexibility to direct resources to meet local needs. By the end of the year, the Bank of America Charitable Foundation will have committed nearly $70 million through the Neighborhood Excellence Initiative. Through this comprehensive approach — which is unique among corporate giving programs — Bank of America is forging strong philanthropic partnerships with leading organizations addressing the most pressing needs in local communities and neighborhoods.

Our associates

Last, we encourage our associates — the 200,000 employees of Bank of America — to give back to their communities in cash and contributions of talent and time. We match any charitable donation by a Bank of America employee, up to $5,000 per year. Through the Team Bank of America network, associates in 2006 volunteered more than 350,000 hours at local non-profit organizations. For example, Team Bank of America volunteers are presenting the CHOICES stay-in-school and financial literacy message to more than 23,000 middle-school students in 18 states. And, our "Banking on our Future" classroom volunteers teach banking and financial awareness in more than 13 markets each year.

For more than 70 years, Bank of America has partnered with United Way investing millions of dollars in communities across the United States to help change and improve lives. Associates in the company have donated to fund programs that help children and youth succeed, strengthen and support families, promote self-sufficiency, build vital and safe neighborhoods and support vulnerable and aging populations. Bank of America is one of the top four organizations participating in nationwide United Way campaigns. During the 2006 campaign, Bank of America associates pledged nearly $27 million and donated thousands of hours through volunteer activities.

BANK OF AMERICA CARD SERVICES

Bank of America Credit Card Services is one of the largest issuers of credit cards in the world. We operate in the United States, Canada, Ireland, Spain and the U.K. Our primary business is to make unsecured loans through credit cards. We also process credit card transactions for small businesses and large corporations through our Merchant Services business.

Let me begin by describing for the Committee how credit cards work in practice and the substantial benefits they provide consumers. I will then discuss how Bank of America establishes the terms and conditions of its cards, and then focus on some particular practices about which the Committee has raised questions.

How Credit Cards Work

The nature of open-end credit

When a customer charges an item on his or her credit card, the customer is receiving an unsecured loan that the lender grants based largely on the customer's earlier promise to repay. If the customer wishes to charge additional items or is unable to repay the loan immediately, the lender has agreed in advance to allow the customer to revolve a balance on the loan up to a pre-determined amount and repay a portion each month, thereby avoiding the need to apply for a new loan.

Credit card lending is open-end credit, which is distinguishable from closed-end credit, such as mortgage or small business loans. A credit card relationship involves a series of loans of varying amounts that are drawn, repaid and redrawn, whereas closed-end credit constitutes a single loan made for a specified maturity on terms fixed at the outset of the lending relationship. Each credit card transaction is, in effect, a new loan. Therefore, a credit card agreement has more variables than a closed-end loan; for the same reason, different regulatory regimes apply.

In a credit card agreement both parties have the ability to alter or end the lending relationship. The customer can, and frequently does, end the relationship by transferring an outstanding balance to another issuer or by paying off the balance and closing the account. Customers also routinely seek, and are granted, favorable changes in terms — higher credit limits, lower interest rates or other more favorable terms, if their repayment history has been good and their financial situation supports it. Credit card issuers, including Bank of America, also retain rights to change the terms upon notice to and acceptance by the customer. The proposed change in terms could include, for example, a higher interest rate, because market interest rates have risen.

As an individual consumer's circumstances often change quickly, speed and timing are essential to successful management of credit risk in an open-end, unsecured credit relationship. Indicators of higher credit risk often include failure to make payments when due, rapid growth in the amount of credit outstanding, large and unplanned cash advances and simultaneous establishment of multiple relationships with other lenders. Open-end credit relationships involve an ongoing commitment by the lender to extend credit and a continuing obligation by the customer to repay. Prudent risk management requires that lenders maintain flexibility in the level of credit extended and the interest rates charged. Credit card lenders retain the tools and flexibility to make necessary and appropriate real-time adjustments to reflect increased credit risk.

Agreements with customers also generally disclose fees and interest rate increases that will apply in the event customers engage in certain behaviors that indicate increased risk — for example, paying late or exceeding borrowing limits. In practice at Bank of America, only customers who are late twice or exceed their credit limits twice in a 12-month period trigger such fees or repricings. Most of our customers never reach these thresholds.

Credit cards in operation

Making an unsecured loan in a fraction of a second while a customer stands at a merchant check-out line is not a simple matter. Today, more than 10 million credit card transactions are processed every second, and each transaction includes capturing data, linking it to a customer account, transmitting it securely, calculating rewards, and tracking for monthly statements and customer service while preventing and protecting against fraud.

What happens when a consumer hands a card to a merchant to charge a purchase? How does the merchant get paid and how does the customer get charged for the transaction?

This process involves the following parties:

- The cardholder, who uses the card to make a purchase,
- The merchant, which is the business accepting credit card payments for products or services sold to the cardholder,
- The merchant's bank (a.k.a. merchant acquirer or merchant processor), which is the financial institution or other organization that provides card processing, services pursuant to an agreement negotiated with the merchant,
- The card association, which is a network such as VISA®, MasterCard® or American Express® that acts as a gateway between the merchant's bank and the issuer for authorizing and funding transactions, and

- The issuer, which is the financial institution or other organization that issued the credit card to the cardholder.

In a nutshell, merchant banks provide merchants with the infrastructure that allows them to accept electronic payments such as debit and credit cards. Prior to any purchase being made, merchants and their banks negotiate a contract for processing their payment card transactions. Merchants pay their processing bank a fee, called the merchant's discount fee, for processing these transactions. Separately, an issuer enters into a contractual agreement with a consumer to issue a card to that consumer and make unsecured loans at the convenience of, and on demand from, the consumer.

Now, let's look at what happens in more detail:

The flow of information and money between these parties — always through the card association network — involves two stages: authorization, where an electronic request is sent through various parties to approve or decline the transaction; and clearing and settlement, where all parties settle their accounts and get paid.

Authorization

1. The cardholder provides the card or card account information to the merchant for payment of the goods or services purchased. Frequently, customers swipe their own card.
2. The merchant sends the authorization request to the merchant's bank, who switches the transaction to the appropriate network — VISA, MasterCard, American Express, etc.
3. The association routes the request to the cardholder's issuer, any one of 6,000 issuing banks in the United States.
4. The issuer approves or declines the request depending on the status of the customer's account at the time of the transaction.
5. The association sends the issuer's response to the merchant's bank.
6. The merchant's bank sends the response to the merchant.

7. In a matter of seconds, the merchant receives the response and either completes or declines the transaction. If the sale is authorized, the merchant is completely protected from fraud, unlike other forms of payment.

Clearing and settlement

To clear and settle the account, the following steps occur:

1. Once the sale is completed, the merchant sends its merchant bank a file requesting settlement of funds.
2. The merchant bank sends the request for settlement of funds to the associations.
3. The associations forward the request for settlement of funds to each appropriate issuing bank, one of 6,000 issuing banks in the United States and could include issuing banks outside of the United States as well.
4. Once funds are received from the associations via the issuing banks, the merchant's bank credits the merchant's account.
5. The funds are distributed to the merchant's account via the Automatic Clearing House system or direct connect, usually within one to three days of when the merchant submits a request for settlement of funds.
6. The issuer posts the transaction to the cardholder's account and then sends the customer a monthly statement.
7. The cardholder receives the statement and remits a payment.

The system, not the consumer, protects against and ultimately absorbs the risk of fraud.

The Value of Credit Cards

Credit cards are now so ubiquitous that it is easy to forget a time not so long ago when access to credit was a privilege reserved for those on the higher end of the financial spectrum. Competition in the credit card industry over the past several decades has driven the product from its origins as a pay-in-full charge card with an annual fee to a far more versatile product that offers seamless access to credit.

Instant access to credit

There was a time when, if you wanted a $300 personal loan, you had to fill out an application, sign documents and wait days or weeks for your approval. Now, you can go anywhere any time to get a loan for nearly anything — and do so at the point of sale or online. Or, you can just use a credit card to get that cash loan from an ATM — anywhere in the world, in any currency. If there's a problem customer service is available 24 hours a day, seven days a week. And if your card is lost or stolen, your bank will replace it for free, and you bear no cost of any fraudulent use of the card.

Under the current system, the consumer is able to access money or shop anywhere in the world, merchants can sell merchandise to consumers they don't know or may never see, and transactions are processed safely and almost instantaneously.

Interest-free credit on purchases

Today, nearly all credit cards offer a grace period, which is a time frame within which a customer can pay his or her credit card balances in full and on time each month without incurring a finance charge on purchases — in essence, an interest-free loan. Customers have come to expect the feature, and a competitive market has produced it.

Many customers do not pay finance charges. According to the 2006 GAO report, 41% of all cardholders are convenience users, meaning they pay off their balances in full every month. Likewise, the report indicated that 48% of the cardholders did not pay finance charges in the last 10 months of 2005, and 47% of cardholders paid no finance charges in 2003 and 2004.

Other benefits

The advantages of holding a credit card extend far beyond mere access to credit.

Building a Credit History

First, a credit card, handled responsibly, is now the easiest way for a consumer to build a credit history, qualifying for other types of credit, such as a mortgage or auto loan. Generally, customers who make on-time payments will generate good credit histories and earn higher FICO scores.

A FICO score is a credit score developed by Fair, Isaac & Co. as a method of determining the likelihood that credit users will pay their bills. Fair, Isaac began its pioneering work with credit scoring in the late 1950s and, since then, scoring has become widely accepted by lenders as a reliable means of credit evaluation. A credit score attempts to condense a borrower's credit history into a single number that is a reliable predictor of credit worthiness. While we do not rely solely on this number for making credit decisions, it is a factor in our determinations.

Rewards

Credit card companies also compete for customers by offering features that customers value, including rewards, such as frequent flier miles. Rewards encourage consumers to obtain cards, and encourage customers with more than one card to use the cards that earn rewards. A relatively new component of many credit card programs is the points program, where the customer receives points for using the card and then can redeem the points for discounts on merchandise, travel, or cash back.

Bank of America has one of the most robust rewards programs in the industry, WorldPoints™. WorldPoints enables the customer to redeem points for travel, merchandise, cash back, and special experiences, like tickets to the Super Bowl or golf with a PGA tour professional.

Security

Credit cards save us from having to carry cash, and are a very secure way to make payments. Today, the system, not the customer, assumes the risk of fraud on the card account. Under the law, consumers are liable for only $50 in the event of unauthorized purchases. To ensure customer satisfaction, at Bank of America we have gone even farther by having a $0 liability policy. In other words, we assume 100% of the risk for unauthorized purchases.

Protection against transaction fraud That said, let's take a closer look at fraud and what we do at Bank of America to protect and help our customers. There are two types of fraud: transaction fraud and identity theft. Transaction fraud occurs when a credit card is lost, stolen or counterfeit and used without authorization. Transaction fraud can also involve access checks, the checks issued from credit card companies that draw on the credit card account.

While transaction fraud can be a significant nuisance for the customer, it can be relatively easy to fix. The customer calls the credit card company and reports that the card is lost or stolen. Bank of America immediately closes the account, issues a new account with a new number and sends a new credit card to the customer, which the customer receives within five to seven business days. If the customer needs the card in a hurry, it can be sent by overnight courier. Fraudulent charges are credited back consistent with our zero liability policy to protect customers against fraud.

Identity theft Identity theft is actually much more difficult for the customer to fix. In this case, the perpetrator has enough personal information about the customer to provide a fraudulent application or to take over an existing account. Usually, the perpetrator can impersonate the customer, causing high unpaid balances, delinquent accounts and poor credit bureau reports. The victim then must correct all the records and reporting.

When identity theft happens to one of our customers, we clear the charges on the account and help the customer obtain his or her credit bureau report to check the balances and activity. We also help the customer navigate the process of working with the police, Bank of America Card Services, and the credit bureaus to straighten out the account and prevent any more fraud on their accounts. In addition, Bank of America Card Services offers two fraud protection products that: monitor credit bureau reports for discrepancies, and provide access to credit education specialists and identity theft recovery units that help resolve and prevent fraud in the event a customer's identity is stolen.

Bank of America is a founding member and a top contributor to Identity Theft Assistance Corporation (ITAC), a consortium of financial services companies formed to help victims of identity theft. We refer and pay for customers to use the organization to regain their identity and correct all their records. In 2006, approximately 4,000 customers who called us to report identity theft were referred to an ITAC counselor.

Fraud procedures at Bank of America Working to prevent fraud and keep our customers' accounts secure is part of how we do business. If we think we see an issue, we act quickly to mitigate fraud risk by declining transactions and/or seeking point-of-sale customer identification. We reach out directly to cardholders to inquire about suspicious transactions. Every time a customer calls, we verify the customer's identity and try to protect the account from fraud. Our customers continually express appreciation for such vigilance.

We have billions of dollars invested in fraud prevention strategies, including customer authentication and account review strategies. We devote $200 million each year to prevent fraud and keep our customers' accounts secure. Over the last five years, we have invested millions in capital to upgrade our systems to meet this growing challenge. One result of all these efforts is that credit card losses due to fraud, measured as a percent of sales, are now at historic lows.

Benefits of credit cards for the economy

While an individual credit card has significant benefits for the holder, there are also broader benefits from the system as a whole. Credit cards are now widely accepted virtually everywhere from big box retailers to small "mom and pop" stores, from grocery stores to doctors' offices. Companies like Amazon, e-Bay and other online stores would not be possible without credit cards. Even flea market vendors accept credit cards these days. And, small businesses are not limited to only local sales, with the world market safely open to them.

Regardless of the size or industry of the business, merchants benefit from accepting credit cards. Remember what it was like before payment cards became so widely used. If a customer wanted to pay by check, the merchant assumed the risk that the check would bounce. If a customer wanted the merchant to extend credit by saying "Put it on my tab," the merchant ran the risk of never getting paid as well as the expense of recording and collecting for the sale.

By accepting multiple forms of payment, a merchant can give customers more ways to settle their accounts. In addition, card processing is an efficient, convenient payment solution that helps the merchant ensure he or she will be paid. The card improves cash flow by ensuring timely, automatic deposits to the merchant's account. In the event of fraud, the system assumes the risk of fraudulent charges, not the customer.

THE MARKET FOR CREDIT CARDS, AND OUR PLACE IN THAT MARKET

The credit card market is dynamic and customer-driven. Over the last 25 years, the prevalence and use of credit cards in the United States has grown dramatically. Between 1980 and 2005, the amount that U.S. consumers charged to their cards grew from an estimated $69 billion per year to more than $1.8 trillion, according to 2006 GAO report on the industry.

As we approach the market — that is, as we make our pricing, terms and marketing decisions — our decisions are shaped primarily by four factors: competition, risk, return, and regulation.

COMPETITION

Bank of America Credit Card Services operates in one of the most competitive markets in the world. Today, there are 6,000 credit card issuers in the United States. Because of economies of scale, approximately 90% of cards are issued by the 10 largest issuers, but each offers a wide range of products with different features tailored to the demands of customers. Competition among issuers is fierce. A large percentage of active customers routinely choose to transfer balances from one lender to another, because they can obtain lower interest rates or better terms. We seek to limit the number of our customers who move to other lenders and attract a greater percentage of new customers. Most of those new customers come from other credit card companies. That means all banks have to continually strive to be competitive in the marketplace.

The ongoing competition of this market has three primary benefits for consumers: driving prices lower, spurring innovation, and producing better customer service.

Price

According to the 2006 Government Accountability Office report on credit card rates and fees, consumers now pay lower interest rates than they did when credit cards were introduced in the 1950s. In those early decades, credit cards commonly charged a single fixed interest rate, around 20%, together with an annual fee that was typically between $20 and $50. Over the past 15 years, issuers have competed for customers by offering attractive rates and rewards, and expanded the availability of credit to a much larger segment of the population, according to the 2006 GAO report.

At Bank of America, we compete effectively on price, because we have made substantial investments in our infrastructure — both in processing and customer assistance call centers that function with industry-best efficiency, and in our branch network, which gives us a lower-cost alternative to direct mail as a way of offering credit cards to our customers.

Promotional Rates and Payment Allocations

As you know, credit card companies like Bank of America routinely offer short-term promotional rates on their cards to attract consumers to move from one card to another. Through these offers, a customer may obtain a 0% interest rate for an existing balance transferred from a competing lender.

The Committee has inquired about how we allocate subsequent payments from a customer who has transferred a balance at a low rate, but is making additional purchases at a higher rate. To make the low rates possible, we employ payment allocation rules that retain the benefits of a lower-rate offering while providing a reasonable return to the Bank. Only 15% of our active credit card customers are paying them at more than one rate. For the customers who have different balances at different rates, payments are applied to lowest rate balances first, then to higher rate balances.

For example, assume a customer who had transferred $2,000 from another company and received a 0% interest rate from us on these balances, also had an existing $1,000 balance with us at 8%. If he or she made a payment of $1,000 at the end of the month on the account, the payment would be applied to the 0% balance. However, that customer's effective interest rate would be less than 4% for that month and would continue to be less than 8% until the 0% promotional balances were paid off.

If the payment was applied to the highest rate balances first and then to the lower rate balances, banks would make insufficient returns. Banks would eliminate the 0% offer or increase rates for standard use of cards. Market forces tell us consumers want neither to happen.

Innovation

We also succeed through innovation, which can take numerous forms. For example, Bank of America has distinguished itself as the leader in affinity marketing — that is, by partnering with professional organizations, colleges and universities, conservation groups and others to offer unique credit cards.

The affinity model provides an avenue for us to reach customers but it also provides a significant source of revenue to alumni associations, conservation groups, and professional associations. More than 5,000 organizations worldwide endorse our products. We have as customers tens of thousands of professionals through the endorsements of 1,400 professional associations. In addition, we have affinity relationships with 900 colleges and universities, including 70% of the schools in the Big East, Big 10, and Pac 10, as well as five of the eight Ivy League schools, all of which benefit from this relationship.

We have endorsing relationships with 600 sports-related organizations and 275 financial institutions, credit unions and brokerage houses. We also have partnerships with other affinity organizations, special interest programs including the National Wildlife Federation, and professional associations. And we have co-brand and alliance endorsements with retail partners, including LL Bean.

All of these customers can "wave the flag" for their organizations and demonstrate their passions every time they use their cards. Bank of America Card Services offers more than 6,000 specially designed credit cards that depict the affinity relationships and other interests.

Our products and portfolio

Bank of America offers credit cards through Visa®, MasterCard® and American Express®. We have three different Visa and MasterCard programs and four American Express programs offering various rewards, travel, lifestyle and entertainment, financial and credit features.

For example, the Visa WorldPoints® card provides travel insurance of $200,000, points that do not expire for two years, special travel and retail offers, and a year-end summary of activity, to name a few of the benefits.

Various card programs appeal to different segments of the population and include features that are important to different affinity groups. By making these choices available, we offer the right product to the right customer at the right price.

Service

Another way we compete is through superior service. Once a consumer has a Bank of America card, we want him or her to use it and not have problems or unexpected issues. We provide excellent service to customers to foster loyalty and grow relationships.

The words above every doorway at Bank of America Card Services headquarters, "Think of Yourself as a Customer," are more than a sentence. They embody what everyone can do every day to provide better service to every customer during every interaction. We believe that satisfied customers will remain our customers, and will grow with Bank of America as their financial needs evolve. It is our goal to maintain the relationship going with each customer. So we strive to be courteous, efficient, honest and fair with every customer every day.

Just as you listen and respond to your constituents, we listen and respond to our customers. In fact, in addition to tracking sales and service trends, we devote extensive resources to various means of capturing what our customers want and need. We use Voice of Customer research methodologies, develop customer satisfaction scores and rely on executive listening programs — where leaders monitor calls from customers — to gauge what customers expect.

Just like the rest of us, what they want is simply "no surprises." To that end, Bank of America customers may sign up to receive various alerts if they are approaching their spending limits or their due dates, so they can avoid overlimit and late fees. We are developing additional plain language guides for our customers that go above and beyond what we are required to do to make sure they understand their terms and conditions — and help our customers avoid fees and penalties.

We also serve our customers by making it easy for them to pay their credit card bills. Our customers can pay their bills at no charge in any of four ways:
1) Through the U.S. mail;
2) At one of our 5,700 banking centers nationwide;
3) Over the phone by using the voice response unit (VRU) and paying from a Bank of America account; and
4) Online though our Web site at bankofamerica.com.

Mail payments received before 5 p.m. Eastern time are posted the day they are received. Our payment-by-mail process is automated: Machines can open an envelope, extract the check and remittance form, read both and store the image electronically, record when the payment was received, and dispose of the envelope — all in seconds and without any human hand touching the envelope.

Payments made before 5 p.m. from the Bank of America Internet site at bankofamerica.com are posted the same day without a fee. Online payments made from other Web sites or services such as CheckFree are posted the day they are received at Bank of America. As soon as the payment is posted, the amount is available for credit purchases once again, and the average daily balance is lowered. The credit card company assumes the risk that the payment will clear.

All these options are free of charge.

Bank of America Card Services also accepts phone payments. However, there is a $15 fee when paying through a customer service representative or through the Voice Response Unit (VRU) from a non-Bank of America account. When paying through a VRU, we waive the fee if the payment is from a Bank of America checking account. In advance, we inform every customer seeking to make such a payment what the fee will be and advise the customer of the other free options for making a payment.

CUSTOMER BEHAVIOR AND RISK

Just as our approach to the market is shaped by competition, it also considers the risk of this unique type of unsecured lending. We make informed lending decisions.

We manage risk in three primary ways. First, we issue cards to those who demonstrate the ability to repay. Second, we monitor our customers' behavior, both in their dealings with us and others, and assess fees and rates consistent with their behavior. Third, we work with customers who are experiencing problems to give them opportunities to repay, even if that means lowering their interest rates and deferring penalties.

Extending Credit

We invest substantial resources at the front end of the lending relationship to ensure that we are lending money to borrowers who can repay. Our highly experienced lending analysts make lending decisions based on a personal analysis of the application, coupled with input from sophisticated software models.

Whenever an application shows incomplete information, or if further information is needed to get a complete picture of the applicant, a credit analyst will call the applicant to ask about number of years in the same job, whether the applicant own or rents a home, household income, and other factors that determine the applicant's credit worthiness.

A credit analyst evaluates each application individually and makes sound and consistent credit decisions based primarily on the customer's ability, stability, and demonstrated willingness to repay debts. In this way, we strive to extend credit while managing risk on an individual basis, looking at the customer as a person, not just as a score on a credit bureau report. We take pride in the fact that we treat each customer as an individual, and we make decisions based on an analysis of that individual's credit worthiness as it evolves over time.

We also believe that we have a competitive advantage because we use a combination of computer modeling and personal review to make credit decisions. Really, that's just old-school lending, where an individual lender looks at a borrower's whole history, and even speaks with the borrower, before deciding whether to lend. That personal review is coupled with algorithms that consider FICO score and internal scoring models. Using a human touch has allowed us to offer credit to customers we previously would have overlooked.

Our analysts do not simply crunch numbers the way an automated system would. They consider a myriad of attributes, including credit history with us, length of time in the job, whether the applicant owns or rents a home, and more. Similarly, for existing customers who want credit line increases, the personal review can include looking at payment behavior, size of existing balances, and more. At Bank of America, interest rates, risk and keeping a customer on the books are overlapping strategies.

Demographics

Our lending approach has led to a strong portfolio of credit card customers. Our average new credit card applicant has a household income of more than $80,000 Our applicant group has an average credit history of 15 years and more than 60% are homeowners.

Clearly, these are customers who show stability as well as ability and willingness to pay. Our credit card marketing strategies to attract new customers do not target the sub-prime market.

Fees and Rates

Since about 1990, credit card pricing has evolved to encompass greater variety of interest rates and fees that can increase the cardholders' costs, according to the 2006 GAO report. However, the report says, cardholders are generally assessed lower interest rates than those that prevailed in the past, and most have not been assessed penalty fees. According to the GAO, the average interest rate as of Dec. 31, 2005, was 12%, and more than 40% of the customers of the six largest issuers have rates below 15%.

In addition, after 1990, the largest credit card issuers, including Bank of America, began applying multiple interest rates to a single card account. The rates vary depending on the type of transaction in which a cardholder engages. For instance, one rate may apply to cash advances, another to balance transfers, and another to retail purchases.

In response to this evolving market, Bank of America moved away from a one-size-fits-all pricing model. We strive to balance risk and competitive pressures to provide a great service at the right price. In fact, the cost to use a card now varies according to the risk posed by the individual cardholder as described in detail below.

Multiple interest rates and promotional rates

Each credit card account may carry different interest rates depending on the type of transaction. The account may have a higher interest rate for using the credit card to obtain cash from an ATM or bank, or for other forms of cash including foreign currency.

To attract new customers and to compete in the marketplace, Bank of America offers select customers 0% introductory interest rates for limited periods on new purchases, balance transfers and/or convenience checks. Convenience checks, called "access checks" at Bank of America, are simply another way that cardholders can access their existing credit. Cardholders can write these checks against the available credit limit in a credit card account. They do not represent an additional credit, just another option for accessing their credit. When the introductory period ends, the rate will change to the standard rate specified in the credit card agreement.

Grace periods and double cycle billing

As noted earlier, nearly all credit cards include a grace period. Bank of America customers also receive this significant benefit. By granting a grace period, we are essentially making an interest-free loan from the time the consumer charges an item until the next payment due date. Of course, we are exposed to credit risk — the risk that the customer will not repay — for that period. In all other types of lending, lenders demand interest payments to earn a return on that risk. Auto loans, mortgages, and many other consumer loans operate in this manner, and consumers are familiar with this type of interest on other loans. But with a grace period, we are effectively permitting a pay-in-full customer (generally about 40% of our active portfolio) to have an interest-free loan.

Some lenders calculate finance charges on purchases using a method called double-cycle billing or two-cycle billing. Bank of America does not now — and never did — engage in double-cycle billing or two-cycle billing.

Late Fees

Bank of America has a simplified system of late fees that uses more than one late fee amount — a "standard fee" for typical balance amounts and a reduced fee for lower balances that is more proportional to those balances. We call this "tiered late-fee pricing." Bank of America Card Services charges a standard late fee of $35 to $39 on balances above $250. Our reduced late fees apply to balances below $250, and we assess no fee at all for missed payments on balances less than $30. For example, for balances between $30 and $100, the late fee is only $15.

During 2005, the vast majority of Bank of America's active credit accounts were not subject to late fees.

Overlimit fees

Bank of America has a standard $39 overlimit fee in effect for typical balances, and a reduced fee for accounts with balances under $1,000.

In addition, Bank of America suspends overlimit fees after the third consecutive occurrence, as part of a suite of debt management benefits for distressed borrowers. These benefits are tailored to each borrower's circumstances, but may include debt consolidation loans at more attractive rates, fixed repayment amounts and terms, and suspension of some fees.

During 2005, the vast majority of all active Bank of America credit card accounts incurred no overlimit fees.

Default Pricing

Default pricing (sometimes called penalty pricing) occurs when a customer is late or overlimit on an account, and the APR is increased as a result of that default event. Default pricing is disclosed upfront as a part of the Schumer Box and is set out in the credit card agreement. The change, therefore, is made in the context of the existing agreement.

In practice at Bank of America, a customer must be late or overlimit not once but twice within a 12-month period on his or her Bank of America credit card account before default pricing is applied. Some issuers treat a bounced payment check as an event of default, but Bank of America does not. In addition, in late 2007, Bank of America plans to further implement a feature that will provide for a "cure" to a lower rate if a customer subject to default pricing has no late or overlimit events for six consecutive months. This new, lower rate will apply to both existing and new balances.

However, not all customers who hit our default triggers are repriced. Of those who are repriced, not all go to the full rate. We look at these customers individually.

Universal default

What Bank of America does not do, and never has done, is engage in universal default. Universal default is commonly understood to mean placing a customer in default — resulting in higher rates without any further notice — as a result of a customer's failure to repay obligations to *other* creditors. Bank of America has never engaged in universal default.

Risk-based pricing

A healthy consumer banking system must be able to detect and respond to changes in risk with appropriate pricing and fees. The terms of an open-end credit product, such as a credit card, are therefore subject to change.

When we see that a customer is exhibiting risky behavior — and this may include problems with other lenders — we may notify the customer of a proposed change in terms of the account — generally, a higher interest rate for outstanding balances. If a deteriorating credit score causes us to question our initial decision to issue credit, we will inform the customer that any future loans will have to come at a higher price. It is worth noting that to the extent that a customer's credit score *improves*, they also frequently seek, and are granted, a higher credit limit or lower rate.

That said, we do not propose a change in terms to customers in the first year of the relationship, and once a proposed change in terms is accepted, we will not propose another change for six months, even if the customer's credit score declines further.

Bank of America makes sure to clearly and fully inform the customer of any changes well in advance of the change in terms. Moreover, whenever we propose a change of terms, the customer has a right to simply say no. The customer is then entitled to repay any outstanding balance under the original terms, rather than the adjusted terms we are proposing. At that point, we can't charge a higher rate on loans the customer has outstanding, but the customer cannot continue taking out new loans at the old rate. That seems fair.

The customer's right to say no is the crucial distinction between risk-based pricing, which we and *all* of our competitors engage in, and universal default, which Bank of America has never engaged in. With universal default, a default to an unaffiliated creditor is treated as a default on every creditor, and triggers repricing without any right to say no. As noted, Bank of America has ever engaged in universal default.

Managing Risk when Customers Experience Serious Trouble

We work to identify and assist customers who are experiencing real financial difficulties and. Once found, we work with them to help rectify the situation. Frequently, that means lowering their interest rates, waiving fees and working with consumer counseling agencies to ensure that credit problems with other lenders are made part of the plan.

Customer Assistance

While most banks have collections departments, Bank of America has Customer Assistance — which captures our philosophy of assisting customers who are experiencing financial hardship.

If a customer falls behind on an account, our experience tells us it is likely due to circumstances outside his or her control. In Customer Assistance, we believe each account should be reviewed on an individual basis by using "account recognition" skills. Account recognition means taking all the customer's information into consideration before determining the best way to resolve the situation.

If assessment of a customer's financial situation determines that he or she is unable to maintain the minimum monthly payments, we will offer several options to assist with the repayment of the loan. The right program is determined by understanding if the customer is experiencing short- or long-term financial difficulties. We also have specialty units to handle higher-risk accounts as well as customers who have multiple relationships with Bank of America.

In addition, on an annual basis, we award approximately $6 million to non-profit credit-counseling agencies that help people work their way out of financial distress. We work hand-in-hand with these agencies to tailor customized loan arrangements to fit individual circumstances and to help people get back on a solid financial footing.

As this Committee knows well, there are some for-profit counseling agencies that do not really help customers. They recommend that customers stop paying on credit card accounts, knowing that the credit card companies will reduce the rates or offer payouts to get the account up to date. While that may seem advantageous for the customer, what actually happens is the customer suffers, because the account is reported to the credit bureaus and the customer's FICO score drops. In addition, these agencies often charge large up-front fees with enticing promises of debt forgiveness and then do little to help the customer out of financial distress.

Minimum payments

For customers whose incomes may fluctuate over the course of the year, the option of a low minimum payments can be a flexible tool for managing monthly budgets.

While the minimum payment is meant as a tool or a guideline for consumers, it is not where we want our customers to consistently be. Actually, only a very small fraction of our customers — approximately 1% — fall into the habit of repeatedly making only a minimum payment three months in a row.

Regarding those customers with payment habits that suggest the possibility of financial stress, we develop payment strategies that suit their circumstances. Last month, we worked with more than 47,000 customers just to make sure they were not headed for trouble, and to intercede if they were.

RETURN

Credit card pricing is dictated by fierce competition and customer demand, which in recent years lowered credit card costs for millions of Americans. Competition, for example, has all but eliminated annual fees on credit cards and created grace periods that make card usage interest-free for millions of consumers.

Customers understand that the costs they incur are frequently related to their own behaviors: If they pay in full, the cost of the loan is interest-free, and if they pay late or make a partial payment, they incur fees and may have higher interest rates. Moreover, the rates and fees a bank can charge today are limited by competition. If a bank's rates or fees are too high, customers will transfer their balances to other lenders.

As the GAO has observed, industry profits are not increasing at the high growth rates that existed when the industry was young. The largest credit-card issuing banks have not substantially increased their credit card profitability over the last 20 years, according to the report. The return on assets for large credit card issuers has generally been stable since 1999, with returns in the 3% o 3.5% range, and profitability for the largest issuers between 2003 and 2005 has reportedly been stable in the range from 3.6% to 4.1%.

Now let's turn to the reason we are in this business, which is to earn the maximum possible risk-adjusted return for our shareholders. We set our fees and interest rates to earn a return, not just to recapture costs. But we operate in a highly competitive environment. The free enterprise system is driving the credit card market, and great credit card companies, like Bank of America, must constantly review existing practices and innovate to stay ahead of increased competition and the demands of consumers.

We also consider, though, that our goal at Bank of America is to offer a full range of financial products to every customer, including every credit card customer. We regularly ask our customers two crucial questions: Will your next purchase of a financial product come from us, and would you recommend Bank of America to a friend? We quickly change practices — both in our credit card business and elsewhere — if customers answer "no."

DISCLOSURE AND REGULATION

We at Bank of America want our customers to understand the terms of their credit, and we want them to be able to compare those terms with those of our competitors. We are ready to compete hard on price, to compete hard through innovation, and to compete hard through customer service. Customer confusion simply makes this more difficult for all parties to the transaction. We take many steps to ensure that customers understand the terms of their credit. That said, many of our customer communications are governed by federal regulation, in particular the Truth in Lending Act or the Federal Reserve's Regulation Z. Government regulation here is a necessity, because unless terms are disclosed in a uniform way, comparison shopping would become very difficult.

A lot of our products are designed to help people begin to build assets, establish good credit records, and work toward financial security for their families. But as we all know, financial products have increased in complexity and the need for financial literacy is greater than ever. For those reasons, we believe we have an obligation to make sure those people entering the financial mainstream have the knowledge they need to be responsible in their use of credit card products.

Disclosure requirements

Many of our customer communications are governed by federal regulations, in particular the Truth in Lending Act and the Federal Reserve's Regulation Z. The goal of these laws is to allow customers to understand the terms of their credit agreement and to be able to comparison-shop among issuers. Government regulation here is a necessity because unless terms are disclosed in a uniform way, comparison shopping would become very difficult. In enacting the Truth in Lending Act, which largely regulates disclosures, there is no federal regulation of the price of credit.

In its 2006 report on credit card rates and fees, the GAO gathered input from focus groups of customers regarding the disclosure statements. Consumers who found the terms and conditions statements difficult to understand. That complexity was because issuers were trying to reduce regulatory exposure by adhering to the formats and language prescribed by federal law and regulations, which no longer suit the complex features and terms of many cards, the report said.

Therefore, we support the Federal Reserve Board's ongoing review of Regulation Z, and we expect to comment on whatever the board proposes. We believe this review is necessary because consumer credit markets and communications technology have changed significantly since the act was last revised in 1980. We have further suggested that the board be guided by two fundamental principles as it considers revisions to the act.

First, disclosures must be simple

We know from talking to our customers that they dislike regulatory language that issuers are required to use in disclosures. In fact, a 2006 GAO report found that disclosures for customers were often written well above the eighth-grade level at which half of U.S. adults read. We believe it should be a priority to shorten and simplify disclosure language and to focus on the most relevant terms and conditions that consumers most need to understand.

Second, disclosures must be clear

There are several consumer-tested models for presenting complex information in a clear and effective manner. We recommend that in addition to containing shorter, simplified language, disclosures should also be presented in ways that are understandable and meaningful.

In this regard, Bank of America is in the process of developing and testing a plain-language brochure that focuses on credit card pricing and advises our customers of steps they can take to keep their costs of credit lower.

We support the Federal Reserve Board's ongoing review of Regulation Z. We look forward to the Board's upcoming proposal, and will seek to work with the Federal Reserve Board, industry and consumer groups to ensure that the final rule allows consumers to make informed choices about their credit.

Financial Education

We have also incorporated consumer financial education into the core of what we do, the services that we provide and the way we interact with our customers. For example, each one of our new student account holders receives our Student Financial Handbook, an easy-to-use guide for understanding the basics of managing their finances, including how to balance a checkbook, how a credit card works, and so on.

In addition, thousands of our new student credit card customers receive statement inserts under a theme of Sound Advice that speak to key credit education subjects such as What is a Credit Rating?, Building a Better Credit History, Achieve Your Goals and Simple Secrets that assist to education our customers on financial literacy/credit education. With periodic statements, there are a series of messages on the same theme.

We also developed a brochure explaining in simple English our account fees in an effort to help our customers better understand and avoid fees wherever possible. We are currently working on an enhanced brochure.

Bank of America sponsors basic money management programs for high school and college students with our partner, Monster.com. We are the only lender partnering with Monster's Making It Count division to offer Ultimate Money Skills. This program educates college students and their parents on financial products, how to establish a solid credit history, and maintain identity theft protection. The presentations are conducted by professional speakers on campuses nationwide. Since August 2006, we have made more than 160 presentations to more than 19,000 students.

Our Monster.com partnership for high school students focuses on creating a plan to finance college education. This program is delivered offline at more than 500 high schools across the nation. In conjunction with these efforts, we built an online eLearning tool to facilitate the process for financial aid, scholarships, grants and loans.

There also is extensive information about savings, budgeting, purchasing a home, purchasing a car, credit cards, other lines of credit, investing, retirement, estate planning, tax preparation, planning for college and consolidating debt available at (http://www.bankofamerica.com/financialtools/index.cfm). All this information is free for anyone to access.

CONCLUSION

In sum, the United States credit card industry has evolved to become the most sophisticated credit-granting system in the world. The millions of secure credit card transactions that occur seamlessly each day are largely transparent to consumers, and yet they are fundamental to consumers' daily lives.

The credit card market is also a mature market that is fiercely competitive. Competition causes card companies like Bank of America to provide superior service, to innovate and, most important, to keep their card pricing lower. The effective elimination of annual fees, universal acceptance of interest-free grace periods and 0% interest-rate loans are just a few examples of how millions of consumers have benefited from industry innovation spurred by competition.

Our commitment to winning and retaining customer loyalty also drives our behavior. Our credit-granting processes, which have become increasingly sophisticated over the years, are designed largely to better understand our customers in order to anticipate and meet their credit needs. But we also manage carefully the risk of this unique type of unsecured lending and ensure the bank receives an appropriate return for that risk.

We strive through our disclosures to make these processes and other practices clear to our customers. In today's environment, credit costs that customers incur are frequently related to their own behaviors. We strive to help our customers understand this.

To that end, we also are committed to work with Congress and our federal regulators to find ways to help consumers understand our products and industry.

Thank you for the opportunity to share our story and our views with you. We look forward to answering any questions that you may have.

STATEMENT OF
RICHARD SREDNICKI
CHIEF EXECUTIVE OFFICER
CHASE CARD SERVICES
U.S. SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
March 7, 2007

Mr. Chairman, Members of the Committee, good morning. My name is Richard Srednicki; I am the Chief Executive Officer of the Wilmington, Delaware-based Chase Card Services division of Chase Bank U.S.A., N.A.

I am proud to represent, today, more than 16,000 Chase employees around the country who serve the needs of more than 100 million Chase credit card customers.

The credit card business at Chase is based on our relationship with these customers. The great majority of Chase customers fall into categories our industry calls "super-prime" and "prime." This means, that regardless of income, they are among the most responsible and knowledgeable credit users in the country. They use their credit cards wisely to manage cash flow and provide themselves and their families with the convenience, protections and special offers of credit cards, while avoiding fees and maintaining low annual interest rates.

The numbers are a direct reflection of this. Chase has one of the lowest average effective interest rates in the industry. Well over a third of our customers regularly pay their balances in full, enjoying the convenience of an interest-free loan every month – something that is unique to credit cards. More than 90 percent of our customers regularly pay more than the minimum monthly payment, and late fees and over limit fees affect a very small portion of our customers each month.

We appreciate our customers, and we believe our success is based on maintaining a solid, long-term relationship with every one of them. We also believe it makes good business sense for our customers to take advantage of the benefits that we offer and that come with responsible credit use.

The vast majority of Chase Card customers are extremely responsible users of credit and credit cards.

Let me give you a composite portrait of a typical Chase credit card customer family. Sarah and John are schoolteachers and live in suburban Philadelphia. They have two children and together earn just over $75,000 a year. They use their Chase credit card, which provides them with airline mile rewards for vacations, and most months they pay off their balance in full. Last summer, they bought some furniture for their new nursery and made the decision to pay for it over several months, during which time they managed their other expenses carefully to accommodate the special purchase. They, and millions of Chase customers like them, appreciate the security, instant access to credit, and flexibility of payment preference their card gives them; and they use it wisely in a way that makes sense for their family.

Sarah and John represent the 92 percent of our customers who begin and end the year with the same or a better interest rate because they manage their credit responsibly, pay their bills on time, and stay within their credit limit.

Let me also make it very clear that we are well aware that a very small group of our customers may, at some time, find themselves in financial difficulty. For some, their difficulty may be for a short period of time as a result of a temporary situation; others may have more serious situations that have longer-term consequences. We care deeply about our customers who may find themselves in any of these situations, and we have trained advisors and systems to identify and assist these families, long before the situation becomes dire or impossible. It is in both of our best interests, the bank's and the customer's, to identify them and help them pay off a balance or work out a payment plan.

This outreach process may begin with a letter or a call from us to let someone know we are aware they are behind on a payment – a reminder of the consequences of being late and an offer to discuss the situation. Over time, it may lead to entering a debt management program where interest rates are reduced and fees suspended to help people work their way out of debt.

We assist over half a million customers in this way every year. Through programs and policies designed to help improve their situations, 70 percent, or more than two out of three of our customers who enter into debt counseling and management do get out of debt and back on track.

We maintain an active and open dialogue with our customers in these assistance programs and continuously assess their satisfaction. Among the customers in assistance programs, we have an overall satisfaction rate of 82 percent. This indicates that the lion's share of our customers who encounter difficulties feel that we work to try to help them.

Because we are real people working to serve 100 million customers, I regret to say that there could be instances where a customer facing these kinds of difficulties may fall through the cracks. Clearly, there is room for improvement, and Chase is an organization dedicated to continually evaluating its policies and procedures in an ongoing effort to improve them.

We work very hard to be a responsible credit card bank, and this means treating all of our customers fairly. We believe that is the best way we can do business and assure ourselves good customer relations for the long term.

Part of treating our millions of customers fairly is to understand that we owe them something in addition to the attractive and competitive credit card products they hold.

The first thing we owe them is clear information about the card, including their annual interest rate and what can happen if they do not understand and meet the obligations of their account agreement. We also owe them a fair and proactive effort on our part to help them understand and follow the rules, which is why we continue to develop ways to communicate with customers online, through mailings, and with our customer service advisors.

We are always reviewing our customer card agreements and other disclosure communications and looking for ways to improve the clarity of the information and help enhance customer understanding.

Clarity, simplicity and fairness are important because credit cards have become more complex financial products. Over the last 20 years, many issuers in the credit card industry have changed their pricing models from a one-size-fits-all format to one that is focused on individual creditworthiness – a format that encourages and rewards responsible use of credit with the best rates and terms. Indeed, our research shows that consumers overwhelmingly prefer a system of pricing tailored for every consumer.

This individual approach to pricing has afforded many consumer benefits and, indeed, has had a major impact on society, making credit cards available to vastly more people at greatly reduced interest rates. According to a recent Government Accountability Office (GAO) report, 15 years ago the average interest rate paid by a credit card holder was roughly 20 percent, and most cards had annual fees of $20[1] or more. During the mid-1980's, there were about 100 million cards in use in this country[2]. Today, says the GAO, the average interest rate is 12 percent[3] and, in addition, nearly 75 percent of credit cards do not have annual fees[4]. By 2005, there were more than 690 million cards in use[5], helping produce $2 trillion dollars in sales in the U.S. economy[6].

The change to pricing, which is tailored to individuals, indeed rewards those who manage their credit responsibly, who make their payments on time, who do not go over their credit limit, and who do not let their overall credit score deteriorate.

Like all banks, we follow the regulatory language regarding disclosure about the credit card agreement between the issuing bank and the customer, and that language is long and legal. We know that the industry and the government are reviewing ways to simplify and improve – and we are part of that process.

However, we are not waiting for new regulations; we are taking our own proactive steps to help improve the clarity of information we share with our clients now.

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[1] Credit Cards – Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers, The United States Government Accountability Office, p. 15.
[2] Ibid, p.10.
[3] Ibid, p.15.
[4] Ibid, p.13.
[5] Ibid, p.10
[6] Ibid, p. 9

At Chase, we are testing simplified, easy-to-understand explanations of the rules of our credit cards agreements. We want this clear information to guide customers in understanding the most important aspects of their credit card relationship with us. This is in addition to the supplemental information – above and beyond the required disclosures – that we provide to our cardmembers regarding the best ways to avoid fees and preserve their best rates (see addendum 2).

We have worked hard to build our business around our customers' needs. Customers have asked us to help them avoid late and "over-the-limit" fees and maintain the best interest rate available. So Chase has developed a service called "Free Alerts." Customers can choose a telephone, email or text message alert that reminds them when a payment is due and when a payment has been posted to their account – or notifies them when their spending has reached their self-determined limit.

Many customers have told us, too, that they want greater options for paying their bills, including those that allow them to make payments on their due dates. We recently further upgraded our online services and continue to see an increase in customer adoption and usage to manage their accounts. Now, through our Chase automatic payment program, we offer an enhanced ability to make fast, free electronic payments on the exact day they are due, to avoid late fees and retain access to their funds for the maximum amount of time.

In addition, we allow our customers to select a personal payment due date that we will never change from month to month so they can best time payments to pay days or other income streams. We believe that common sense tools that can help our customers will go a long way toward making their lives a bit easier and reinforcing our long-term, valued relationship with them.

These tools help create good customers for Chase too. It is in our best interest, to have satisfied customers who pay their bills on time, stay within their credit limits and manage their credit wisely.

That is why we believe all consumers, customers or not, should have the opportunity to increase their financial literacy. There is a steady drumbeat in the print, TV and online press aimed at consumers, telling them that an essential step to controlling finances is gaining control over credit cards. At Chase, we believe the responsible use of credit cards by our customers helps develop the best, long-term relationship with them.

That is why we have made more than $100 million in grants to community-based organizations to help fund credit education programs and credit counseling services over the past few years. This month we launched a new, multi-million financial literacy grant program – adding to our multi-million dollar investment in helping people of all ages use credit responsibly. We are also continually adding to our credit education programs aimed at helping students understand the importance of responsible credit use. We support several innovative financial education programs for students that we believe have helped cultivate the responsible behavior of young people.

The high creditworthiness of our customers, our ability to effectively evaluate risk, together with the high value we place on customer relationships, are the reasons why 92 percent of Chase customers begin and end the year with the same rate or a better interest rate.

Only a small segment of our customers will have a change in creditworthiness that will result in a higher interest rate. When they do, we deal with them fairly and responsibly. We let them know the reasons for the change in status, and we let them know they have options. They can discuss the matter with us and, if they wish, they can opt out and close an account and pay off the balance at the old interest rate over time.

We do want to help customers, and we treat them as individuals.

We proactively reach out to all customers to make sure they understand the importance of paying on time and how to avoid fees. We also contact customers who pay us late or have other behavior that indicates that they may be getting into financial difficulty. We want to help customers maintain a good relationship and low interest rate with Chase. Once again, this illustrates in real terms the value we place on long-term relationships with our customers.

We believe that our individualized approach to dealing with on-going pricing decisions results in fewer customers being impacted than at many other banks. For example, while our policies give us the ability to raise an interest rate if a customer pays us late, we take that action sparingly. We only change the rate of one in ten customers who pay a late fee. Why? Because we recognize that for the majority of our customers, an occasional slip up is not an indicator of increased risk.

There are many elements to pricing. Each issuer has a unique model based on the customers they have, and each issuer applies its polices in different ways. One element of pricing, viewed without consideration of others, does not provide a picture of the full customer experience. We are confident that the pricing model and practices at Chase provide the best value to our customers.

We believe that our success in retaining customers over the long-term indicates to us that the vast majority of our customers feel they are being treated fairly – in fact, in this very competitive environment, more than 85 percent of the customers that we had five years ago are still with us (This excludes accounts that have defaulted.) Our good customers are highly desirable to our competitors and often have many attractive credit card offers from which to choose. We are pleased and gratified that only a small percentage of our customers leave us each year for our competitors.

Chase is committed to responsibly providing excellent credit products to customers who use them responsibly, and customers are willing to pay for credit cards because they provide a unique set of benefits. Our business model is based on this relationship of responsibility.

In this way, our customers win with the convenience and exceptional benefits that come with credit cards today: no liability for fraud and misuse so that credit cards are safer than cash; ease of purchase, ubiquitous acceptance and clear records of expenditures; instant access to credit – or in the language of many small businesses, capital; rewards that come in the form of travel, merchandise and cash; and for those who pay their bills in full each month – more than a third of our customers – the equivalent of a free loan for up to 55 days.

Chase wins because we have a solid, stable business.

And society wins because the credit card industry as a whole has fueled tremendous growth in the consumer goods sector, which represents 70 percent of the GDP. In 2006, credit cards financed $2 trillion worth of transactions at more than 25 million businesses, small and large. Without credit cards, there would be no commerce over the phone, reduced business by catalog and virtually no consumer business over the Internet – today, the fastest growing sector of the economy today.

The reality is that the highly competitive credit card business of today is working. Reports over the past several years by the Federal Reserve and the Government Accountability Office generally paint a picture of a credit card industry that is in balance with the needs of Americans.

The most recent Survey of Consumer Finances by the Federal Reserve finds that half of the U.S. households that have credit card balances owe $2,200 or less[7]. It says that, among lower income households, the percentage with credit card balances have declined. Further, it says that 31.5 percent of households surveyed paid off their most recent credit card bills in full[8]. Now this data is from 2004, and we await the next triennial report, but my belief is that the numbers will have improved based on increased payment rates in the industry.

The 2006 reports by the Federal Reserve and the GAO reach similar conclusions about the credit card industry. The Federal Reserve report concluded that lenders analyze consumer financial behavior carefully before offering credit[9]. At Chase, we extend cards to people we believe are fully able to pay their credit card bills. It is within our business strategy to do so and initiate a relationship that has a solid chance of being long-term in duration.

To the concerns raised in some quarters that consumers pay ever higher fees, accounting for a large part of bank profits, the GAO report found that the total annual and penalty

[7] Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances, The Federal Reserve Board, p. A31.
[8] Ibid.
[9] The Report to the Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and their Effects on Consumer Debt and Insolvency – Board of Governors of the Federal Reserve System, June 2006, p. 3.

fees were roughly the same in 2004 as they were in 1990[10]. Both studies concluded that most bankruptcies occur – not as a result of credit card debt, but primarily as a result of "unforeseen adverse events such as job loss, divorce and uninsured illness[11]."

The GAO report did conclude that, in the words of its title, there is a "Need for More Effective Disclosures to Consumers." We agree.

Let me return to the issue of disclosure and reinforce what I said earlier. At Chase, we continue to work on this. We believe that clear, simple information is key to a successful customer relationship, and we are committed to keeping our customers clearly and fairly informed of every aspect of their accounts. Well-informed customers are the most likely to understand and appreciate our products, and to use them wisely.

We pay strict attention to the standards that the Federal Reserve Board has set for credit card disclosures, including the level of detail we are required to provide and the specific language they suggest.

However, we believe everyone is in agreement that the volume and types of disclosures mandated also by federal and state laws have not led to greater understanding. Our customers are telling us that today's disclosure lacks sufficient clarity. We pay close attention to our customer feedback. In turn, we have proactively taken steps to help customers understand the aspects of the credit relationship that they have indicated to be confusing.

We have developed supplemental language designed to help customers understand how they can best use their credit cards and avoid fees and having their interest rates raised. We are moving ahead with our programs as we work with the Federal Reserve on its disclosure revisions.

We believe that regulators, consumers and the industry need to work together to improve the clarity, simplicity, fairness and understandability of disclosures. We not only welcome, but also actively seek, opportunities to work with regulators to make significant improvements that provide consumers with clearer, more effective disclosures.

Let me close, Mr. Chairman, by saying that we at Chase Card Services understand that, while disclosure is a critical issue for consumers, it will not immediately mitigate every concern raised in relation to consumers who are working through very difficult credit situations. At Chase, we too are concerned, which is why we support financial literacy programs and have worked with our own customers to help them work their way out of severe debt situations. In addition, we are constantly looking for ways to improve our

[10] Credit Cards – Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers, The United States Government Accountability Office, p. 105.
[11] The Report to the Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and their Effects on Consumer Debt and Insolvency – Board of Governors of the Federal Reserve System, June 2006, p. 25.

customer service procedures in order to identify as soon as possible those who are seriously mired in problems not of their own making. I believe that when we are willing to work with customers and treat them fairly, we can be proud of a credit card system that is doing well by the vast majority of the millions and millions of Americans who use credit cards every day.

Mr. Chairman, we look forward to working with you and the Members of the Committee today to answer your questions and address your concerns.

Thank you.

Addendum to Statement
Richard Srednicki
Chief Executive Officer
Chase Card Services
U. S. Senate Permanent Subcommittee on Investigations
March 7, 2007

1. Chase Card Services Overall Portfolio

Through its wholly-owned subsidiary, Chase Bank USA, N.A., JPMorgan Chase and Co. ("Chase") at any one time owns approximately 100 to 110 million credit card accounts. Chase will refer to its credit card operations as "Chase Card Services" hereinafter.

Chase Card Services operations resulted in profits of $3,206,000,000 in 2006. Chase Card Services contributed to 22 percent of Chase's earnings in 2006.

2. Chase Card Services Billing Policies and Practices

Grace period:
Chase Card Services does not charge periodic finance charges on new purchases billed during a billing cycle if it receives payment of the new entire balance on the current and previous billing statement by the date and time the minimum payment is due, which is generally 20 to 25 days from the current or previous cycle billing date, as applicable. This "grace period" does not apply to cash advances, convenience checks, balance transfers or other cash equivalents. Chase Card Services will assign either a 20-day or 25-day period before the payment due date based on a periodic evaluation of customers' payment behavior. A large majority of our customers are assigned a 25-day period. Most customers assigned a 20-day grace period typically promptly pay their account balance in full each month or are carrying most of their balances at very low interest rates and don't require extended time to pay. If they do pay late as a result of a change in grace period and incur a late fee, we waive the fee upon request.

Interest rates for different types of charges and balances:

An account has various APRs associated with each balance type. Merchandise, balance transfers, cash advances and overdraft protection APRs are initially disclosed at new account opening. These rates are generally fixed (ie. do not vary with a change in an index or variable.) In addition, from time to time, we may offer promotional rate offers that apply to specific transactions or to specific activity that occurs on an account. These rates may be limited in duration or may last until the balance is paid in full. Customers may also request reduced APRs, which are evaluated on a case-by-case basis.

Several conditions may cause an increase in rate. Variable rate changes may increase rates based on changes in the relevant index such as Prime. When customers default under the pre-disclosed terms of the cardmember agreement, we may evaluate the accounts for a change in APR. Finally, we may send a change in terms to populations of customers and increase specific APRs on their accounts. This change in terms may be driven by a deterioration of the customer's overall credit standing or by a change in the economic or competitive environment. Whenever we send a non-default change in terms the customer has a right to reject the change and remain at the old APR.

Application of interest payments to monthly bills:

Chase Card Services applies interest to its balances by the use of the average daily balance method. Briefly put, this method involves netting charges and credit every day and then averaging the balances on the account at the end of the monthly billing cycle. Interest is added to the balance each day. The rate of interest, reduced to a daily factor, is multiplied by the balance each day to determine that day's interest. The sum total of each day's interest is the total interest for the month. This calculation continues to be performed until the account is paid in full. However, no interest is charged on purchases if the customer pays in full each month.

Chase Card Services reserves the right to credit payments in an order that it selects. However, Chase Card Services normally credits low rate, promotional balances first. This fact is disclosed in the materials that are a part of all applications, in the customer agreement and a third time when a promotional offer is made to the cardmember.

How interest is charged on accounts with partial payments:

When a customer has a purchase balance on his or her account and pays the purchase balance in full each month, there is no finance charge assessed. When a customer makes a partial payment on the account, the account is now "revolving" and behaves like any other loan. This means that finance charges will be assessed on the loan that is outstanding each day that it is outstanding. For example, if a customer is revolving a balance of $1,000 and pays $500 half way through the month, the customer will be assessed finance charges on $1,000 for half the month and on only $500 for the remainder of the month. This example excludes daily compounding of finance charges. As described above, finance charges are compounded daily.

3. Chase Card Services Fees

Chase Card Services typically does not solicit new accounts with an annual membership fee unless the account participates in certain rewards programs.

Fees may be charged for certain types of transactions. Purchases made using a credit card are not subject to a separate fee from Chase Card Services. Transactions that may be subject to a fee include foreign currency transactions, cash advances, cash equivalents, balance transfers or the use of checks posted to a credit card account. The fee is generally equal to a charge of up to three percent of the amount of the transaction, with a minimum ranging from $5 to $15, and generally a cap of $99 or less for most balance transfers or balance transfer checks and no maximum for cash advances and cash equivalents. These fees may be waived for special promotions.

Chase Card Services may assess a late payment fee, generally ranging from $15 to $39, depending on the balance on the account for most consumer revolving credit card accounts, if it does not receive the minimum payment by the payment due date shown on the monthly billing statement.

Chase Card Services may assess a return payment fee of $39, for each payment check or electronic payment that is dishonored, an overlimit fee of $39 when the credit line is exceeded and administrative fees for certain functions performed at the request of the cardholder.

Customers can make payments for free by mailing their payment to the designated P.O. Box shown on their billing statements, making their payment online through Chase's website, arranging automatic debit of an account that the customer designates, or through a Chase bank branch.

Payments made in the following ways are charged fees:

Chase advisor-assisted payments: $14.95.
Chase voice response system (VRU) payments: $9.95.
Chase online payments – expedited after 4 PM, "same-day" basis: $14.95.

4. Chase Card Services Payment Allocation Policies

Promotional rate balances are paid before higher rate balances. Within each balance type, finance charge balances are paid before principal balances. Payments are generally applied last to standard-APR cash advance balances.

Applying payments to lower APR balances first reduces the balance that will convert to a higher APR when the promotional period ends.

5. Chase Card Services Handling of [higher risk] Customers

It is our policy and practice to offer a variety of solutions to cardmembers who demonstrate a need for alternative arrangements or have requested assistance. The solutions range from temporary to long-term, such as fee adjustments, fee suppression, APR reduction, re-aging the delinquency status, minimum monthly payment changes, settlement arrangements and Consumer Credit Counseling referrals. The solution offered varies depending upon the individual cardmember's situation. In doing so, Chase Card Services will adhere to the Federal Financial

Institutions Examination Council (FFIEC) Retail Credit Classification and Account Management guidelines (AMG) ensuring proper handling of cardmember accounts.

Chase Card Services also proactively reaches out to customers who, while still making their payments obligations, are also showing early indications of financial distress. Chase Card Services contacts the customers to review their situations and provides credit education and alternative solutions if needed.

As we have explained to the Permanent Subcommittee on Investigations (PSI) Staff, disclosure of the Chase Card Service collection policy would give Chase Card Services competitors valuable information that could be used to better compete with Chase Card Services. The agreement that Chase Card Services and Staff have reached is that Chase Card Services will produce the specific policy that is applicable to the testifying witness. Staff will in turn assure us that the policy will not be disclosed except in the event that (a) Senator Levin should refer to it during the hearing or (b) PSI publishes a report of the hearing.

AVOID PENALTIES FOR LATE BILL PAYMENTS AND KEEP YOUR GOOD RATE

HERE'S HOW:

FREE Auto Bill Pay

- *Set your payments for the full statement balance or minimum monthly payment.*
- *Choose the bank account from which you wish to make your automatic payment.*
- *Select the payment due date that works best for you.*

FREE Online Bill Pay

- *Log on and pay your credit card bill online anytime, anywhere.*
- *Our secure payment center is available 24 hours a day, seven days a week.*
- *There's never a fee for payments made within our normal bill processing hours.*

FREE E-mail Alerts

- *Customized reminders to notify you of your available credit or current balance.*
- *Alerts when your payment is due, a payment has been posted to your account, or no payment has been received.*

FREE Paperless Statements

- *View statements from the secure website in the same format as your current paper statement.*
- *View current statement and up to six months of previous statements online.*
- *Get notified by E-mail when your current statement is ready.*
- *Save statements to a personal computer and print a copy as needed.*

Follow these easy tips

Just remember this advice to keep your credit in good standing:

- *Pay at least your minimum balance every month.*
- *Keep your balance below your credit line at all times.*

Visit www.chase.com to sign up today!
It's fast, convenient, secure, and free!

CHASE

YOUR CHOICE YOUR CHASE

Testimony of Vikram A. Atal
Chairman & Chief Executive Officer of Citi Cards

Before the Senate Permanent Subcommittee on Investigations

March 7, 2007

Thank you Mr. Chairman and Members of the Subcommittee. My name is Vikram Atal, and I am the Chairman and Chief Executive Officer of Citi Cards. I joined Citibank in 1986 and began working in the company's cards business in 1996. I have been CEO of Citi Cards since September 2005. I appreciate the opportunity to appear before you today to discuss the credit card business and how we serve our customers. These are important issues that I know have long been of interest and concern to you and I look forward to reviewing them with the Subcommittee.

I understand that the Subcommittee's primary focus today is on issues relating to the transparency and fairness with which card issuers treat their customers. We welcome that conversation and I will explain what we have been doing at Citi in recent years to pursue those ends, including important new initiatives that we have recently announced. Our overriding commitment is to put our customers first. That's good for our customers and good for business. We think we do quite a good job of that, but are also continually looking for ways to do still better.

Background

At the outset, I'd like to step back for a moment and provide some context for addressing the important issues the Subcommittee has identified. To appreciate how interest rates, fees, and grace periods work, it is important to understand how the credit card business model works, how that has changed in the past 20 years, and why we think this change fundamentally has served the public.

Credit cards have become an integral part of our nation's economy, providing real and significant benefits to merchants and consumers alike. Merchants of all sizes benefit from the liquidity, security, and efficiency of credit cards. And for consumers, credit cards are a safe and convenient alternative to cash, making everyday purchases more efficient, opening up the option of online shopping, and facilitating consumers' ability to track and manage their spending. Responsible credit card use is also often an individual's first step toward establishing the positive credit record necessary to finance a car, a house, or a small business, or to achieve other personal financial milestones.

At the same time, to understand how the business of credit cards works, it is crucial to recognize what is actually going on whenever a person uses his or her credit card. While I imagine that most people don't think of it this way, the reality is that every time a person uses a credit card to buy something, we are in effect making them an unsecured loan -- one that is a lot riskier from a lender's perspective than many of the common loans consumers take out. A credit card loan, after all, is not backed up by any tangible security as are mortgages, auto loans or home equity lines of credit. Nor is it based on any detailed or personal familiarity between a local banker and his customer. It is an extension of credit secured only by a customer's promise to repay.

Before the late 1980s, the credit card market was essentially a one-size fits all proposition and was far narrower than the market we see today. Customers were typically assessed a $20 annual fee and interest rates were nearly 20% across the board, regardless of the risk profile of any particular customer. In the last 15 years, this model has changed dramatically. Underwriting practices have become more refined, allowing banks both to offer lower priced credit for people with solid credit histories and to extend credit to customers who were previously underserved or had no access to unsecured credit. The availability and competitive pricing for credit cards combined with more precise underwriting analytics has, over time, led to an expansion of consumer credit across the economic spectrum. Banks are able to open more new accounts, increase existing account credit lines, and offer rewards programs and the like to a broad range of customers.

The capacity to consider risk when making credit available is the key that makes this system work. Without that ability to differentiate risk, less creditworthy consumers would have fewer appropriate means of accessing credit, relatively risk-free consumers would face a higher cost of credit, and bank lending strategies would be significantly curtailed. Our practices as they concern interest rates and fees all need to be considered in this light.

As a general matter, the broad expansion of credit I've referred to-- some call it as the democratization of credit -- has been a good thing. Average credit card rates have declined nearly six percentage points compared to the average rates that prevailed in 1990. Overall, credit card debt remains a small portion of household debt. The Federal Reserve has reported that credit card balances as a percentage of total household debt actually *declined* from 3.9 percent in 1995 to 3.0 percent in 2004.

The lending model for credit cards is unique and the business works on a relatively thin margin. Year after year, we make roughly the same return of $2-2.50 for every $100 we lend, which equates to only about $1 for every $100 of sales charged to our credit cards. And even that margin depends on careful management of several different kinds of risk -- the credit risk involved in whether customers will be able to repay their obligations; the interest rate risk that our own cost of funds may rise more rapidly than expected; general economic risk; the fraud risk that cards fall into the wrong hands and are used illegally; and the operational risk that any business faces when managing complex systems.

Citi's Record of Serving Customers

We operate in a highly competitive marketplace in which consumers have numerous payment card choices. Customer satisfaction drives our revenues and lost customers are difficult to replace. We constantly work to meet consumer demand and maintain customer loyalty, because we know that if we don't provide the best products and the best service, our customers will go elsewhere. So our mission is to put our customers first.

With this in mind, we have taken many steps in recent years to improve the products and services we offer our customers. I want to discuss briefly a few of these, and I want to start with two important changes that we announced just last week.

Universal Default. First, we are eliminating re-pricing for what we call "off-us" behavior, known by some as "universal default." It is standard practice for credit card issuers to consider a customer's credit behavior with respect to other financial commitments to other companies, and to increase their interest rates if warranted by such behavior. That is not an illogical practice, since a customer's credit behavior elsewhere has proven to be predictive of their behavior with us. Still we recognize why customers, and others, would question the practice. So even before last week, we engaged in the customer-friendly practice of giving customers the right to opt out of any such proposed increase in their interest rates, while still maintaining full use of their card until expiration.

But last week we decided to go even further. We eliminated the practice altogether for all customers during the term of their card. Citi will consider increasing a customer's interest rate only on the basis of his or her behavior with us -- when the customer fails to pay on time, goes over the credit limit, or bounces a checks. This change will be described in our customer communications by summer.

"Any time any reason." Second, we are eliminating what is commonly known as "any time for any reason" increases to the rates and fees of our customer accounts. Traditionally, credit card issuers have taken the position that they can increase the rates and fees of a cardholder's account at any time for any reason, for example, to respond to general conditions in the financial markets. But last week we announced that we are giving up that practice. Once a card is issued, we will not voluntarily increase the rates or fees on the account until the card expires and a new card is issued (generally two years). The interest rate on the card, if linked to the prime rate as is typically the case, would still go up or down as the prime rate moves. But the only reason we would consider increasing the rates or fees before the card expires would be if a cardholder pays Citi late, exceeds the credit limit, or pays with a check that bounces. We believe we are the first bank to adopt this policy.

When a credit card expires and a new card is issued we will, as is customary, consider a customer's credit risk and general market conditions in establishing new rates, fees and terms of the account. If we believe any changes are needed at that time, we will give the customer advance notice and the right to opt out. We are implementing the change immediately for new customers and will have it implemented for existing Citi branded credit card customers in April. It will be reflected in our customer communications by the summer.

Customer Alerts. In recent years we have seen our customers change the way they prefer to interact with us. They have demanded greater utility online and look for us to provide the tools that allow them to manage all of their account needs through the Internet. This has included viewing their account activity in real time, making payments, changing addresses, requesting statements, and ordering additional cards.

In response to customer expectations we have also developed a set of online tools that are designed to make it easy for cardholders to avoid late fees and to understand and manage their relationship with us. For example, because pay days vary, our customers can choose the day of the month they would find it most convenient to pay their bills. And they can elect to be notified, in advance, about key dates and information related to their bills when they are approaching their credit limit or a payment due date, for example. The program is highly flexible: cardholders can choose which alerts to receive and, for some alerts, how often to get them -- daily, weekly or monthly. These individualized services exist now but are going to be improved in the months ahead to make sure customers are aware of these opportunities and can use them easily.

Alerts are particularly helpful for people who tend to wait until the last minute to pay their bills. We think this kind of customer is better off interacting with us on the Internet. Indeed, when a customer calls to pay by phone, we educate them about how to pay on the Internet. And in fact that's why we have decided to waive the fee for new customers paying by phone for the first time, while encouraging them to pay online next time.

Financial literacy and consumer credit education. Citi is an industry leader in financial education and literacy and we have put in place numerous programs to encourage and promote responsible borrowing. We believe it is in the industry's interest to do business with educated consumers who have the ability to pay their bills on time and avoid credit pitfalls.

The centerpiece of our credit education effort is the Use Credit Wisely program, an online program designed to assist consumers in understanding credit basics, how credit works, budgeting, and how to work through difficult situations such as disability or living on a fixed income. The Use Credit Wisely program also includes specific information and resources on fraud prevention, identity theft and legal rights for consumers; a credit education web site in Spanish for Hispanic consumers and Use Credit Wisely for Business, a site designed specifically for the needs of business owners.

In addition, through the innovative components of our Credit-ED program, Citi provides ongoing support and the latest resources through a variety of targeted channels to help students manage their credit and money responsibly. Since its inception in 2000, the Credit-ED program has distributed more than five million credit education materials free to students, administrators, and parents. Our mtvU Card was acknowledged by the advocacy group Consumer Action as the most impressive program for rewarding students based on good grades and responsible credit behavior.

We are proud that Drexel University's LeBow College of Business in Philadelphia, Pennsylvania has incorporated the Credit-ED challenge as part of the university's financial education curriculum requirement for freshmen. For students, parents, and campus administrators, Credit-ED's comprehensive credit education site, www.Students.UseCreditWisely.com, features a number of free interactive tools and information on using credit wisely.

Moreover, in 2004 Citigroup and the Citigroup Foundation made a 10-year, $200 million global commitment to Financial Education and to date have made donations of nearly $53 million to Financial Education programs in 68 countries.

Security and protection. Citi is an industry leader in protecting customers from theft and fraud and in offering immediate and effective help to victims. We pioneered the prevention and detection of credit card fraud and have been in the forefront of researching and discovering new and innovative ways to protect our customer accounts and personal information. Starting in 1989, we offered customers our Fraud Early Warning feature and in 1992, we introduced the Photocard to help deter unauthorized use of credit cards. Today, should our card members become victims of identify theft or fraud, we offer the most comprehensive and innovative free service—Citi Identity Theft Solutions—to help them. We have a dedicated team of specialists who immediately assist victims of identity theft and fraud, and help prevent victims' accounts and credit status from being affected. Our service streamlines and simplifies the entire process of re-establishing a victim's identity and credit history -- saving the customer significant time, money and inconvenience – even if the fraud happened on another credit card.

Disclosure. We realize it can be difficult for credit card customers to understand the statements and other materials card issuers send out. Our goal is to assure "no surprises" for our customers and to continually improve upon our practices. This means that all of our written materials must describe our products, clearly, accurately, and fairly. In fact, the effective and simpler to read disclosures cited by GAO in its September 2006 report on credit cards were all Citi disclosures.

We are also in the process of a major initiative to redesign our customer statements. We are currently using the redesigned statement with some two million of our customers and are working with them to understand how we might continue to improve the statements. Some key features of the current new statement include: color printing; clarified purchase section; enhanced display of rewards information; improved display of statement messages; prominent messaging for checks; laser high-quality charts/graphs/photographs; more flexibility with varying typefaces, type treatments and increased point size.

Hardship assistance. Citi has put in place a number of customer assistance programs to help people in need. We know that keeping up with credit card bills can become difficult in times of sudden illness, job loss or other catastrophic event. For these temporary hardships we offer programs that can include full or partial deferments, APRs as low as 0%, and/or suspension of late and over-credit-limit fees for up to 12 months. And we also offer longer-term paydown programs that include fee waivers and reduced interest for five years, with the goal of helping the customer to pay off his balance by the end of the period.

Going Forward

Mr. Chairman, we are working on a daily basis to enhance the products and services we provide our customers. At Citi, we put our customers first. We seek always to treat them fairly and communicate with them in a clear and understandable way. Above all, we want to make sure that our customer's Citi Card is a convenience that can make managing their financial affairs as easy and stress free as possible. This job is never finished and we know that there is always room for improvement. I look forward to answering any questions that you may have.

# # #

Summary of Wannemacher Account

(March 2001 to February 2007)

Total purchases:	$3,200
Total interest charges:	$4,900
Total over-limit charges:	$1,500
Total late fees:	$1,100
Total charges as of February 2007:	$10,700
Total payments:	$6,300
Owed as of February 2007:	$4,400

Prepared by the Permanent Subcommittee on Investigations Staff, March 2007

Permanent Subcommittee on Investigations
EXHIBIT #1

Permanent Subcommittee on Investigations
EXHIBIT #2

EXAMPLE OF INTEREST CHARGES ON CREDIT CARD DEBT THAT IS PAID ON TIME BUT NOT IN FULL

January 1 **Bill for Dec. Charges**	**February 1** **Bill for Jan. Charges**	**March 1** **Bill for Feb. Charges**
Owe: $5,020	**Owe: $55.21** • **$20** balance from Jan. bill; • **$34.78** (interest on $5,020 from Jan. 1-15) • **$0.43** (interest on $20 from Jan. 16-31) No new purchases (17.99% interest is assessed on each day's balance and compounded daily)	**Owe: $0.38** • **$0.38** (interest on $55.21 from Feb. 1-15) No new purchases (17.99% interest is assessed on each day's balance and compounded daily)
Pay on time (1/15): $5,000	**Pay on time (2/15): $55.21**	
Balance: $20	**Balance: $0**	

Prepared by U.S. Senate Permanent Subcommittee on Investigations Staff, March 2007

BANK OF AMERICA
BILLING STATEMENT DISCLOSURES

IMPORTANT INFORMATION ABOUT THIS ACCOUNT USE111 Rev. 09/06

GRACE PERIOD

"Grace Period" means the period of time during a billing cycle when you will not accrue Periodic Rate Finance Charges on certain transactions or balances. There is no Grace Period for Category A or B Cash Advances. If you pay in full this statement's New Balance Total by its Payment Due Date and if you paid in full this statement's Previous Balance in this statement's billing cycle, then you will have a Grace Period during the billing cycle that began the day after this statement's Closing Date on the Category C or D portions of this statement's New Balance Total.

During a 0% promotional APR period: 1) no Periodic Rate Finance Charges accrue on balance categories with the 0% promotional APR; and 2) you must pay the Total Minimum Payment Due by its Payment Due Date (and avoid any other "promotion turn-off event" as defined in your Credit Card Agreement) to maintain the 0% promotional APR.

** If a corresponding Annual Percentage Rate in the Finance Charge Schedule on the front of this statement contains a "***" symbol, then with respect to those balance categories: 1) the 0% promotional APR for each of the balance categories will expire as of the end of the next billing cycle; and 2) you must pay this statement's New Balance Total by its Payment Due Date to avoid Periodic Rate Finance Charges after the end of the 0% promotional APR period on those balances existing as of the Closing Date of this statement.

CALCULATION OF BALANCES SUBJECT TO FINANCE CHARGE

Categories A and B – Average Balance Method (including new Cash Advances): We calculate separate Balances Subject to Finance Charge for Category A balances and Category B balances. We do this by: (1) calculating a daily balance for each day in this statement's billing cycle; (2) calculating a daily balance for each day prior to this statement's billing cycle that had a "Pre-Cycle Cash Advance" balance, which is a Cash Advance with a transaction date prior to this statement's billing cycle but with a posting date within this statement's billing cycle; (3) adding all the daily balances together; and (4) dividing the sum of the daily balances by the number of days in this statement's billing cycle.

To calculate the daily balance for each day in this statement's billing cycle, we take the beginning balance, add an amount equal to the applicable Daily Periodic Rate multiplied by the previous day's daily balance, add new Cash Advances and Transaction Fees, and subtract applicable payments and credits. If any daily balance is less than zero we treat it as zero.

To calculate a daily balance for each day prior to this statement's billing cycle that had a Pre-Cycle Cash Advance balance, we take the beginning balance attributable solely to Pre-Cycle Cash Advances (which will be zero on the transaction date of the first Pre-Cycle Cash Advance), add an amount equal to the applicable Daily Periodic Rate multiplied by the previous day's daily balance, and add only the applicable Pre-Cycle Cash Advances, and their related Transaction Fees. We exclude from this calculation all transactions posted in previous billing cycles.

Categories C and D – Average Daily Balance Method (including new transactions): We calculate separate Balances Subject to Finance Charge for Category C balances and Category D balances. We do this by: (1) calculating a daily balance for each day in the billing cycle; (2) adding all the daily balances together; and (3) dividing the sum of the daily balances by the number of days in the billing cycle.

To calculate the daily balance for each day in this statement's billing cycle, we take the beginning balance, add an amount equal to the applicable Daily Periodic Rate multiplied by the previous day's daily balance, add new transactions, new Account Fees, and new Transaction Fees, and subtract applicable payments and credits. If any daily balance is less than zero we treat it as zero. If the Previous Balance shown on this statement was paid in full in this statement's billing cycle, then on the day after that payment in full date, we exclude from the beginning balance new transactions, new Account Fees, and new Transaction Fees which posted on or before that payment in full date, and we do not add new transactions, new Account Fees, or new Transaction Fees which post after that payment in full date.

We include the costs for the Credit Protection plan or for credit insurance purchased through us in calculating the beginning balance for the first day of the billing cycle after the billing cycle in which such costs are billed.

TOTAL PERIODIC RATE FINANCE CHARGE COMPUTATION

Periodic Rate Finance Charges accrue and are compounded on a daily basis. To determine the Periodic Rate Finance Charge for each category, we multiply the Balance Subject to Finance Charge by its applicable Daily Periodic Rate and that result by the number of days in the billing cycle. To determine the total Periodic Rate Finance Charge for the billing cycle, we add the Periodic Rate Finance Charges for each category together. Each Daily Periodic Rate is calculated by dividing its corresponding Annual Percentage Rate by 365.

HOW WE ALLOCATE YOUR PAYMENTS

We will allocate your payments in the manner we determine. In most instances, we will allocate your payments to balances (including transactions made after this statement) with lower APRs before balances with higher APRs. This will result in balances with lower APRs (such as new balances with promotional APR offers) being paid before any other existing balances.

Payment Due Dates and Keeping Your Account In Good Standing

Your Payment Due Date will not fall on the same day each month. In order to help maintain any promotional rates, to avoid the imposition of Default Rates (if applicable), to avoid late fees, and to avoid overlimit fees, we must receive at least the Total Minimum Payment Due by its Payment Due Date each billing cycle and you must maintain your account balance below your Credit Limit each day.

MISCELLANEOUS

For the complete terms and conditions of your account, consult your Account Agreement. FIA Card Services is a tradename of FIA Card Services, N.A. This account is issued and administered by FIA Card Services, N.A.

CUSTOMER STATEMENT OF DISPUTED ITEM *– Please call toll free 1-866-266-0212 Monday-Thursday 8am-9pm (Eastern Time) and Friday 8am-7pm (Eastern Time). For prompt service please have the merchant reference number(s) available for the charge(s) in question.*

PLEASE DO NOT ALTER WORDING ON THIS FORM AND DO NOT MAIL YOUR LETTER OR FORM WITH YOUR PAYMENT. Choose only one dispute reason.

Your Name: ____________________
Transaction Date: ____________ Posting Date: ____________
Amount $: ____________ Disputed Amount $: ____________

Account Number: ____________________
Reference Number: ____________________
Merchant Name: ____________________

☐ 1. The amount of the charge was increased from $________ to $________ or my sales slip was added incorrectly. Enclosed is a copy of the sales slip that shows the correct amount.

☐ 2. I certify that the charge listed above was not made by me or a person authorized by me to use my card, nor were the goods or services represented by the transaction received by me or a person authorized by me.

☐ 3. I have not received the merchandise that was to be shipped to me on ____/____/____ (MM/DD/YY). I have asked the merchant to credit my account.

☐ 4. I was issued a credit slip that was not shown on my statement. A copy of my credit slip is enclosed. The merchant has up to 30 days to credit your account.

☐ 5. Merchandise that was shipped to me has arrived damaged and/or defective. I returned it on ____/____/____ (MM/DD/YY) and asked the merchant to credit my account. Attach a letter describing how the merchandise was damaged and/or defective and a copy of the proof of return.

☐ 6. Although I did engage in the above transaction, I have contacted the merchant, returned the merchandise on ____/____/____ (MM/DD/YY) and requested a credit. I either did not receive this credit or it was unsatisfactory. Attach a letter explaining why you are disputing this charge with a copy of the proof of return. If you are unable to return the merchandise, please explain.

☐ 7. I certify that the charge in question was a single transaction, but was posted twice to my statement. I did not authorize the second transaction. Sale #1 $________ Reference # ________ Sale #2 $________ Reference # ________

☐ 8. I notified the merchant on ____/____/____ (MM/DD/YY) to cancel the pre-authorized order (reservation). Please note cancellation # and if available, enclose a copy of your contract and a copy of your telephone bill showing date and time of cancellation. Reason for cancellation / cancellation #: ____________________

☐ 9. Although I did engage in the above transaction, I have contacted the merchant for credit. The services to be provided on ____/____/____ (MM/DD/YY) were not received or were unsatisfactory. Attach a letter describing the services expected, your attempts to resolve with the merchant and a copy of your contract.

☐ 10. I certify that I do not recognize the transaction. Merchants often provide telephone numbers next to their name on your billing statement. Please attempt to contact the merchant for information.

☐ 11. If your dispute is for a different reason, please contact us at the above telephone number.

Signature (required): ____________ Date: ____________
Best contact telephone #: ____________ Home#: ____________

Billing rights are only preserved by written inquiry. To preserve your billing rights, please return a copy of this form and any supporting information regarding the merchant charge in question to: Attn: Billing Inquiries, P.O. Box 15026, Wilmington, DE 19850-5026, USA.

PLEASE KEEP THE ORIGINAL FOR YOUR RECORDS AND SEND A COPY OF THIS STATEMENT.

Payments

We credit payments as of the date received, if the payment is 1) received by 5 p.m. (Eastern Time), 2) received at the address shown in the bottom left-hand corner of the front of this statement, 3) paid with a check drawn in U.S. dollars on a U.S. financial institution or a U.S. dollar money order, and 4) sent in the enclosed return envelope with only the bottom portion of this statement accompanying it. Payments received after 5 p.m. on any day including the Payment Due Date, but that otherwise meet the above requirements, will be credited as of the next day. We will reject payments that are not drawn in U.S. dollars and those drawn on a financial institution located outside of the United States. Credit for any other payments may be delayed up to five days. No payment shall operate as an accord and satisfaction without the prior written approval of one of our Senior Officers.

We process most payment checks electronically by using the information found on your check. Each check authorizes us to create a one-time electronic funds transfer (or process it as a check or paper draft). Funds may be withdrawn from your account as soon as the same day we receive your payment. Checks are not returned to you. For more information or to stop the electronic funds transfers, call us at the number listed on the front.

If yon have authorized us to pay your credit card bill automatically from your savings or checking account with us, you can stop the payment on any amount you think is wrong. To stop the payment your letter must reach us at least three business days before the automatic payment is scheduled to occur.

If your billing address or contact information has changed, or if your address is incorrect as it appears on this bill, please provide all corrections here.

Address 1 ____________________

Address 2 ____________________

City ____________________

State ____________ Zip ____________

Area Code & Home Phone –

Area Code & Work Phone –

Permanent Subcommittee on Investigations
EXHIBIT #3a

CHASE BANK
BILLING STATEMENT DISCLOSURES

Street Address: ______________________________

City: ____________________

State: __

Zip: _____ ____

Home Phone: ___ ___ ____

Work Phone: ___ ___ ____

E-mail Address: ________________________________

Information About Your Account

Lost or Stolen Cards: Please report your lost or stolen card immediately by calling the Customer Service number found on the front of your statement. Advisors are always available to assist you. You can reach an Advisor by pressing 0 after you enter your account number.

Crediting of Payments: For payments by regular U.S. mail, send at least your minimum payment due to our post office box designated for payments shown on this statement. Your payments by mail must comply with the instructions on this statement, and must be made by check or money order, payable in U.S. Dollars, and drawn on or payable through a U.S. financial institution or the U.S. branch of a foreign financial institution. Do not send cash. Write your account number on your check or money order. Payments must be accompanied by the payment coupon in the envelope provided with our address visible through the envelope window; the envelope cannot contain more than one payment or coupon; and there can be no staples, paper clips, tape or correspondence included with your payment. If your payment is in accordance with our payment instructions and is made available to us on any day except December 25 by 1:00 p.m. local time at our post office box designated for payments on this statement, we will credit the payment to your account as of that day. If your payment is in accordance with our payment instructions, but is made available to us after 1:00 p.m. local time at our post office box designated for payments on this statement, we will credit it to your account as of the next day. If you do not follow our payment instructions or if your payment is not sent by regular U.S. mail to our post office box designated for payments, crediting of your payment may be delayed for up to 5 days. Payments made electronically through our automated telephone service, Customer Service advisors, or our web site will be subject to any processing times disclosed for those payments.

Account Information Reported to Credit Bureaus: We may report information about your account to credit bureaus. Late payments, missed payments or other defaults on your account may be reflected in your credit report. If you think we have reported inaccurate information to a credit bureau, you may write to us at the Cardmember Service address listed on your billing statement.

Checks Collected Electronically: We reserve the right to electronically collect your eligible payment checks, at first presentment and any representment, from the bank account on which the check was drawn. Our receipt of your payment check is your authorization for us to collect the amount of the check electronically, or if needed by a draft drawn against the bank account. Checks will be collected electronically by sending the check amount along with the check, routing and account numbers to your bank. Your bank account may be debited as early as the same day we receive your payment. The original check will be destroyed and an image will be maintained in our records.

Conditional Payments: Any payment check or other form of payment that you send us for less than the full balance due that is marked "paid in full" or contains a similar notation or that you otherwise tender in full satisfaction of a disputed amount, must be sent to Card Services, P.O. Box 15049, Wilmington, DE 19850-5049. We reserve all our rights regarding these payments (e.g., if it is determined there is no valid dispute or if any such check is received at any other address, we may accept the check and you will still owe any remaining balance). We may refuse to accept any such payment by returning it to you, not cashing it or destroying it. All other payments that you make should be sent to the appropriate payment address.

Annual Renewal Notice: If your account has an annual fee, it will be billed each year or in monthly installments, whether or not you use your account, and you agree to pay it when billed. The annual fee is non-refundable unless you notify us that you wish to close your account within 30 days of the date we mail your statement on which the annual fee is charged and at the same time, you pay your outstanding balance in full. Your payment of the annual fee does not affect our rights to close your account and to limit your right to make transactions on your account. If your account is closed by you or us, we will continue to charge the annual fee until you pay your outstanding balance in full and terminate your account relationship.

Explanation of Finance Charges: We calculate periodic finance charges, using the applicable periodic rates shown on this statement, separately for each feature (e.g., balance transfer/convenience checks and cash advance checks ("check transaction"), purchases, balance transfers, cash advances, promotional balances or overdraft advances). These calculations may combine different categories with the same daily periodic rates. If there is a "V" next to a periodic rate on this statement, that rate may vary, and the index and margin used to determine that rate and its corresponding APR are described in your Cardmember Agreement, as amended. There is a minimum finance charge in any billing cycle in which you owe any periodic finance charges, and a transaction finance charge for each balance transfer, cash advance, or check transaction, in the amounts stated in your Cardmember Agreement, as amended.

To get the daily balance for each day of the current billing cycle, we take the beginning balance for each feature, add any new transactions or other debits (including fees, unpaid finance charges and other charges), subtract any payments or credits, and make other adjustments. Transactions are added as of the transaction date, the beginning of the billing cycle in which they are posted to your account, or a later date of our choice (except that check transactions are added as of the date deposited by the payee or a later date of our choice). Fees are added either on the date of a related transaction, the date they are posted to your account, or the last day of the billing cycle. This gives us that day's daily balance. A credit balance is treated as a balance of zero. If a daily periodic rate applies to any feature, we multiply the daily balance by the daily periodic rate to get your periodic finance charges for that day. We then add these periodic finance charges to your daily balance to get the beginning balance for the next day. (If more than one daily periodic rate could apply based on the average daily balance, we will use the daily periodic rate that applies for the average daily balance amount at the end of the billing cycle to calculate the daily periodic finance charge each day.) If this statement shows a previous cycle average daily balance for purchases, we do the same thing for each day of the previous cycle to get the daily balance of purchases for the previous billing cycle. However, the daily balance for previous billing cycle purchases is considered to be zero for each day of the previous billing cycle if a periodic finance charge was already billed on purchases itemized on your previous statement or we received payment of your New Balance on your previous statement in full by the date and time your payment was due.

To get your total periodic finance charge for a billing cycle when a daily periodic rate(s) applies, we add all of the daily periodic finance charges for all features. To determine an average daily balance, we add your daily balances and divide by the number of the days in the applicable billing cycle(s). If you multiply the average daily balance for each feature by the applicable daily periodic rate and then multiply each of these results by the number of days in the applicable billing cycle(s), and then add all of the results together, the total will also equal the periodic finance charges for the billing cycle, except for minor variations due to rounding. To get your total periodic finance charge for a billing cycle when a monthly periodic rate(s) applies, multiply the average daily balance for each feature by the applicable monthly periodic rate and add the results together. The total will equal the periodic finance charges for the billing cycle, except for minor variations due to rounding.

Grace Period (at least 20 days): We accrue periodic finance charges on a transaction, fee, or finance charge from the date it is added to your daily balance until payment in full is received on your account. However, we do not charge periodic finance charges on new purchases billed during a billing cycle if we receive both payment of your New Balance on your current statement by the date and time your payment is due and also payment of your New Balance on your previous statement by the date and time your payment was due. There is no grace period for balance transfers, cash advances, check transactions, or overdraft advances.

Grace Period for Qualifying Promotional Balances: You will not incur periodic finance charges on a qualifying promotional balance if you pay that balance in full by the specified expiration date. To avoid finance charges on new purchases when your New Balance includes a qualified promotional balance, pay your full New Balance minus your total qualifying promotional balances by the date and time your payment is due. However, if your statement shows that a minimum payment is due, we must receive at least that minimum payment by the date and time specified on your statement, even if your only balance consists of qualifying promotional balances.

BILLING RIGHTS SUMMARY

In Case of Errors or Questions About Your Bill: If you think your bill is wrong, or if you need more information about a transaction on your bill, write Cardmember Service on a separate sheet at P.O. Box 15299 Wilmington, DE 19850-5299 as soon as possible. We must hear from you no later than 60 days after we sent you the first bill on which the error or problem appeared. You can telephone us, but doing so will not preserve your rights.

In your letter, give us the following information.

- Your name and account number
- The dollar amount of the suspected error
- Describe the error and explain, if you can, why you believe there is an error. If you need more information, describe the item you are unsure about.

You do not have to pay any amount in question while we are investigating, but you are still obligated to pay the parts of your bill that are not in question. While we investigate your question, we cannot report you as delinquent or take action to collect the amount you question. If you have authorized us to pay your credit card bill automatically from your savings or checking account, you can stop the payment on any amount you think is wrong. To stop the payment, your letter or call (using the Cardmember Service address or telephone number shown on this statement) must reach us at least three business days before the automatic payment is scheduled to occur.

Special Rule for Credit Card Purchases: If you have a problem with the quality of goods or services that you purchased with a credit card (excluding purchases made with a check), and you have tried in good faith to correct the problem with the merchant, you may not have to pay the remaining amount due on the goods or services. You have this protection only when the purchase price was more than $50 and the purchase was made in your home state or within 100 miles of your mailing address. These limitations do not apply if we own or operate the merchant, or if we mailed you the advertisement for the property or services.

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Permanent Subcommittee on Investigations

EXHIBIT #3b

CITIGROUP
BILLING STATEMENT DISCLOSURES

Information About Your Account

Grace Period for Purchases: The grace period for purchases is at least 20 days. Therefore, to avoid periodic finance charges on purchases (excluding balance transfers) that appear on this statement, you must have paid the New Balance on the last statement by that statement's payment due date and also pay the New Balance on this statement by this statement's payment due date. If you made a balance transfer, you may be unable to avoid periodic finance charges on new purchases, as described in that balance transfer offer.

Grace Period for Advances: none.

Rates: Your annual percentage rates (APRs) and periodic rates may vary. (D) and (F) indicate daily periodic rate. (M) indicates monthly periodic rate.

Balance Subject to Finance Charge: We calculate periodic finance charges separately for each balance subject to different terms (e.g., Standard Purch, Standard Adv, and each numbered Offer). Charges include purchases, balances transfers, cash advances, transaction fees, other fees, and any minimum finance charge.

- **Average Daily Balance (Including New Transactions):** For each balance, we multiply the daily balance by the applicable daily periodic rate. We do this for each day in the billing period, including the Statement/Closing Date. To get the daily balance, we take the beginning balance for each balance every day, add any new charges and any periodic finance charge on the previous day's balance, subtract any credits or payments credited as of that day, and make other adjustments. A credit balance is treated as a balance of zero. For each balance, the Balance Subject to Finance Charge is the average of the daily balances during the billing period. If you multiply this figure for each balance by the number of days in the billing period and by the applicable daily periodic rate, the result is the periodic finance charges assessed for that balance, except for minor variations caused by rounding.
- **Special Calculation Method for Certain Cardmembers:** If a periodic rate is followed by an "(M)" or an "(F)", we use the following Average Daily Balance (including new transactions) method. We take the beginning balance for each balance every day (including periodic finance charges imposed in previous billing periods), add any new charges, subtract any credits or payments credited as of that day, and make other adjustments. A credit balance is treated as a balance of zero. This gives us the daily balance. We add up all the daily balances for the billing period (except the balances on the Statement/Closing Date) and divide by the total number of days in the billing period. (For finance charge calculation purposes, the billing period begins on the Statement/Closing Date of the previous billing period.) This gives us the Balance Subject to Finance Charge for that balance. If the balance is subject to a monthly periodic rate, we figure the periodic finance charge by multiplying the Balance Subject to Finance Charge for that balance by the applicable monthly periodic rate. If the balance is subject to a daily periodic rate, we figure the periodic finance charge by multiplying the Balance Subject to Finance Charge for that balance by the applicable daily periodic rate and by the number of days in the billing period.

Annual Membership Fee: Any annual membership fee is billed once a year. The amount of the fee is shown on the statement when the fee is billed. If, within 30 days from the mailing or delivery date of the statement with the fee, you contact Customer Service at the address or phone number on this statement to close your account, we will credit your account for the amount of the fee, even if you use your card during that 30 day period.

Certain Choice Accounts: If the periodic rate for a CHOICE account cash advance is followed by an (F), the advance is included in the applicable advance balance from the day you take it until the Statement/Closing Date on the current statement. Thereafter, any remaining advance balance is included in the Standard Purch balance.

Minimum Finance Charge: We assess a minimum finance charge of $.50 if the periodic finance charge for the billing period would otherwise be less.

BILLING RIGHTS SUMMARY

In Case of Errors or Questions About Your Bill: If you think your bill is wrong, or if you need more information about a transaction on your bill, write us at the Customer Service address specified on this statement as soon as possible (you may use, but are not required to use, the 'Notification of Disputed Item' form provided below or a copy of it). We must hear from you no later than 60 days after we send you the first bill on which the error or problem appeared. You can telephone us, but doing so will not preserve your rights.

If you choose to use the form below, please call Customer Service for assistance.

If you send us a letter please include the following information:

- Your name and account number.
- The dollar amount of the suspected error.
- Describe the error and explain, if you can, why you believe there is an error. If you need more information, describe the item you are unsure about.
- Please be sure all correspondence is signed by the primary cardholder.

You do not have to pay any amount in question while we are investigating, but you are still obligated to pay the parts of your bill that are not in question. While we investigate your question, we cannot report you as delinquent on the disputed item or take any action to collect the amount you question.

Special Rule for Credit Card Purchases: If you have a problem with the quality of goods or services that you purchased with a credit card, and you have tried in good faith to correct the problem with the merchant, you may not have to pay the remaining amount due on the goods or services. You have this protection only when the purchase price is more than $50 and the purchase is made in your home state or within 100 miles of your mailing address. (If we own or operate the merchant, or if we mailed you the advertisement for the property or services, all purchases are covered regardless of amount or location of purchase.)

Notification of Disputed Item-Please call Customer Service before completing this form.

Please sign and return this form to the Customer Service address on this statement. You may write us or use this form (or a copy). However, if you use this form, you may want to record the information on the reverse side for your records. Don't mail the form with your payment. You authorize us to send any information you provide in connection with this billing dispute to the merchant. Please print in blue or black ink. If your card has been lost, stolen or you haven't received it, call Customer Service immediately. Don't use this form.

CASE ID: ____________________

Name (Please Print) ____________________

Signature/Date ____________________

Account # ____________________

Reference # ____________________ Amount of Dispute ____________________

Merchant ____________________

I have examined the charges made to my account and am disputing an item for the following reason:

☐ 1. Neither I nor any person authorized by me to use my card made the charge listed above. In addition, neither I nor anyone authorized by me received the goods and services represented by this transaction. **(If you don't recognize a sale, choose this option and call Customer Service immediately).**

CB11

☐ 2. Although I did participate in a transaction with the merchant, I was billed for ____________ transaction(s) totaling $____________ that I didn't engage in, nor did anyone else authorized to use my card. I do have all my cards in my possession. **Enclosed is a copy of the Authorized sales slip.**

☐ 3. I haven't received the merchandise that was to have been shipped to me. Expected date of delivery was ____________ (mm-dd-yy). I contacted the merchant on ____________ (mm-dd-yy) and the merchant's response was ____________ ____________. (In order to assist you, the merchant must be contacted.)

☐ 4. I have (circle one) returned/canceled merchandise on ____________ (mm-dd-yy) because ____________. **Provide a copy of the return receipt, postal receipt or proof of refund.**

☐ 5. The attached credit slip was listed as a charge on my statement.

☐ 6. I was issued a credit slip for $____________ on ____________ (mm-dd-yy), which was not shown on my statement. **A copy of my credit slip is enclosed.**

☐ 7. Merchandise that was shipped to me arrived damaged and/or defective on ____________ (mm-dd-yy). I returned it on ____________ (mm-dd-yy). Merchant response was ____________. **Please provide postal receipt and/or credit slip.**

☐ 8. My account was charged $____________, but I should have been billed $____________. **Enclosed is a copy of the sales receipt and/or other documents which indicate the correct amount.**

☐ 9. **Other** – Attach letter describing the dispute.

B0186108C00206 (Rev. 2/06)

Permanent Subcommittee on Investigations

EXHIBIT #3c

Wannemacher Account Transactions, March 2001-February 2007

Statement Closing Date	Amount Due	Component Parts of Amount Due					Minimum Payment Due	Payments Made
		Purchases	Finance Charges	Late Fees	Overlimit Fees	Other Fees		
3/6/01	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
9/6/01	$2,918.11	$2,918.11	$0.00	$0.00	$0.00	$0.00	$58.00	$0.00
10/5/01	$3,111.69	$85.08	$50.50	$29.00	$29.00	$0.00	$231.69	$0.00
11/5/01	$3,040.70	$178.09	$51.15	$0.00	$29.00	$0.00	$100.70	$329.23
12/5/01	$2,980.27	$0.00	$49.57	$0.00	$0.00	$0.00	$59.00	$110.00
2001 subtotal		$3,181.28	$151.22	$29.00	$58.00	$0.00		$439.23
1/4/02	$2,998.20	$0.00	$48.93	$29.00	$0.00	$0.00	$59.00	$60.00
2/5/02	$3,019.73	$0.00	$52.53	$29.00	$0.00	$0.00	$79.73	$60.00
3/5/02	$3,136.24	$0.00	$58.51	$29.00	$29.00	$0.00	$258.24	$0.00
4/3/02	$2,937.56	$0.00	$59.32	$0.00	$0.00	$0.00	$58.00	$258.00
5/3/02	$3,027.60	$0.00	$61.04	$29.00	$0.00	$0.00	$145.60	$0.00
6/5/02	$3,037.96	$35.00	$67.36	$0.00	$29.00	$29.00	$97.96	$150.00
7/5/02	$3,029.64	$0.00	$62.68	$0.00	$29.00	$0.00	$89.64	$100.00
8/6/02	$3,160.90	$0.00	$67.26	**$35.00**	$29.00	$0.00	$283.90	$0.00
9/5/02	$3,052.72	$0.00	$62.82	$0.00	$29.00	$0.00	$113.72	$200.00
10/4/02	$3,178.01	$0.00	$61.29	$35.00	$29.00	$0.00	$302.01	$0.00
11/5/02	$3,076.42	$0.00	$69.41	$0.00	$29.00	$0.00	$146.42	$200.00
12/4/02	$3,202.21	$0.00	$61.79	$35.00	$29.00	$0.00	$336.21	$0.00
2002 subtotal		$35.00	$732.94	$221.00	$232.00	$29.00		$1,028.00
1/6/03	$3,339.55	$0.00	$73.34	$35.00	$29.00	$0.00	$547.55	$0.00
		February 03 UNAVAILABLE						
3/6/03	$3,180.36	$0.00	$63.47	$0.00	$29.00	$0.00	$243.36	$250.00
4/4/03	$3,308.21	$0.00	$63.85	$35.00	$29.00	$0.00	$437.21	$0.00
		May 03 UNAVAILABLE						
6/4/03	$3,427.95	$0.00	$71.74	$35.00	**$35.00**	$0.00	$572.95	$0.00
7/3/03	$3,280.87	$0.00	$67.92	$0.00	$35.00	$0.00	$348.87	$250.00
8/5/03	$3,429.05	$0.00	$78.18	$35.00	$35.00	$0.00	$576.05	$0.00
9/4/03	$3,503.85	$0.00	$72.80	$35.00	$35.00	$0.00	$655.85	$68.00
10/6/03	$3,466.82	$0.00	$79.97	$0.00	$35.00	$0.00	$546.82	$152.00
11/5/03	$3,611.78	$0.00	$74.96	$35.00	$35.00	$0.00	$766.78	$0.00
12/4/03	$3,607.11	$0.00	$75.33	$35.00	$35.00	$0.00	$683.11	$150.00
2003 subtotal		$0.00	$721.56	$245.00	$332.00	$0.00		$870.00

Permanent Subcommittee on Investigations

EXHIBIT #4

Statement Closing Date	Amount Due	Component Parts of Amount Due					Minimum Payment Due	Payments Made
		Purchases	Finance Charges	Late Fees	Overlimit Fees	Other Fees		
1/6/04	$3,763.05	$0.00	$85.94	$35.00	$35.00	$0.00	$925.05	$0.00
2/4/04	$3,712.10	$0.00	$76.05	**$0.00**	$35.00	$0.00	$789.10	$162.00
3/4/04	$3,859.63	$0.00	$77.53	$35.00	$35.00	$0.00	$1,013.63	$0.00
4/5/04	$3,826.57	$0.00	$85.94	$0.00	$35.00	$0.00	$912.57	$154.00
5/5/04	$3,979.29	$0.00	$82.72	$35.00	$35.00	$0.00	$1,148.29	$0.00
6/3/04	$3,895.72	$0.00	$81.43	$0.00	$35.00	$0.00	$977.72	$200.00
7/6/04	$4,058.52	$0.00	$92.80	$35.00	$35.00	$0.00	$1,233.52	$0.00
8/4/04	$4,003.23	$0.00	$84.71	$0.00	$35.00	$0.00	$1,088.23	$175.00
9/3/04	$4,161.45	$0.00	$88.22	$35.00	$35.00	$0.00	$1,335.45	$0.00
10/5/04	$4,243.57	$0.00	$97.12	$35.00	$35.00	$0.00	$1,430.57	$85.00
11/3/04	$4,180.87	$0.00	$89.30	$0.00	$35.00	$0.00	$1,270.87	$187.00
12/6/04	$4,354.34	$0.00	$103.47	$35.00	$35.00	$0.00	$1,548.34	$0.00
2004 subtotal		$0.00	$1,045.23	$245.00	$420.00	$0.00		$963.00
1/5/05	$4,523.05	$0.00	$98.71	$35.00	$35.00	$0.00	$1,816.05	$0.00
2/3/05	$4,692.10	$0.00	$99.05	$35.00	$35.00	$0.00	$2,085.10	$0.00
3/7/05	$4,427.10	$0.00	**$0.00**	$35.00	**$0.00**	$0.00	$1,608.10	$300.00
4/5/05	$4,559.87	$0.00	$98.77	**$39.00**	$35.00	$0.00	$1,879.87	$0.00
5/4/05	$4,453.90	$0.00	$99.03	$0.00	$35.00	$0.00	$1,553.90	$280.00
6/6/05	$4,642.28	$0.00	$114.38	$39.00	$35.00	$0.00	$1,857.28	$0.00
7/6/05	$4,825.43	$0.00	$109.15	$39.00	$35.00	$0.00	$2,150.43	$0.00
8/4/05	$4,639.42	$0.00	$103.99	$0.00	$35.00	$0.00	$1,743.42	$325.00
9/4/05	$4,827.23	$0.00	$113.81	$39.00	$35.00	$0.00	$2,045.23	$0.00
10/4/05	$4,911.19	$0.00	$113.96	$39.00	$35.00	$0.00	$2,139.19	$104.00
11/4/05	$4,837.98	$0.00	$119.79	$0.00	$35.00	$0.00	$1,957.98	$228.00
12/5/05	$5,029.61	$0.00	$117.63	$39.00	$35.00	$0.00	$2,267.61	$0.00
2005 subtotal		$0.00	$1,188.27	$339.00	$385.00	$0.00		$1,237.00
1/4/06	$4,950.65	$0.00	$124.04	$0.00	$35.00	$0.00	$2,075.65	$238.00
2/4/06	$5,151.28	$0.00	$126.63	$39.00	$35.00	$0.00	$2,403.28	$0.00
3/4/06	$5,091.63	$0.00	$118.35	$39.00	$35.00	$0.00	$2,210.63	$252.00
4/4/06	$5,301.05	$0.00	$131.42	$39.00	**$39.00**	$0.00	$2,552.05	$0.00
5/4/06	$5,166.73	$0.00	$68.68	$0.00	$0.00	$0.00	$2,362.73	$203.00
6/4/06	$5,096.32	$0.00	$69.59	$0.00	$0.00	$0.00	$2,285.32	$140.00
7/4/06	$5,022.56	$0.00	$66.24	$0.00	$0.00	$0.00	$2,204.56	$140.00
8/4/06	$4,949.87	$0.00	$67.31	$0.00	$0.00	$0.00	$2,124.87	$140.00
9/4/06	$4,805.97	$0.00	$66.10	$0.00	$0.00	$0.00	$1,938.97	$210.00
10/4/06	$4,728.77	$0.00	$62.80	$0.00	$0.00	$0.00	$1,861.77	$140.00
11/4/06	$4,652.43	$0.00	$63.66	$0.00	$0.00	$0.00	$1,785.43	$140.00
12/4/06	$4,542.89	$0.00	$60.46	$0.00	$0.00	$0.00	$1,675.89	$170.00
2006 subtotal		$0.00	$1,025.28	$117.00	$144.00	$0.00		$1,773.00
1/4/07	$4,474.20	$0.00	$61.31	$0.00	$0.00	$0.00	$1,607.20	$130.00
2/4/07	$4,434.84	$0.00	$0.00	$0.00	$0.00	$0.00	$1,600.84	$100.00
2007 subtotal		$0.00	$61.31	$0.00	$0.00	$0.00		$230.00
Cumulative totals		$3,216.28	$4,864.50	$1,196.00	$1,571.00	$29.00		$6,310.23

Prepared by U.S. Senate Permanent Subcommittee on Investigations Staff, March 2007

Wannemacher Credit Card Account

Purchases

In July 2000, Wes Wannemacher opened a credit card account with a $3,000 credit limit at Chase Bank.

In August 2001, he made purchases to cover his wedding expenses totaling $2,918.11. He made purchases in three later months, totaling less than $300. In June 2002, Mr. Wannemacher stopped using the credit card.

Mr. Wannemacher's total purchases using the credit card were **$3,216.28**, which exceeded the card's credit limit by about $200.

Interest and Fee Charges

To date, on purchases of $3,216.28, Mr. Wannemacher has been billed a total of: **$4,864.50** in interest charges, **$1,196.00** in late fees, **$29.00** for a returned check, and **$1,571.00** in over-limit fees.

The account's interest rate began at 17.99%, rose steadily to 29.74% in 2005, and in April 2006, after Mr. Wannemacher began a repayment plan, dropped to 15.99%.

Late fees began at $29/month, increased in August 2002 to $35/month, and increased again in April 2005 to $39/month. Over-limit fees began at $29/month, increased in June 2003 to $35/month, and increased again in March 2006 to $39/month.

In April 2006, after Mr. Wannemacher began a repayment plan, late and over-limit fees were no longer charged to his account.

Payments

From 2001 to 2007, Mr. Wannemacher attempted to pay off the $3,216.28 debt. Altogether, he made payments to Chase totaling **$6,310.23**. A Feb. 2007 billing statement nevertheless showed that he still owed **$4,434.84.**

In Feb. 2005, when he owed $4,692.10, Mr. Wannemacher offered to settle the account for $3,000; the bank counteroffered for $3,500, which he was unable to pay. In 2006, he requested and the bank agreed to a repayment plan that eliminated the monthly fees and reduced the interest rate to 15.99%. In Nov. and Dec. 2006, and Feb. 2007, the bank declined Mr. Wannemacher's requests to consolidate the repayment plan with a larger debt management plan he had established with a credit counseling agency.

On Feb. 26, 2007, after the Subcommittee had asked Chase to review the account, the bank telephoned Mr. Wannemacher to say it had decided to forgive the debt and he no longer owed any money on the account.

Prepared by U.S. Senate Permanent Subcommittee on Investigations Staff, March 2007.

Permanent Subcommittee on Investigations
EXHIBIT #5

United States Government Accountability Office

GAO

Report to the Ranking Minority Member, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

September 2006

CREDIT CARDS

Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers

G A O
Accountability * Integrity * Reliability

GAO-06-929

Permanent Subcommittee on Investigations
EXHIBIT #6

September 2006

GAO
Accountability·Integrity·Reliability

Highlights

Highlights of GAO-06-929, a report to the Ranking Minority Member, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

CREDIT CARDS

Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers

Why GAO Did This Study

With credit card penalty rates and fees now common, the Federal Reserve has begun efforts to revise disclosures to better inform consumers of these costs. Questions have also been raised about the relationship among penalty charges, consumer bankruptcies, and issuer profits. GAO examined (1) how card fees and other practices have evolved and how cardholders have been affected, (2) how effectively these pricing practices are disclosed to cardholders, (3) the extent to which penalty charges contribute to cardholder bankruptcies, and (4) card issuers' revenues and profitability. Among other things, GAO analyzed disclosures from popular cards; obtained data on rates and fees paid on cardholder accounts from 6 large issuers; employed a usability consultant to analyze and test disclosures; interviewed a sample of consumers selected to represent a range of education and income levels; and analyzed academic and regulatory studies on bankruptcy and card issuer revenues.

What GAO Recommends

As part of revising card disclosures, the Federal Reserve should ensure that such disclosure materials more clearly emphasize those terms that can significantly affect cardholder costs, such as the actions that can cause default or other penalty pricing rates to be imposed. The Federal Reserve generally concurred with the report.

www.gao.gov/cgi-bin/getrpt?GAO-06-929

To view the full product, including the scope and methodology, click on the link above. For more information, contact David G. Wood at (202) 512-8678 or woodd@gao.gov.

What GAO Found

Originally having fixed interest rates around 20 percent and few fees, popular credit cards now feature a variety of interest rates and other fees, including penalties for making late payments that have increased to as high as $39 per occurrence and interest rates of over 30 percent for cardholders who pay late or exceed a credit limit. Issuers explained that these practices represent risk-based pricing that allows them to offer cards with lower costs to less risky cardholders while providing cards to riskier consumers who might otherwise be unable to obtain such credit. Although costs can vary significantly, many cardholders now appear to have cards with lower interest rates than those offered in the past, data from the top six issuers reported to GAO indicate that, in 2005, about 80 percent of their accounts were assessed interest rates of less than 20 percent, with over 40 percent having rates below 15 percent. The issuers also reported that 35 percent of their active U.S. accounts were assessed late fees and 13 percent were assessed over-limit fees in 2005.

Although issuers must disclose information intended to help consumers compare card costs, disclosures by the largest issuers have various weaknesses that reduced consumers' ability to use and understand them. According to a usability expert's review, disclosures from the largest credit card issuers were often written well above the eighth-grade level at which about half of U.S. adults read. Contrary to usability and readability best practices, the disclosures buried important information in text, failed to group and label related material, and used small typefaces. Perhaps as a result, cardholders that the expert tested often had difficulty using the disclosures to find and understand key rates or terms applicable to the cards. Similarly, GAO's interviews with 112 cardholders indicated that many failed to understand key aspects of their cards, including when they would be charged for late payments or what actions could cause issuers to raise rates. These weaknesses may arise from issuers drafting disclosures to avoid lawsuits, and from federal regulations that highlight less relevant information and are not well suited for presenting the complex rates or terms that cards currently feature. Although the Federal Reserve has started to obtain consumer input, its staff recognizes the challenge of designing disclosures that include all key information in a clear manner.

Although penalty charges reduce the funds available to repay cardholders' debts, their role in contributing to bankruptcies was not clear. The six largest issuers reported that unpaid interest and fees represented about 10 percent of the balances owed by bankrupt cardholders, but were unable to provide data on penalty charges these cardholders paid prior to filing for bankruptcy. Although revenues from penalty interest and fees have increased, profits of the largest issuers have been stable in recent years. GAO analysis indicates that while the majority of issuer revenues came from interest charges, the portion attributable to penalty rates has grown.

Contents

Abbreviations

APR	Annual Percentage Rate
FDIC	Federal Deposit Insurance Corporation
OCC	Office of the Comptroller of the Currency
ROA	Return on assets
SEC	Securities and Exchange Commission
TILA	Truth in Lending Act

GAO

Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, D.C. 20548

September 12, 2006

The Honorable Carl Levin
Ranking Minority Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate

Dear Senator Levin:

Over the past 25 years, the prevalence and use of credit cards in the United States has grown dramatically. Between 1980 and 2005, the amount that U.S. consumers charged to their cards grew from an estimated $69 billion per year to more than $1.8 trillion, according to one firm that analyzes the card industry.[1] This firm also reports that the number of U.S. credit cards issued to consumers now exceeds 691 million. The increased use of credit cards has contributed to an expansion in household debt, which grew from $59 billion in 1980 to roughly $830 billion by the end of 2005.[2] The Board of Governors of the Federal Reserve System (Federal Reserve) estimates that in 2004, the average American household owed about $2,200 in credit card debt, up from about $1,000 in 1992.[3]

Generally, a consumer's cost of using a credit card is determined by the terms and conditions applicable to the card—such as the interest rate(s), minimum payment amounts, and payment schedules, which are typically presented in a written cardmember agreement—and how a consumer uses

[1]CardWeb.com, Inc., an online publisher of information about the payment card industry.

[2]Based on data from the Federal Reserve Board's monthly G.19 release on consumer credit. In addition to credit card debt, the Federal Reserve also categorizes overdraft lines of credit as revolving consumer debt (an overdraft line of credit is a loan a consumer obtains from a bank to cover the amount of potential overdrafts or withdrawals from a checking account in amounts greater than the balance available in the account). Mortgage debt is not captured in these data.

[3]B.K. Bucks, A.B. Kennickell, and K.B. Moore, "Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances," *Federal Reserve Bulletin*, March 22, 2006. Also, A.B. Kennickell and M. Starr-McCluer, "Changes in Family Finances from 1989 to 1992: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin*, October 1994. Adjusted for inflation, credit card debt in 1992 was $1,298 for the average American household.

a card.[4] The Federal Reserve, under the Truth in Lending Act (TILA), is responsible for creating and enforcing requirements relating to the disclosure of terms and conditions of consumer credit, including those applicable to credit cards.[5] The regulation that implements TILA's requirements is the Federal Reserve's Regulation Z.[6] As credit card use and debt have grown, representatives of consumer groups and issuers have questioned the extent to which consumers understand their credit card terms and conditions, including issuers' practices that—even if permitted under applicable terms and conditions—could increase consumers' costs of using credit cards. These practices include the application of fees or relatively high penalty interest rates if cardholders pay late or exceed credit limits. Issuers also can allocate customers' payments among different components of their outstanding balances in ways that maximize total interest charges. Although card issuers have argued that these practices are appropriate because they compensate for the greater risks posed by cardholders who make late payments or exhibit other risky behaviors, consumer groups say that the fees and practices are harmful to the financial condition of many cardholders and that card issuers use them to generate profits.

You requested that we review a number of issues related to credit card fees and practices, specifically of the largest issuers of credit cards in the United States. This report discusses (1) how the interest, fees, and other practices that affect the pricing structure of cards from the largest U.S. issuers have evolved and cardholders' experiences under these pricing structures in recent years; (2) how effectively the issuers disclose the pricing structures of cards to their cardholders (3) whether credit card debt and penalty interest and fees contribute to cardholder bankruptcies; and (4) the extent to which penalty interest and fees contribute to the revenues and profitability of issuers' credit card operations.

To identify the pricing structures of cards—including their interest rates, fees, and other practices—we analyzed the cardmember agreements, as

[4]We recently reported on minimum payment disclosure requirements. See GAO, *Credit Cards: Customized Minimum Payment Disclosures Would Provide More Information to Consumers, but Impact Could Vary*, GAO-06-434 (Washington, D.C.: Apr. 21, 2006).

[5]Pub. L. No. 90-321, Title I, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. §§ 1601-1666).

[6]Regulation Z is codified at 12 C.F.R. Part 226.

well as materials used by the six largest issuers as of December 31, 2004, for 28 popular cards used to solicit new credit card customers from 2003 through 2005.[7] To determine the extent to which these issuers' cardholders were assessed interest and fees, we obtained data from each of the six largest issuers about their cardholder accounts and their operations. To protect each issuer's proprietary information, a third-party organization, engaged by counsel to the issuers, aggregated these data and then provided the results to us. Although the six largest issuers whose accounts were included in this survey and whose cards we reviewed may include some subprime accounts, we did not include information in this report relating to cards offered by credit card issuers that engage primarily in subprime lending.[8] To assess the effectiveness of the disclosures that issuers provide to cardholders in terms of their usability or readability, we contracted with a consulting firm that specializes in assessing the readability and usability of written and other materials to analyze a representative selection of the largest issuers' cardmember agreements and solicitation materials, including direct mail applications and letters, used for opening an account (in total, the solicitation materials for four cards and cardmember agreements for the same four cards).[9] The consulting firm compared these materials to recognized industry guidelines for readability and presentation and conducted testing to assess how well cardholders could use the materials to identify and understand information about these credit cards. While the materials used for the readability and usability assessments appeared to be typical of the large issuers' disclosures, the results cannot be generalized to materials that were not reviewed. We also conducted structured interviews to learn about the card-using behavior and knowledge of various credit card terms and conditions of 112 consumers recruited by a market research organization to represent a range of adult income and education levels. However, our sample of cardholders was too

[7]These issuers' accounts constitute almost 80 percent of credit card lending in the United States. Participating issuers were Citibank (South Dakota), N.A.; Chase Bank USA, N.A.; Bank of America; MBNA America Bank, N.A.; Capital One Bank; and Discover Financial Services. In providing us with materials for the most popular credit cards, these issuers determined which of their cards qualified as popular among all cards in their portfolios.

[8]Subprime lending generally refers to extending credit to borrowers who exhibit characteristics indicating a significantly higher risk of default than traditional bank lending customers. Such issuers could have pricing structures and other terms significantly different from those of the popular cards offered by the top issuers.

[9]Regulation Z defines a "solicitation" as an offer (written or oral) by the card issuer to open a credit or charge card account that does not require the consumer to complete an application. 12 C.F.R. § 226.5a(a)(1).

small to be statistically representative of all cardholders, thus the results of our interviews cannot be generalized to the population of all U.S. cardholders. We also reviewed comment letters submitted to the Federal Reserve in response to its comprehensive review of Regulation Z's open-end credit rules, including rules pertaining to credit card disclosures.[10] To determine the extent to which credit card debt and penalty interest and fees contributed to cardholder bankruptcies, we analyzed studies, reports, and bank regulatory data relating to credit card debt and consumer bankruptcies, as well as information reported to us as part of the data request to the six largest issuers. To determine the extent to which penalty interest and fees contributes to card issuers' revenues and profitability, we analyzed publicly available sources of revenue and profitability data for card issuers, including information included in reports filed with the Securities and Exchange Commission and bank regulatory reports, in addition to information reported to us as part of the data request to the six largest issuers.[11] In addition, we spoke with representatives of other U.S. banks that are large credit card issuers, as well as representatives of consumer groups, industry associations, academics, organizations that collect and analyze information on the credit card industry, and federal banking regulators. We also reviewed research reports and academic studies of the credit card industry.

We conducted our work from June 2005 to September 2006 in Boston; Chicago; Charlotte, North Carolina; New York City; San Francisco; Wilmington, Delaware; and Washington, D.C., in accordance with generally accepted government auditing standards. Appendix I describes the objectives, scope, and methodology of our review in more detail.

Results in Brief

Since about 1990, the pricing structures of credit cards have evolved to encompass a greater variety of interest rates and fees that can increase

[10]See Truth in Lending, 69 Fed. Reg. 70925 (advanced notice of proposed rulemaking, published Dec. 8, 2004). "Open-end credit" means consumer credit extended by a creditor under a plan in which: (i) the creditor reasonably contemplates repeated transactions, (ii) the creditor may impose a finance charge from time to time on an outstanding unpaid balance and (iii) the amount of credit that may be extended to the consumer is generally made available to the extent that any outstanding balance is repaid. 12 C.F.R. § 226.2(a)(20).

[11]Although we had previously been provided comprehensive data from Visa International on credit industry revenues and profits for a past report on credit card issues, we were unable to obtain these data for this report.

cardholder's costs; however, cardholders generally are assessed lower interest rates than those that prevailed in the past, and most have not been assessed penalty fees. For many years after being introduced, credit cards generally charged fixed single rates of interest of around 20 percent, had few fees, and were offered only to consumers with high credit standing. After 1990, card issuers began to introduce cards with a greater variety of interest rates and fees, and the amounts that cardholders can be charged have been growing. For example, our analysis of 28 popular cards and other information indicates that cardholders could be charged

- up to three different interest rates for different transactions, such as one rate for purchases and another for cash advances, with rates for purchases that ranged from about 8 percent to about 19 percent;
- penalty fees for certain cardholder actions, such as making a late payment (an average of almost $34 in 2005, up from an average of about $13 in 1995) or exceeding a credit limit (an average of about $31 in 2005, up from about $13 in 1995); and
- a higher interest rate—some charging over 30 percent—as a penalty for exhibiting riskier behavior, such as paying late.

Although consumer groups and others have criticized these fees and other practices, issuers point out that the costs to use a card can now vary according to the risk posed by the cardholder, which allows issuers to offer credit with lower costs to less-risky cardholders and credit to consumers with lower credit standing, who likely would have not have received a credit card in the past. Although cardholder costs can vary significantly in this new environment, many cardholders now appear to have cards with interest rates less than the 20 percent rate that most cards charged prior to 1990. Data reported by the top six issuers indicate that, in 2005, about 80 percent of their active U.S. accounts were assessed interest rates of less than 20 percent—with more than 40 percent having rates of 15 percent or less.[12] Furthermore, almost half of the active accounts paid little or no interest because the cardholder generally paid the balance in full. The issuers also reported that, in 2005, 35 percent of their active U.S. accounts were assessed late fees and 13 percent were assessed over-limit fees.

[12]For purposes of this report, active accounts refer to accounts of the top six issuers that had had a debit or credit posted to them by December 31 in 2003, 2004, and 2005.

Although credit card issuers are required to provide cardholders with information aimed at facilitating informed use of credit and enhancing consumers' ability to compare the costs and terms of credit, we found that these disclosures have serious weaknesses that likely reduced consumers' ability to understand the costs of using credit cards. Because the pricing of credit cards, including interest rates and fees, is not generally subject to federal regulation, the disclosures required under TILA and Regulation Z are the primary means under federal law for protecting consumers against inaccurate and unfair credit card practices.[13] However, the assessment by our usability consultant found that the disclosures in the customer solicitation materials and cardmember agreements provided by four of the largest credit card issuers were too complicated for many consumers to understand. For example, although about half of adults in the United States read at or below the eighth-grade level, most of the credit card materials were written at a tenth- to twelfth-grade level. In addition, the required disclosures 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. Perhaps as a result of these weaknesses, the cardholders tested by the consultant often had difficulty using these disclosures to locate and understand key rates or terms applicable to the cards. Similarly, our interviews with 112 cardholders indicated that many failed to understand key terms or conditions that could affect their costs, including when they would be charged for late payments or what actions could cause issuers to raise rates. The disclosure materials that consumers found so difficult to use resulted from issuers' attempts to reduce regulatory and liability exposure by adhering to the formats and language prescribed by federal law and regulations, which no longer suit the complex features and terms of many cards. For example, current disclosures require that less important terms, such as minimum finance charge or balance computation method, be prominently disclosed, whereas information that could more significantly affect consumers' costs, such as the actions that could raise their interest rate, are not as prominently disclosed. With the goal of improving credit card disclosures, the Federal Reserve has begun obtaining public and industry input as part of a comprehensive review of Regulation Z. Industry participants and others have provided various suggestions to improve

[13]TILA also contains procedural and substantive protections for consumers for credit card transactions.

disclosures, such as placing all key terms in one brief document and other details in a much longer separate document, and both our work and that of others illustrated that involving consultants and consumers can help develop disclosure materials that are more likely to be effective. Federal Reserve staff told us that they have begun to involve consumers in the preparation of potentially new and revised disclosures. Nonetheless, Federal Reserve staff recognize the challenge of presenting the variety of information that consumers may need to understand the costs of their cards in a clear way, given the complexity of credit card products and the different ways in which consumers use credit cards.

Although paying penalty interest and fees can slow cardholders' attempts to reduce their debt, the extent to which credit card penalty fees and interest have contributed to consumer bankruptcies is unclear. The number of consumers filing for bankruptcy has risen more than sixfold over the past 25 years—a period when the nation's population grew by 29 percent—to more than 2 million filings in 2005, but debate continues over the reasons for this increase. Some researchers attribute the rise in bankruptcies to the significant increase in household debt levels that also occurred over this period, including the dramatic increase in outstanding credit card debt. However, others have found that relatively steady household debt burden ratios over the last 15 years indicate that the ability of households to make payments on this expanded indebtedness has kept pace with growth in their incomes. Similarly, the percentage of households that appear to be in financial distress—those with debt payments that exceed 40 percent of their income—did not change much during this period, nor did the proportion of lower-income households with credit card balances. Because debt levels alone did not appear to clearly explain the rise in bankruptcies, some researchers instead cited other explanations, such as a general decline in the stigma associated with bankruptcies or the increased costs of major life events—such as health problems or divorce—to households that increasingly rely on two incomes. Although critics of the credit card industry have cited the emergence of penalty interest rates and growth in fees as leading to increased financial distress, no comprehensive data exist to determine the extent to which these charges contributed to consumer bankruptcies. Any penalty charges that cardholders pay would consume funds that could have been used to repay principal, and we obtained anecdotal information on a few court cases involving consumers who incurred sizable penalty charges that contributed to their financial distress. However, credit card issuers said that they have little incentive to cause their customers to go bankrupt. The six largest issuers reported to us that of their active accounts in 2005 pertaining to cardholders who had filed for bankruptcy before their account became 6 months delinquent, about 10 percent of the outstanding balances on those accounts represented unpaid interest and fees. However, issuers told us that their data system and recordkeeping limitations prevented them from providing us with data that would more completely illustrate a relationship between penalty charges and bankruptcies, such as the amount of penalty charges that bankrupt cardholders paid in the months prior to filing for bankruptcy or the amount of penalty charges owed by cardholders who went bankrupt after their accounts became more than 6 months delinquent.

Although penalty interest and fees have likely increased as a portion of issuer revenues, the largest issuers have not experienced greatly increased profitability over the last 20 years. Determining the extent to which penalty interest charges and fees contribute to issuers' revenues and profits was difficult because issuers' regulatory filings and other public sources do not include such detail. Using data from bank regulators, industry analysts, and information reported by the five largest issuers, we estimate that the majority—about 70 percent in recent years—of issuer revenues came from interest charges, and the portion attributable to penalty rates appears to have been growing. The remaining issuer revenues came from penalty fees—which had generally grown and were estimated to represent around 10 percent of total issuer revenues—as well as fees that issuers receive for processing merchants' card transactions and other sources. The profits of the largest credit-card-issuing banks, which are generally the most profitable group of lenders, have generally been stable over the last 7 years.

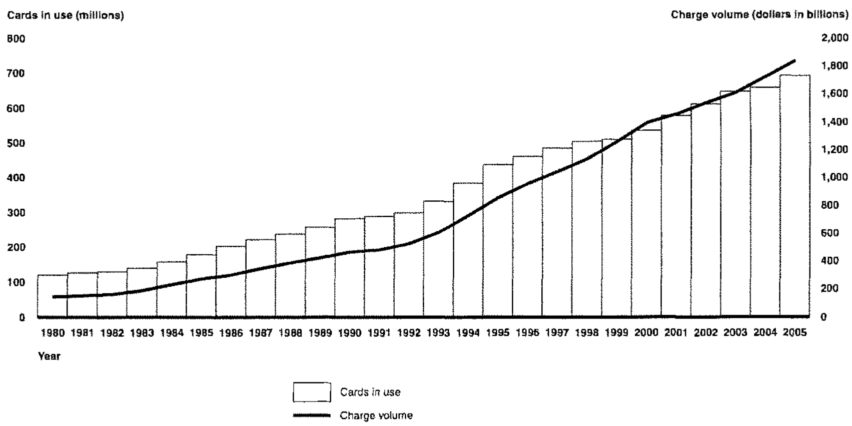
This report recommends that, as part of its effort to increase the effectiveness of disclosure materials, the Federal Reserve should ensure that such disclosures, including model forms and formatting requirements, more clearly emphasize those terms that can significantly affect cardholder costs, such as the actions that can cause default or other penalty pricing rates to be imposed. We provided a draft of this report to the Federal Reserve, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Federal Trade Commission, the National Credit Union Administration, and the Office of Thrift Supervision for comment. In its written comments, the Federal Reserve agreed that current credit card pricing structures have added to the complexity of card disclosures and indicated that it is studying alternatives for improving both the content and format of disclosures, including involving consumer testing and design consultants.

Background

Credit card use has grown dramatically since the introduction of cards more than 5 decades ago. Cards were first introduced in 1950, when Diners Club established the first general-purpose charge card that allowed its cardholders to purchase goods and services from many different merchants. In the late 1950s, Bank of America began offering the first widely available general purpose credit card, which, unlike a charge card that requires the balance to be paid in full each month, allows a cardholder to make purchases up to a credit limit and pay the balance off over time. To increase the number of consumers carrying the card and to reach retailers outside of Bank of America's area of operation, other banks were given the opportunity to license Bank of America's credit card. As the network of banks issuing these credit cards expanded internationally, administrative operations were spun off into a separate entity that evolved into the Visa network. In contrast to credit cards, debit cards result in funds being withdrawn almost immediately from consumers' bank accounts (as if they had a written a check instead). According to CardWeb.com, Inc., a firm that collects and analyzes data relating to the credit card industry, the number of times per month that credit or debit cards were used for purchases or other transactions exceeded 2.3 billion in May 2003, the last month for which the firm reported this data.

The number of credit cards in circulation and the extent to which they are used has also grown dramatically. The range of goods and services that can be purchased with credit cards has expanded, with cards now being used to pay for groceries, health care, and federal and state income taxes. As shown in figure 1, in 2005, consumers held more than 691 million credit cards and the total value of transactions for which these cards were used exceeded $1.8 trillion.

Figure 1: Credit Cards in Use and Charge Volume, 1980-2005



Source: GAO analysis of CardWeb.com, Inc. data.

The largest issuers of credit cards in the United States are commercial banks, including many of the largest banks in the country. More than 6,000 depository institutions issue credit cards, but, over the past decade, the majority of accounts have become increasingly concentrated among a small number of large issuers. Figure 2 shows the largest bank issuers of credit cards by their total credit card balances outstanding as of December 31, 2004 (the most recent data available) and the proportion they represent of the overall total of card balances outstanding.

Figure 2: The 10 Largest Credit Card Issuers by Credit Card Balances Outstanding as of December 31, 2004

Card issuer	Outstanding receivables	Percent of total market
Citigroup Inc.	$139,600,000,000	20.2
Chase Card Services	135,370,000,000	19.5
MBNA America	101,900,000,000	14.7
Bank of America	58,629,000,000	8.5
Capital One Financial Corp.	48,609,571,000	7.0
Discover Financial Services, Inc.	48,261,000,000	7.0
American Express Centurion Bank	39,600,000,000	5.7
HSBC Credit Card Services	19,670,000,000	2.8
Providian Financial Corp.	18,100,000,000	2.6
Wells Fargo	13,479,889,059	1.9
	$623,219,460,059	90.0

Source: GAO analysis of Card Industry Directory data.

TILA is the primary federal law pertaining to the extension of consumer credit. Congress passed TILA in 1968 to provide for meaningful disclosure of credit terms in order to enable consumers to more easily compare the various credit terms available in the marketplace, to avoid the uninformed use of credit, and to protect themselves against inaccurate and unfair credit billing and credit card practices. The regulation that implements TILA's requirements is Regulation Z, which is administered by the Federal Reserve.

Under Regulation Z, card issuers are required to disclose the terms and conditions to potential and existing cardholders at various times. When first marketing a card directly to prospective cardholders, written or oral applications or solicitations to open credit card accounts must generally disclose key information relevant to the costs of using the card, including the applicable interest rate that will be assessed on any outstanding balances and several key fees or other charges that may apply, such as the fee for making a late payment.[14] In addition, issuers must provide consumers with an initial disclosure statement, which is usually a component of the issuer's cardmember agreement, before the first transaction is made with a card. The cardmember agreement provides more comprehensive information about a card's terms and conditions than would be provided as part of the application or a solicitation letter.

In some cases, the laws of individual states also can affect card issuers' operations. For example, although many credit card agreements permit issuers to make unilateral changes to the agreement's terms and conditions, some state laws require that consumers be given the right to opt out of changes. However, as a result of the National Bank Act, and its interpretation by the U.S. Supreme Court, the interest and fees charged by a national bank on credit card accounts is subject only to the laws of the state in which the bank is chartered, even if its lending activities occur outside of its charter state.[15] As a result, the largest banks have located their credit card operations in states with laws seen as more favorable for the issuer with respect to credit card lending.

Various federal agencies oversee credit card issuers. The Federal Reserve has responsibility for overseeing issuers that are chartered as state banks and are also members of the Federal Reserve System. Many card issuers are chartered as national banks, which OCC supervises. Other regulators of bank issuers are FDIC, which oversees state-chartered banks with federally insured deposits that are not members of the Federal Reserve System; the Office of Thrift Supervision, which oversees federally chartered and state-chartered savings associations with federally insured deposits; or the

[14]Issuers have several disclosure options with respect to applications or solicitations made available to the general public, including those contained in catalogs or magazines. Specifically, on such applications or solicitations issuers may, but are not required to, disclose the same key pricing terms required to be disclosed on direct mail applications and solicitations. Alternatively, issuers may include in a prominent location on the application or solicitation a statement that costs are associated with use of the card and a toll-free telephone number and mailing address where the consumer may contact the issuer to request specific information. 12 C.F.R. § 226.5a(e)(3).

[15]The National Bank Act provision codified at 12 U.S.C. § 85 permits national banks to charge interest at a rate allowed by laws of the jurisdiction in which the bank is located. In *Marquette National Bank v. First of Omaha Service Corp. et al.*, 439 U.S. 299 (1978), the U.S. Supreme Court held that a national bank is deemed to be "located" in the state in which it is chartered. *See also Smiley v. Citibank (South Dakota)*, N.A., 517 U.S. 735 (1996) (holding that "interest" under 12 U.S.C. § 85 includes any charges attendant to credit card usage).

National Credit Union Administration, which oversees federally-chartered and state-chartered credit unions whose member accounts are federally insured. As part of their oversight, these regulators review card issuers' compliance with TILA and ensure that an institution's credit card operations do not pose a threat to the institutions' safety and soundness. The Federal Trade Commission generally has responsibility for enforcing TILA and other consumer protection laws for credit card issuers that are not depository institutions.

Credit Card Fees and Issuer Practices That Can Increase Cardholder Costs Have Expanded, but a Minority of Cardholders Appear to Be Affected

Prior to about 1990, card issuers offered credit cards that featured an annual fee, a relatively high, fixed interest rate, and low penalty fees, compared with average rates and fees assessed in 2005. Over the past 15 years, typical credit cards offered by the largest U.S. issuers evolved to feature more complex pricing structures, including multiple interest rates that vary with market fluctuations. The largest issuers also increased the number, and in some cases substantially increased the amounts, of fees assessed on cardholders for violations of the terms of their credit agreement, such as making a late payment. Issuers said that these changes have benefited a greater number of cardholders, whereas critics contended that some practices unfairly increased cardholder costs. The largest six issuers provided data indicating that most of their cardholders had interest rates on their cards that were lower than the single fixed rates that prevailed on cards prior to the 1990s and that a small proportion of cardholders paid high penalty interest rates in 2005. In addition, although most cardholders did not appear to be paying penalty fees, about one-third of the accounts with these largest issuers paid at least one late fee in 2005.

Issuers Have Developed More Complex Credit Card Pricing Structures

The interest rates, fees, and other practices that represent the pricing structure for credit cards have become more complex since the early 1990s. After first being introduced in the 1950s, for the next several decades, credit cards commonly charged a single fixed interest rate around 20 percent—as the annual percentage rate (APR)—which covered most of an issuer's expenses associated with card use.[16] Issuers also charged cardholders an annual fee, which was typically between $20 and $50

[16]Unless otherwise noted, in this report we will use the term "interest rate" to describe annual percentage rates, which represent the rates expressed on an annual basis even though interest may be assessed more frequently.

beginning in about 1980, according to a senior economist at the Federal Reserve Board. Card issuers generally offered these credit cards only to the most creditworthy U.S. consumers. According to a study of credit card pricing done by a member of the staff of one of the Federal Reserve Banks, few issuers in the late 1980s and early 1990s charged cardholders fees as penalties if they made late payments or exceeded the credit limit set by the issuer.[17] Furthermore, these fees, when they were assessed, were relatively small. For example, the Federal Reserve Bank staff member's paper notes that the typical late fee charged on cards in the 1980s ranged from $5 to $10.

Multiple Interest Rates May Apply to a Single Account and May Change Based on Market Fluctuations

After generally charging just a single fixed interest rate before 1990, the largest issuers now apply multiple interest rates to a single card account balance and the level of these rates can vary depending on the type of transaction in which a cardholder engages. To identify recent pricing trends for credit cards, we analyzed the disclosures made to prospective and existing cardholders for 28 popular credit cards offered during 2003, 2004, and 2005 by the six largest issuers (based on credit card balances outstanding at the end of 2004).[18] At that time, these issuers held almost 80 percent of consumer debt owed to credit card issuers and as much as 61 percent of total U.S. credit card accounts. As a result, our analysis of these 28 cards likely describes the card pricing structure and terms that apply to the majority of U.S. cardholders. However, our sample of cards did not include subprime cards, which typically have higher cost structures to compensate for the higher risks posed by subprime borrowers.

We found that all but one of these popular cards assessed up to three different interest rates on a cardholder's balance. For example, cards assessed separate rates on

- balances that resulted from the purchase or lease of goods and services, such as food, clothing, and home appliances;

[17]M. Furletti, "Credit Card Pricing Developments and Their Disclosure," Federal Reserve Bank of Philadelphia's Payment Cards Center, January 2003. In preparing this paper, the author relied on public data, proprietary issuer data, and data from a review of more than 150 cardmember agreements from 15 of the largest issuers in the United States for the 5-year period spanning 1997 to 2002.

[18]See *Card Industry Directory: The Blue Book of the Credit and Debit Card Industry in North America,* 17th Edition, (Chicago, IL: 2005). These issuers were Bank of America, Capital One Bank; Chase Bank USA: Citibank (South Dakota), N.A.; Discover Financial Services; and MBNA America Bank.

- balances that were transferred from another credit card, which cardholders may do to consolidate balances across cards to take advantage of lower interest rates; and

- balances that resulted from using the card to obtain cash, such as a withdrawal from a bank automated teller machine.

In addition to having separate rates for different transactions, popular credit cards increasingly have interest rates that vary periodically as market interest rates change. Almost all of the cards we analyzed charged variable rates, with the number of cards assessing these rates having increased over the most recent 3-year period. More specifically, about 84 percent of cards we reviewed (16 of 19 cards) assessed a variable interest rate in 2003, 91 percent (21 of 23 cards) in 2004, and 93 percent (25 of 27 cards) in 2005.[19] Issuers typically determine these variable rates by taking the prevailing level of a base rate, such as the prime rate, and adding a fixed percentage amount.[20] In addition, the issuers usually reset the interest rates on a monthly basis.

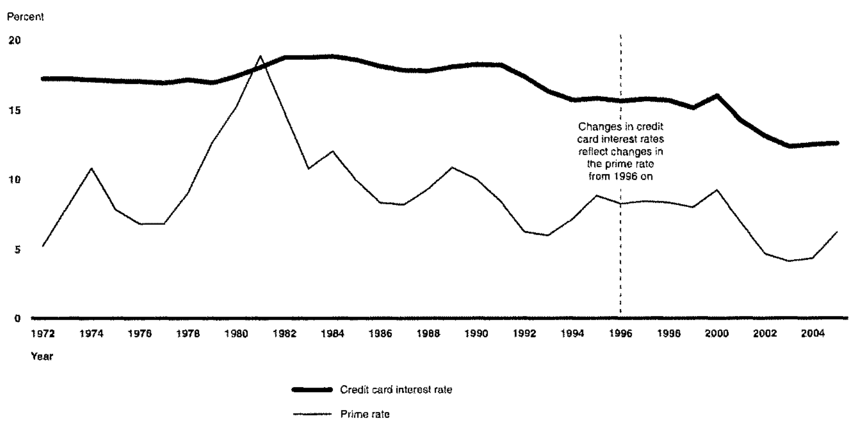
Issuers appear to have assessed lower interest rates in recent years than they did prior to about 1990. Issuer representatives noted that issuers used to generally offer cards with a single rate of around 20 percent to their cardholders, and the average credit card rates reported by the Federal Reserve were generally around 18 percent between 1972 and 1990. According to the survey of credit card plans, conducted every 6 months by the Federal Reserve, more than 100 card issuers indicated that these issuers charged interest rates between 12 and 15 percent on average from 2001 to 2005. For the 28 popular cards we reviewed, the average interest rate that would be assessed for purchases was 12.3 percent in 2005, almost 6 percentage points lower than the average rates that prevailed until about 1990. We found that the range of rates charged on these cards was between about 8 and 19 percent in 2005. The average rate on these cards climbed slightly during this period, having averaged about 11.5 percent in 2003 and about 12 percent in 2004, largely reflecting the general upward movement

[19]Although we reviewed a total of 28 card products for 2003 to 2005, we did not obtain disclosure documents for all card products for every year.

[20]The prime rate is the rate that commercial banks charge to the most creditworthy borrowers, such as large corporations for short-term loans. The prime rate reported by *The Wall Street Journal* is often used as a benchmark for credit card loans made in the United States.

in prime rates. Figure 3 shows the general decline in credit card interest rates, as reported by the Federal Reserve, between about 1991 and 2005 compared with the prime rate over this time. As these data show, credit card interest rates generally were stable regardless of the level of market interest rates until around 1996, at which time changes in credit card rates approximated changes in market interest rates. In addition, the spread between the prime rate and credit card rates was generally wider in the period before the 1980s than it has been since 1990, which indicates that since then cardholders are paying lower rates in terms of other market rates.

Figure 3: Credit Card Interest Rates, 1972-2005



Source: GAO analysis of Federal Reserve data.

Recently, many issuers have attempted to obtain new customers by offering low, even zero, introductory interest rates for limited periods. According to an issuer representative and industry analyst we interviewed, low introductory interest rates have been necessary to attract cardholders in the current competitive environment where most consumers who qualify for a credit card already have at least one. Of the 28 popular cards that we analyzed, 7 cards (37 percent) offered prospective cardholders a low introductory rate in 2003, but 20 (74 percent) did so in 2005—with most rates set at zero for about 8 months. According to an analyst who studies the credit card industry for large investors, approximately 25 percent of all purchases are made with cards offering a zero percent interest rate.

Increased competition among issuers, which can be attributed to several factors, likely caused the reductions in credit card interest rates. In the early 1990s, new banks whose operations were solely focused on credit cards entered the market, according to issuer representatives. Known as monoline banks, issuer representatives told us these institutions competed for cardholders by offering lower interest rates and rewards, and expanded the availability of credit to a much larger segment of the population. Also, in 1988, new requirements were implemented for credit card disclosures that were intended to help consumers better compare pricing information on credit cards. These new requirements mandated that card issuers use a tabular format to provide information to consumers about interest rates and some fees on solicitations and applications mailed to consumers. According to issuers, consumer groups, and others, this format, which is popularly known as the Schumer box, has helped to significantly increase consumer awareness of credit card costs.[21] According to a study authored by a staff member of a Federal Reserve Bank, consumer awareness of credit card interest rates has prompted more cardholders to transfer card balances from one issuer to another, further increasing competition among issuers.[22] However, another study prepared by the Federal Reserve Board also attributes declines in credit card interest rates to a sharp drop in issuers' cost of funds, which is the price issuers pay other lenders to obtain the funds that are then lent to cardholders.[23] (We discuss issuers' cost of funds later in this report.)

[21]The Schumer box is the result of the Fair Credit and Charge Card Disclosure Act, Pub. L. No. 100-583, 102 Stat. 2960 (1988), which amended TILA to provide for more detailed and uniform disclosures of rates and other cost information in applications and solicitations to open credit and charge card accounts. The act also required issuers to disclose pricing information, to the extent practicable as determined by the Federal Reserve, in a tabular format. This table is also known as the Schumer box, named for the Congressman that introduced the provision requiring this disclosure into the legislation.

[22]Furletti, "Credit Card Pricing Developments and Their Disclosure."

[23]Board of Governors of the Federal Reserve System, *The Profitability of Credit Card Operations of Depository Institutions*, (Washington, D.C.: June 2005).

Our analysis of disclosures also found that the rates applicable to balance transfers were generally the same as those assessed for purchases, but the rates for cash advances were often higher. Of the popular cards offered by the largest issuers, nearly all featured rates for balance transfers that were substantially similar to their purchase rates, with many also offering low introductory rates on balance transfers for about 8 months. However, the rates these cards assessed for obtaining a cash advance were around 20 percent on average. Similarly to rates for purchases, the rates for cash advances on most cards were also variable rates that would change periodically with market interest rates.

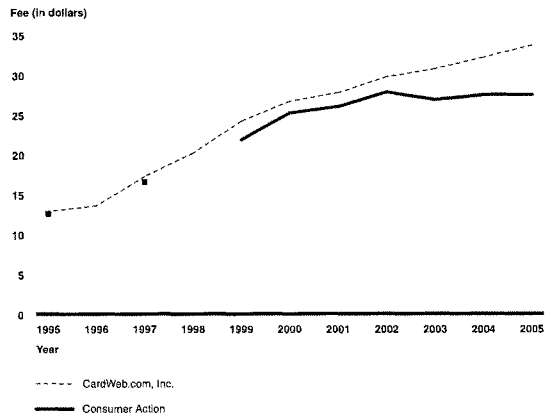
Credit Cards Increasingly Have Assessed Higher Penalty Fees

Although featuring lower interest rates than in earlier decades, 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. One penalty fee, commonly included as part of credit card terms, is the late fee, which issuers assess when they do not receive at least the minimum required payment by the due date indicated in a cardholder's monthly billing statement. As noted earlier, prior to 1990, the level of late fees on cards generally ranged from $5 to $10. However, late fees have risen significantly. According to data reported by CardWeb.com, Inc., credit card late fees rose from an average of $12.83 in 1995 to $33.64 in 2005, an increase of over 160 percent. Adjusted for inflation, these fees increased about 115 percent on average, from $15.61 in 1995 to $33.64 in 2005.[24] Similarly, Consumer Action, a consumer interest group that conducts an annual survey of credit card costs, found late fees rose from an average of $12.53 in 1995 to $27.46 in 2005, a 119 percent increase (or 80 percent after adjusting for inflation).[25] Figure 4 shows trends in average late fee assessments reported by these two groups.

[24]Dollar values adjusted using the Gross Domestic Product (GDP) deflator, with 2005 as the base year.

[25]Consumer Action analyzed more than 100 card products offered by more than 40 issuers in each year they conducted the survey, except in 1995, when 71 card products were included.

Figure 4: Average Annual Late Fees Reported from Issuer Surveys, 1995-2005 (unadjusted for inflation)



Source: GAO analysis of Consumer Action Credit Card Survey, CardWeb.com, Inc.

Notes: Consumer Action data did not report values for 1996 and 1998.

CardWeb.com, Inc. data are for financial institutions with more than $100 million in outstanding receivables.

In addition to increased fees a cardholder may be charged per occurrence, many cards created tiered pricing that depends on the balance held by the cardholder.[26] Between 2003 and 2005, all but 4 of the 28 popular cards that we analyzed used a tiered fee structure. Generally, these cards included three tiers, with the following range of fees for each tier:

- $15 to $19 on accounts with balances of $100 or $250;
- $25 to $29 on accounts with balances up to about $1,000; and

[26]Based on our analysis of the Consumer Action survey data, issuers likely began introducing tiered late fees in 2002.

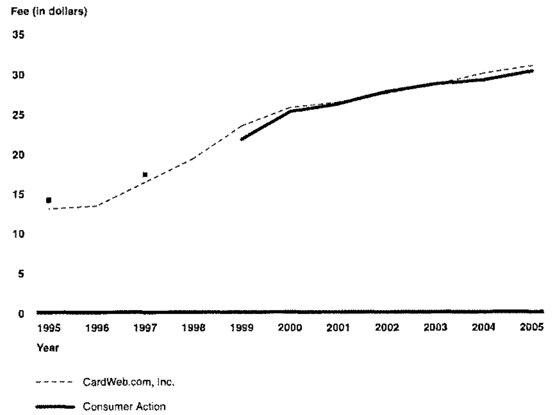
- $34 to $39 on accounts with balances of about $1,000 or more.

Tiered pricing can prevent issuers from assessing high fees to cardholders with comparatively small balances. However, data from the Federal Reserve's Survey of Consumer Finances, which is conducted every 3 years, show that the median total household outstanding balance on U.S. credit cards was about $2,200 in 2004 among those that carried balances. When we calculated the late fees that would be assessed on holders of the 28 cards if they had the entire median balance on one card, the average late fee increased from $34 in 2003 to $37 in 2005, with 18 of the cards assessing the highest fee of $39 in 2005.

Issuers also assess cardholders a penalty fee for exceeding the credit limit set by the issuer. In general, issuers assess over-limit fees when a cardholder exceeds the credit limit set by the card issuer. Similar to late fees, over-limit fees also have been rising and increasingly involve a tiered structure. According to data reported by CardWeb.com, Inc., the average over-limit fees that issuers assessed increased 138 percent from $12.95 in 1995 to $30.81 in 2005. Adjusted for inflation, average over-limit fees reported by CardWeb.com increased from $15.77 in 1995 to $30.81 in 2005, representing about a 95 percent increase.[27] Similarly, Consumer Action found a 114 percent increase in this period (or 76 percent, after adjusting for inflation). Figure 5 illustrates the trend in average over-limit fees over the past 10 years from these two surveys.

[27]Dollar values adjusted using the Gross Domestic Product (GDP) deflator, with 2005 as the base year.

Figure 5: Average Annual Over-limit fees Reported from Issuer Surveys, 1995-2005 (unadjusted for inflation)



Source: GAO analysis of Consumer Action Credit Card Survey, CardWeb.com, Inc.

Notes: Consumer Action did not report values for 1996 and 1998.

CardWeb.com, Inc. data are for financial institutions with more than $100 million in outstanding receivables.

The cards we analyzed also increasingly featured tiered structures for over-limit fees, with 29 percent (5 of 17 cards) having such structures in 2003, and 53 percent (10 of 19 cards) in 2005. Most cards that featured tiered over-limit fees assessed the highest fee on accounts with balances greater than $1,000. But not all over-limit tiers were based on the amount of the cardholder's outstanding balance. Some cards based the amount of the over-limit fee on other indicators, such as the amount of the cardholder's credit limit or card type. For the six largest issuers' popular cards with over-limit fees, the average fee that would be assessed on accounts that carried the median U.S. household credit card balance of $2,200 rose from $32 in 2003 to $34 in 2005. Among cards that assessed over-limit fees in 2005, most charged an amount between $35 and $39.

Not all of the 28 popular large-issuer cards included over-limit fees and the prevalence of such fees may be declining. In 2003, 85 percent, or 17 of 20 cards, had such fees, but only 73 percent, or 19 of 26 cards, did in 2005. According to issuer representatives, they are increasingly emphasizing competitive strategies that seek to increase the amount of spending that their existing cardholders do on their cards as a way to generate revenue. This could explain a movement away from assessing over-limit fees, which likely discourage cardholders who are near their credit limit from spending.

Cards also varied in when an over-limit fee would be assessed. For example, our analysis of the 28 popular large-issuer cards showed that, of the 22 cards that assessed over-limit fees, about two-thirds (14 of 22) would assess an over-limit fee if the cardholder's balance exceeded the credit limit within a billing cycle, whereas the other cards (8 of 22) would assess the fee only if a cardholder's balance exceeded the limit at the end of the billing cycle. In addition, within the overall limit, some of the cards had separate credit limits on the card for how much a cardholder could obtain in cash or transfer from other cards or creditors, before similarly triggering an over-limit fee.

Finally, issuers typically assess fees on cardholders for submitting a payment that is not honored by the issuer or the cardholder's paying bank. Returned payments can occur when cardholders submit a personal check that is written for an amount greater than the amount in their checking account or submit payments that cannot be processed. In our analysis of 28 popular cards offered by the six largest issuers, we found the average fee charged for such returned payments remained steady between 2003 and 2005 at about $30.

Cards Now Frequently Include a Range of Other Fees

Since 1990, issuers have appended more fees to credit cards. In addition to penalties for the cardholder actions discussed above, the 28 popular cards now often include fees for other types of transactions or for providing various services to cardholders. As shown in table 1, issuers assess fees for such services as providing cash advances or for making a payment by telephone. According to our analysis, not all of these fees were disclosed in the materials that issuers generally provide to prospective or existing cardholders. Instead, card issuers told us that they notified their customers of these fees by other means, such as telephone conversations.

Table 1: Various Fees for Services and Transactions, Charged in 2005 on Popular Large-Issuer Cards

Fee type	Assessed for:	Number of cards that assessed fee in 2005	Average or range of amounts generally assessed (if charged)
Cash advance	Obtaining cash or cash equivalent item using credit card or convenience checks	26 of 27	3% of cash advance amount or $5 minimum
Balance transfer	Transferring all or part of a balance from another creditor	15 of 27	3% of transfer amount or $5 to $10 minimum
Foreign transaction	Making purchases in a foreign country or currency	19 of 27	3% of transaction amount (in U.S. dollars)
Returned convenience check	Using a convenience check that the issuer declines to honor	20 of 27	$31
Stop payment	Requesting to stop payment on a convenience check written against the account	20 of 27	$26
Telephone payment	Arranging a single payment through a customer service agent	N/A[a]	$5-$15
Duplicate copy of account records	Obtaining a copy of a billing statement or other record	N/A[a]	$2-$13 per item
Rush delivery of credit card	Requesting that a card be sent by overnight delivery	N/A[a]	$10-$20

Source: GAO.

Note: Cash equivalent transactions include the purchase of items such as money orders, lottery tickets and casino chips. Convenience checks are personalized blank checks that issuers provide cardholders that can be written against the available credit limit of a credit card account.

[a]We were unable to determine the number of cards that assessed telephone payment, duplicate copy, or rush delivery fees in 2005 because these fees are not required by regulation to be disclosed with either mailed solicitation letters or initial disclosure statements. We obtained information about the level of these fees from a survey of the six largest U.S. issuers.

While issuers generally have been including more kinds of fees on credit cards, one category has decreased: most cards offered by the largest issuers do not require cardholders to pay an annual fee. An annual fee is a fixed fee that issuers charge cardholders each year they continue to own that card. Almost 75 percent of cards we reviewed charged no annual fee in 2005 (among those that did, the range was from $30 to $90). Also, an industry group representative told us that approximately 2 percent of cards featured annual fee requirements. Some types of cards we reviewed were more likely to apply an annual fee than others. For example, cards that offered airline tickets in exchange for points that accrue to a cardholder for using the card were likely to apply an annual fee. However, among the 28 popular cards that we reviewed, not all of the cards that offered rewards charged annual fees.

Recently, some issuers have introduced cards without certain penalty fees. For example, one of the top six issuers has introduced a card that does not charge a late fee, over-limit fee, cash-advance fee, returned payment fee, or an annual fee. Another top-six issuer's card does not charge the cardholder a late fee as long as one purchase is made during the billing cycle. However, the issuer of this card may impose higher interest rates, including above 30 percent, if the cardholder pays late or otherwise defaults on the terms of the card.

Issuers Have Introduced Various Practices that Can Significantly Affect Cardholder Costs

Popular credit cards offered by the six largest issuers involve various issuer practices that can significantly affect the costs of using a credit card for a cardholder. These included practices such as raising a card's interest rates in response to cardholder behaviors and how payments are allocated across balances.

Interest Rate Changes

One of the practices that can significantly increase the costs of using typical credit cards is penalty pricing. Under this practice, the interest rate applied to the balances on a card automatically can be increased in response to behavior of the cardholder that appears to indicate that the cardholder presents greater risk of loss to the issuer. For example, representatives for one large issuer told us they automatically increase a cardholder's interest rate if a cardholder makes a late payment or exceeds the credit limit. Card disclosure documents now typically include information about default rates, which represent the maximum penalty rate that issuers can assess in response to cardholders' violations of the terms of the card. According to an industry specialist at the Federal Reserve, issuers first began the practice of assessing default interest rates as a penalty for term violations in the late 1990s. As of 2005, all but one of the cards we reviewed included default rates. The default rates were generally much higher than rates that otherwise applied to purchases, cash advances, or balance transfers. For example, the average default rate across the 28 cards was 27.3 percent in 2005—up from the average of 23.8 percent in 2003—with as many as 7 cards charging rates over 30 percent. Like many of the other rates assessed on these cards in 2005, default rates generally were variable rates. Increases in average default rates between 2003 and 2005 resulted from increases both in the prime rate, which rose about 2 percentage points during this time, and the average fixed amount that issuers added. On average, the fixed amount that issuers added to the index rate in setting default rate levels increased from about 19 percent in 2003 to 22 percent in 2005.

Four of the six largest issuers typically included conditions in their disclosure documents that could allow the cardholder's interest rate to be reduced from a higher penalty rate. For example some issuers would lower a cardholders' rate for not paying late and otherwise abiding by the terms of the card for a period of 6 or 12 consecutive months after the default rate was imposed. However, at least one issuer indicated that higher penalty rates would be charged on existing balances even after six months of good behavior. This issuer assessed lower nonpenalty rates only on new purchases or other new balances, while continuing to assess higher penalty rates on the balance that existed when the cardholder was initially assessed a higher penalty rate. This practice may significantly increase costs to cardholders even after they've met the terms of their card agreement for at least six months.

The specific conditions under which the largest issuers could raise a cardholder's rate to the default level on the popular cards that we analyzed varied. The disclosures for 26 of the 27 cards that included default rates in 2005 stated that default rates could be assessed if the cardholders made late payments. However, some cards would apply such default rates only after multiple violations of card terms. For example, issuers of 9 of the cards automatically would increase a cardholder's rates in response to two late payments. Additionally, for 18 of the 28 cards, default rates could apply for exceeding the credit limit on the card, and 10 cards could also impose such rates for returned payments. Disclosure documents for 26 of the 27 cards that included default rates also indicated that in response to these violations of terms, the interest rate applicable to purchases could be increased to the default rate. In addition, such violations would also cause issuers to increase the rates applicable to cash advances on 16 of the cards, as well as increase rates applicable to balance transfers on 24 of the cards.

According to a paper by a Federal Reserve Bank researcher, some issuers began to increase cardholders' interest rates in the early 2000s for actions they took with other creditors.[28] According to this paper, these issuers would increase rates when cardholders failed to make timely payments to other creditors, such as other credit card issuers, utility companies, and mortgage lenders. Becoming generally known as "universal default," consumer groups criticized these practices. In 2004, OCC issued guidance to the banks that it oversees, which include many of the largest card

[28]Furletti, "Credit Card Pricing Developments and Their Disclosure."

issuers, which addressed such practices.[29] While OCC noted that the repricing might be an appropriate way for banks to manage their credit risk, they also noted that such practices could heighten a bank's compliance and reputation risks. As a result, OCC urged national banks to fully and prominently disclose in promotional materials the circumstances under which a cardholder's interest rates, fees, or other terms could be changed and whether the bank reserved the right to change these unilaterally. Around the time of this guidance, issuers generally ceased automatically repricing cardholders to default interest rates for risky behavior exhibited with other creditors. Of the 28 popular large issuer cards that we reviewed, three cards in 2005 included terms that would allow the issuer to automatically raise a cardholder's rate to the default rate if they made a late payment to another creditor.

Although the six largest U.S. issuers appear to have generally ceased making automatic increases to a default rate for behavior with other creditors, some continue to employ practices that allow them to seek to raise a cardholder's interest rates in response to behaviors with other creditors. During our review, representatives of four of these issuers told us that they may seek to impose higher rates on a cardholder in response to behaviors related to other creditors but that such increases would be done as a change-in-terms, which can require prior notification, rather than automatically.[30] Regulation Z requires that the affected cardholders be notified in writing of any such proposed changes in rate terms at least 15 days before such change becomes effective.[31] In addition, under the laws of the states in which four of the six largest issuers are chartered, cardholders would have to be given the right to opt out of the change.[32] However, issuer representatives told us that few cardholders exercise this right. The ability of cardholders to opt out of such increases also has been questioned. For example, one legal essay noted that some cardholders may not be able to reject the changed terms of their cards if the result would be a requirement

[29]Credit Card Practices, OCC Advisory Letter AL 2004-10 (Sept. 14, 2004).

[30]At least one of the six largest issuers may automatically increase a cardholder's rates for violations of terms on any loan the cardholder held with the issuer or bank with which it was affiliated.

[31]12 C.F.R. § 226.9(c).

[32]States in which issuers have a statutory obligation to afford cardholders an opportunity to opt-out or reject a change-in-terms to increase the interest rate on their credit card account include Delaware, South Dakota, New Hampshire, Florida and Georgia.

to pay off the balance immediately.[33] In addition, an association for community banks that provided comments to the Federal Reserve as part of the ongoing review of card disclosures noted that 15 days does not provide consumers sufficient time to make other credit arrangements if the new terms were undesirable.

Payment Allocation Method

The way that issuers allocate payments across balances also can increase the costs of using the popular cards we reviewed. In this new credit environment where different balances on a single account may be assessed different interest rates, issuers have developed practices for allocating the payments cardholders make to pay down their balance. For 23 of the 28 popular larger-issuer cards that we reviewed, cardholder payments would be allocated first to the balance that is assessed the lowest rate of interest.[34] As a result, the low interest balance would have to be fully paid before any of the cardholder's payment would pay down balances assessed higher rates of interest. This practice can prolong the length of time that issuers collect finance charges on the balances assessed higher rates of interest.

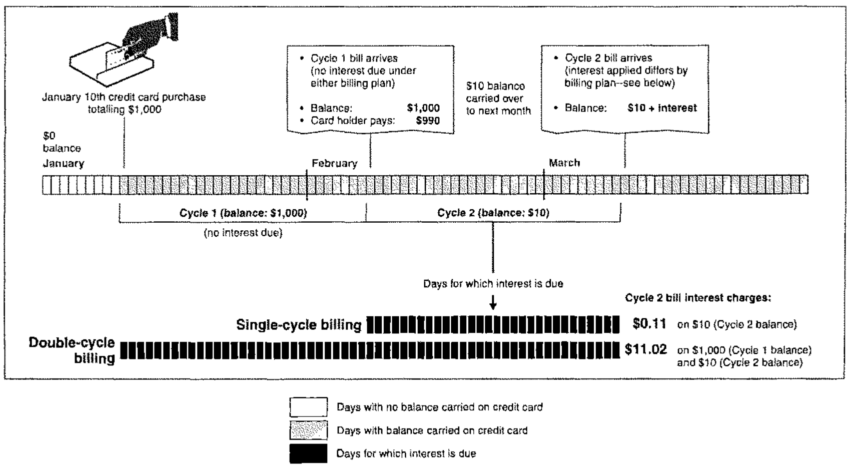
Balance Computation Method

Additionally, some of the cards we reviewed use a balance computation method that can increase cardholder costs. On some cards, issuers have used a double-cycle billing method, which eliminates the interest-free period of a consumer who moves from nonrevolving to revolving status, according to Federal Reserve staff. In other words, in cases where a cardholder, with no previous balance, fails to pay the entire balance of new purchases by the payment due date, issuers compute interest on the original balance that previously had been subject to an interest-free period. This method is illustrated in figure 6.

[33]Samuel Issacharoff and Erin F. Delaney, "Symposium: Homo Economicus, Homo Myopicus, and the Law and Economics of Consumer Choice," *University of Chicago Law Review* 73 (Winter: 2006).

[34]Issuers of the remaining five cards would apply cardholder payments in a manner subject to their discretion.

Figure 6: How the Double-Cycle Billing Method Works



Sources: GAO analysis of Federal Reserve Bank data; Art Explosion (images).

Note: We calculated finance charges assuming a 13.2 percent APR, 30-day billing cycle, and that the cardholder's payment is credited on the first day of cycle 2. We based our calculations on an average daily balance method and daily compounding of finance charges.

In our review of 28 popular cards from the six largest issuers, we found that two of the six issuers used the double-cycle billing method on one or more popular cards between 2003 and 2005. The other four issuers indicated they would only go back one cycle to impose finance charges.

New Practices Appear to Affect a Minority of Cardholders

Representatives of issuers, consumer groups, and others we interviewed generally disagreed over whether the evolution of credit card pricing and other practices has been beneficial to consumers. However, data provided by the six largest issuers show that many of their active accounts did not pay finance charges and that a minority of their cardholders were affected by penalty charges in 2005.

Issuers Say Practices Benefit More Cardholders, but Critics Say Some Practices Harm Consumers

The movement towards risk-based pricing for cards has allowed issuers to offer better terms to some cardholders and more credit cards to others. Spurred by increased competition, many issuers have adopted risk-based pricing structures in which they assess different rates on cards depending on the credit quality of the borrower. Under this pricing structure, issuers have offered cards with lower rates to more creditworthy borrowers, but also have offered credit to consumers who previously would not have been considered sufficiently creditworthy. For example, about 70 percent of families held a credit card in 1989, but almost 75 percent held a card by 2004, according to the Federal Reserve Board's Survey of Consumer Finances. Cards for these less creditworthy consumers have featured higher rates to reflect the higher repayment risk that such consumers represented. For example, the initial purchase rates on the 28 popular cards offered by the six largest issuers ranged from about 8 percent to 19 percent in 2005.

According to card issuers, credit cards offer many more benefits to users than they did in the past. For example, according to the six largest issuers, credit cards are an increasingly convenient and secure form of payment. These issuers told us credit cards are accepted at more than 23 million merchants worldwide, can be used to make purchases or obtain cash, and are the predominant form of payment for purchases made on the Internet. They also told us that rewards, such as cash-back and airline travel, as well as other benefits, such as rental car insurance or lost luggage protection, also have become standard. Issuers additionally noted that credit cards are reducing the need for cash. Finally, they noted that cardholders typically are not responsible for loss, theft, fraud, or misuse of their credit cards by unauthorized users, and issuers often assist cardholders that are victims of identity theft.

In contrast, according to some consumer groups and others, the newer pricing structures have resulted in many negative outcomes for some consumers. Some consumer advocates noted adverse consequences of offering credit, especially at higher interest rates, to less creditworthy consumers. For example, lower-income or young consumers, who do not have the financial means to carry credit card debt, could worsen their financial condition.[35] In addition, consumer groups and academics said that

[35]We previously reported on the marketing of credit cards to students and student experiences with credit cards. See GAO *Consumer Finance: College Students and Credit Cards,* GAO-01-773, (Washington, D.C.: June 20, 2001).

various penalty fees could increase significantly the costs of using cards for some consumers. Some also argued that card issuers were overly aggressive in their assessment of penalty fees. For instance, a representative of a consumer group noted that issuers do not reject cardholders' purchases during the sale authorization, even if the transaction would put the cardholder over the card's credit limit, and yet will likely later assess that cardholder an over-limit fee and also may penalize them with a higher interest rate. Furthermore, staff for one banking regulator told us that they have received complaints from consumers who were assessed over-limit fees that resulted from the balance on their accounts going over their credit limit because their card issuer assessed them a late fee. At the same time, credit card issuers have incentives not to be overly aggressive with their assessment of penalty charges. For example, Federal Reserve representatives told us that major card issuers with long-term franchise value are concerned that their banks not be perceived as engaging in predatory lending because this could pose a serious risk to their brand reputation. As a result, they explained that issuers may be wary of charging fees that could be considered excessive or imposing interest rates that might be viewed as potentially abusive. In contrast, these officials noted that some issuers, such as those that focus on lending to consumers with lower credit quality, may be less concerned about their firm's reputation and, therefore, more likely to charge higher fees.

Controversy also surrounds whether higher fees and other charges were commensurate with the risks that issuers faced. Consumer groups and others questioned whether the penalty interest rates and fees were justifiable. For example, one consumer group questioned whether submitting a credit card payment one day late made a cardholder so risky that it justified doubling or tripling the interest rate assessed on that account. Also, as the result of concerns over the level of penalty fees being assessed by banks in the United Kingdom, a regulator there has recently announced that penalty fees greater than 12 pounds (about $23) may be challenged as unfair unless they can be justified by exceptional factors.[36] Representatives of several of the issuers with whom we spoke told us that the levels of the penalty fees they assess generally were set by considering various factors. For example, they noted that higher fees help to offset the increased risk of loss posed by cardholders who pay late or engage in other

[36]Office of Fair Trading, *Calculating Fair Default Charges in Credit Card Contracts: A Statement of the OFT's Position*, OFT842 (April 2006).

negative behaviors. Additionally, they noted a 2006 study, which compared the assessment of penalty fees that credit card banks charged to bankruptcy rates in the states in which their cards were marketed, and found that late fee assessments were correlated with bankruptcy rates.[37] Some also noted that increased fee levels reflected increased operating costs; for example, not receiving payments when due can cause the issuer to incur increased costs, such as those incurred by having to call cardholders to request payment. Representatives for four of the largest issuers also told us that their fee levels were influenced by what others in the marketplace were charging.

Concerns also have been expressed about whether consumers adequately consider the potential effect of penalty interest rates and fees when they use their cards. For example, one academic researcher, who has written several papers about the credit card industry, told us that many consumers do not consider the effect of the costs that can accrue to them after they begin using a credit card. According to this researcher, many consumers focus primarily on the amount of the interest rate for purchases when deciding to obtain a new credit card and give less consideration to the level of penalty charges and rates that could apply if they were to miss a payment or violate some other term of their card agreement. An analyst that studies the credit card industry for large investors said that consumers can obtain low introductory rates but can lose them very easily before the introductory period expires.

Most Active Accounts Are Assessed Lower Rates Than in the Past

As noted previously, the average credit card interest rate assessed for purchases has declined from almost 20 percent, that prevailed until the late 1980s, to around 12 percent, as of 2005. In addition, the six largest issuers—whose accounts represent 61 percent of all U.S. accounts—reported to us that the majority of their cardholders in 2005 had cards with interest rates lower than the rate that generally applied to all cardholders prior to about 1990. According to these issuers, about 80 percent of active accounts were assessed interest rates below 20 percent as of December 31, 2005, with

[37]Massoud, N., Saunders A., and Scholnick B., "The Cost of Being Late: The Case of Credit Card Penalty Fees," January 2006. Published with financial assistance from the Social Sciences Research Council of Canada and the National Research Program on Financial Services and Public Policy at the Schulich School of Business, York University in Toronto, Ontario (Canada). This study examined data from the Federal Reserve's survey of U.S. credit card rates and fees and compared them to bankruptcy rates across states.

more than 40 percent having rates below 15 percent.[38] However, the proportion of active accounts assessed rates below 15 percent declined since 2003, when 71 percent received such rates. According to issuer representatives, a greater number of active accounts were assessed higher interest rates in 2004 and 2005 primarily because of changes in the prime rate to which many cards' variable rates are indexed. Nevertheless, cardholders today have much greater access to cards with lower interest rates than existed when all cards charged a single fixed rate.

A large number of cardholders appear to avoid paying any significant interest charges. Many cardholders do not revolve a balance from month to month, but instead pay off the balance owed in full at the end of each month. Such cardholders are often referred to as convenience users. According to one estimate, about 42 percent of cardholders are convenience users.[39] As a result, many of these cardholders availed themselves of the benefits of their cards without incurring any direct expenses. Similarly, the six largest issuers reported to us that almost half, or 48 percent, of their active accounts did not pay a finance charge in at least 10 months in 2005, similar to the 47 percent that did so in 2003 and 2004.

Minority of Cardholders Appear to Be Affected by Penalty Charges Assessed by the Largest U.S. Issuers

Penalty interest rates and fees appear to affect a minority of the largest six issuers' cardholders.[40] No comprehensive sources existed to show the extent to which U.S. cardholders were paying penalty interest rates, but, according to data provided by the six largest issuers, a small proportion of their active accounts were being assessed interest rates above 25 percent—which we determined were likely to represent penalty rates. However, this proportion had more than doubled over a two-year period by having increased from 5 percent at the end of 2003 to 10 percent in 2004 and 11 percent in 2005.

[38]For purposes of this report, active accounts refer to accounts of the top six issuers that had had a debit or credit posted to them by December 31 in 2003, 2004, and 2005.

[39]CardWeb.com, Inc.

[40]Our data likely undercounted the cards and cardholders that were affected by these charges because our data was comprised of active accounts for the six largest U.S. issuers. Although these issuers have some subprime accounts (accounts held by less-creditworthy borrowers), we did not include issuers in our sample that predominantly market to subprime borrowers.

Although still representing a minority of cardholders, cardholders paying at least one type of penalty fee were a significant proportion of all cardholders. According to the six largest issuers, 35 percent of their active accounts had been assessed at least one late fee in 2005. These issuers reported that their late fee assessments averaged $30.92 per active account. Additionally, these issuers reported that they assessed over-limit fees on 13 percent of active accounts in 2005, with an average over-limit fee of $9.49 per active account.

Weaknesses in Credit Card Disclosures Appear to Hinder Cardholder Understanding of Fees and Other Practices That Can Affect Their Costs

The disclosures that issuers representing the majority of credit card accounts use to provide information about the costs and terms of using credit cards had serious weaknesses that likely reduce their usefulness to consumers. These disclosures are the primary means under federal law for protecting consumers against inaccurate and unfair credit card practices. The disclosures we analyzed had weaknesses, such as presenting information written at a level too difficult for the average consumer to understand, and design features, such as text placement and font sizes, that did not conform to guidance for creating easily readable documents. When attempting to use these disclosures, cardholders were often unable to identify key rates or terms and often failed to understand the information in these documents. Several factors help explain these weaknesses, including outdated regulations and guidance With the intention of improving the information that consumers receive, the Federal Reserve has initiated a comprehensive review of the regulations that govern credit card disclosures. Various suggestions have been made to improve disclosures, including testing them with consumers. While Federal Reserve staff have begun to involve consumers in their efforts, they are still attempting to determine the best form and content of any revised disclosures. Without clear, understandable information, consumers risk making poor choices about using credit cards, which could unnecessarily result in higher costs to use them.

Mandatory Disclosure of Credit Card Terms and Conditions Is the Primary Means Regulators Use for Ensuring Competitive Credit Card Pricing

Having adequately informed consumers that spur competition among issuers is the primary way that credit card pricing is regulated in the United States. Under federal law, a national bank may charge interest on any loan at a rate permitted by the law of the state in which the bank is located.[41] In 1978, the U.S. Supreme Court ruled that a national bank is "located" in the state in which it is chartered, and, therefore, the amount of the interest rates charged by a national bank are subject only to the laws of the state in which it is chartered, even if its lending activities occur elsewhere.[42] As a result, the largest credit card issuing banks are chartered in states that either lacked interest rate caps or had very high caps from which they would offer credit cards to customers in other states. This ability to "export" their chartered states' interest rates effectively removed any caps applicable to interest rates on the cards from these banks. In 1996, the U.S. Supreme Court determined that fees charged on credit extended by national banks are a form of interest, allowing issuers to also export the level of fees allowable in their state of charter to their customers nationwide, which effectively removed any caps on the level of fees that these banks could charge.[43]

In the absence of federal regulatory limitations on the rates and fees that card issuers can assess, the primary means that U.S. banking regulators have for influencing the level of such charges is by facilitating competition among issuers, which, in turn, is highly dependent on informed consumers. The Truth in Lending Act of 1968 (TILA) mandates certain disclosures aimed at informing consumers about the cost of credit. In approving TILA, Congress intended that the required disclosures would foster price competition among card issuers by enabling consumers to discern differences among cards while shopping for credit. TILA also states that its purpose is to assure that the consumer will be able to compare more readily the various credit terms available to him or her and avoid the uninformed use of credit. As authorized under TILA, the Federal Reserve has promulgated Regulation Z to carry out the purposes of TILA. The Federal Reserve, along with the other federal banking agencies, enforces compliance with Regulation Z with respect to the depository institutions under their respective supervision.

In general, TILA and the accompanying provisions of Regulation Z require credit card issuers to inform potential and existing customers about specific pricing terms at specific times. For example, card issuers are

[41] 12 U.S.C. § 85.

[42] *Marquette National Bank v First of Omaha Service Corp. et. al,* 439 U.S. 299 (1978).

[43] *Smiley v. Citibank,* 517 U.S. 735 (1996).

required to make various disclosures when soliciting potential customers, as well as on the actual applications for credit. On or with card applications and solicitations, issuers generally are required to present pricing terms, including the interest rates and various fees that apply to a card, as well as information about how finance charges are calculated, among other things. Issuers also are required to provide cardholders with specified disclosures prior to the cardholder's first transaction, periodically in billing statements, upon changes to terms and conditions pertaining to the account, and upon account renewal. For example, in periodic statements, which issuers typically provide monthly to active cardholders, issuers are required to provide detailed information about the transactions on the account during the billing cycle, including purchases and payments, and are to disclose the amount of finance charges that accrued on the cardholder's outstanding balance and detail the type and amount of fees assessed on the account, among other things.

In addition to the required timing and content of disclosures, issuers also must adhere to various formatting requirements. For example, since 1989, certain pricing terms must be disclosed in direct mail, telephone, and other applications and solicitations and presented in a tabular format on mailed applications or solicitations.[44] This table, generally referred to as the Schumer box, must contain information about the interest rates and fees that could be assessed to the cardholder, as well as information about how finance charges are calculated, among other things.[45] According to a Federal Reserve representative, the Schumer box is designed to be easy for consumers to read and use for comparing credit cards. According to a consumer group representative, an effective regulatory disclosure is one that stimulates competition among issuers; the introduction of the Schumer box in the late 1980s preceded the increased price competition in the credit card market in the early 1990s and the movement away from uniform credit card products.

Not all fees that are charged by card issuers must be disclosed in the Schumer box. Regulation Z does not require that issuers disclose fees unrelated to the opening of an account. For example, according to the Official Staff Interpretations of Regulation Z (staff interpretations), nonperiodic fees, such as fees charged for reproducing billing statements

[44]See generally 12 C.F.R. § 226.5a.

[45]See supra note 21.

or reissuing a lost or stolen card, are not required to be disclosed. Staff interpretations, which are compiled and published in a supplement to Regulation Z, are a means of guiding issuers on the requirements of Regulation Z.[46] Staff interpretations also explain that various fees are not required in initial disclosure statements, such as a fee to expedite the delivery of a credit card or, under certain circumstances, a fee for arranging a single payment by telephone. However, issuers we surveyed told us they inform cardholders about these other fees at the time the cardholders request the service, rather than in a disclosure document.

Although Congress authorized solely the Federal Reserve to adopt regulations to implement the purposes of TILA, other federal banking regulators, under their authority to ensure the safety and soundness of depository institutions, have undertaken initiatives to improve the credit card disclosures made by the institutions under their supervision. For example, the regulator of national banks, OCC, issued an advisory letter in 2004 alerting banks of its concerns regarding certain credit card marketing and account management practices that may expose a bank to compliance and reputation risks. One such practice involved the marketing of promotional interest rates and conditions under which issuers reprice accounts to higher interest rates.[47] In its advisory letter, OCC recommended that issuers disclose any limits on the applicability of promotional interest rates, such as the duration of the rates and the circumstances that could shorten the promotional rate period or cause rates to increase. Additionally, OCC advised issuers to disclose the circumstances under which they could increase a consumer's interest rate or fees, such as for failure to make timely payments to another creditor.

Credit Card Disclosures Typically Provided to Many Consumers Have Various Weaknesses

The disclosures that credit card issuers typically provide to potential and new cardholders had various weaknesses that reduced their usefulness to consumers. These weaknesses affecting the disclosure materials included the typical grade level required to comprehend them, their poor organization and formatting of information, and their excessive detail and length.

[46] Compliance with these official staff interpretations afford issuers protection from liability under Section 130(f) of TILA, which protects issuers from civil liability for any act done or omitted in good faith compliance with any official staff interpretation. 12 C.F.R. Part 226, Supp. I.

[47] Credit Card Practices, OCC Advisory Letter AL 2004-10 (Sept. 14, 2004).

Disclosures Written at Too High a Level

The typical credit card disclosure documents contained content that was written at a level above that likely to be understandable by many consumers. To assess the readability of typical credit card disclosures, we contracted with a private usability consultant to evaluate the two primary disclosure documents for four popular, widely-held cards (one each from four large credit card issuers). The two documents were (1) a direct mail solicitation letter and application, which must include information about the costs and fees associated with the card; and (2) the cardmember agreement that contains the full range of terms and conditions applicable to the card.[48] Through visual inspection, we determined that this set of disclosures appeared representative of the disclosures for the 28 cards we reviewed from the six largest issuers that accounted for the majority of cardholders in the United States. To determine the level of education likely needed for someone to understand these disclosures, the usability consultant used computer software programs that applied three widely used readability formulas to the entire text of the disclosures. These formulas determined the readability of written material based on quantitative measures, such as average number of syllables in words or numbers of words in sentences. For more information about the usability consultant's analyses, see appendix I.

On the basis of the usability consultant's analysis, the disclosure documents provided to many cardholders likely were written at a level too high for the average individual to understand. The consultant found that the disclosures on average were written at a reading level commensurate with about a tenth- to twelfth-grade education. According to the consultant's analysis, understanding the disclosures in the solicitation letters would require an eleventh-grade level of reading comprehension, while understanding the cardmember agreements would require about a twelfth-grade education. A consumer advocacy group that tested the reading level needed to understand credit card disclosures arrived at a similar conclusion. In a comment letter to the Federal Reserve, this consumer group noted it had measured a typical passage from a change-in-terms notice on how issuers calculate finance charges using one of the readability formulas and that this passage required a twelfth-grade reading level.

[48]We did not evaluate disclosures that issuers are required to provide at other times—such as in periodic billing statements or change in terms notices.

These disclosure documents were written such that understanding them required a higher reading level than that attained by many U.S. cardholders. For example, a nationwide assessment of the reading level of the U.S. population cited by the usability consultant indicated that nearly half of the adult population in the United States reads at or below the eighth-grade level.[49] Similarly, to ensure that the information that public companies are required to disclose to prospective investors is adequately understandable, the Securities and Exchange Commission (SEC) recommends that such disclosure materials be written at a sixth- to eighth-grade level.[50]

In addition to the average reading level, certain portions of the typical disclosure documents provided by the large issuers required even higher reading levels to be understandable. For example, the information that appeared in cardmember agreements about annual percentage rates, grace periods, balance computation, and payment allocation methods required a minimum of a fifteenth-grade education, which is the equivalent of 3 years of college education. Similarly, text in the documents describing the interest rates applicable to one issuer's card were written at a twenty-seventh-grade level. However, not all text in the disclosures required such high levels. For example, the consultant found that the information about fees that generally appeared in solicitation letters required only a seventh- and eighth-grade reading level to be understandable. Solicitation letters likely required lower reading levels to be understandable because they generally included more information in a tabular format than cardmember agreements.

Poor Organization and Formatting

The disclosure documents the consultant evaluated did not use designs, including effective organizational structures and formatting, that would have made them more useful to consumers. To assess the adequacy of the design of the typical large issuer credit card solicitation letters and cardmember agreements, the consultant evaluated the extent to which these disclosures adhered to generally accepted industry standards for

[49]1992 National Adult Literacy Survey. The 2003 National Assessment of Adult Literacy (renamed from 1992) found that reading comprehension levels did not significantly change between 1992 and 2003 and that there was little change in adults' ability to read and understand sentences and paragraphs.

[50]U.S. Securities and Exchange Commission, *Plain English Handbook: How to Create Clear SEC Disclosure Documents* (Washington, D.C.: 1998). The Securities and Exchange Commission regulates the issuance of securities to the public, including the information that companies provide to their investors.

effective organizational structures and designs intended to make documents easy to read. In the absence of best practices and guidelines specifically for credit card disclosures, the consultant used knowledge of plain language, publications design guidelines, and industry best practices and also compared the credit card disclosure documents to the guidelines in the Securities and Exchange Commission's plain English handbook. The usability consultant used these standards to identify aspects of the design of the typical card disclosure documents that could cause consumers using them to encounter problems.

On the basis of this analysis, the usability consultant concluded that the typical credit card disclosures lacked effective organization. For example, the disclosure documents frequently placed pertinent information toward the end of sentences. Figure 7 illustrates an example taken from the cardmember agreement of one of the large issuers that shows that a consumer would need to read through considerable amounts of text before reaching the important information, in this case the amount of the annual percentage rate (APR) for purchases. Best practices would dictate that important information—the amount of the APR—be presented first, with the less important information—the explanation of how the APR is determined—placed last.

Figure 7: Example of Important Information Not Prominently Presented in Typical Credit Card Disclosure Documents

Usability consultant's comments: Placing pertinent information, in this case the APR for purchases, near the end of sentences requires readers to wade through considerable amounts of text before reaching important information.

3.3.1.a: Purchases. The Annual Percentage Rate for Purchases, a variable rate, is the Index plus a Margin of 4.99%. Based on this formula, the APR as of May 4, 2005 is 10.99% (0.03011% corresponding Daily Periodic Rate).

Sources: UserWorks, Inc.; Information International Associates.

In addition, the disclosure documents often failed to group relevant information together. Although one of the disclosure formats mandated by law—the Schumer box—has been praised as having simplified the presentation of complex information, our consultant observed that the amount of information that issuers typically presented in the box compromised the benefits of using a tabular format. Specifically, the typical credit card solicitation letter, which includes a Schumer box, may be causing difficulties for consumers because related information generally is not grouped appropriately, as shown in figure 8.

Figure 8: Example of How Related Information Was Not Being Grouped Together in Typical Credit Card Disclosure Documents

Annual Percentage Rate (APR) for Purchases[3]	0.0% fixed introductory rate until October 1, 2006;[1] thereafter, a variable APR, currently 13.49%.
Other APRs[3]	**Non-Check Balance Transfers:** 0.0% fixed introductory APR until October 1, 2006;[1] thereafter, together with all other Balance Transfers, a variable APR, currently 13.49%. **Cash Advances and Convenience Checks:** A variable APR, currently 22.49%. **Penalty APR:** A variable APR, currently up to 30.49%.[3]
Variable Rate Information[2]	All APRs (other than your introductory APRs) may vary. They are determined by adding the following margin to the Prime Rate: 6.99% for Purchases and Non-Check Balance Transfers; 15.99% for Cash Advances and Convenience Checks; and up to 23.99% for Penalty APRs.
Balance Calculation Method for Purchases	Average Daily Balance (including new purchases)
Annual Fee	None
Grace Period for Purchases	At least 20 days
Minimum Finance Charge for Purchases	$1.50 (unless purchase Average Daily Balance is zero)

Current rate for purchases

How the rate is determined

†The terms of your Account, including any APR (or how an APR is Calculated) are subject to change. Any changes will be made in accordance with the Cardholder Agreement.

[1]If an introductory rate is applicable to this product and we do not receive at least the Minimum Payment Due during any billing cycle, you exceed your credit limit or you close your account, any introductory rate on Purchases and Balance Transfers will terminate.

[2]The Prime Rate used in your APR calculations is determined on the last day of each month by taking the highest prime rate published in the Money Rates section of The Wall Street Journal in effect within the prior three months (the "Index Date(s)"). All Prime Rate changes will take effect on the first day of your Billing Cycle that ends in the calendar month following the Index Date. All variable rate disclosures are based on the Prime Rate of 6.50% in effect on August 10, 2005.

How the prime rate is determined

Usability consultant's comments:
Related information, in this case the APR for purchases, is not grouped together, potentially causing difficulties for readers.

Sources: GAO analysis of data from UserWorks, Inc.; Information International Associates.

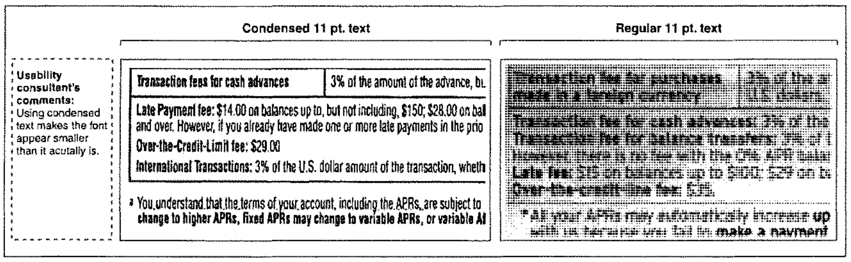
As shown in figure 8, information about the APR that would apply to purchases made with the card appeared in three different locations. The first row includes the current prevailing rate of the purchase APR; text that describes how the level of the purchase APR could vary according to an underlying rate, such as the prime rate, is included in the third row; and text describing how the issuer determines the level of this underlying rate is included in the footnotes. According to the consultant, grouping such related information together likely would help readers to more easily understand the material.

In addition, of the four issuers whose materials were analyzed, three provided a single document with all relevant information in a single cardmember agreement, but one issuer provided the information in separate documents. For example, this issuer disclosed specific information about the actual amount of rates and fees in one document and presented information about how such rates were determined in another document. According to the readability consultant, disclosures in multiple documents can be more difficult for the reader to use because they may require more work to find information.

Formatting weaknesses also likely reduced the usefulness of typical credit card disclosure documents. The specific formatting issues were as follows:

- *Font sizes.* According to the usability consultant's analysis, many of the disclosure documents used font sizes that were difficult to read and could hinder consumers' ability to find information. For example, the consultant found extensive use of small and condensed typeface in cardmember agreements and in footnotes in solicitation materials when best practices would suggest using a larger, more legible font size. Figure 9 contains an illustration of how the disclosures used condensed text that makes the font appear smaller than it actually is. Multiple consumers and consumer groups who provided comments to the Federal Reserve noted that credit card disclosures were written in a small print that reduces a consumer's ability to read or understand the document. For example, a consumer who provided comments to the Federal Reserve referred to the text in card disclosures as "mice type." This example also illustrates how notes to the text, which should be less important, were the same size and thus given the same visual emphasis as the text inside the box. Consumers attempting to read such disclosures may have difficulty determining which information is more important.

Figure 9: Example of How Use of Small Font Sizes Reduces Readability in Typical Credit Card Disclosure Documents



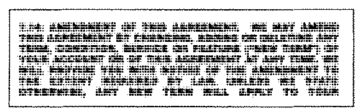
Sources: UserWorks, Inc.; Information International Associates.

Note: Graphic shown is the actual size it appears in issuer disclosure documents. Graphic is intentionally portioned off to focus attention to headings.

- *Ineffective font placements.* According to the usability consultant, some issuers' efforts to distinguish text using different font types sometimes had the opposite effect. The consultant found that the disclosures from all four issuers emphasized large amounts of text with all capital letters and sometimes boldface. According to the consultant, formatting large blocks of text in capitals makes it harder to read because the shapes of the words disappear, forcing the reader to slow down and study each letter (see figure 10). In a comment letter to the Federal Reserve, an industry group recommended that boldfaced or capitalized text should be used discriminately, because in its experience, excessive use of such font types caused disclosures to lose all effectiveness. SEC's guidelines for producing clear disclosures contain similar suggestions.

Figure 10: Example of How Use of Ineffective Font Types Reduces Readability in Typical Credit Card Disclosure Documents

Usability consultant's comments:
By emphasizing all the text in a paragraph, nothing is emphasized.



ARBITRATION: PLEASE READ THIS PROVISION CAREFULLY. IT PROVIDES THAT ANY DISPUTE MAY BE RESOLVED BY BINDING ARBITRATION. ARBITRATION REPLACES THE RIGHT TO GO TO COURT. YOU WILL NOT BE ABLE TO BRING A CLASS ACTION OR SIMILAR PROCEEDING IN COURT, NOR WILL YOU BE ABLE TO BRING ANY CLAIM IN

Sources: UserWorks, Inc.; Information International Associates.

- *Selecting text for emphasis.* According to the usability consultant, most of the disclosure documents unnecessarily emphasized specific terms. Inappropriate emphasis of such material could distract readers from more important messages. Figure 11 contains a passage from one cardmember agreement that the readability consultant singled out for its emphasis of the term "periodic finance charge," which is repeated six times in this example. According to the consultant, the use of boldface and capitalized text calls attention to the word, potentially requiring readers to work harder to understand the entire passage's message.

Figure 11: Example of How Use of Inappropriate Emphasis Reduces Readability in Typical Credit Card Disclosure Documents

Usability consultant's comments:
Repeated use of boldface and caps calls attention to a word, potentially requiring readers to work harder to understand the passage's message.

zero. We multiply the daily balance by the applicable Daily Periodic Rate, as stated in the Table of Interest Charges, to get your **Periodic FINANCE CHARGES** for that day. We then add these **Periodic FINANCE CHARGES** to your daily balance to get the beginning balance for the next day. For Purchases, we do the same thing for each day of the previous cycle to get the daily balance of Purchases for the previous billing cycle. However, the daily balance for previous billing cycle Purchases is considered to be zero for each day of the previous billing cycle if a **Periodic FINANCE CHARGE** was already imposed on Purchases itemized on your previous statement or you paid your New Balance on your previous statement in full by the payment due date.

To get your total **Periodic FINANCE CHARGE** for a billing cycle, we add all of the daily **Periodic FINANCE CHARGES** for all features. If you multiply the Average Daily Balance for each feature by the applicable Daily Periodic Rate and the number of days in the applicable billing cycle(s) and add the results together, the total will equal the **Periodic FINANCE CHARGES** for the billing cycle, except for minor variations due to rounding. To determine an Average Daily Balance, we add your daily balances and divide by the number of the days in the applicable billing cycle(s).

Sources: UserWorks, Inc.; Information International Associates.

- *Use of headings.* According to the usability consultant, disclosure documents from three of the four issuers analyzed contained headings that were difficult to distinguish from surrounding text. Headings, according to the consultant, provide a visual hierarchy to help readers quickly identify information in a lengthy document. Good headers are easy to identify and use meaningful labels. Figure 12 illustrates two examples of how the credit card disclosure documents failed to use headings effectively.

Figure 12: Example of Ineffective and Effective Use of Headings in Typical Credit Card Disclosure Documents

Ineffective heading use (shading added by GAO)

Section 2: USE OF YOUR ACCOUNT
2.1: Types of Transactions. You may use your Account for the following types of consumer transactions:
2.1.1: Purchases. Purchase goods or services with your Card.
2.1.2: Cash Advances. Obtain cash from a participating financial institution or merchant ("Cash Disbursement") or from an ATM ("ATM Advance"), write a Convenience Check for any legal purpose ("Convenience Check Advance") or purchase money orders, travelers checks, foreign currency, lottery tickets, casino chips, racetrack wagers, vouchers redeemable for cash or other items readily convertible into cash ("Quasi Cash"), or transfer funds from your Account to your personal checking account for overdraft protection ("Overdraft Protection").
2.1.3: Balance Transfers. Transferred balances to your Account from other creditors, except those made using a Convenience Check.
2.2: Limitations on Use

Payment Allocation: You agree that we are authorized to allocate your payments and credits in a way that is most favorable to or convenient for us. For example, you authorize us to apply your payments and credits to balances with lower **Annual Percentage Rates** ("APRs") (such as promotional APRs) before balances with higher APRs for all balances except promotional balances for Disney vacation packages.
Credit Line/Authorized Usage: Your credit line is shown on the folder containing your Card. Since we may change your credit line from time to time, your latest credit line will appear on your monthly statement. You agree not to make a Purchase or obtain a Cash Advance that would cause the unpaid balance of your Account to exceed your

Usability consultant's comments:

1 Headings are easy to identify, but are preeeded by an unnecessary string of numbers that do not correspond to anything useful like a table of contents.

2 Headings are not substantially different from the text.

Effective heading use (shading added by GAO)

3 ***How We Determine the Balance:***
The total outstanding balance (the amount you owe us) appears as the "New Balance" on the billing statement. To determine the New Balance, we begin with the outstanding balance on your account at the beginning of each billing period, called the "Previous Balance" on the billing statement. We add any purchases or cash advances and subtract any credits or payments credited as of that billing period. We then add the appropriate finance charges and fees and make other applicable adjustments.

Annual Percentage Rates for Purchases and Cash Advances:
Your annual percentage rates and the corresponding daily periodic rates appear on the card carrier. A daily periodic rate is the appli-

Usability consultant's comments:

3 Headings are easy to distinguish from the surrounding text.

Sources: UserWorks, Inc.; Information International Associates.

In the first example, the headings contained an unnecessary string of numbers that the consultant found would make locating a specific topic in the text more difficult. As a result, readers would need to actively ignore the string of numbers until the middle of the line to find what they wanted. The consultant noted that such numbers might be useful if this document had a table of contents that referred to the numbers, but it did not. In the second example, the consultant noted that a reader's ability to locate information using the headings in this document was hindered because the headings were not made more visually distinct, but instead were aligned with other text and printed in the same type size as the text that followed. As a result, these headings blended in with the text. Furthermore, the consultant noted that because the term "Annual Percentage Rates" was given the same visual treatment as the two headings in the example, finding headings quickly was made even more difficult. In contrast, figure 12 also shows an example that the consultant identified in one of the disclosure documents that was an effective use of headings.

- *Presentation techniques.* According to the usability consultant, the disclosure documents analyzed did not use presentation techniques, such as tables, bulleted lists, and graphics, that could help to simplify the presentation of complicated concepts, especially in the cardmember agreements. Best practices for document design suggest using tables and bulleted lists to simplify the presentation of complex information. Instead, the usability consultant noted that all the cardmember agreements reviewed almost exclusively employed undifferentiated blocks of text, potentially hindering clear communication of complex information, such as the multiple-step procedures issuers use for calculating a cardholder's minimum required payment. Figure 13 below presents two samples of text from different cardmember agreements describing how minimum payments are calculated. According to the consultant, the sample that used a bulleted list was easier to read than the one formatted as a paragraph. Also, an issuer stated in a letter to the Federal Reserve that their consumers have welcomed the issuer's use of bullets to format information, emphasizing the concept that the visual layout of information either facilitates or hinders consumer understanding.

Figure 13: Example of How Presentation Techniques Can Affect Readability in Typical Credit Card Disclosure Documents

MINIMUM MONTHLY PAYMENT. The Minimum Payment Due each month will be the sum of any amount past due and the minimum monthly payment. The minimum monthly payment each month will be the greater of $10 or 1/50th of the New Balance, rounded to the next higher whole dollar amount. If any ANNUAL PERCENTAGE RATE applicable to your Account is greater than 22.99%, but less than 26.00%, your minimum monthly payment will be the greater of $10 or 1/45th of the New Balance, rounded to the next higher whole dollar amount. If any ANNUAL PERCENTAGE RATE applicable to your Account is 26.00% or greater, your minimum monthly payment will be the greater of $10 or 1/40th of the New Balance. Regardless of the Annual Percentage Rates on your Account, if the New Balance is less than $10.00, the minimum monthly payment will be the amount of the New Balance. We may also include in your minimum monthly payment all or a portion of the amount by which your outstanding balance exceeds your Account credit limit as of the last day of the billing period. Paying the Minimum Payment Due may be insufficient to bring

Usability consultant's comments:
Expressing a complicated, multistep process as prose makes it difficult to understand the relationships between steps.

Minimum Amount Due:
Each month you must pay a minimum amount that is calculated as follows. First, we begin with any amount that is past due and add to it any amount in excess of your credit line. Second, we add the largest of the following:

- The New Balance on the billing statement if it is less than $20;
- $20 if the New Balance is at least $20;
- 1% of the New Balance (which calculation is rounded down to the nearest dollar) plus the amount of your billed finance charges and any applicable late fee; or
- 1.5% of the New Balance (which calculation is rounded down to the nearest dollar).

However, the Minimum Amount Due will never exceed your New Balance. In calculating the Minimum Amount Due, we may subtract from the New Balance certain fees added to your account during the billing period.

Usability consultant's comments:
By using bullet points, it is much easier to see multiple steps broken out into individual steps and when they are applied.

Sources: UserWorks, Inc.; Information International Associates.

Excessive Complexity and Volume of Information

The content of typical credit card disclosure documents generally was overly complex and presented in too much detail, such as by using unfamiliar or complex terms to describe simple concepts. For example, the usability consultant identified one cardmember agreement that used the term "rolling consecutive twelve billing cycle period" instead of saying "over the course of the next 12 billing statements" or "next 12 months"—if that was appropriate. Further, a number of consumers, consumer advocacy groups, and government and private entities that have provided comments to the Federal Reserve agreed that typical credit card disclosures are written in complex language that hinders consumers' understanding. For example, a consumer wrote that disclosure documents were "loaded with booby traps designed to trip consumers, and written in intentionally impenetrable and confusing language." One of the consumer advocacy groups stated the disclosures were "full of dense, impenetrable legal jargon that even lawyers and seasoned consumer advocates have difficulty understanding." In addition, the consultant noted that many of the disclosures, including solicitation letters and cardmember agreements, contained overly long and complex sentences that increase the effort a reader must devote to understanding the text. Figure 14 contains two examples of instances in which the disclosure documents used uncommon words and phrases to express simple concepts.

Figure 14: Examples of How Removing Overly Complex Language Can Improve Readability in Typical Credit Card Disclosure Documents

101 words

[a]If at any time during any rolling consecutive twelve billing cycle period you fail to make two Minimum Payments on a timely basis or exceed your Credit Limit twice we may elect to increase your Purchase, Cash Advance and/or Balance Transfer APRs to the Penalty APRs. All Penalty APRs will remain in effect until, in a subsequent rolling consecutive six billing cycle period, you do not exceed your Credit Limit at any time and you make all of your required Minimum Payments on a timely basis when, in your next billing cycle, all Penalty APRs will no longer apply.

50 words

Usability consultant's rewrite:
If you pay late or go over your credit limit twice in a year, the interest rate you pay on most things goes up to the default rate, currently 30.49%. It will go back down when you pay on time and do not go over your credit limit for six months.

69 words

Using Your Account: You may use your Card or Account to purchase or lease goods or services, or pay amounts you owe, wherever the Card is honored, transfer balances from other accounts or, if applicable, to obtain advances to cover an overdraft on your checking account with a affiliate under the terms of this Agreement and your Overdraft Protection Agreement, ("Overdraft Advances"). (Purchases, Balance Transfers and Overdraft Advances are collectively called "Purchases").

20 words

Usability consultant's rewrite:
You can use this card to buy things, pay off other accounts, transfer balances, or keep from bouncing a check.

Sources: UserWorks, Inc.; Information International Associates.

In addition, the disclosure documents regularly presented too much or irrelevant detail. According to the usability consultant's analysis, the credit card disclosures often contained superfluous information. For example, figure 15 presents an example of text from one cardmember agreement that described the actions the issuer would take if its normal source for the rate information used to set its variable rates—*The Wall Street Journal*—were to cease publication. Including such an arguably unimportant detail lengthens and makes this disclosure more complex. According to SEC best practices for creating clear disclosures, disclosure documents are more effective when they adhere to the rule that less is more. By omitting unnecessary details from disclosure documents, the usability consultant indicated that consumers would be more likely to read and understand the information they contain.

Figure 15: Example of Superfluous Detail in Typical Credit Card Disclosure Documents

Usability consultant's comments: This section provides superfluous information on how the prime rate is determined. For example, the explanation of the actions if the Wall Street Journal was to cease publication.

If any annual percentage rate is based on the U.S. Prime Rate plus a margin, we will calculate the rate for each billing period by adding the applicable margin that appears on the card carrier to the U.S. Prime Rate. For each billing period we will use the U.S. Prime Rate published in *The Wall Street Journal* two business days prior to your Statement/Closing Date for that billing period. Any increase or decrease in a variable annual percentage rate due to a change in the U.S. Prime Rate takes effect as of the first day of the billing period for which we calculate the variable annual percentage rate. If more than one U.S. Prime Rate is published, we may choose the highest rate. If *The Wall Street Journal* ceases publication or to publish the U.S. Prime Rate, we may use the U.S. Prime Rate published in any other newspaper of general circulation, or we may substitute a similar reference rate at our sole discretion. When a change in an applicable variable annual percentage rate takes effect we will apply it to any existing balances, subject to any promotional rate that may apply.

Sources: UserWorks, Inc.; Information International Associates.

Consumer Confusion Indicated That Disclosures Were Not Communicating Credit Card Cost Information Clearly

Many of the credit cardholders that were tested and interviewed as part of our review exhibited confusion over various fees, practices, and other terms that could affect the cost of using their credit cards. To understand how well consumers could use typical credit card disclosure documents to locate and understand information about card fees and other practices, the usability consultant with whom we contracted used a sample of cardholders to perform a usability assessment of the disclosure documents from the four large issuers. As part of this assessment, the consultant conducted one-on-one sessions with a total of 12 cardholders so that each set of disclosures, which included a solicitation letter and a cardmember agreement, was reviewed by 3 cardholders.[51] Each of these cardholders were asked to locate information about fee levels and rates, the circumstances in which they would be imposed, and information about changes in card terms. The consultant also tested the cardholders' ability to explain various practices used by the issuer, such as the process for determining the amount of the minimum monthly payment, by reading the disclosure documents. Although the results of the usability testing cannot

[51]According to the consultant, testing with small numbers of individuals can generally identify many of the problems that can affect the readability and usability of materials.

be used to make generalizations about all cardholders, the consultant selected cardholders based on the demographics of the U.S. adult population, according to age, education level, and income, to ensure that the cardholders tested were representative of the general population. In addition, as part of this review, we conducted one-on-one interviews with 112 cardholders to learn about consumer behavior and knowledge about various credit card terms and practices.[52] Although we also selected these cardholders to reflect the demographics of the U.S. adult population, with respect to age, education level, and income, the results of these interviews cannot be generalized to the population of all U.S. cardholders.[53]

Based on the work with consumers, specific aspects of credit card terms that apparently were not well understood included:

- *Default interest rates.* Although issuers can penalize cardholders for violating the terms of the card, such as by making late payments or by increasing the interest rates in effect on the cardholder's account to rates as high as 30 percent or more, only about half of the cardholders that the usability consultant tested were able to use the typical credit card disclosure documents to successfully identify the default rate and the circumstances that would trigger rate increases for these cards. In addition, the usability consultant observed the cardholders could not identify this information easily. Many also were unsure of their answers, especially when rates were expressed as a "prime plus" number, indicating the rate varied based on the prime rate. Locating information in the typical cardmember agreement was especially difficult for cardholders, as only 3 of 12 cardholders were able to use such documents to identify the default interest rate applicable to the card. More importantly, only about half of the cardholders tested using solicitation letters were able to accurately determine what actions could potentially cause the default rate to be imposed on these cards.

- *Other penalty rate increases.* Although card issuers generally reserve the right to seek to raise a cardholder's rate in other situations, such as when a cardholder makes a late payment to another issuer's credit card, (even if the cardholder has not defaulted on the cardmember

[52]We also used this data in a previous report to show cardholder preferences for customized information in their monthly billing statements about the consequences of making minimum payments on their outstanding balance. GAO-06-434.

[53]For more information about our scope and methodology, see appendix I.

agreement), about 71 percent of the 112 cardholders we interviewed were unsure or did not believe that issuers could increase their rates in such a case. In addition, about two-thirds of cardholders we interviewed were unaware or did not believe that a drop in their credit score could cause an issuer to seek to assess higher interest rates on their account.[54]

- *Late payment fees.* According to the usability assessment, many of the cardholders had trouble using the disclosure documents to correctly identify what would occur if a payment were to be received after the due date printed in the billing statement. For example, nearly half of the cardholders were unable to use the cardmember agreement to determine whether a payment would be considered late based on the date the issuer receives the payment or the date the payment was mailed or postmarked. Additionally, the majority of the 112 cardholders we interviewed also exhibited confusion over late fees: 52 percent indicated that they have been surprised when their card company applied a fee or penalty to their account.

- *Using a credit card to obtain cash.* Although the cardholders tested by the consultant generally were able to use the disclosures to identify how a transaction fee for a cash advance would be calculated, most were unable to accurately use this information to determine the transaction fee for withdrawing funds, usually because they neglected to consider the minimum dollar amount, such as $5 or $10, that would be assessed.

- *Grace periods.* Almost all 12 cardholders in the usability assessment had trouble using the solicitation letters to locate and define the grace period, the period during which the a cardholder is not charged interest on a balance. Instead, many cardholders incorrectly indicated that the grace period was instead when their lower, promotional interest rates would expire. Others incorrectly indicated that it was the amount of time after the monthly bill's due date that a cardholder could submit a payment without being charged a late fee.

- *Balance computation method.* Issuers use various methods to calculate interest charges on outstanding balances, but only 1 of the 12 cardholders the usability consultant tested correctly described average

[54]A credit score is a number, roughly between 300 and 800, that reflects the credit history detailed by a person's credit report. Lenders use borrowers' credit scores in the process of assigning rates and terms to the loans they make.

daily balance, and none of the cardholders were able to describe two-cycle average daily balance accurately. At least nine letters submitted to the Federal Reserve in connection with its review of credit card disclosures noted that few consumers understand balance computation methods as stated in disclosure documents.

Perhaps as a result of weaknesses previously described, cardholders generally avoid using the documents issuers provide with a new card to improve their understanding of fees and practices. For example, many of the cardholders interviewed as part of this report noted that the length, format, and complexity of disclosures led them to generally disregard the information contained in them. More than half (54 percent) of the 112 cardholders we interviewed indicated they read the disclosures provided with a new card either not very closely or not at all. Instead, many cardholders said they would call the issuer's customer service representatives for information about their card's terms and conditions. Cardholders also noted that the ability of issuers to change the terms and conditions of a card at any time led them to generally disregard the information contained in card disclosures. Regulation Z allows card issuers to change the terms of credit cards provided that issuers notify cardholders in writing within 15 days of the change. As a result, the usability consultant observed some participants were dismissive of the information in the disclosure documents because they were aware that issuers could change anything.

Federal Reserve Effort to Revise Regulations Presents Opportunity to Improve Disclosures

With liability concerns and outdated regulatory requirements seemingly explaining the weaknesses in card disclosures, the Federal Reserve has begun efforts to review its requirements for credit card disclosures. Industry participants have advocated various ways in which the Federal Reserve can act to improve these disclosures and otherwise assist cardholders.

Regulations and Guidance May Contribute to Weaknesses in Current Disclosures

Several factors may help explain why typical credit card disclosures exhibit weaknesses that reduce their usefulness to cardholders. First, issuers make decisions about the content and format of their disclosures to limit potential legal liability. Issuer representatives told us that the disclosures made in credit card solicitations and cardmember agreements are written for legal purposes and in language that consumers generally could not understand. For example, representatives for one large issuer told us they cannot always state information in disclosures clearly because the increased potential that simpler statements would be misinterpreted would expose them to litigation. Similarly, a participant of a symposium on credit card disclosures said that disclosures typically became lengthier after the issuance of court rulings on consumer credit issues. Issuers can attempt to reduce the risk of civil liability based on their disclosures by closely following the formats that the Federal Reserve has provided in its model forms and other guidance. According to the regulations that govern card disclosures, issuers acting in good faith compliance with any interpretation issued by a duly authorized official or employee of the Federal Reserve are afforded protection from liability.[55]

Second, the regulations governing credit card disclosures have become outdated. As noted earlier in this report, TILA and Regulation Z that implements the act's provisions are intended to ensure that consumers have adequate information about potential costs and other applicable terms and conditions to make appropriate choices among competing credit cards. The most recent comprehensive revisions to Regulation Z's open-end credit rules occurred in 1989 to implement the provisions of the Fair Credit and Charge Card Act. As we have found, the features and cost structures of credit cards have changed considerably since then. An issuer representative told us that current Schumer box requirements are not as useful in presenting the more complicated structures of many current cards. For example, they noted that it does not easily accommodate information about the various cardholder actions that could trigger rate increases, which they argued is now important information for consumers to know when shopping for credit. As a result, some of the specific requirements of Regulation Z that are intended to ensure that consumers have accurate information instead may be diminishing the usefulness of these disclosures.

Third, the guidance that the Federal Reserve provides issuers may not be consistent with guidelines for producing clear, written documents. Based on our analysis, many issuers appear to adhere to the formats and model forms that the Federal Reserve staff included in the Official Staff Interpretations of Regulation Z, which are prepared to help issuers comply with the regulations. For example, the model forms present text about how rates are determined in footnotes. However, as discussed previously, not grouping related information undermines the usability of documents. The

[55]Under Section 130(f) of the TILA, creditors are protected from civil liability for any act done or omitted in good faith in conformity with any interpretation issued by a duly authorized official or employee of the Federal Reserve System. 15 U.S.C. § 1640.

Schumer box format requires a cardholder to look in several places, such as in multiple rows in the table and in notes to the table, for information about related aspects of the card. Similarly, the Federal Reserve's model form for the Schumer box recommends that the information about the transaction fee and interest rate for cash advances be disclosed in different areas.

Finally, the way that issuers have implemented regulatory guidance may have contributed to the weaknesses typical disclosure materials exhibited. For example, in certain required disclosures, the terms "annual percentage rate" and "finance charge," when used with a corresponding amount or percentage rate, are required to be more conspicuous than any other required disclosures.[56] Staff guidance suggests that such terms may be made more conspicuous by, for example, capitalizing these terms when other disclosures are printed in lower case or by displaying these terms in larger type relative to other disclosures, putting them in boldface print or underlining them.[57] Our usability consultant's analysis found that card disclosure documents that followed this guidance were less effective because they placed an inappropriate emphasis on terms. As shown previously in figure 11, the use of bold and capital letters to emphasize the term "finance charge" in the paragraph unnecessarily calls attention to that term, potentially distracting readers from information that is more important. The excerpt shown in figure 11 is from an initial disclosure document which, according to Regulation Z, is subject to the "more conspicuous" rule requiring emphasis of the terms "finance charge" and "annual percentage rate."

Suggestions for Improving Disclosures Included Obtaining Input from Consumers

With the intention of improving credit card disclosures, the Federal Reserve has begun efforts to develop new regulations. According to its 2004 notice seeking public comments on Regulation Z, the Federal Reserve hopes to address the length, complexity, and superfluous information of disclosures and produce new disclosures that will be more useful in helping consumers compare credit products.[58] After the passage of the

[56]See generally 12 C.F.R. 225.5(a)(3) and the corresponding staff commentary.

[57]Notwithstanding the more conspicuous rule, Regulation Z expressly provides that the annual percentage rate for purchases required to be disclosed in the Schumer box must be in at least 18-point type. 12 C.F.R. § 226.5a(b)(1).

[58]Truth in Lending, 69 Fed. Reg. 70925 (advanced notice of proposed rulemaking, published Dec. 8, 2004).

Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (Bankruptcy Act) in October of that year, which included amendments to TILA, the Federal Reserve sought additional comments from the public to prepare to implement new disclosure requirements including disclosures intended to advise consumers of the consequences of making only minimum payments on credit cards.[59] According to Federal Reserve staff, new credit card disclosure regulations may not be in effect until sometime in 2007 or 2008 because of the time required to conduct consumer testing, modify the existing regulations, and then seek comment on the revised regulation.

Industry participants and others have provided input to assist the Federal Reserve in this effort. Based on the interviews we conducted, documents we reviewed, and our analysis of the more than 280 comment letters submitted to the Federal Reserve, issuers, consumer groups, and others provided various suggestions to improve the content and format of credit card disclosures, including:

- *Reduce the amount of information disclosed.* Some industry participants said that some of the information currently presented in the Schumer box could be removed because it is too complicated to disclose meaningfully or otherwise lacks importance compared to other credit terms that are arguably more important when choosing among cards. Such information included the method for computing balances and the amount of the minimum finance charge (the latter because it is typically so small, about 50 cents in 2005).
- *Provide a shorter document that summarizes key information.* Some industry participants advocated that all key information that could significantly affect a cardholder's costs be presented in a short document that consumers could use to readily compare across cards, with all other details included in a longer document. For example, although the Schumer box includes several key pieces of information, it does not include other information that could be as important for consumer decisions, such as what actions could cause the issuer to raise the interest rate to the default rate.

[59] Truth in Lending, 70 Fed. Reg. 60235 (request for comments; extension of comment period, published October 17, 2005).

- *Revise disclosure formats to improve readability.* Various suggestions were made to improve the readability of card disclosures, including making more use of tables of contents, making labels and headings more prominent, and presenting more information in tables instead of in text. Disclosure documents also could use consistent wording that could allow for better comparison of terms across cards.

Some issuers and others also told us that the new regulations should allow for more flexibility in card disclosure formats. Regulations mandating formats and font sizes were seen as precluding issuers from presenting information in more effective ways. For example, one issuer already has conducted market research and developed new formats for the Schumer box that it says are more readable and contain new information important to choosing cards in today's credit card environment, such as cardholder actions that would trigger late fees or penalty interest rate increases.

In addition to suggestions about content, obtaining the input of consumers, and possibly other professionals, was also seen as an important way to make any new disclosures more useful. For example, participants in a Federal Reserve Bank symposium on credit card disclosures recommended that the Federal Reserve obtain the input of marketers, researchers, and consumers as part of developing new disclosures. OCC staff suggested that the Federal Reserve also employ qualitative research methods such as in-depth interviews with consumers and others and that it conduct usability testing.

Consumer testing can validate the effectiveness or measure the comprehension of messages and information, and detect document design problems. Many issuers are using some form of market research to test their disclosure materials and have advocated improving disclosures by seeking the input of marketers, researchers, and consumers.[60] SEC also has recently used consumer focus groups to test the format of new disclosures related to mutual funds. According to an SEC staff member who participated in this effort, their testing provided them with valuable information on what consumers liked and disliked about some of the initial forms that the regulator had drafted. In some cases, they learned that

[60]Consumer testing can be conducted in several ways, such as focus groups, where consumers analyze products in a group setting, and conjoint analysis, which helps companies understand the extent to which consumers prefer certain product attributes over others.

information that SEC staff had considered necessary to include was not seen as important by consumers. As a result, they revised the formats for these disclosures substantially to make them simpler and may use graphics to present more information rather than text.[61] According to Federal Reserve staff, they have begun to involve consumers in the development of new credit card disclosures. According to Federal Reserve staff, they have already conducted some consumer focus groups. In addition, they have contracted with a design consultant and a market research firm to help them develop some disclosure formats that they can then use in one-on-one testing with consumers. However, the Federal Reserve staff told us they recognize the challenge of designing disclosures that include all key information in a clear manner, given the complexity of credit card products and the different ways in which consumers use credit cards.

Although Credit Card Penalty Fees and Interest Could Increase Indebtedness, the Extent to Which They Have Contributed to Bankruptcies Was Unclear

The number of consumers filing for bankruptcy has risen more than six-fold over the past 25 years, and various factors have been cited as possible explanations. While some researchers have pointed to increases in total debt or credit card debt in particular, others found that debt burdens and other measures of financial distress had not increased and thus cite other factors, such as a general decline in the stigma of going bankrupt or the potentially increased costs of major life events such as health problems or divorce. Some critics of the credit card industry have cited penalty interest and fees as leading to increased financial distress; however, no comprehensive data existed to determine the extent to which these charges were contributing to consumer bankruptcies. Data provided by the six largest card issuers indicated that unpaid interest and fees represented a small portion of the amounts owed by cardholders that filed for bankruptcy; however, these data alone were not sufficient to determine any relationship between the charges and bankruptcies filed by cardholders.

Researchers Cited Various Factors as Explanations for Rise in Consumer Bankruptcies

According to U.S. Department of Justice statistics, consumer bankruptcy filings generally rose steadily from about 287,000 in 1980 to more than 2 million as of December 31, 2005, which represents about a 609 percent

[61]Securities Exchange Act Release No. 33-8544 (Feb. 28, 2005).

increase over the last 25 years.[62] Researchers have cited a number of factors as possible explanations for the long-term trend.

Increase in Household Indebtedness

The total debt of American households is composed of mortgages on real estate, which accounts for about 80 percent of the total, and consumer credit debt, which includes revolving credit, such as balances owed on credit cards, and nonrevolving credit, primarily consisting of auto loans. According to Federal Reserve statistics, consumers' use of debt has expanded over the last 25 years, increasing more than sevenfold from $1.4 trillion in 1980 to about $11.5 trillion in 2005. Some researchers pointed to this rise in overall indebtedness as contributing to the rise in bankruptcies. For example, a 2000 Congressional Budget Office summary of bankruptcy research noted that various academic studies have argued that consumer bankruptcies are either directly or indirectly caused by heavy consumer indebtedness.

Rather than total debt, some researchers and others argue that the rise in bankruptcies is related to the rise in credit card debt in particular. According to the Federal Reserve's survey of consumer debt, the amount of credit card debt reported as outstanding rose from about $237 billion to more than $802 billion—a 238 percent increase between 1990 and 2005.[63] One academic researcher noted that the rise in bankruptcies and charge-offs by banks in credit card accounts grew along with the increase in credit card debt during the 1973 to 1996 period he examined.[64] According to some consumer groups, the growth of credit card debt is one of the primary explanations of the increased prevalence of bankruptcies in the United States. For example, one group noted in a 2005 testimony before Congress that growth of credit card debt—particularly among lower and moderate income households, consumers with poor credit scores, college students,

[62]Bankruptcy filings sharply increased recently, with filings in 2005 30 percent higher than in 2004. This increase likely resulted from the accelerated rate of filing that occurred in the months before the new Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which tightened eligibility for filing, became effective on October 17, 2005.

[63]In addition to capturing amounts outstanding on credit cards, the number reported in the Federal Reserve's survey of consumer debt for revolving debt also includes other types of revolving debt. However, Federal Reserve staff familiar with the survey's results indicated that the vast majority of the amount reported as revolving debt is from credit cards.

[64]L. Ausubel, "Credit Card Defaults, Credit Card Profits, and Bankruptcy," *The American Bankruptcy Law Journal*, 71 (Spring 1997).

older Americans, and minorities—was contributing to the rise in bankruptcies.[65]

However, other evidence indicates that increased indebtedness has not severely affected the financial condition of U.S. households in general. For example:

- Some researchers note that the ability of households to make payments on debt appears to be keeping pace. For example, total household debt levels as a percentage of income has remained relatively constant since the 1980s. According to the Federal Reserve, the aggregate debt burden ratio—which covers monthly aggregate required payments of all households on mortgage debt and both revolving and non-revolving consumer loans relative to the aggregate monthly disposable income of all households—for U.S. households has been above 13 percent in the last few years but generally fluctuated between 11 percent and 14 percent from 1990 to 2005, similar to the levels observed during the 1980s. According to one researcher, although the debt burden ratio has risen since the 1980s, the increase has been gradual and therefore cannot explain the six-fold increase in consumer bankruptcy filings over the same period.
- Credit card debt remains a small portion of overall household debt, even among households with the lowest income levels. According to the Federal Reserve, credit card balances as a percentage of total household debt have declined from 3.9 percent of total household debt in 1995 to just 3.0 percent as of 2004.
- The proportion of households that could be considered to be in financial distress does not appear to be increasing significantly. According to the Federal Reserve Board's Survey of Consumer Finances, the proportion of households that could be considered to be in financial distress—those that report debt-to-income ratios exceeding 40 percent and that have had at least one delinquent payment within the last 60 days—was relatively stable between 1995 and 2004. Further, the proportion of the

[65]Consumer Federation of America testimony before the Committee on Banking, Housing, and Urban Affairs of the United States Senate, "*Examining the Current Legal and Regulatory Requirements and Industry Practices for Credit Card Issuers with Respect to Consumer Disclosures and Marketing Efforts*," 109th Congress, 2nd sess., May 17, 2005. We reported on issues relating to college students and credits in 2001. See GAO, *Consumer Finance: College Students and Credit Cards*, GAO-01-773 (Washington, D.C.; June 20, 2001).

lowest-income households exhibiting greater levels of distress was lower in 2004 than it was in the 1990s.

Other Explanations

With the effect of increased debt unclear, some researchers say that other factors may better explain the surge in consumer bankruptcy filings over the past 25 years. For example, the psychological stigma of declaring bankruptcy may have lessened. One academic study examined a range of variables that measured the credit risk (risk of default) of several hundred thousand credit card accounts and found that because the bankruptcy rate for the accounts was higher than the credit-risk variables could explain, the higher rate must be the result of a reduced level of stigma associated with filing.[66] However, others have noted that reliably measuring stigma is difficult. Some credit card issuers and other industry associations also have argued that the pre-2005 bankruptcy code was too debtor-friendly and created an incentive for consumers to borrow beyond the ability to repay and file for bankruptcy.

In addition to the possibly reduced stigma, some academics, consumer advocacy groups, and others noted that the normal life events that reduce incomes or increase expenses for households may have a more serious effect today. Events that can reduce household incomes include job losses, pay cuts, or having a full-time position converted to part-time work. With increasing health care costs, medical emergencies can affect household expenses and debts more significantly than in the past, and, with more families relying on two incomes, so can divorces. As a result, one researcher explains that while these risks have always faced households, their effect today may be more severe, which could explain higher bankruptcy rates.[67]

Researchers who assert that life events are the primary explanation for bankruptcy filings say that the role played by credit cards can vary. They acknowledged that credit card debt can be a contributing factor to a bankruptcy filing if a person's income is insufficient to meet all financial obligations, including payments to credit card issuers. For example, some individuals experiencing an adverse life event use credit cards to provide

[66]David B. Gross and Nicholas S. Souleles, "Explaining the Increase in Bankruptcy and Delinquency: Stigma Versus Risk-Composition." Mimeo, University of Chicago, (August 28, 1998).

[67]Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School, "The Growing Threat to Middle Class Families," *Brooklyn Law Review*, (April 2003).

additional funds to satisfy their financial obligations temporarily but ultimately exhaust their ability to meet all obligations. However, because the number of people that experience financially troublesome life events likely exceeds the number of people who file for bankruptcy, credit cards in other cases may serve as a critical temporary source of funding they needed to avert a filing until that person's income recovers or expenses diminish. (Appendix II provides additional detail about the factors that may have affected the rise in consumer bankruptcy filings and its relationship with credit card debt.)

The Extent to Which Credit Card Penalty Interest and Fees Contribute to Consumer Bankruptcies Remains Controversial in the Absence of Comprehensive Data

With very little information available on the financial condition of individuals filing for bankruptcy, assessing the role played by credit card debt, including penalty interest and fees, is difficult. According to Department of Justice officials who oversee bankruptcy trustees in most bankruptcy courts, the documents submitted as part of a bankruptcy filing show the total debt owed to each card issuer but not how much of this total consists of unpaid principal, interest, or fees. Similarly, these Justice officials told us that the information that credit card issuers submit when their customers reaffirm the debts owed to them—known as proofs of claim—also indicate only the total amount owed. Likewise, the amount of any penalty interest or fees owed as part of an outstanding credit card balance is generally not required to be specified when a credit card issuer seeks to obtain a court judgment that would require payment from a customer as part of a collection case.

Opinions on the Link between Credit Card Practices and Bankruptcies Vary

Although little comprehensive data exist, some consumer groups and others have argued that penalty interest and fees materially harm the financial condition of some cardholders, including those that later file for bankruptcy. Some researchers who study credit card issues argue that high interest rates (applicable to standard purchases) for higher risk cardholders, who are also frequently lower-income households, along with penalty and default interest rates and fees, contribute to more consumer bankruptcy filings. Another researcher who has studied issues relating to credit cards and bankruptcy asserted that consumers focus too much on the introductory purchase interest rates when shopping for credit cards and, as a result, fail to pay close attention to penalty interest rates, default clauses, and other fees that may significantly increase their costs later. According to this researcher, it is doubtful that penalty fees (such as late fees and over-limit fees) significantly affect cardholders' debt levels, but accrued interest charges—particularly if a cardholder is being assessed a high penalty interest rate—can significantly worsen a cardholder's financial distress.

Some consumer advocacy groups and academics say that the credit card industry practice of raising cardholder interest rates for default or increased risky behavior likely has contributed to some consumer bankruptcy filings. According to these groups, cardholders whose rates are raised under such practices can find it more difficult to reduce their credit card debt and experience more rapid declines in their overall financial conditions as they struggle to make the higher payments that such interest rates may entail. As noted earlier in this report, card issuers have generally ceased practicing universal default, although representatives for four of the six issuers told us that they might increase their cardholder's rates if they saw indications that the cardholder's risk has increased, such as how well they were making payments to other creditors. In such cases, the card issuers said they notify the cardholders in advance, by sending a change in terms notice, and provide an option to cancel the account but keep the original terms and conditions while paying off the balance.

Some organizations also have criticized the credit card industry for targeting lower-income households that they believe may be more likely to experience financial distress or file for bankruptcy. One of the criticisms these organizations have made is that credit card companies have been engaging in bottom-fishing by providing increasing amounts of credit to riskier lower-income households that, as a result, may incur greater levels of indebtedness than appropriate. For example, an official from one consumer advocacy group testified in 2005 that card issuers target lower-income and minority households and that this democratization of credit has had serious negative consequences for these households, placing them one financial emergency away from having to file for bankruptcy.[68] Some consumer advocacy group officials and academics noted that card issuers market high-cost cards, with higher interest rates and fees, to customers with poor credit histories—called subprime customers—including some just coming out of bankruptcy. However, as noted earlier, Federal Reserve survey data indicate that the proportion of lower-income households—those with incomes below the fortieth percentile—exhibiting financial distress has not increased since 1995. In addition, in a June 2006 report that the Federal Reserve Board prepared for Congress on the relationship

[68]See above: Consumer Federation of America testimony before the Committee on Banking, Housing, and Urban Affairs of the United States Senate on May 17, 2005.

between credit cards and bankruptcy, it stated that credit card issuers do not solicit customers or extend credit to them indiscriminately or without assessing their ability to repay debt as issuers review all received applications for risk factors.[69]

In addition, representatives of credit card issuers argued that they do not offer credit to those likely to become financially bankrupt because they do not want to experience larger losses from higher-risk borrowers. Because card accounts belonging to cardholders that filed for bankruptcy account for a sizeable portion of issuers' charge-offs, card issuers do not want to acquire new customers with high credit risk who may subsequently file for bankruptcy. However, one academic researcher noted that, if card issuers could increase their revenue and profits by offering cards to more customers, including those with lower creditworthiness, they could reasonably be expected to do so until the amount of expected losses from bankruptcies becomes larger than the expected additional revenues from the new customers.

In examining the relationship between the consumer credit industry and bankruptcy, the Federal Reserve Board's 2006 report comes to many of the same conclusions as the studies of other researchers we reviewed. The Federal Reserve Board's report notes that despite large growth in the proportion of households with credit cards and the rise in overall credit card debt in recent decades, the debt-burden ratio and other potential measures of financial distress have not significantly changed over this period. The report also found that, while data on bankruptcy filings indicate that most filers have accumulated consumer debt and the proportion of filings and rise in revolving consumer debt have risen in tandem, the decision to file for bankruptcy is complex and tends to be driven by distress arising from life events such as job loss, divorce, or uninsured illness.

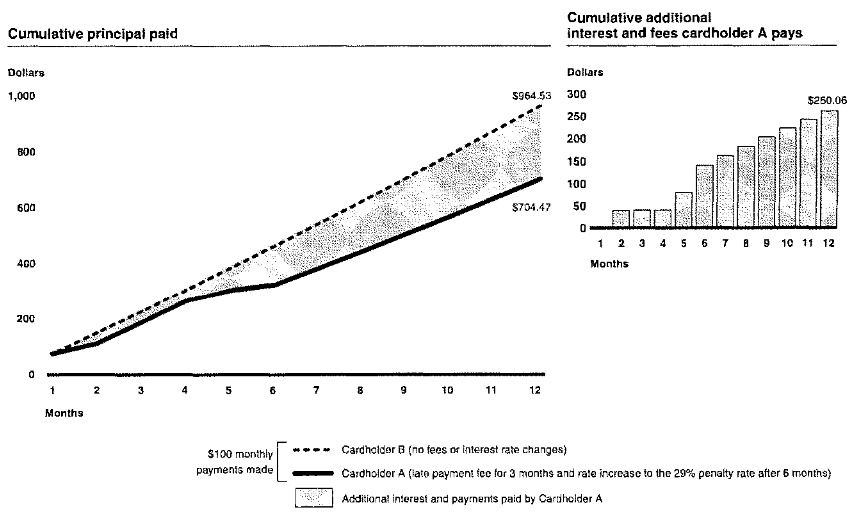
Penalty Interest and Fees Can Affect Cardholders' Ability to Reduce Outstanding Balances

While the effect of credit card penalty interest charges and fees on consumer bankruptcies was unclear, such charges do reduce the ability of cardholders to reduce their overall indebtedness. Generally, any penalty charges that cardholders pay would consume funds that could have been used to repay principal. Figure 16 below, compares two hypothetical

[69]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* (Washington, D.C.: June 2006).

cardholders with identical initial outstanding balances of $2,000 that each make monthly payments of $100. The figure shows how the total amounts of principal are paid down by each of these two cardholders over the course of 12 months, if penalty interest and fees apply. Specifically, cardholder A (1) is assessed a late payment fee in three of those months and (2) has his interest rate increased to a penalty rate of 29 percent after 6 months, while cardholder B does not experience any fees or penalty interest charges. At the end of 12 months, the penalty and fees results in cardholder A paying down $260 or 27 percent less of the total balance owed than does cardholder B who makes on-time payments for the entire period.

Figure 16: Hypothetical Impact of Penalty Interest and Fee Charges on Two Cardholders



Source: GAO.

In Some Court Cases, Cardholders Paid Significant Amounts of Penalty Interest and Fees

In reviewing academic literature, hearings, and comment letters to the Federal Reserve, we identified some court cases, including some involving the top six issuers, that indicated that cardholders paid large amounts of penalty interest and fees. For example:

- In a collections case in Ohio, the $1,963 balance on one cardholder's credit card grew by 183 percent to $5,564 over 6 years, despite the cardholder making few new purchases. According to the court's records, although the cardholder made payments totaling $3,492 over this period, the holder's balance grew as the result of fees and interest charges. According to the court's determinations, between 1997 and 2003, the cardholder was assessed a total of $9,056, including $1,518 in over-limit fees, $1,160 in late fees, $369 in credit insurance, and $6,009 in interest charges and other fees. Although the card issuer had sued to collect, the judge rejected the issuer's collection demand, noting that the cardholder was the victim of unreasonable, unconscionable practices.[70]

- In a June 2004 bankruptcy case filed in the U.S. Bankruptcy Court for the Eastern District of Virginia, the debtor objected to the proofs of claim filed by two companies that had been assigned the debt outstanding on two of the debtor's credit cards. One of the assignees submitted monthly statements for the credit card account it had assumed. The court noted that over a two-year period (during which balance on the account increased from $4,888 to $5,499), the debtor made only $236 in purchases on the account, while making $3,058 in payments, all of which had gone to pay finance charges, late charges, over-limit fees, bad check fees and phone payment fees.[71]

- In a bankruptcy court case filed in July 2003 in North Carolina, 18 debtors filed objections to the claims by one card issuer of the amounts owed on their credit cards.[72] In response to an inquiry by the judge, the card issuer provided data for these accounts that showed that, in the

[70]"Comments of the National Consumer Law Center et al. regarding Advance Notice of Proposed Rulemaking Review of the Revolving Credit Rules of Regulation Z," p. 7-9.

[71]*McCarthy vs. eCast Settlement Corporation et al.*, No.04-10493-SSM (Bankr. E.D. Va. filed June 9, 2004).

[72]*See Blair v. Capital One Bank*, No. 02-11400, *Amended Order Overruling Objection to Claim(s)s* (Bankr. W.D. NC filed Feb. 10, 2004) (disposing of, on a consolidated basis, similar objections filed in 18 separate Chapter 13 cases against a common creditor) (Additional docket numbers omitted.).

aggregate, 57 percent of the amounts owed by these 18 accounts at time of their bankruptcy filings represented interest charges and fees. However, the high percentage of interest and fees on these accounts may stem from the size of these principal balances, as some were as low as $95 and none was larger than $1,200.

Regulatory interagency guidance published in 2003 for all depository institutions that issue credit cards may have reduced the potential for cardholders who continue to make minimum payments to experience increasing balances.[73] In this guidance, regulators suggested that card issuers require minimum repayment amounts so that cardholders' current balance would be paid off–amortized–over a reasonable amount of time. In the past, some issuers' minimum monthly payment formulas were such that a full payment may have resulted in little or no principal being paid down, particularly if the cardholder also was assessed any fees during a billing cycle. In such cases, these cardholders' outstanding balances would increase (or negatively amortize). In response to this guidance, some card issuers we interviewed indicated that they have been changing their minimum monthly payment formulas to ensure that credit card balances will be paid off over a reasonable period by including at least some amount of principal in each payment due.

Representatives of card issuers also told us that the regulatory guidance, issued in 2003, addressing credit card workout programs—which allow a distressed cardholder's account to be closed and repaid on a fixed repayment schedule—and other forbearance practices, may help cardholders experiencing financial distress avoid fees. In this guidance, the regulators stated that (1) any workout program offered by an issuer should be designed to have cardholders repay credit card debt within 60 months and (2) to meet this time frame, interest rates and penalty fees may have to be substantially reduced or eliminated so that principal can be repaid. As a result, card issuers are expected to stop imposing penalty fees and interest charges on delinquent card accounts or hardship card accounts enrolled in repayment workout programs. According to this guidance, issuers also can negotiate settlement agreements with cardholders by forgiving a portion of

[73]*Credit Card Lending: Account Management and Loss Allowance Guidance* (January 2003), joint guidance issued under the auspices of the Federal Financial Institutions Examination Council by the Office of the Comptroller of the Currency (OCC Bulletin 2003-1), Federal Reserve (Supervisory Letter SR-03-1), Federal Deposit Insurance Corporation (Financial Institution Letter, FIL-2-2003), and Office of Thrift Supervision (OTS Release 03-01).

the amount owed. In exchange, a cardholder can be expected to pay the remaining balance either in a lump-sum payment or by amortizing the balance over a several month period. Staff from OCC and an association of credit counselors told us that, since the issuance of this guidance, they have noticed that card issuers are increasingly both reducing and waiving fees for cardholders who get into financial difficulty. OCC officials also indicated that issuers prefer to facilitate repayment of principal when borrowers adopt debt management plans and tend to reduce or waive fees so the accounts can be amortized. On the other hand, FDIC staff indicated that criteria for waiving fees and penalties are not publicly diselosed to cardholders. These staff noted that most fee waivers occurs after cardholders call and complain to the issuer and are handled on a case-by-case basis.

Data for Some Bankrupt Cardholders Shows Little in Interest and Fees Owed, but Comprehensive Data Were Not Available

Card issuers generally charge-off credit card loans that are no longer collectible because they are in default for either missing a series of payments or filing for bankruptcy. According to the data provided by the six largest issuers, the number of accounts that these issuers collectively had to charge off as a result of the cardholders filing for bankruptcy ranged from about 1.3 million to 1.6 million annually between 2003 and 2005. Collectively, these represented about 1 percent of the six issuers' active accounts during this period. Also, about 60 percent of the accounts were 2 or more months delinquent at the time of the charge-off. Most of the cardholders whose accounts were charged off as the result of a bankruptcy owed small amounts of fees and interest charges at the time of their bankruptcy filing. According to the data the six issuers provided, the average account that they charged off in 2005 owed approximately $6,200 at the time that bankruptcy was filed. Of this amount, the issuers reported that on average 8 percent represented unpaid interest charges; 2 percent unpaid fees, including any unpaid penalty charges; and about 90 percent principal.

However, these data do not provide complete information about the extent to which the financial condition of the cardholders may have been affected by penalty interest and fee charges. First, the amounts that these issuers reported to us as interest and fees due represent only the unpaid amounts that were owed at the time of bankruptcy. According to representatives of the issuers we contacted, each of their firms allocates the amount of any payment received from their customers first to any outstanding interest charges and fees, then allocates any remainder to the principal balance. As a result, the amounts owed at the time of bankruptcy would not reflect any previously paid fees or interest charges. According to representatives of these issuers, data system and recordkeeping limitations prevented them from providing us the amounts of penalty interest and fees assessed on these accounts in the months prior to the bankruptcy filings.

Furthermore, the data do not include information on all of the issuers' cardholders who went bankrupt, but only those whose accounts the issuers charged off as the result of a bankruptcy filing. The issuers also charge off the amounts owed by customers who are delinquent on their payments by more than 180 days, and some of those cardholders may subsequently file for bankruptcy. Such accounts may have accrued larger amounts of unpaid penalty interest and fees than the accounts that were charged off for bankruptcy after being delinquent for less than 180 days, because they would have had more time to be assessed such charges. Representatives of the six issuers told us that they do not maintain records on these customers after they are charged off, and, in many cases, they sell the accounts to collection firms.

Although Penalty Interest and Fees Likely Have Grown as a Share of Credit Card Revenues, Large Card Issuers' Profitability Has Been Stable

Determining the extent to which penalty interest charges and fees contribute to issuers' revenues and profits was difficult because issuers' regulatory filings and other public sources do not include such detail. According to bank regulators, industry analysts, and information reported by the five largest issuers, we estimate that the majority of issuer revenues—around 70 percent in recent years—came from interest charges, and the portion attributable to penalty rates appears to be growing. Of the remaining issuer revenues, penalty fees had increased and were estimated to represent around 10 percent of total issuer revenues. The remainder of issuer revenues came from fees that issuers receive for processing merchants' card transactions and other types of consumer fees. The largest credit card-issuing banks, which are generally the most profitable group of lenders, have not greatly increased their profitability over the last 20 years.

Publicly Disclosed Data on Revenues and Profits from Penalty Interest and Fees Are Limited

Determining the extent to which penalty interest and fee charges are contributing to card issuer revenues and profits is difficult because limited information is available from publicly disclosed financial information. Credit card-issuing banks are subject to various regulations that require them to publicly disclose information about their revenues and expenses. As insured commercial banks, these institutions must file reports of their financial condition, known as call reports, each quarter with their respective federal regulatory agency. In call reports, the banks provide comprehensive balance sheets and income statements disclosing their earnings, including those from their credit card operations. Although the call reports include separate lines for interest income earned, this amount is not further segregated to show, for example, income from the application of penalty interest rates. Similarly, banks report their fee income on the call reports, but this amount includes income from all types of fees, including those related to fiduciary activities, and trading assets and liabilities and is not further segregated to show how much a particular bank has earned from credit card late fees, over-limit fees, or insufficient payment fees.

Another limitation of using call reports to assess the effect of penalty charges on bank revenues is that these reports do not include detailed information on credit card balances that a bank may have sold to other investors through a securitization. As a way of raising additional funds to lend to cardholders, many issuers combine the balances owed on large groups of their accounts and sell these receivables as part of pools of securitized assets to investors. In their call reports, the banks do not report revenue received from cardholders whose balances have been sold into credit card interest and fee income categories.[74] The banks report any gains or losses incurred from the sale of these pooled credit card balances on their call reports as part of noninterest income. Credit card issuing banks generally securitize more than 50 percent of their credit card balances.

Although many card issuers, including most of the top 10 banks, are public companies that must file various publicly available financial disclosures on an ongoing basis with securities regulators, these filings also do not disclose detailed information about penalty interest and fees. We reviewed the public filings by the top five issuers and found that none of the financial statements disaggregated interest income into standard interest and penalty interest charges. In addition, we found that the five banks' public financial statements also had not disaggregated their fee income into penalty fees, service fees, and interchange fees. Instead, most of these card issuers disaggregated their sources of revenue into two broad categories—interest and noninterest income.

[74]In accordance with generally accepted accounting principles (Standards of Financial Accounting Statement 140), when card issuers sell any of their credit card receivables as part of a securitization, they subtract the amount of these receivables from the assets shown on their balance sheets.

Majority of Card Issuer Revenues Came from Interest Charges

Although limited information is publicly disclosed, the majority of credit card revenue appears to have come from interest charges. According to regulators, information collected by firms that analyze the credit card industry, and data reported to us by the five of the six largest issuers, the proportion of net interest revenues to card issuers' total revenues is as much as 71 percent. For example, five of the six largest issuers that provided data to us reported that the proportion of their total U.S. card operations income derived from interest charges ranged from 69 to 71 percent between 2003 and 2005.[75]

[75]One of the top six largest issuers, Discover, Inc., operates its own transaction processing network; the other issuers process card transactions through the networks operated by Visa International or Mastercard. Because this difference could have reduced the comparability of the data we obtained from these issuers, the information on revenue and profitability aggregated by the third party in response to our data request excludes Discover, Inc.

Credit card bank revenue sources

The sources of revenues for credit card banks are different than those of nonfinancial businesses. For example, the profits of a manufacturing business are determined by subtracting its production costs and the other expenses it incurs from the revenues it earns from selling the goods it produces. In contrast, banks' profits are generally derived by subtracting the interest expenses they incur on the sources of funds—such as savings deposits—that they use to make loans from the interest revenues they earn on those loans. The difference between banks' interest revenues and their interest expenses represents their net interest income. To determine the total net income from a bank's operations, any revenues from noninterest sources, such as fees, are added to its net interest income, and then all other expenses, including amounts owed on loans that now appear uncollectible—loan losses—and the expenses of operating the bank, including staff salaries and marketing expenses, are subtracted. Figure 17 shows a simplified example of a typical bank's income statement.

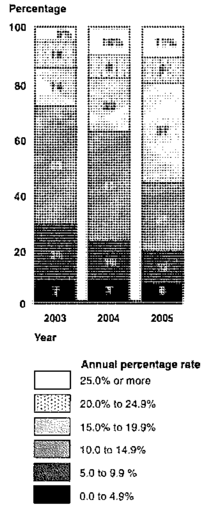
Figure 17: Example of a Typical Bank's Income Statement

Revenue/expense category	Description
Interest charges ($)/yield (%)	Received from loans to corporate and consumer borrowers, credit card holders carrying balances, etc.
- Cost of funds	Paid on deposits or borrowings from other banks
Net interest income	
+ Noninterest income	From fees or other charges for services paid by borrowers or other customers
Total revenue from operations	
- Credit losses	From the writeoff of amounts of loans or card balances that will not be paid by borrowers who have defaulted
Net risk-adjusted revenue	
- Noninterest expenses	Operating expenses such as postage, utilities, etc., for staff and other noninterest expenses
- Fraud losses	
Noninterest expense + fraud losses	
+ Pre-tax income	
- Taxes	
Net income	

Source: GAO analysis of data reported by the six largest credit card issuers.

We could not precisely determine the extent to which penalty interest charges contribute to this revenue, although the amount of penalty interest that issuers have been assessing has increased. In response to our request, the six largest issuers reported the proportions of their total cardholder accounts that were assessed various rates of interest for 2003 to 2005. On the basis of our analysis of the popular cards issued by these largest issuers, all were charging, on average, default interest rates of around 27 percent. According to the data these issuers provided, the majority of cardholders paid interest rates below 20 percent, but the proportion of their cardholders that paid interest rates at or above 25 percent—whicb likely represent default rates—has risen from 5 percent in 2003 to 11 percent in 2005. As shown in Figure 18, the proportion of cardholders paying between 15 and 20 percent has also increased, but an issuer representative told us that this likely was due to variable interest rates on cards rising as a result of increases in U.S. market interest rates over the last 3 years.

Figure 18: Proportion of Active Accounts of the Six Largest Card Issuers with Various Interest Rates for Purchases, 2003 to 2005



Source: GAO analysis of data reported by the six largest credit card issuers.

Although we could not determine the amounts of penalty interest the card issuers received, the increasing proportion of accounts assessed rates of 25 percent suggests a significant increase in interest revenues. For example, a cardholder carrying a stable balance of $1,000 and paying 10 percent interest would pay approximately $100 annually, while a cardholder carrying the same stable balance but paying 25 percent would pay $250 to the card issuer annually. Although we did not obtain any information on the size of balances owed by the cardholders of the largest issuers, the proportion of the revenues these issuers received from cardholders paying penalty interest rates may also be greater than 11 percent because such cardholders may have balances larger than the $2,500 average for 2005 that the issuers reported to us.

Fees Represented the Remainder of Issuer Revenues

The remaining card issuer revenues largely come from noninterest sources, including merchant and consumer fees. Among these are penalty fees and other consumer fees, as well as fees that issuers receive as part of processing card transactions for merchants.

Penalty Fees Had Increased

Although no comprehensive data exist publicly, various sources we identified indicated that penalty fees represent around 10 percent of issuers' total revenues and had generally increased. We identified various sources that gave estimates of penalty fee income as a percentage of card issuers' total revenues that ranged from 9 to 13 percent:

- Analysis of the data the top six issuers provided to us indicated that each of these issuers assessed an average of about $1.2 billion in penalty fees for cardholders that made late payments or exceeded their credit limit in 2005. In total, these six issuers reported assessing $7.4 billion for these two penalty fees that year, about 12 percent of the $60.3 billion in total interest and consumer fees (penalty fees and fees for other cardholder services).[76]

- According to a private firm that assists credit card banks with buying and selling portfolios of credit card balance receivables, penalty fees likely represented about 13 percent of total card issuer revenues. According to an official with this firm, it calculated this estimate by using information from 15 of the top 20 issuers, as well as many smaller banks, that together represent up to 80 percent of the total credit card industry.[77]

[76]We were not provided information on the portion of revenues these issuers earned from these penalty fees and consumer fees.

[77]Although we were not able to completely assess the reliability of this organization's data and its methods for making its estimates of industry revenue components, we present this information because it appeared to be similar to the proportions reported by the top six issuers that provided us data.

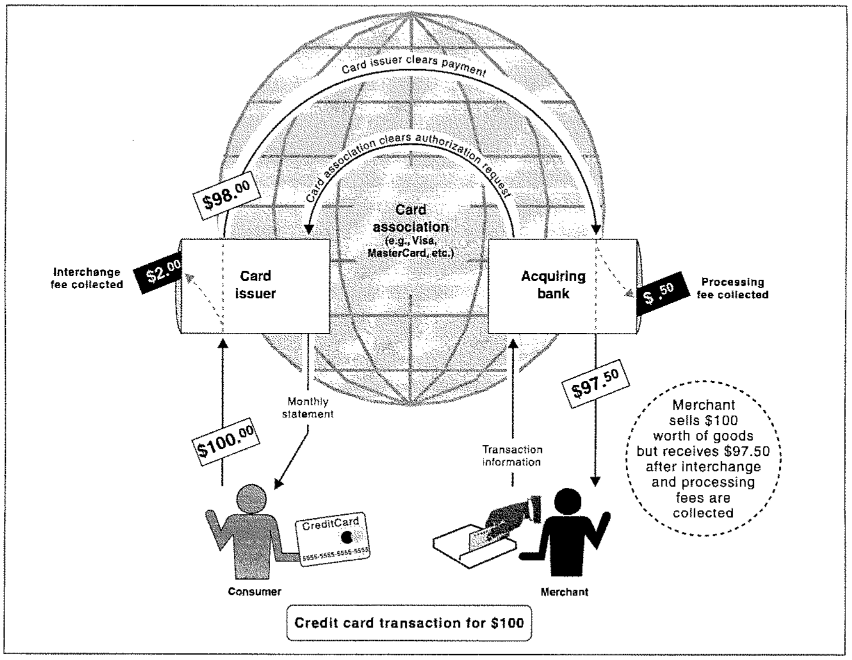
- An estimate from an industry research firm that publishes data on credit card issuer activities indicated that penalty fees represented about 9 percent of issuer total revenues.

Issuers Also Collect Revenues from Processing Merchant Card Transactions

When a consumer makes a purchase with a credit card, the merchant selling the goods does not receive the full purchase price. When the cardholder presents the credit card to make a purchase, the merchant transmits the cardholder's account number and the amount of the transaction to the merchant's bank.[78] The merchant's bank forwards this information to the card association, such as Visa or Mastercard, requesting authorization for the transaction. The card association forwards the authorization request to the bank that issued the card to the cardholder. The issuing bank then responds with its authorization or denial to the merchant's bank and then to the merchant. After the transaction is approved, the issuing bank will send the purchase amount, less an interchange fee, to the merchant's bank. The interchange fee is established by the card association. Before crediting the merchant's account, the merchant's bank will subtract a servicing fee. These transaction fees—called interchange fees—are commonly about 2 percent of the total purchase price. As shown in figure 19, the issuing banks generally earn about $2.00 for every $100 purchased as interchange fee revenue. In addition, the card association receives a transaction processing fee. The card associations, such as Visa or Mastercard, assess the amount of these fees and also conduct other important activities, including imposing rules for issuing cards, authorizing, clearing and settling transactions, advertising and promoting the network brand, and allocating revenues among the merchants, merchant's bank, and card issuer.

[78]The bank that a merchant uses to process its credit card transactions is known as the acquiring bank.

Figure 19: Example of a Typical Credit Card Purchase Transaction Showing How Interchange Fees Paid by Merchants Are Allocated



Sources: GAO (analysis); Art Explosion (images).

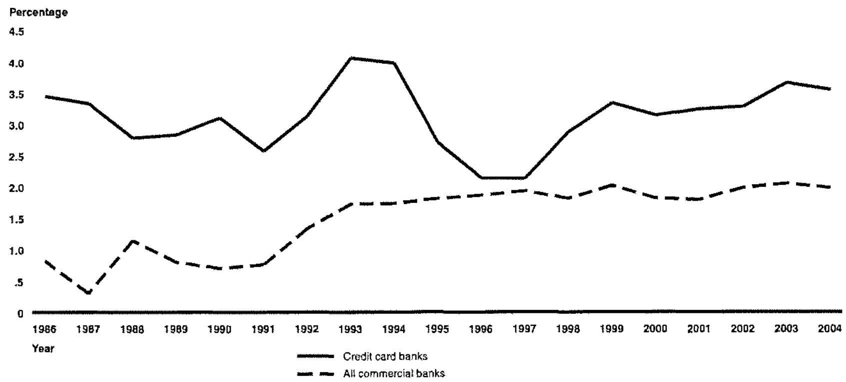
In addition to penalty fees and interchange fees, the remaining noninterest revenues for card issuers include other consumer fees or other fees. Card issuers collect annual fees, cash advance fees, balance transfer fees, and other fees from their cardholders. In addition, card issuers collect other revenues, such as from credit insurance. According to estimates by industry analyst firms, such revenues likely represented about 8 to 9 percent of total issuer revenues.

Large Credit Card Issuer Profitability Has Been Stable

The profits of credit card-issuing banks, which are generally the most profitable group of lenders, have been stable over the last 7 years. A commonly used indicator of profitability is the return on assets ratio (ROA). This ratio, which is calculated by dividing a company's income by its total assets, shows how effectively a business uses its assets to generate profits. In annual reports to Congress, the Federal Reserve provides data on the profitability of larger credit card issuers—which included 17 banks in 2004.[79] Figure 20 shows the average ROA using pretax income for these large credit card issuers compared with pretax ROA of all commercial banks during the period 1986 to 2004. In general, the large credit card issuers earned an average return of 3.12 percent over this period, which was more than twice as much as the 1.49 percent average returns earned by all commercial banks.

[79]See Federal Reserve System, *Profitability of Credit Card Operations*, June 2005. The data included in these reports are for all commercial banks with at least $200 million in yearly average assets (loans to individuals plus securitizations) and at least 50 percent of assets in consumer lending, of which 90 percent must be in the form of revolving credit.

Figure 20: Average Pretax Return on Assets for Large Credit Card Banks and All Commercial Banks, 1986 to 2004



Source: Federal Reserve Board.

As shown in the figure above, the ROA for larger credit card banks, although fluctuating more widely during the 1990s, has generally been stable since 1999, with returns in the 3.0 to 3.5 percent range. The return on assets for the large card issuers peaked in 1993 at 4.1 percent and has declined to 3.55 percent in 2004. In contrast, the profitability of all commercial banks has been generally increasing over this period, rising more than 140 percent between 1986 and 2004. Similar to the data for all larger credit card issuers, data that five of the six largest issuers provided to us indicated that their profitability also has been stable in the 3 years between 2003 and 2005. These five issuers reported that the return on their pretax earnings over their credit card balances over this 3-year period ranged from about 3.6 percent to 4.1 percent.

Because of the high interest rates that issuers charge and variable rate pricing, credit card lending generally is the most profitable type of consumer lending, despite the higher rate of loan losses that issuers incur on cards. Rates charged on credit cards generally are the highest of any consumer lending category because they are extensions of credit that are not secured by any collateral from the borrower. In contrast, other common types of consumer lending, such as automobile loans or home mortgages, involve the extension of a fixed amount of credit under fixed terms of repayment that are secured by the underlying asset—the car or the house—which the lender can repossess in the event of nonpayment by the borrower. Collateral and fixed repayment terms reduce the risk of loss to the lender, enabling them to charge lower interest rates on such loans. In contrast, credit card loans, which are unsecured, available to large and heterogeneous populations, and repayable on flexible terms at the cardholders' convenience, present greater risks and have commensurately higher interest rates. For example, according to Federal Reserve statistics, the interest rate charged on cards by lenders generally has averaged above 16 percent since 1980, while the average rate charged on car loans since then has averaged around 10 percent. Borrowers may be more likely to cease making payments on their credit cards if they become financially distressed than they would on other loans that are secured by an asset they could lose. For example, the percentage of credit card loans that banks have had to charge off averaged above 4 percent between 2003 and 2005; in contrast, charge-offs for other types of consumer loans average about 2 percent, with charge-offs for mortgage loans averaging less than 1 percent, during those 3 years. (App. III provides additional detail about the factors that affect the profitability of credit card issuers.)

Conclusions

Credit cards provide various benefits to their cardholders, including serving as a convenient way to pay for goods and services and providing additional funds at rates of interest generally lower than those consumers would have paid to borrow on cards in the past. However, the penalties for late payments or other behaviors involving card use have risen significantly in recent years. Card issuers note that their use of risk-based pricing structures with multiple interest rates and fees has allowed them to offer credit cards to cardholders at costs that are commensurate with the risks presented by different types of customers, including those who previously might not have been able to obtain credit cards. On the whole, a large number of cardholders experience greater benefits—either by using their cards for transactions without incurring any direct expense or by enjoying generally lower costs for borrowing than prevailed in the past—from using credit cards than was previously possible, but the habits or financial circumstances of other cardholders also could result in these consumers facing greater costs than they did in the past.

The expansion and increased complexity of card rates, fees, and issuer practices has heightened the need for consumers to receive clear disclosures that allow them to more easily understand the costs of using cards. In the absence of any regulatory or legal limits on the interest or fees that cards can impose, providing consumers with adequate information on credit card costs and practices is critical to ensuring that vigorous competition among card issuers produces a market that provides the best possible rates and terms for U.S. consumers. Our work indicates that the disclosure materials that the largest card issuers typically provided under the existing regulations governing credit cards had many serious weaknesses that reduced their usefulness to the consumers they are intended to help. Although these regulations likely were adequate when card rates and terms were less complex, the disclosure materials they produce for cards today, which have a multitude of terms and conditions that can affect cardholders' costs, have proven difficult for consumers to use in finding and understanding important information about their cards. Although providing some key information, current disclosures also give prominence to terms, such as minimum finance charge or balance computation method, that are less significant to consumers' costs and do not adequately emphasize terms such as those cardholder actions that could cause their card issuer to raise their interest rate to a high default rate. Because part of the reason that current disclosure materials may be less effective is that they were designed in an era when card rates and terms were less complex, the Federal Reserve also faces the challenge of creating disclosure requirements that are more flexible to allow them to be adjusted more quickly as new card features are introduced and others become less common.

The Federal Reserve, which has adopted these regulations, has recognized these problems, and its current review of the open-end credit rules of Regulation Z presents an opportunity to improve the disclosures applicable to credit cards. Based on our work, we believe that disclosures that are simpler, better organized, and use designs and formats that comply with best practices and industry standards for readability and usability would be more effective. Our work and the experiences of other regulators also confirmed that involving experts in readability and testing documents with actual consumers can further improve any resulting disclosures. The Federal Reserve has indicated that it has begun to involve consumers in the design of new model disclosures, but it has not completed these efforts to date, and new model disclosures are not expected to be issued until 2007 or 2008. Federal Reserve staff noted that they recognize the challenge of how best to incorporate the variety of information that consumers may need to understand the costs of their cards in clear and concise disclosure materials. Until such efforts are complete, consumers will continue to face difficulties in using disclosure materials to better understand and compare costs of credit cards. In addition, until more understandable disclosures are issued, the ability of well-informed consumers to spur additional competition among issuers in credit card pricing is hampered.

Definitively determining the extent to which credit card penalty interest and fees contribute to personal bankruptcies and the profits and revenues of card issuers is difficult given the lack of comprehensive, publicly available data. Penalty interest and fees can contribute to the total debt owed by cardholders and decrease the funds that a cardholder could have used to reduce debt and possibly avoid bankruptcy. However, many consumers file for bankruptcy as the result of significant negative life events, such as divorces, job losses, or health problems, and the role that credit cards play in avoiding or accelerating such filings is not known. Similarly, the limited available information on card issuer operations indicates that penalty fees and interest are a small but growing part of such firms' revenues. With the profitability of the largest card issuers generally being stable over recent years, the increased revenues gained from penalty interest and fees may be offsetting the generally lower amounts of interest that card issuers collect from the majority of their cardholders. These results appear to indicate that while most cardholders likely are better off, a smaller number of cardholders paying penalty interest and fees are accounting for more of issuer revenues than they did in the past. This further emphasizes the importance of taking steps to ensure that all cardholders receive disclosures that help them clearly understand their card costs and how their own behavior can affect those costs.

Recommendation for Executive Action

As part of its effort to increase the effectiveness of disclosure materials used to inform consumers of rates, fees, and other terms that affect the costs of using credit cards, the Chairman, Federal Reserve should ensure that such disclosures, including model forms and formatting requirements, more clearly emphasize those terms that can significantly affect cardholder costs, such as the actions that can cause default or other penalty pricing rates to be imposed.

Agency Comments and Our Evaluation

We provided a draft of this report to the Federal Reserve, OCC, FDIC, the Federal Trade Commission, the National Credit Union Administration, and the Office of Thrift Supervision for their review and comment. In a letter from the Federal Reserve, the Director of the Division of Consumer and

Community Affairs agreed with the findings of our report that credit card pricing has become more complex and that the disclosures required under Regulation Z could be improved with the input of consumers. To this end, the Director stated that the Board is conducting extensive consumer testing to identify the most important information to consumers and how disclosures can be simplified to reduce current complexity. Using this information, the Director said that the Board would develop new model disclosure forms with the assistance of design consultants. If appropriate, the Director said the Board may develop suggestions for statutory changes for congressional consideration.

We also received technical comments from the Federal Reserve and OCC, which we have incorporated in this report as appropriate. FDIC, the Federal Trade Commission, the National Credit Union Administration, and the Office of Thrift Supervision did not provide comments.

As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this report. At that time, we will send copies of this report to the Chairman, Permanent Subcommittee on Investigations, Senate Committee on Homeland Security and Governmental Affairs; the Chairman, FDIC; the Chairman, Federal Reserve; the Chairman, Federal Trade Commission; the Chairman, National Credit Union Administration; the Comptroller of the Currency; and the Director, Office of Thrift Supervision and to interested congressional committees. We will also make copies available to others upon request. The report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions regarding this report, please contact me at (202) 512-8678 or woodd@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix IV.

Sincerely yours,

David G. Wood

David G. Wood
Director, Financial Markets
and Community Investment

Appendix I

Objectives, Scope and Methodology

Our objectives were to determine (1) how the interest, fees, and other practices that affect the pricing structure of cards from the largest U.S. issuers have evolved, and cardholders' experiences under these pricing structures in recent years; (2) how effectively the issuers disclose the pricing structures of cards to their cardholders; (3) whether credit card debt and penalty interest and fees contribute to cardholder bankruptcies; and (4) the extent to which penalty interest and fees contribute to the revenues and profitability of issuers' credit card operations.

Methodology for Identifying the Evolution of Pricing Structures

To identify how the pricing structure of cards from the largest U.S. issuers has evolved, we analyzed disclosure documents from 2003 to 2005 for 28 popular cards that were issued by the six largest U.S. card issuers, as measured by total outstanding receivables as of December 31, 2004 (see fig. 2 in the body of this report). These issuers were Bank of America; Capital One Bank; Chase Bank USA, N.A.; Citibank (South Dakota), N.A.; Discover Financial Services; and MBNA America Bank, N.A. Representatives for these six issuers identified up to five of their most popular cards and provided us actual disclosure materials, including cardmember agreements and direct mail applications and solicitations used for opening an account for each card. We calculated descriptive statistics for various interest rates and fees and the frequency with which cards featured other practices, such as methods for calculating finance charges. We determined that these cards likely represented the pricing and terms that applied to the majority of U.S. cardholders because the top six issuers held almost 80 percent of consumer credit card debt and as much as 61 percent of total U.S. credit card accounts.

We did not include in our analysis of popular cards any cards offered by credit card issuers that engage primarily in subprime lending. Subprime lending generally refers to extending credit to borrowers who exhibit characteristics indicating a significantly higher risk of default than traditional bank lending customers. Such issuers could have pricing structures and other terms significantly different to those of the popular cards offered by the top issuers. As a result, our analysis may underestimate the range of interest rate and fee levels charged on the entire universe of cards. To identify historical rate and fee levels, we primarily evaluated the Federal Reserve Board's G.19 Consumer Credit statistical release for 1972 to 2005 and a paper written by a Federal Reserve Bank staff, which included more than 150 cardmember agreements from 15 of the largest U.S. issuers in 1997 to 2002.[1]

To evaluate cardholders' experiences with credit card pricing structures in recent years, we obtained proprietary data on the extent to which issuers assessed various interest rate levels and fees for active accounts from the six largest U.S. issuers listed above for 2003, 2004, and 2005. We obtained data directly from issuers because no comprehensive sources existed to show the extent to which U.S. cardholders were paying penalty interest rates. Combined, these issuers reported more than 180 million active accounts, or about 60 percent of total active accounts reported by CardWeb.com, Inc. These accounts also represented almost $900 billion in credit card purchases in 2005, according to these issuers. To preserve the anonymity of the data, these issuers engaged legal counsel at the law firm Latham & Watkins, LLP, to which they provided their data on interest rate and fee assessments, which then engaged Argus Information and Advisory Services, LLC, a third-party analytics firm, to aggregate the data, and then supplied it to us. Although we originally provided a more comprehensive data request to these issuers, we agreed to a more limited request with issuer representatives as a result of these firms' data availability and processing limitations. We discussed steps that were taken to attempt to ensure that the data provided to us were complete and accurate with representatives of these issuers and the third party analytics firm. We also shared a draft of this report with the supervisory agencies of these issuers. However, we did not have access to the issuers' data systems to fully assess the reliability of the data or the systems that housed them. Therefore, we present these data in our report only as representations made to us by the six largest issuers.

Methodology for Assessing Effectiveness of Disclosures

To determine how effectively card issuers disclose to cardholders the rates, fees, and other terms related to their credit cards, we contracted with UserWorks, Inc., a private usability consulting firm, which conducted three separate evaluations of a sample of disclosure materials. We provided the usability consultant with a cardmember agreement and solicitation letter for one card from four representative credit card issuers—a total of four cards and eight disclosure documents. The first evaluation, a readability assessment, used computer-facilitated formulas to predict the grade level

[1]M. Furletti, "Credit Card Pricing Developments and Their Disclosure," Federal Reserve Bank of Philadelphia's Payment Cards Center, January 2003.

required to understand the materials. Readability formulas measure the elements of writing that can be subjected to mathematical calculation, such as average number of syllables in words or numbers of words in sentences in the text. The consultant applied the following industry-standard formulas to the documents: Flesch Grade Level, Frequency of Gobbledygook (FOG), and the Simplified Measure of Gobbledygook (SMOG). Using these formulas, the consultant measured the grade levels at which the disclosure documents were written overall, as well as for selected sections. Secondly, the usability consultant conducted an heuristic evaluation that assessed how well these card disclosure documents adhered to a recognized set of principles or industry best practices. In the absence of best practices specifically applicable to credit card disclosures, the consultant used guidelines from the U.S. Securities and Exchange Commission's 1998 guidebook *Plain English Handbook: How to Create Clear SEC Disclosure Documents*.

Finally, the usability consultant tested how well actual consumers were able to use the documents to identify and understand information about card fees and other practices and used the results to identify problem areas. The consultant conducted these tests with 12 consumers.[2] To ensure sample diversity, the participants were selected to represent the demographics of the U.S. adult population in terms of education, income, and age. While the materials used for the readability and usability assessments appeared to be typical of the large issuers' disclosures, the results cannot be generalized to materials that were not reviewed.

To obtain additional information on consumers' level of awareness and understanding of their key credit card terms, we also conducted in-depth, structured interviews in December 2005 with a total of 112 adult cardholders in three locations: Boston, Chicago, and San Francisco.[3] We contracted with OneWorld Communications, Inc., a market research organization, to recruit a sample of cardholders that generally resembled the demographic makeup of the U.S. population in terms of age, education levels, and income. However, the cardholders recruited for the interviews did not form a random, statistically representative sample of the U.S.

[2]According to the consultant, testing with small numbers of individuals can generally identify many of the problems that can affect the readability and usability of materials.

[3]We conducted these interviews when preparing our report on the feasibility and usefulness of requiring additional disclosures to cardholders on the consequences of making only the minimum payment on their cards.

population and therefore cannot be generalized to the population of all U.S. cardholders. Cardholders had to speak English, have owned at least one general-purpose credit card for a minimum of 12 months, and have not participated in more than one focus group or similar in-person study in the 12 months prior to the interview. We gathered information about the cardholders' knowledge of credit card terms and conditions, and assessed cardholders' use of card disclosure materials by asking them a number of open- and closed-ended questions.

Methodology for Determining How Penalty Charges Contribute to Bankruptcy

To determine whether credit card debt and penalty interest and fees contribute to cardholder bankruptcies, we interviewed Department of Justice staff responsible for overseeing bankruptcy courts and trustees about the availability of data on credit card penalty charges in materials submitted by consumers or issuers as part of bankruptcy filings or collections cases. We also interviewed two attorneys that assist consumers with bankruptcy filings. In addition, we reviewed studies that analyzed credit card and bankruptcy issues published by various academic researchers, the Congressional Research Service, and the Congressional Budget Office. We did not attempt to assess the reliability of all of these studies to the same, full extent. However, because of the prominence of some of these data sources, and frequency of use of this data by other researchers, as well as the fact that much of the evidence is corroborated by other evidence, we determined that citing these studies was appropriate.

We also analyzed aggregated card account data provided by the six largest issuers (as previously discussed) to measure the amount of credit card interest charges and fees owed at the time these accounts were charged off as a result of becoming subject to bankruptcy filing. We also spoke with representatives of the largest U.S. credit card issuers, as well as representatives of consumer groups and industry associations, and with academic researchers that conduct analysis on the credit card industry.

Methodology for Determining How Penalty Charges Contribute to Issuer Revenues

To determine the extent to which penalty interest and fees contributed to the revenues and profitability of issuers' credit card operations, we reviewed the extent to which penalty charges are disclosed in bank regulatory reports—the call reports—and in public disclosures—such as annual reports (10-Ks) and quarterly reports (10-Qs) made by publicly traded card issuers. We analyzed data reported by the Federal Reserve on the profitability of commercial bank card issuers with at least $200 million in yearly average assets (loans to individuals plus securitizations) and at least 50 percent of assets in consumer lending, of which 90 percent must be in the form of revolving credit. In 2004, the Federal Reserve reported that 17 banks had card operations with at least this level of activity in 2004. We also analyzed information from the Federal Deposit Insurance Corporation, which analyzes data for all federally insured banks and savings institutions and publishes aggregated data on those with various lending activity concentrations, including a group of 33 banks that, as of December 2005, had credit card operations that exceeded 50 percent of their total assets and securitized receivables.

We also analyzed data reported to us by the six largest card issuers on their revenues and profitability of their credit card operations for 2003, 2004, and 2005. We also reviewed data on revenues compiled by industry analysis firms, including *Card Industry Directory* published by Sourcemedia, and R.K. Hammer. Because of the proprietary nature of their data, representatives for Sourcemedia and R.K. Hammer were not able to provide us with information sufficient for us to assess the reliability of their data. However, we analyzed and presented some information from these sources because we were able to corroborate their information with each other and with data from sources of known reliability, such as regulatory data, and we attribute their data to them.

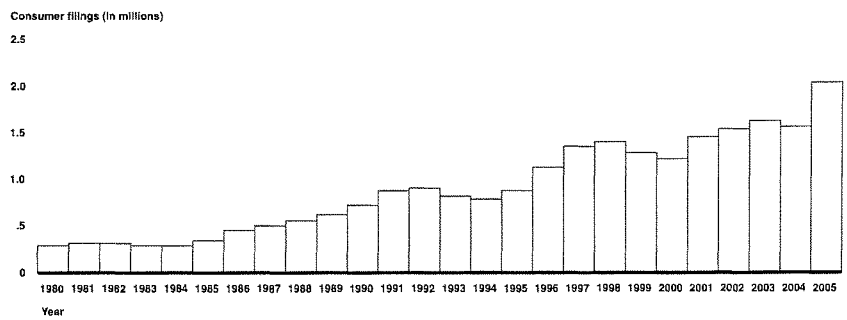
We also interviewed broker-dealer financial analysts who monitor activities by credit card issuers to identify the extent to which various sources of income contribute to card issuers' revenues and profitability. We attempted to obtain the latest in a series of studies of card issuer profitability that Visa, Inc. traditionally has compiled. However, staff from this organization said that this report is no longer being made publicly available.

We discussed issues relevant to this report with various organizations, including representatives of 13 U.S. credit card issuers and card networks, 2 trade associations, 4 academics, 4 federal bank agencies, 4 national consumer interest groups, 2 broker dealer analysts that study credit card issuers for large investors, and a commercial credit-rating agency. We also obtained technical comments on a draft of this report from representatives of the issuers that supplied data for this study.

Consumer Bankruptcies Have Risen Along with Debt

Consumer bankruptcies have increased significantly over the past 25 years. As shown in figure 21 below, consumer bankruptcy filings rose from about 287,000 in 1980 to more than 2 million as of December 31, 2005, about a 609 percent increase over the last 25 years.[1]

Figure 21: U.S. Consumer Bankruptcy Filings, 1980-2005



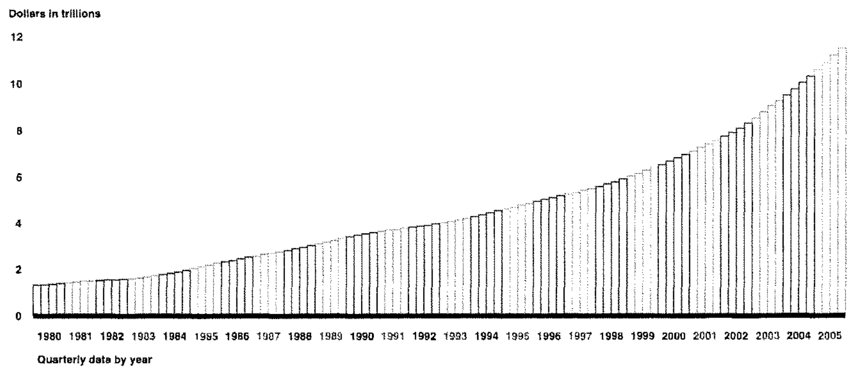
Source: GAO analysis of Congressional Research Service report and Administrative Office of the United States Courts data.

Debt Levels Have Also Risen

The expansion of consumers' overall indebtedness is one of the explanations cited for the significant increase in bankruptcy filings. As shown in figure 22, consumers' use of debt has expanded over the last 25 years, increasing more than 720 percent from about $1.4 trillion in 1980 to about $11.5 trillion in 2005.

[1]Of the filings in 2005, approximately 80 percent were Chapter 7 cases and the other 20 percent were Chapter 13 cases.

Figure 22: U.S. Household Debt, 1980-2005



Source: Board of Governors of the Federal Reserve System.

Some researchers have been commenting on the rise in overall indebtedness as a contributor to the rise in bankruptcies for some time. For example, in a 1997 congressional testimony, a Congressional Budget Office official noted that the increase in consumer bankruptcy filings and the increase in household indebtedness appeared to be correlated.[2] Also, an academic paper that summarized existing literature on bankruptcy found that some consumer bankruptcies were either directly or indirectly caused by heavy consumer indebtedness, specifically pointing to the high correlation between consumer bankruptcies and consumer debt-to-income ratios.[3]

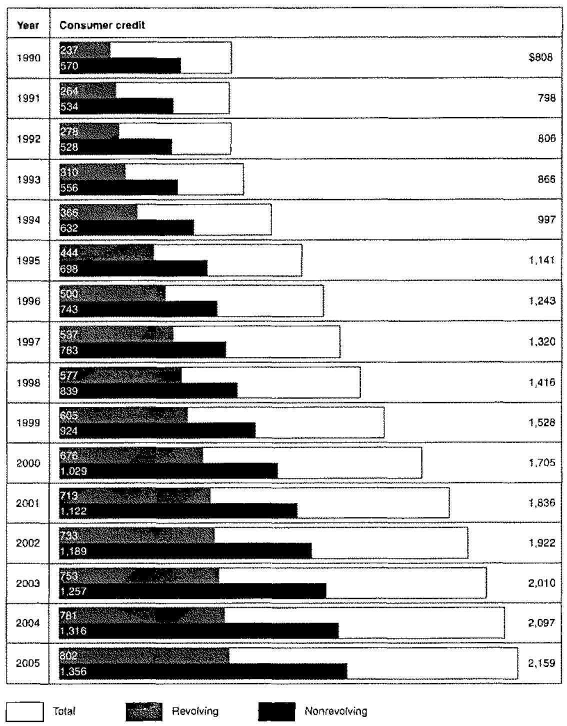
[2] Kim Kowalewski, "Consumer Debt and Bankruptcy," Congressional Budget Office testimony before the United States Senate Subcommittee on Administrative Oversight and the Courts, Committee on the Judiciary, 105th Congress, 1st sess., Apr. 11, 1997.

[3] Todd J. Zywicki, "An Economic Analysis of the Consumer Bankruptcy Crisis," *Northwestern University Law Review*, 99, no.4, (2005).

Beyond total debt, some researchers and others argue that the rise in bankruptcies also was related to the rise in credit debt, in particular. As shown in figure 23, the amount of credit card debt reported also has risen from $237 billion to about $802 billion—a 238 percent increase between 1990 and 2005.[4]

[4]In addition to capturing amounts outstanding on credit cards, the number reported in the Federal Reserve's survey of consumer debt for revolving debt also includes other types of revolving debt. However, Congressional Research Service staff familiar with the survey's results indicated that the vast majority of the amount reported as revolving debt is from credit cards.

Figure 23: Credit Card and Other Revolving and Nonrevolving Debt Outstanding, 1990 to 2005



Source: GAO analysis of Congressional Research Service report data.

Increased Access to Credit Cards by Lower-income Households Raised Concerns

Rather than total credit card debt alone, some researchers argued that growth in credit card use and indebtedness by lower-income households has contributed to the rise in bankruptcies. In the survey of consumer finances conducted every 3 years, the Federal Reserve reports on the use and indebtedness on credit cards by households overall and also by income percentiles. As shown in figure 24 below, the latest Federal Reserve survey results indicated the greatest increase of families reporting credit card debt occurred among those in the lowest 20 percent of household income between 1998 and 2001.

Figure 24: Percent of Households Holding Credit Card Debt by Household Income, 1998, 2001, and 2004

Percentile of income	1998	2001	2004
Less than 20	24.5	30.3	28.8
20-39.9	40.9	44.5	42.9
40-59.9	50.1	52.8	55.1
60-79.9	57.4	52.6	56.0
80-89.9	53.1	50.3	57.6
90-100	42.1	33.1	38.5
All	44.1	44.4	46.2

Source: Federal Reserve Board's Survey of Consumer Finances.

In the last 15 years, credit card companies have greatly expanded the marketing of credit cards, including to households with lower incomes than previously had been offered cards. An effort by credit card issuers to expand its customer base in an increasingly competitive market dramatically increased credit card solicitations. According to one study, more than half of credit cards held by consumers are the result of receiving mail solicitations.[5] According to another academic research paper, credit card issuers have increased the number of mail solicitations they send to consumers by more than five times since 1990, from 1.1 billion to 5.23 billion in 2004, or a little over 47 solicitations per household. The research paper also found that wealthier families receive the highest number of solicitations but that low-income families were more likely to open them.[6] As shown in figure 25 above, the Federal Reserve's survey results indicated that the number of lower income households with credit cards has also grown the most during 1998 to 2001, reflecting issuers' willingness to grant greater access to credit cards to such households than in the past.

Levels of Financial Distress Have Remained Stable among Households

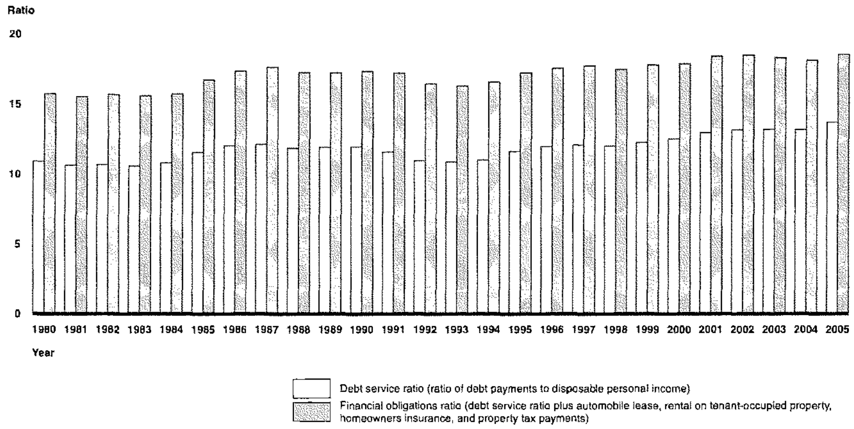
The ability of households to make the payments on their debt appeared to be keeping pace with their incomes as their total household debt burden levels—which measure their payments required on their debts as percentage of household incomes—have remained relatively constant since the 1980s. As shown below in figure 25, Federal Reserve statistics show that the aggregate debt burden ratio for U.S. households has generally fluctuated between 10.77 percent to 13.89 percent between 1990 to 2005, which are similar to the levels for this ratio that were observed during the 1980s. Also shown in figure 25 are the Federal Reserve's statistics on the household financial obligations ratio, which compares the total payments that a household must make for mortgages, consumer debt, auto leases, rent, homeowners insurance, and real estate taxes to its after-tax income. Although this ratio has risen from around 16 percent in 1980 to over 18 percent in 2005—representing an approximately 13 percent increase—Federal Reserve staff researchers indicated that it does not necessarily indicate an increase in household financial stress because

[5] Vertis, "*Financial Direct Mail Readers Interested in Credit Card Offers*," (Jan. 25, 2005), cited in the Consumer Federation of America testimony before the Committee on Banking, Housing, and Urban Affairs of the United States Senate, "*Examining the Current Legal and Regulatory Requirements and Industry Practices for Credit Card Issuers with Respect to Consumer Disclosures and Marketing Efforts*," 109th Congress, 2nd sess., May, 17, 2005.

[6] Amdetsion Kidane and Sandip Mukerji, "Characteristics of Consumers Targeted and Neglected by Credit Card Companies," *Financial Services Review*, 13, no. 3, (2004), cited in the Consumer Federation of America testimony before the Committee on Banking, Housing, and Urban Affairs of the United States Senate, "*Examining the Current Legal and Regulatory Requirements and Industry Practices for Credit Card Issuers with Respect to Consumer Disclosures and Marketing Efforts*," 109th Congress, 2nd sess., May 17, 2005.

much of this increase appeared to be the result of increased use of credit cards for transactions and more households with cards.[7]

Figure 25: U.S. Household Debt Burden and Financial Obligations Ratios, 1980 to 2005



Source: Federal Reserve.

In addition, credit card debt remains a small portion of overall household debt, including those with the lowest income levels. As shown in table 2, credit card balances as a percentage of total household debt actually have been declining since the 1990s.

[7]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* (Washington, D.C.: June 2006).

Table 2: Portion of Credit Card Debt Held by Households

Type of debt	1995	1998	2001	2004
Amount of debt of all families, distributed by type of debt				
Secured home loan	80.7	78.9	81.4	83.7
Lines of credit not secured by residential property	0.6	0.3	0.5	0.7
Installment loans	12.0	13.1	12.3	11.0
Credit card balances	3.9	3.9	3.4	3.0
Other	2.9	3.7	2.3	1.6
Total	**100**	**100**	**100**	**100**

Source: Federal Reserve.

Also, as shown in table 3, median credit card balances for the lowest-income households has remained stable from 1998 through 2004.

Table 3: Credit Card Debt Balances Held by Household Income[8]

	1998	2001	2004
Median value of holdings for families holding credit card debt			
All families	$1,900	$2,000	$2,200
Percentile of income			
Less than 20	$1,000	$1,100	$1,000
20-39.9	$1,300	$1,300	$1,900
40-59.9	$2,100	$2,100	$2,200
60-79.9	$2,400	$2,400	$3,000
80-89.9	$2,200	$4,000	$2,700
90-100	$3,300	$3,000	$4,000

Source: Federal Reserve.

As shown in figure 26 below, the number of households in the twentieth percentile of income or less that reportedly were in financial distress has remained relatively stable.

[8]The 1998 median credit card balance in 2001 dollars; 2001 and 2004 median credit card balances in 2004 dollars.

Figure 26: Households Reporting Financial Distress by Household Income, 1995 through 2004

Percentile of income	1995	1998	2001	2004
All	11.7	13.6	11.8	12.2
Less than 20	27.5	29.9	29.3	27.0
20-39.9	18.0	18.3	16.6	18.6
40-59.9	9.9	15.8	12.3	13.7
60-79.9	7.7	9.8	6.5	7.10
80-89.9	4.7	3.5	3.5	2.4
90-100	2.3	2.8	2.0	1.8

Source: Federal Reserve Survey of Consumer Finances.

As shown in figure 26 above, more lower-income households generally reported being in financial distress than did other households in most of the other higher-income groups. In addition, the lowest-income households in the aggregate generally did not exhibit greater levels of distress over the last 20 years, as the proportion of households that reported distress was higher in the 1990s than in 2004.

Some Researchers Find Other Factors May Trigger Consumer Bankruptcies and that Credit Cards Role Varied

Some academics, consumer advocacy groups, and others have indicated that the rise in consumer bankruptcy filings has occurred because the normal life events that reduce incomes or increase expenses for households have more serious effects today. Events that can reduce household incomes include job losses, pay cuts, or conversion of full-time positions to part-time work. Medical emergencies can result in increased household expenses and debts. Divorces can both reduce income and increase expenses. One researcher explained that, while households have faced the same kinds of risks for generations, the likelihood of these types of life events occurring has increased. This researcher's studies noted that the likelihood of job loss or financial distress arising from medical problems and the risk of divorce have all increased. Furthermore, more households send all adults into the workforce, and, while this increases their income, it also doubles their total risk exposure, which increases their likelihood of having to file for bankruptcy. According to this researcher, about 94 percent of families who filed for bankruptcy would qualify as middle class.[9]

Although many of the people who file for bankruptcy have considerable credit card debt, those researchers that asserted that life events were the primary explanation for filings noted that the role played by credit cards varied. According to one of these researchers, individuals who have filed for bankruptcy with outstanding credit card debt could be classified into three groups:

- Those who had built up household debts, including substantial credit card balances, but filed for bankruptcy after experiencing a life event that adversely affected their expenses or incomes such that they could not meet their obligations.
- Those who experienced a life event that adversely affected their expenses or incomes, and increased their usage of credit cards to avoid falling behind on other secured debt payments (such as mortgage debt), but who ultimately failed to recover and filed for bankruptcy.
- Those with very little credit card debt who filed for bankruptcy when they could no longer make payments on their secured debt. This represented the smallest category of people filing for bankruptcy.

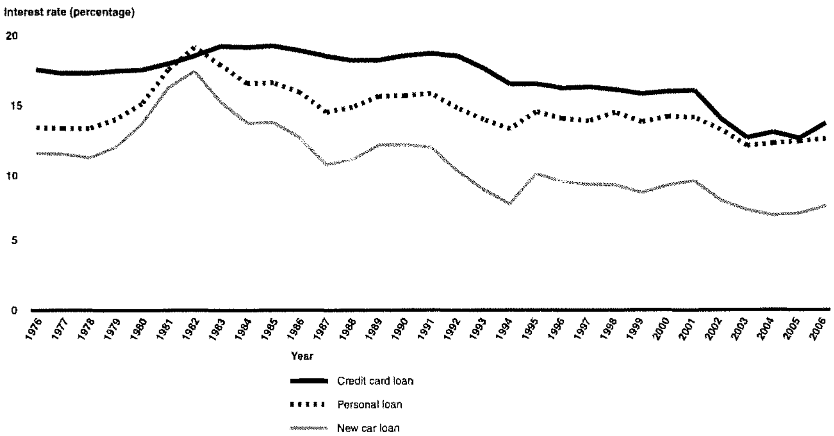
[9]Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School, "The Growing Threat to Middle Class Families," *Brooklyn Law Review*, (April 2003).

Factors Contributing to the Profitability of Credit Card Issuers

Various factors help to explain why banks that focus on credit card lending generally have higher profitability than other lenders. The major source of income for credit card issuers comes from interest they earn from their cardholders who carry balances—that is, do not payoff the entire outstanding balance when due. One factor that contributes to the high profitability of credit card operations is that the average interest rates charged on credit cards are generally higher than rates charged on other types of lending. Rates charged on credit cards are generally the highest because they are extensions of credit that are not secured by any collateral from the borrower. Unlike credit cards, most other types of consumer lending involve the extension of a fixed amount of credit under fixed terms of repayment (i.e., the borrower must repay an established amount of principal, plus interest each month) and are collateralized—such as loans for cars, under which the lender can repossess the car in the event the borrower does not make the scheduled loan payments. Similarly, mortgage loans that allow borrowers to purchase homes are secured by the underlying house. Loans with collateral and fixed repayment terms pose less risk of loss, and thus lenders can charge less interest on such loans. In contrast, credit card loans, which are unsecured, available to large and heterogeneous populatious, and can be repaid on flexible terms at the cardholders' convenience, present greater risks and have commensurately higher interest rates.

As shown in figure 27, data from the Federal Reserve shows that average interest rates charged on credit cards were generally higher than interest rates charged on car loans and personal loans. Similarly, average interest rates charged on corporate loans are also generally lower than credit cards, with the best business customers often paying the prime rate, which averaged 6.19 percent during 2005.

Figure 27: Average Credit Card, Car Loans and Personal Loan Interest Rates

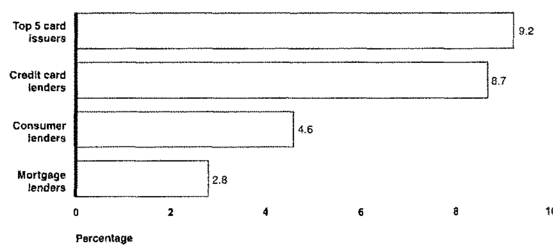


Source: Federal Reserve.

Moreover, many card issuers have increasingly begun setting the interest rates they charge their cardholders using variable rates that change as a specified market index rate, such as the prime rate, changes. This allows credit card issuers' interest revenues to rise as their cost of funding rises during times when market interest rates are increasing. Of the most popular cards issued by the largest card issuers between 2004 and 2005 that we analyzed, more than 90 percent had variable rates that changed according to an index rate. For example, the rate that the cardholder would pay on these large issuer cards was determined by adding between 6 and 8 percent to the current prime rate, with a new rate being calculated monthly.

As a result of the higher interest charges assessed on cards and variable rate pricing, banks that focus on credit card lending had the highest net interest margin compared with other types of lenders. The net interest income of a bank is the difference between what it has earned on its interest-bearing assets, including the balances on credit cards it has issued and the amounts loaned out as part of any other lending activities, and its interest expenses. To compare across banks, analysts calculate net interest margins, which express each banks' net interest income as a percentage of interest-bearing assets. The Federal Deposit Insurance Corporation (FDIC) aggregates data for a group of all federally insured banks that focus on credit card lending, which it defines as those with more than 50 percent of managed assets engaged in credit card operations; in 2005, FDIC identified 33 banks with at least this much credit card lending activity. As shown in figure 28, the net interest margin of all credit card banks, which averaged more than 8 percent, was about two to three times as high as other consumer and mortgage lending activities in 2005. Five of the six largest issuers reported to us that their average net interest margin in 2005 was even higher, at 9 percent.

Figure 28: Net Interest Margin for Credit Card Issuers and Other Consumer Lenders in 2005

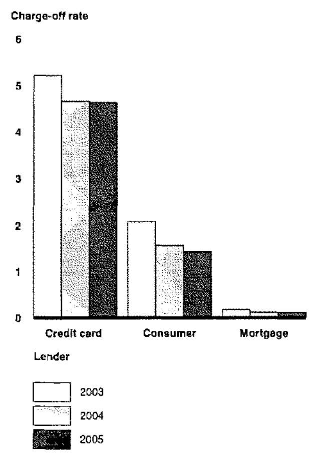


Source: GAO analysis of public financial statements of the five largest credit card issuers.

Credit Card Operations Also Have Higher Rates of Loan Losses and Operating Expenses

Although profitable, credit card operations generally experience higher charge-off rates and operating expenses than those of other types of lending. Because these loans are generally unsecured, meaning the borrower will not generally immediately lose an asset—such as a car or house—if payments are not made, borrowers may be more likely to cease making payments on their credit cards if they become financially distressed than they would for other types of credit. As a result, the rate of losses that credit card issuers experience on credit cards is higher than that incurred on other types of credit. Under bank regulatory accounting practices, banks must write off the principal balance outstanding on any loan when it is determined that the bank is unlikely to collect on the debt. For credit cards, this means that banks must deduct, as a loan loss from their income, the amount of balance outstanding on any credit card accounts for which either no payments have been made within the last 180 days or the bank has received notice that the cardholder has filed for bankruptcy. This procedure is called charging the debt off. Card issuers have much higher charge-off rates compared to other consumer lending businesses as shown in figure 29.

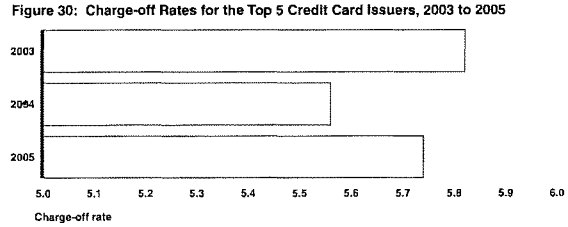
Figure 29: Charge-off Rates for Credit Card and Other Consumer Lenders, 2004 to 2005



Source: FDIC.

The largest credit card issuers also reported similarly high charge-off rates for their credit card operations. As shown in figure 30, five of the top six credit card issuers that we obtained data from reported that their average charge-off rate was higher than 5.5 percent between 2003 and 2005, well above other consumer lenders' average net charge-off rate of 1.44 percent.

Figure 30: Charge-off Rates for the Top 5 Credit Card Issuers, 2003 to 2005

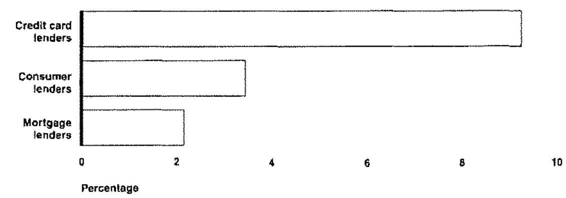


Source: GAO analysis of public financial statements of the five largest credit card issuers.

Credit card issuers also incur higher operating expenses compared with other consumer lenders. Operating expense is another one of the largest cost items for card issuers and, according to a credit card industry research firm, accounts for approximately 37 percent of total expenses in 2005. The operating expenses of a credit card issuer include staffing and the information technology costs that are incurred to maintain cardholders' accounts. Operating expense as a proportion of total assets for credit card lending is higher because offering credit cards often involves various activities that other lending activities do not. For example, issuers often incur significant expenses in postage and other marketing costs as part of soliciting new customers. In addition, some credit cards now provide rewards and loyalty programs that allow cardholders to earn rewards such as free airline tickets, discounts on merchandise, or cash back on their accounts, which are not generally expenses associated with other types of lending. Credit card operating expense burden also may be higher because issuers must service a large number of relatively small accounts. For example, the six large card issuers that we surveyed reported that they each had an average of 30 million credit card accounts, the average outstanding balance on these accounts was about $2,500, and 48 percent of accounts did not revolve balances in 2005.

As a result, the average operating expense, as a percentage of total assets for banks, that focus on credit card lending averaged over 9 percent in 2005, as shown in figure 31, which was well above the 3.44 percent average for other consumer lenders. The largest issuers operating expenses may not be as high as all banks that focus on credit card lending because their larger operations give them some cost advantages from economies of scale. For example, they may be able to pay lower postage rates by being able to segregate the mailings of account statements to their cardholders by zip code, thus qualifying for bulk-rate discounts.

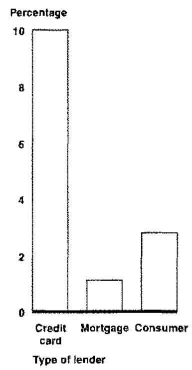
Figure 31: Operating Expense as Percentage of Total Assets for Various Types of Lenders in 2005



Source: FDIC.

Another reason that the banks that issue credit cards are more profitable than other types of lenders is that they earn greater percentage of revenues from noninterest sources, including fees, than lenders that focus more on other types of consumer lending. As shown in figure 32, FDIC data indicates that the ratio of noninterest revenues to assets—an indicator of noninterest income generated from outstanding credit loans—is about 10 percent for the banks that focus on credit card lending, compared with less than 2.8 percent for other lenders.

Figure 32: Non-Interest Revenue as Percentage of Their Assets for Card Lenders and Other Consumer Lenders



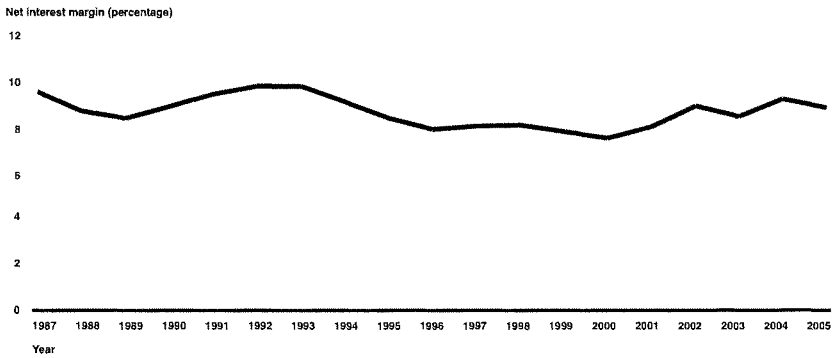
Source: GAO analysis of FDIC data.

Effect of Penalty Interest and Fees on Credit Card Issuer Profitability

Although penalty interest and fees apparently have increased, their effect on issuer profitability may not be as great as other factors. For example, while more cardholders appeared to be paying default rates of interest on their cards, issuers have not been experiencing greater profitability from interest revenues. According to our analysis of FDIC Quarterly Banking Profile data, the revenues that credit card issuers earn from interest generally have been stable over the last 18 years.[1] As shown in figure 33, net interest margin for all banks that focused on credit card lending has ranged between 7.4 percent and 9.6 percent since 1987. Similarly, according to the data that five of the top six issuers provided to us, their net interest margins have been relatively stable between 2003 and 2005, ranging from 9.2 percent to 9.6 percent during this period.

[1]The Quarterly Banking Profile is issued by the FDIC and provides a comprehensive summary of financial results for all FDIC-insured institutions. This report card on industry status and performance includes written analyses, graphs, and statistical tables.

Figure 33: Net Interest Margin for All Banks Focusing on Credit Card Lending, 1987-2005



Source: FDIC.

These data suggest that increases in penalty interest assessments could be offsetting decreases in interest revenues from other cardholders. During the last few years, card issuers have competed vigorously for market share. In doing so, they frequently have offered cards to new cardholders that feature low interest rates—including zero percent for temporary introductory periods, usually 8 months—either for purchases or sometimes for balances transferred from other cards. The extent to which cardholders now are paying such rates is not known, but the six largest issuers reported to us that the proportion of their cardholders paying interest rates below 5 percent—which could be cardholders enjoying temporarily low introductory rates—represented about 7 percent of their cardholders between 2003 and 2005. To the extent that card issuers have been receiving lower interest as the result of these marketing efforts, such declines could be masking the effect of increasing amounts of penalty interest on their overall interest revenues.

Although revenues from penalty fees have grown, their effect on overall issuer profitability is less than the effect of income from interest or other factors. For example, we obtained information from a Federal Reserve

Bank researcher with data from one of the credit card industry surveys that illustrated that the issuers' cost of funds may be a more significant factor for their profitability lately. Banks generally obtain the funds they use to lend to others through their operations from various sources, such as checking or savings deposits, income on other investments, or borrowing from other banks or creditors. The average rate of interest they pay on these funding sources represents their cost of funds. As shown in table 4 below, the total cost of funds (for $100 in credit card balances outstanding) for the credit card banks included in this survey declined from $8.98 in 1990 to a low of $2.00 in 2004—a decrease of 78 percent. Because card issuers' net interest income generally represents a much higher percentage of revenues than does income from penalty fees, its impact on issuers' overall profitability is greater; thus the reduction in the cost of funds likely contributed significantly to the general rise in credit card banks' profitability over this time.

Table 4: Revenues and Profits of Credit Card Issuers in Card Industry Directory per $100 of Credit Card Assets

Revenues and profits	1990	2004	Percent change
Interest revenues	$16.42	$12.45	-24%
Cost of funds	8.98	2.00	-78
Net interest income	7.44	10.45	40
Interchange fee revenues	2.15	2.87	33
Penalty fee revenues	0.69	1.40	103
Annual fee revenues	1.25	0.42	-66
Other revenues	0.18	0.87	383
Total revenue from operations	11.71	16.01	37
Other expenses	8.17	10.41	27
Taxes	1.23	1.99	62
Net income	2.30	3.61	57

Source: GAO Analysis of Card Industry Directory data.

Although card issuer revenues from penalty fees have been increasing since the 1980s, they remain a small portion of overall revenues. As shown in table 4 above, our analysis of the card issuer data obtained from the Federal Reserve indicated that the amount of revenues that issuers collected from penalty fees for every $100 in credit card balances outstanding climbed from 69 cents to $1.40 between 1990 and 2004—an increase of 103 percent. During this same period, net interest income collected per $100 in card balances outstanding grew from $7.44 to $10.45—an increase of about 41 percent. However, the relative size of each of these two sources of income indicates that interest income is between 7 to 8 times more important to issuer revenues than penalty fee income is in 2004. Furthermore, during this same time, collections of annual fees from cardholders declined from $1.25 to 42 cents per every $100 in card balances—which means that the total of annual and penalty fees in 2004 is about the same as in 1990 and that this decline may also be offsetting the increased revenues from penalty fees.

Appendix IV

Comments from the Federal Reserve Board

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

SANDRA F. BRAUNSTEIN
DIRECTOR
DIVISION OF CONSUMER
AND COMMUNITY AFFAIRS

August 23, 2006

Mr. David G. Wood
Director, Financial Markets and Community
Investment
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Wood:

Thank you for the opportunity to comment on the GAO's draft report entitled Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers. As the report notes, the Federal Reserve Board has commenced a comprehensive rulemaking to review the Truth in Lending Act (TILA) rules for open-end (revolving) credit, including credit card accounts. The primary goal of the review is to improve the effectiveness and usefulness of consumer disclosures and the substantive protections provided under the Board's Regulation Z, which implements TILA. To ensure that consumers get timely information in a readable form, the Board is studying alternatives for improving both the content and format of disclosures, including revising the model forms published by the Board.

The draft GAO report specifically recommends that the Board revise credit card disclosures to emphasize more clearly the account terms that can significantly affect cardholder costs, such as default or other penalty pricing rates. We agree that increased complexity in credit card pricing has added to the complexity of the disclosures. To help address this, the Board has invited public comment on ways in which the disclosures required under Regulatinn Z can be made more meaningful to consumers. The Board is conducting extensive consumer testing to determine what information is most important to consumers, when that ioformation is most useful, what language and formats work best, and how disclosures can be simplified, prioritized, and organized to reduce complexity and information overload. To that end, the Board has hired design consultants to assist in developing model disclosures that are most likely to be effective in communicating information to consumers. Importantly, the Board also plans to use consumer testing to assist in developing model disclosure forms. Based on this review and testing, the Board will revise Regulatiou Z and, if appropriate, develop suggested statutory changes for congressiooal consideration.

Mr. David G. Wood
Page 2

The Board's staff has provided technical comments on the draft GAO report separately. We appreciate the efforts of your staff to respond to our comments.

Sincerely,

Sandra Braunstein

c: Cody Goebel, Assistant Director, GAO

GAO Contact and Staff Acknowledgments

GAO Contact

Dave Wood (202) 512-8678

Staff Acknowledgments

In addition to those named above, Cody Goebel, Assistant Director; Jon Altshul; Rachel DeMarcus; Kate Magdelena Gonzalez; Christine Houle; Christine Kuduk; Marc Molino; Akiko Ohnuma; Carl Ramirez; Omyra Ramsingh; Barbara Roesmann; Kathryn Supinski; Richard Vagnoni; Anita Visser; and Monica Wolford made key contributions to this report.

Responses of Bank of America Corporation
to the
Supplemental Questions
of the
Permanent Subcommittee On Investigations

1. During the hearing, you testified that Bank of America's policy is to "suspend over limit fees after the third occurrence" for credit card holders who exceed their credit limit. When the Subcommittee reviewed Bank of America accounts for Jack Westbrooks of Michigan, however, the records show that, on one of his accounts, he was charged seven consecutive over limit fees from March 2006 to September 2006, even though he stopped using the card for purchases in April 2006. At the hearing, you indicated that these over limit fee charges had been added to the Westbrooks account in error and contrary to Bank of America policy.

   a. What was the month and year in which Bank of America instituted its policy of prohibiting more than three consecutive over limit fees to be charged to a credit card holder?

   Bank of America's current approach is to waive over limit fees if the account balance is over the credit line at the end of the billing cycle for three consecutive months. Our credit card business today is a combination of the businesses of Bank of America and MBNA, which had different practices at different points in time. The current approach was adopted as a best practice after the merger with MBNA and implemented in December 2006. It applies to all Bank of America accounts.

   b. Please explain the circumstances under which more than three consecutive over limit fees were charged to Mr. Westbrooks' account during 2006.

   Mr. Westbrooks' account was subject to an approach that existed prior to our alignment of practices in December 2006. Under that approach, customers who remained over limit throughout the three consecutive month period would incur no more than three charges; but customers, like Mr. Westbrooks, who went below their credit limits and then above their credit limits at different times during the billing cycles, could continue to incur over limit charges for more than three consecutive billing cycles. As noted above,

Permanent Subcommittee on Investigations
EXHIBIT #7a

our current approach is to waive over limit fees if the account balance is over the credit line at the end of the billing cycle for three consecutive months.

c. Is it possible that other consumers were also charged more than three over limit fees, contrary to Bank of America's policy? Does Bank of America intend to review its accounts to identify other such erroneous over limit fee charges in 2006 and 2007?

We do not believe such a review is necessary. Our current approach has been implemented since December 2006 and is working well.

d. What procedures are in place or will be developed to correct and prevent similar violations of Bank of America's over limit fee policy?

We consider customers who are over limit at the end of the billing cycle three or more consecutive times as "chronic" over limit customers and limit further fees. They are identified through an "exception reporting" process so that over limit fees can be capped. While that process is in place and working well, it is manually administered. We are implementing a systems redesign that will automate the process of precluding imposition of more than three consecutive over limit fees.

e. If four over limit fees were imposed in error on the Westbrooks account, does Bank of America intend to credit these fees and related interest to the Westbrooks account?

As explained, the fees assessed on Mr. Westbrooks' account were not imposed in error.

f. Does Bank of America intend to take steps to remit over limit fees and related interest that were erroneously charged to other credit card accounts? If so, please describe the process.

If a customer determines or believes that we have somehow imposed a fee or charge in error, we invite them to contact customer service so appropriate action can be taken to resolve the situation. Customer service contact information is provided on the back of our cards and on monthly billing statements.

2. During the hearing, you testified that you were unsure as to whether Bank of America charges what was referred to at the hearing as "trailing interest." Using the example in the hearing, suppose a customer owed debt from a prior month, received a bill on February 1st for $55.21, and paid the entire amount requested by the due date of February 15th. Would the customer's next bill reflect interest charges from the period from February 1st to 15th?

   For customers who do not take advantage of our grace period and instead choose to revolve balances, we charge interest on all outstanding balances during the month, and include new and old purchase balances up to the date those balances are paid in full. The practice of charging interest on credit cards up to the date the balance is repaid (so-called "trailing interest") is the same for any other type of loan – interest accrues daily on the outstanding balance until the loan is completely repaid. If a customer calls to receive a payoff figure for a mortgage loan or an automobile loan, for example, the customer will be given a payoff figure that includes interest up to the date the customer actually pays off the loan – not the first day of the month the loan is paid back.

   With respect to the specific example presented, interest would be assessed on the $55.21 outstanding balance from the previous cycle. The $55.21 would be included in the daily balance each day up to the day the payment is received. Again, this only applies to customers who choose to revolve a balance.

3. At the Subcommittee hearing, Senator McCaskill indicated that her credit card bills often arrive so late in the mail that, to avoid missing the specified payment due date, she pays the bill electronically. The Subcommittee has heard from other consumers that the time period between when they receive a bill and the specified payment due date is increasingly short, and that the date of the month on which the payment is due is unpredictable.

a. What is your policy, if any, regarding the minimum number of days that should be available between the date on which you place a credit card bill in the mail to a customer and date on which payment is due from that customer?

The statements are batched and delivered in bulk to the customer's local post office for delivery. Generally, that happens within three days of the statement closing date, which is approximately 17-30 days before the payment due date. At a minimum, however, our policy requires that the statement be mailed at least 14 days prior to Payment Due Date.

b. What procedures do you have, if any, for determining when a credit card bill is placed in the mail to a customer?

When a billing cycle ends (also referred to as the statement closing date), a statement is prepared that reflects all of the transactions for that account. That process starts late in the night of the last day of the billing cycle. Once the computer has run all of the calculations, the data is fed to the statement production area. The statements are then printed, cut, and inserted into envelopes.

Once inserted in an envelope, to achieve faster delivery, the statements are sorted, batched together and then delivered in bulk directly to the customer's local post office (usually by zip code) for delivery. This reduces delivery time to the customer and no single postal facility is overwhelmed by the volume of statements being mailed. Altogether the process generally is completed within three days of the statement closing date.

c. Are your credit card bills routinely postmarked on the day they are placed in the mail to the customer? If not, please explain.

They are not. We have streamlined our processes to be faster and more efficient. Through agreements with the Postal Service, we no longer meter our mail internally or place postmarks on envelopes. Neither does the Postal Service. Eliminating this step speeds the process and ultimately leads to the delivery of the mail sooner.

d. What is your policy, if any, for setting customer payment due dates? Is a customer's bill due on the same date of every month?

As described below, the determination of a customer's billing cycle does not change month to month. As a result, customers can expect to receive their billing statements at roughly the same times each month.

Upon opening, every account is assigned to a billing cycle. The billing cycle assignment determines when that cycle will close each month. Bank of America has twenty-one billing cycles designed to even out processing and mailing volume. Generally speaking, the first billing cycle will close on the first business day of the month, with each subsequent billing cycle following on each non-Sunday, non-holiday day thereafter.

While the billing statement is received at roughly the same time each month, the payment cycle end date shown on that bill will not be the same exact day each month. As described in the hearing, payment cycles range from 20 days to 30 days depending on the type of account. Presently, the Payment Due Date is determined by subtracting a set number of days (generally either one, five, or eleven days) from the next statement closing date. The payment due date will vary from month to month, as the actual cycle end date changes based on the calendar.

For example, assume a customer is on a 25 day payment cycle. If the account was in the fourth billing cycle, and the payment due date was set to be five days before the cycle end date, then in a statement created on June 5th, the Payment Due Date would be July 1st (July 6th-- July 1st was Sunday, July 4th is a holiday-- less five days). The next cycle's statement would then be created July 6th and would have a Payment Due Date of July 30th (August 4th less five days).

e. Do you have a policy or practice that makes a relatively shorter time period available for the payment of a credit card balance for customers who usually pay their credit card bill on time and in full each month?

Yes. Generally, if a customer is a pay-in-full customer, the payment due date is set at Cycle End minus 11 days. The customer is getting an interest free or low interest loan, and we prefer to minimize the time period in which we are extending that interest-free loan.

f. If you have such a policy, how are consumers notified of the potential for the change in their grace period?

The customer is told that the grace period will be "at least 20 days," and that is always the case. If there is a change in grace period because a customer goes from a revolving customer to a pay-in-full customer, then a reminder to make sure payment is received by the due date is included in the monthly statement.

4. At the Subcommittee hearing, Senator McCaskill asked about credit card companies that have sponsorship agreements with universities. Please provide the following information:

   a. Do you have sponsorship agreements with any colleges and universities and, if so, how many?

   MBNA pioneered "affinity marketing" within the credit card industry. Today, nearly 5000 organizations, sports teams and businesses, including colleges and universities, have agreed to allow Bank of America to market credit cards and other financial products with their organizations' logos or trademarks to consumers affiliated with the organizations. Bank of America has more than 700 of what we call collegiate group affinity relationships in the United States. These include colleges and universities, but more often they are with alumni associations, athletic departments, foundations, and similar groups. Approximately 96% of the customers in our collegiate group portfolio are not students, but alumni, employees, etc. and of the 700 affinity relationships, approximately 100 are with colleges or universities.

b. How many of these institutions are public universities or colleges?

Forty-three

c. What are the names of the public universities and colleges with whom you have sponsorship agreements?

With the permission of the committee, we are submitting those separately and understand that they will not be published in the record. We appreciate the willingness of the committee to do so.

d. Are the universities or colleges paid in exchange for agreeing to this sponsorship agreement?

See below response to question 4.e.

e. In general, what duties does a sponsorship agreement entail, both for you and for the university or college?

The affinity agreements generally allow Bank of America to use an organization's logos and provide Bank of America access to lists of the organization's constituents (e.g., members, alumni and season-ticket holders, etc.) for the sole purpose of marketing credit cards and other financial products to those listed individuals. In some instances, this allows Bank of America to market at sporting or other "on campus" events. Also, in some instances, and where permitted by law, Bank of America receives lists of students, but only with the prior consent of those students. Information sharing complies with state and federal privacy laws. Bank of America does not share those lists with any unaffiliated third parties, other than our service providers.

Bank of America compensates endorsing organizations for use of their marks and marketing rights. We understand that our collegiate group partners typically use the compensation from Bank of America for scholarships, operating costs, student and alumni programs, building projects, endowment programs, and to support student-run organizations. Like every other facet

of our business, Bank of America competes vigorously with other financial institutions to win these relationships.

When providing credit to students who are of age and qualify, Bank of America also provides financial literacy materials such as the attached "Student Financial Handbook" in each welcome kit as well as monthly or quarterly inserts into cardholder statements that describe how a student can establish and maintain good credit. In addition, Bank of America sponsors two financial literacy programs through Monster Worldwide's Making It Count division. These programs go to hundreds of colleges and universities and reach hundreds of thousands of students. They are presented free of charge and do not include marketing of financial products.

Credit limits for students are based on several factors including year in school, depth of student's credit bureau history, previous experience handling credit, income and an internal relationship risk score. Based on these factors, credit lines generally range from $500 to $2,000, with the higher lines going to juniors, seniors and grad students.

The majority of new student credit card accounts at Bank of America result from students coming into our branches. In addition, approximately 50% of all new student applications for Bank of America credit cards are declined for reasons that often include a lack of income to support an extension of credit. Bank of America will not knowingly approve applications from students who are under the age of eighteen and we make every effort to avoid sending marketing materials to anyone who is under the age of eighteen.

America, we want to help you understand how your
u can better manage your finances. This brochure ex
your card, like interest rate (sometimes expressed as
ge Rate, or APR) and fees that determine your cost

is educational. It is not a substitute for, or even a par
t, which provides greater detail regarding these and
our entire Credit Card Agreement and any amendm

Bank of America

Thank you for being a valued customer!

your credit card; that's why there's a separate Credit Card Agreem
ins the full contractual terms and required disclosures. But we hop
sics of how your credit card works. Don't forget, at Bank of America
ns 24 hours a day. Our number is on the back of your card.

Interest, the effects of partial payments, and cash advances

The amount of interest you pay depends on two things, how you *use* the account and how you *pay* the account. As described below, one way to limit your interest cost is to only make purchases while paying the entire balance due each month by the payment due date.

Grace Period for Purchases: If you use your card only for purchases, and pay the balance in full *every* month by the payment due date (the whole balance due, not just a part of it), then you will not pay any interest, because purchases have a grace period. If you pay less than the full balance, then you get no grace period at all, and the entire balance will start to accrue interest.

Helpful Hint

If you limit your cash advances to essential situations, and pay them back as soon as possible, you will reduce your fees and interest.

Cash Advances and Balance Transfers: Credit card accounts also allow you to obtain cash and to transfer balances from one card to another. For example, you can take your card to an ATM or bank branch (did you know Bank of America has over 5,700 banking centers in the United States - no other bank has more). Or you can get cash by writing a check on your account. Cash advance and balance transfer balances may be at different APRs than purchases, and may be subject to transaction fees. In addition, they have no grace period, so even if you pay your balance in full every month, you will pay interest on cash advances and balance transfers. Still, they offer great convenience, and possible interest savings.

Payment Allocation: For your convenience, you may make partial payments and not pay your entire balance in full. Generally, your payment is applied to balances with the lowest APR first, even if those are new balances. So, if you have balances at a discounted promotional rate, they will be paid first. Payments will be applied to balances that are at a higher APR only after all lower rate balances have been paid in full.

The importance of on-time payments and staying within your credit limit

Paying by the payment due date and staying below your credit limit are the most important things you can do to keep your credit rating high and your cost of credit down.

When you get your billing statement, check the payment due date. Your payment due date may vary from month to month. Make sure you mail your payment at least seven days before the payment due date, so it arrives on time, or make your credit card payments online at www.bankofamerica.com. At Bank of America, we keep our payment processing centers open until 5:00 pm (Eastern Time) every day of the year. So, if the post office delivers your confirming payment to us by 5:00 pm, we will process it as of that same day. By paying on time, you'll avoid late fees, the loss of promotional rates, and you'll avoid triggering higher interest rates.

Helpful Hint

Scheduling regular online payments can help you avoid late and overlimit fees.

Payments also help keep your account balance below your credit limit. If your balance ever exceeds your credit limit, even if we authorized the charge, you may be assessed an overlimit fee, lose promotional rates, and you may trigger a higher interest rate.

Interest rate changes, and how on-time payments help keep your cost of credit low

During the life of your account we may periodically change your rate or other terms by amending our Credit Card Agreement with you. We will let you know in advance of making any such change. If applicable, you will have an opportunity to reject such an amendment that increases your interest rate, although you may lose future charging privileges. In addition, if you have a variable rate account, your interest rate will change if your index (usually the prime rate) goes up or down.

More importantly, by paying your account as agreed - no missed payments, or account balances which exceed your credit limit - you can avoid the default conditions set out in your Credit Card Agreement that could result in the loss of promotional interest rates, and the assessment of higher, default interest rates. If you trigger default pricing by being late or overlimit, this higher rate is applied without any further notice or opportunity to reject that change.

Student Financial Handbook

An easy-to-use guide to managing your money

Everything you always wanted to know about managing your money is now at your fingertips. Literally.

Inside this helpful guide, you'll find tons of great info about checking, savings, online banking, credit cards, and how to protect yourself financially. There's even an excellent "how to" guide to help you set up a simple budget.

Please take a few minutes to review this handbook and learn the ins and outs of managing your money. When you're through, keep it somewhere handy for future reference.

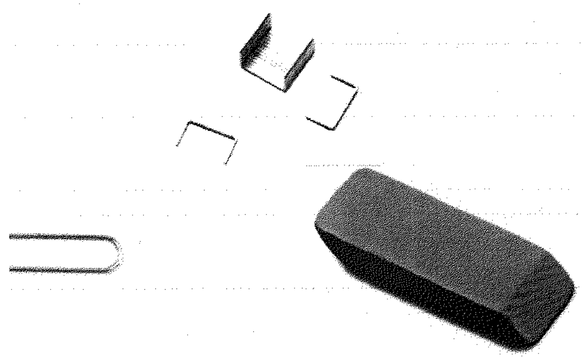


Table of Contents

bankofamerica.com/planahead

Intro to Checking

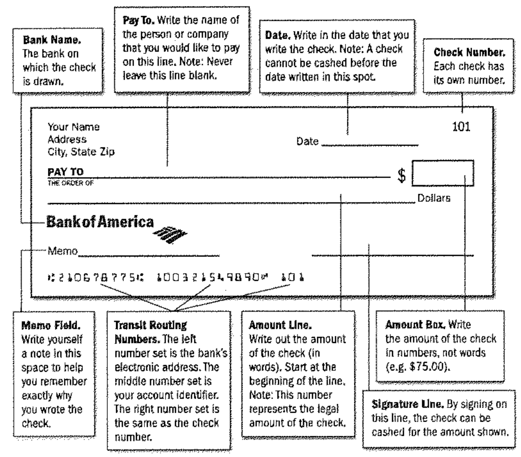
Overview

A checking account is the most fundamental way to manage your money, and then access it to pay your bills. You can do this via banking centers, online banking, ATMs, debit cards and checks.

Checking account

It's convenient. You can pay your bills online or with checks instead of going to a bank or post office for money orders or cashier's checks. You can also use money from your checking account for purchases at stores and restaurants using checks or a debit card. And the money is taken directly from your account.

It helps you keep track of your money. It's hard to keep track of the cash in your wallet or sock drawer. Using your bank's online banking services, you can view account activity from your computer to see how much money you spent, how much you deposited and how much you have left. A checking account also gives you proof of payment showing the amount you paid, to whom and when. So if someone says you didn't pay them, you can just send a copy of the check you used. Nowadays, you can typically view and print check images online.



It saves you money. Checking accounts typically cost from $5.00 to $12.00 per month, although some banks offer ways to avoid the monthly fee. But even with a fee, it's still cheaper than paying bills by money order or cashier's check (they cost $0.80 to $9.00 each).

Once you open your checking account, always be aware of your balance and don't forget to consider checks that haven't cleared through the bank. Remember, you can track your debit card purchases 24/7 through many online banking services. It's also good to keep a record of the checks you've written in your check register. Hang on to your receipts from ATM withdrawals and debit card purchases, and record them in your register, too. That's the best way to know the total amount of money you have spent. Receipts might contain account information, so keeping them helps protect your account. If you discard your receipts, do so in a secure manner. Using a paper shredder is a smart option.

Intro to Checking (continued...)

Debit cards (sometimes called check cards)

Another great thing about a checking account is that you can get a debit card linked to your account. Similar to checks, you can use your debit card to make purchases in stores and restaurants, but you can also make purchases at online retailers and get cash at ATMs.

They're convenient and safe. Debit cards are convenient and safe because you don't have to carry your checkbook or a lot of cash. Plus, you are typically required to enter your secret PIN (personal identification number) or sign the receipt to use the card. (Depending on the dollar amount of the transaction, some merchants no longer require a signature.) When you first get a debit card, you choose a PIN that only you know. Avoid obvious number choices like your address, phone number or birth date. Keep your PIN a secret; don't write it down or tell your friends. That way, no one can use it to get access to your cash except you.

Bank of America offers Photo Security® which puts your picture on the front of your VISA® Check Card to help prevent others from fraudulently using your debit card.

Your debit card account number is not the same as your checking account number for security reasons.

Expiration date of the card (month/year).

Name of the account holder.

Debit cards work anywhere VISA® or MasterCard® debit cards are generally accepted, as well as at your bank's ATMs. Remember that there may be charges for using ATMs that are outside your bank's ATM network.

They're widely accepted. Debit cards are usually good everywhere credit cards are accepted. In fact, they're accepted at more places than checks—even when you're traveling or making Internet purchases.

They're fast and easy. With a debit card, there are no checks to write, and there's no need to give out personal information when you buy something. Because debit cards use your own money directly from your account, they're easier to get than credit cards and have a lot of the same advantages.

Unlike a regular ATM card, a debit card has a VISA or MasterCard logo on it. This allows you to use the card to make purchases anywhere VISA and MasterCard debit cards are accepted. When you're asked to choose between debit or credit, remember that choosing debit means you'll need to use your PIN number, while opting for credit generally requires a signature. Either way, the amount is deducted from your checking account.

In most cases, you are able to enter your PIN into a terminal at the counter. At stores without a PIN pad, a sales clerk can swipe your debit card and give you the receipt to sign. Simply put, a debit card lets you pay directly from your checking account and replaces both cash and checks.

Sometimes the unexpected happens. If your card is lost or stolen, contact your bank right away so that you won't be held responsible for fraudulent charges.

Don't use letters in my PIN because not all keypads have the alphabet in addition to the numbers.

Intro to Checking (continued...)

Chapter Highlight

The best way to know how much money you really have available is to maintain an accurate record of what you deposit and what you withdraw from your checking account. It only takes a few minutes, and you'll save yourself a lot of trouble.

It is recommended that you write everything down in your checkbook register in pencil, since it will be easier to correct errors later.

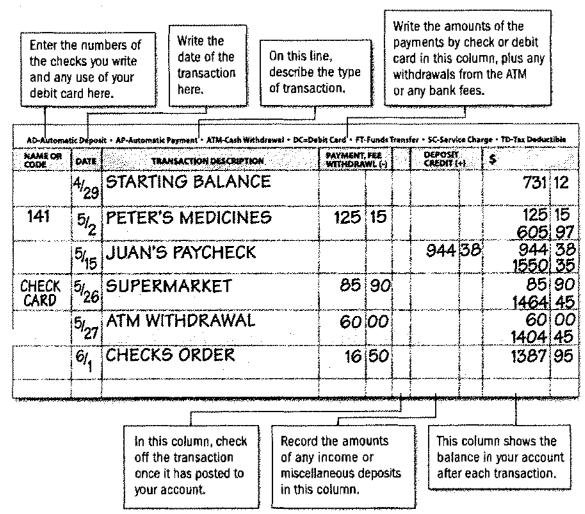
It's important to always have enough money in your checking account to cover the purchases you make. Banks charge a fee for each purchase where there are insufficient funds to pay for the purchase. These fees can really add up if you don't keep track of your checking account balance. So how can you avoid these fees?

- Monitor your account balance by keeping track of your purchases in a check register.

- Link your checking account to a savings account with an overdraft protection program, which transfers money from your savings account to your checking account when you don't have enough money in your checking account to pay for a purchase. The fee charged for this overdraft protection is usually much less than the fee you would otherwise be charged.

- Many banks also offer overdraft protection with a credit card. This can be useful if you don't normally keep enough money in a savings account for overdraft protection.

Below is an example of how to use a checkbook register to maintain an accurate record of your expenses and income. If you follow the instructions correctly, you'll see that it's very easy to keep the register up to date.



Savings 101

Overview

It's never too early to start saving money. Once you get in the habit of saving, you're on your way to building a strong foundation for your financial security. And it's also the best way to prepare for both planned and unexpected expenses.

How to grow your savings

Making recurring deposits is critical to building your savings. By setting money aside from your checking to your savings, you'll find that cash is less likely to be spent. Having a little bit of money tucked away in a savings account certainly gives you peace of mind.

How to choose your savings account

There are a few things you will want to keep in mind when choosing a savings account. First, the growth in your balance comes from the deposits you make, plus the interest you earn. This interest rate is also referred to sometimes as rate of return or annual percentage yield. Also, make sure to be aware of any fees that may apply to minimum balance requirements or withdrawal limits. Review the next few pages to learn about the different types of accounts and how to start saving for your future.

It all starts with a solid budget. See what happens when you open an account with $500—just by leaving the money in your account, you make money over time. Your savings will grow even faster if you continue to make monthly deposits into the account.

Let's say you open your savings account with $500.

	6 Months	12 Months	18 Months
Starting Balance	$500	$500	$500
Add $50 per month	$300	$600	$900
Earn 2% interest	$6.75	$16.50	$29.25
Total	$806.75	$1,116.50	$1,429.25

How to use your savings account

Once you start depositing your money, make sure to keep track of your deposits, withdrawals and transfers so you don't get any unexpected service charges. In fact, if you connect your checking and savings into a combined statement, it's easy to track just how much money you have available in both accounts. After you've accumulated extra money for unexpected expenses, you may want to consider opening a separate savings account for special purchases.

Savings 101 (continued...)

Fact: Higher balances and longer terms can earn higher interest rates.

Standard account types

Bank Savings

There are three basic types of bank savings accounts: regular savings, money market savings and certificates of deposit. It is important to know that you will not lose the amount you deposit in a bank savings account in the event of bank failure, since it is guaranteed by the FDIC. Your deposits are insured to the maximum extent allowed by law.

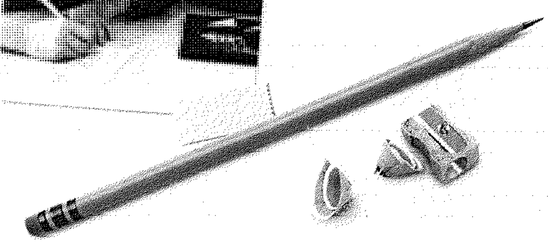
Here's how they work:

Regular Savings

- You earn interest on your balance.
- You get a statement that can be combined with your checking account statement.
- You can access your money anytime.

Money Market Savings

- Your interest rate increases as your balance increases.
- Your interest rate changes more often as the economy changes.
- You can access your money anytime, including by check.



CDs (Certificate of Deposit)

The bank pays you a set interest rate on a set amount of money over a predetermined period of time. What that means is if you put money away for a set period of time without touching it, the bank will pay you a higher interest rate than it would on a Regular Savings account that you can withdraw money from. The longer the term of the CD, from as short as seven days to as long as ten years, the higher the interest rate. This is a simple way to earn a higher fixed interest rate with no fees.

Fact: If you save \$5 a day for 5 years, you'll save \$9,130.

Savings 101 (continued...)

Saving for the future

Stocks

A stock represents partial ownership of a corporation. Stockholders own a share of the company expressed in a percentage of the company and are entitled to a share of the profits. Stockholders even get to vote on company decisions.

Here's how they work:

The company profits may be divided among shareholders and are called dividends. Dividends are usually paid to stockholders quarterly. Stocks are traded on the open market, which means they can earn money when the value of the stock, the market value, increases. They can also lose money when the value decreases. This can be an advantage when the market value is up, but it can be a disadvantage when the market value goes down. You can see why "playing the stock market" can be tricky, so it's a good idea to get help from a brokerage firm or an advisor with experience.

Tip:
Unlike bank savings, you can lose the money you invest in stocks or mutual funds.
So, be cautious when making your investment decisions and understand the risk factors.

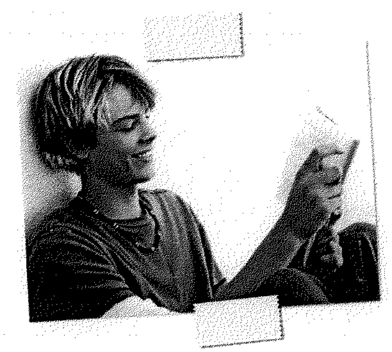
Mutual Funds

A mutual fund is a portfolio of investments that is managed by a professional investment advisor. It is made up of stocks, bonds and other investments, and is owned "mutually" by many investors.

Here's how they work:

When you buy shares, the fund uses the money to purchase stocks, bonds and other investments. The profits are returned to shareholders monthly, quarterly or semiannually in the form of dividends. The advantage of mutual funds over individual stocks is small investors can benefit from the advice of a professional account manager who diversifies the portfolio for you, so all of your eggs aren't in one basket.

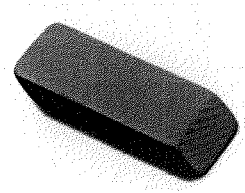
But keep in mind that this has some of the same risks as buying stocks. Even though your investment is now "diversified" and someone is watching it for you, it still can also decrease in value.



Retirement Plans
So maybe you aren't thinking about retirement yet, but it's never too early to start saving for it.

Here's how they work:
Retirement plans help people set aside money for expenses after they retire. Federal income tax is not immediately due on money put into a retirement account or even on the interest it makes, so you can save more today. Income tax is paid when you take out the money, but because your income is typically lower after retirement, so is your tax rate. Keep in mind that if you take out money before retirement there may be penalty charges, so it is best to access this money only if it's absolutely necessary.

There are two main types of retirement accounts:
- **Individual Retirement Account (IRA)** – An IRA lets you contribute money in installments throughout the year or in one lump sum each year. There is a legal limit on the maximum dollar contribution that can be made each year.
- **401(k)** – A 401(k) lets you contribute to a savings plan through your employer. The money is taken from your pretax earnings, so you save money on taxes. Not only do you save money on taxes, but some employers match the money you put into your 401(k) up to a certain percentage level. So your savings grow even more.



The Truth In Savings Act
(Federal Reserve Regulation DD)
Banks and financial institutions must disclose certain information about the consumer deposit products they offer:
- Fees on deposit accounts
- Interest rates
- Other terms and conditions
- The annual percentage yield (APY), which is the percentage rate for the total amount of interest that you would receive on a $100 deposit with the annual rate and compounding interest. Compounding interest means the interest is added to the account periodically (monthly, for example), so you earn interest on the interest.

Chapter Highlight

To start your savings plan, a good rule of thumb is to keep enough money in your checking account to pay your monthly bills and put the rest into savings.

Check out how much your retirement plan can earn:
Let's say you contribute $2,000 a year to an IRA for 9 years from age 22-30 for a total investment of $18,000. If your annual interest rate is 9%, by the age of 65 you will have saved $579,468.
It's amazing how fast it can add up.

Online Banking Tutorial

Overview

You do just about everything online. You keep in touch with friends, research assignments for school, buy music and rent movies. But what about banking? Do you still pay your bills the old-fashioned way, with pen and paper? If you do, it might be time to check out the online options at your bank.

Online banking is just like regular banking except it's more efficient and paper-free. You can often access your statements, canceled checks and transaction records without having to dig through all the papers piled up under your bed. Here are just a few more advantages of banking online:

Convenience: Online banking is generally available 24 hours a day, seven days a week, right from your computer.

Easy Access: Oftentimes you can access and manage all of your checking and savings accounts from one secure site. Online banking enables you to frequently check account balances and keep an eye on recent transactions.

Useful Tools: Many online banking sites have useful tools that help you manage your accounts, including bill paying tutorials, online transfers between your accounts, online statements, the ability to view check copies online, as well as information on how to plan for college and get a student loan.

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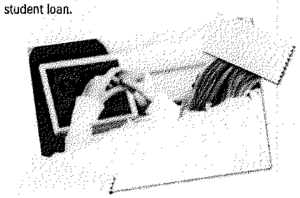


Getting started

To start banking online, you'll probably have to provide ID and sign up at a bank branch. At some banks, you may be able to enroll online by accessing the bank's website from your home computer. Really, nothing could be more convenient.

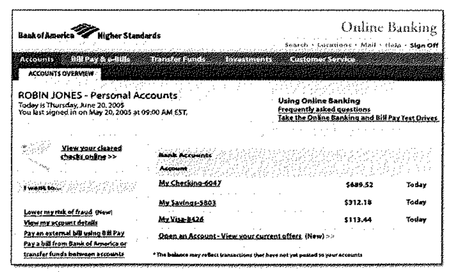
Good forms of ID:
- driver's license
- passport
- state ID

Receive and pay your bills online

At some banks, you can get your bills delivered to you online. You'll see the amount due, the fees and other payment information—everything you would normally see on your paper bill. Then you can pay your bills when you want. You can even set up your online service to automatically pay regular expenses like rent or your phone bill.

View online copies of your paper statements

With many online banking services, you can see your past statements and print them whenever you want, often up to 18 months worth of past statements. There's less paper, less hassle and less risk of mail fraud or identity theft when you get statements online instead of through the mail.



Online Banking Tutorial (continued...)

Transfer money

Some online banking services offer you the capability to move money from one of your accounts to another and even to other banks or financial institutions electronically. Often you can transfer money from checking to savings, or to a credit card or an installment loan as a payment. Some banks even allow you to transfer money to their other customers. This would be ideal for your parents to send you money—instantly.

Update personal information

Name, address, birth date, your pet's name—just to get a book from the library? You're probably tired of filling out forms for everything. Now you don't have to, because your keyboard can do it for you.

It's important to keep all your personal information—such as mailing address, email address, and phone number—up-to-date on all your accounts, so you don't miss receiving any important account notifications. You can usually make all your updates online using the bank's online banking service. You can typically order checks, stop payments and do lots more, right from your computer.

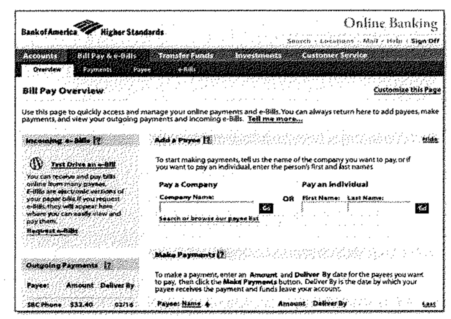
Chapter Highlight

Schedule bill payments

Once you've started banking online, the next step is to schedule payments to pay your bills automatically. That way, you'll never be late paying regular bills, such as your rent or cell phone, again.

Protect your credit while saving time

If the company receiving your bill payment is set up to accept electronic payments, your payment is automatically taken from your account and deposited into theirs. If not, the bank will likely send a check to the company on your behalf.



Pay your bills online without spending a lot of time.

Credit Card Review

Overview

A credit card is a loan from a financial institution that you can repay on a monthly basis. So you can make purchases up to a certain limit and repay the balance over time. The idea is that over time, you will repay the amount you spend, plus interest, to the financial institution for making the loan to you. Credit cards have advantages, but need to be used responsibly. By using your card wisely, you can make the most of having it and limit the risks.

Advantages

- You can buy things you need right away, even if you don't have the money in your checking or savings account.
- You don't have to carry cash.
- It creates a record of your purchases.
- It's more convenient than writing checks.
- It helps consolidate your spending into one payment.
- It can provide you purchase protection and extend product warranties.

When you make purchases over the phone, they ask for the full card number, the expiration date, as well as your name as it appears on the card. That means if your middle initial shows, include it.

Keep in Mind

- Things you buy may cost more than you expect due to accumulated interest and finance charges.
- There may be additional fees, such as an annual card fee.
- Watch how much you spend and be sure it's within your budget.
- Beware of impulse buying.

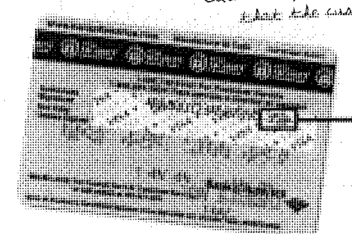
Fact: BankAmericard launched in 1958 and later became the VISA Card!

Credit cards can be useful tools to help you manage money, but misuse can result in negative information on your credit report. If you pay off all that you charge each month by your payment due date, generally there won't be any interest charges. This makes credit cards a convenient way to shop and budget, because your monthly statements show every purchase you make. Credit cards are also a good way to deal with unexpected expenses—like when your "at-least-it's-reliable" car decides to be a little less reliable.

One other thing that might be asked for is the three-digit number on the back.

But just as interest helps your savings account grow, interest charges from a credit card can add up fast if you don't pay off the entire bill each month. For example, the sweater you bought on sale for $20 may end up costing you $25 if you take a while to repay the charge for it.

The security code (referred to as CVV2 or Card Verification Value) helps validate ~~that the~~ customer placing the online or phone order actually has the credit card in his/her possession, and that the credit card account is legitimate. It helps to protect your identity.



Credit Card Review (continued...)

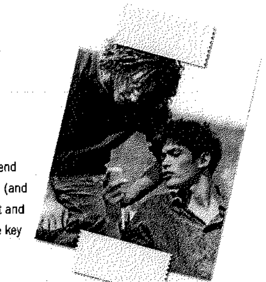
Here's how they work:
There are two basic types of credit cards:

Monthly charge card. Traditional charge cards require you to pay for purchases or services in one lump sum within a given period of time. Usually, you don't have to pay interest for this type of credit, but you are required to pay the balance in full each month.

Revolving credit. Revolving credit is an ongoing cycle of lending and repayment. You repay the amount you borrowed in minimum payments at regular intervals, often monthly. This is a good plan if you want some flexibility in the amounts you spend and repay month to month. If you don't pay off your charges in full from one month to the next, interest is charged on the remaining balance.

Fact:
Eighty percent of young adults (aged 18-20) have credit cards.[3]

Chapter Highlight



Know your limit

Having a credit card makes it easy to spend more than you should or make impulsive (and expensive) purchases. Knowing your limit and understanding what you can afford is the key to using credit wisely.

Have a payment plan

If you're not paying the full balance on your credit card each month, be sure to keep track of how much you're charging, how much you're paying each month, and how much interest is being added to your unpaid balance. Making a plan to repay your credit card balance quickly and responsibly is the first step to good credit card management.

Credit card safety

Financial institutions are continually finding new ways to stay ahead of criminals and to protect you. If your card is lost or stolen or you think you're a victim of fraud, notify your issuing financial institution(s) immediately. If your card displays the VISA logo and you know your credit card number, VISA has a toll-free number that can help: 1-800-VISA-911.

Name of Credit Card	Charges Made	What I'm Paying Each Month	Overall Balance	Interest Charges
	$	$	$	$

Advanced Student Aid and Loans

Overview

College is expensive and lots of people can't afford to pay for it all at once. That's why there's financial aid. The best sources of financial aid are scholarships and other grants that you don't have to pay back. But not everyone will qualify, and scholarships won't necessarily cover the full amount required. Therefore, student loans can be a good option to make up the difference, especially loans with low-interest programs.

Fact: The average debt from undergraduate college loans in 2002 was $18,900 per student.[14]

Financial aid breaks down into two types: 1) scholarships and merit-based aid, and 2) student loans and need-based aid.

Here's how it breaks down:
Scholarships and merit-based aid. There are so many different scholarships, grants and other programs available that you might want to start by doing a little research. Find out what scholarships you may be eligible for. If your grades are very high and you did well on your college entrance exams, you could qualify for merit-based scholarships. But even if you don't have the best grades and highest test scores, you'll find that there are still a number of opportunities for which you may still qualify. It could be an athletic scholarship or one of a number of other different awards given out each year.

I can't believe there is a scholarship for being left-handed![15]

Student loans and need-based aid. There are programs that help students who wouldn't be able to afford college on their own. Federal need-based programs determine how much help you actually need by using a special equation. The equation figures out what your family can contribute toward your education. Typically, this contribution comes from a variety of sources, including savings or loans.

The process of determining need takes into account all of your family's assets including income and investments, and subtracts expenses that you have no control over such as taxes, basic needs and employment expenses. There is an allowance for retirement savings. The rest of the assets are considered discretionary resources. The federal programs determine your financial need based on this discretionary money.

Advanced Student Aid and Loans
(continued...)

Your financial aid

You may end up receiving financial aid from a few different sources, so your aid package could include each of the following:

Grants. Programs designed to help families with the most need pay for college. Unlike federal loan programs, these funds are awarded with no expectation of repayment.

Scholarships. Many foundations, corporations, religious institutions, ethnic organizations and other groups offer monetary financial aid based on a wide variety of qualifications including need, academic or athletic achievement, and special talents.

Federal Work-Study (FWS). This form of financial aid provides qualified students with funds in exchange for performing work for the school. Students are paid at the federal minimum wage (or more) on an hourly basis–the wage is dependent upon skill set and work requirements.

Government-guaranteed loans. A low-cost loan backed by the federal government. There are a number of types available including Stafford, PLUS and Perkins loans.

Private loans. These are for students looking to cover education expenses that federal aid won't cover. Standard features include flexible repayment options, desirable loan limits and a high maximum.

For more information on financial aid, check out the U.S. Department of Education at www.ed.gov, or the Bank of America Student Loan Guide which is available for free at bankofamerica.com/studentloans or by calling 1.800.344.8382.

Sample Stafford Loan Repayment Schedule

The following chart will give you an idea of the monthly payments and the total amount paid for federal loans using the standard plan. The figures assume that 8% of the borrower's income is being used to repay the loan. You may want to adjust the percentage from 5% to 15%, depending on your particular situation.

Amount borrowed	120 Monthly payments	Total amount paid	Total interest paid	Suggested income level
$5,500	$67.46	$8,094.90	$2,594.90	$10,119
10,000	122.65	14,718.32	4,718.32	18,398
20,000	245.31	29,436.63	9,436.63	36,796
30,000	367.96	44,154.95	14,154.95	55,194
40,000	490.61	58,873.26	18,873.26	73,592
50,000	613.26	73,591.58	23,591.58	91,989
60,000	735.92	88,309.89	28,309.89	110,387
70,000	858.57	103,028.21	33,028.21	128,785
80,000	981.22	117,746.52	37,746.52	147,183
90,000	1,103.87	132,464.84	42,464.84	165,581
100,000	1,226.53	147,183.15	47,183.15	183,979
110,000	1,349.18	161,901.47	51,901.47	202,377
120,000	1,471.83	176,619.78	56,619.78	220,775
130,000	1,594.48	191,338.10	61,338.10	239,173

*Based on a 10-year term and the maximum Stafford interest rate of 8.25%. Actual repayment amounts may be lower.

Chapter Highlight

Know and understand your financial aid package. Know where your college money is coming from and whether you'll be responsible for paying it back. Grant programs provide money that you don't have to pay back, while loan programs require you to pay back the loan money in full, with interest, once you graduate or leave school. So if you don't need the money for education expenses, don't take it.

Budget Fundamentals

Overview

Do you have enough money to catch that movie with your friends? Do you need to work extra hours to pay for all your books next semester? Not sure? Then you need a budget—the essential tool to manage your money, know what you can afford, and figure out how much you can save.

Know your needs

Take a look at the big picture of your financial situation. Figure out what you need and what you want. Make two lists: the "I need it" list and the "I want it" list. Sometimes it's hard to tell which is which. Here are some questions that can help:

- Why do I want it?
- How would things be different if I had it?
- What other things would change, for better or worse, if I had it?
- What is truly important to me?
- Is this really what I value/care about?

Set goals

Setting goals is all about turning what you need and want into something concrete. It's the specific result you're working for, like an A in biology or owning a new car. Some goals are realized sooner than others. The A in biology can be achieved over the course of several months, while buying a house or saving for retirement may take years.

Try to set aside at least 10% of your income into a savings account.

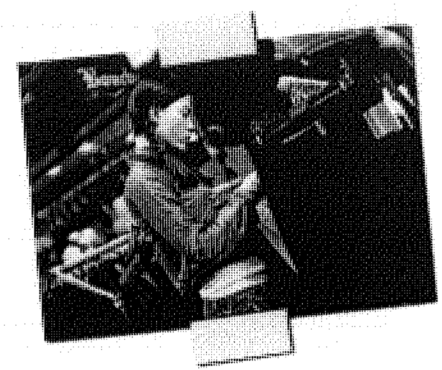
Create a realistic plan and stick to it.

Make a plan

It can be hard to plan for the future when the future feels really, really far away. So start by asking yourself this famous question, "Where do I want to be in 5, 10 or 20 years?" It'll give you an idea of what you want to achieve and what you need to do to get there. Want to buy a car in five years or buy a house in 10? No one knows but you. So start thinking about your goals and how you plan to make them happen. This is the first step toward planning for your future.

Take action

Once you know your goals, how are you going to make them happen? It's time to step up and take action. Having a plan is great, but don't forget to take the first step. To help you get motivated and get in gear, try writing your goals down, telling a friend, saying them out loud or leaving notes for yourself so that you don't lose sight of them. These are all great ways to make them a reality.



Budget Fundamentals (continued...)

Step one: your income

The first thing you need to do is figure out how much money you make on a regular basis. If you get paid once a month, it's easy. Your take-home pay is the amount of money you get from your paycheck after withholdings. If you get paid more than once a month, you'll need to do some math.

- For weekly checks, multiply by 4.333
- For biweekly checks, multiply by 2.167
- For semi-monthly checks, multiply by 2
- For irregular annual income, divide by 12

Don't forget to add other sources of income, such as interest income or checks received from your folks. But be careful not to include *potential* income. Don't assume the birthday check from your grandma will be as generous as it was last year. She might be on a budget, too.

Step two: your expenses

Now you need to estimate how much you spend each month. Write down what you think your big spending areas are. Here are some ideas about possible categories:

· Housing/Rent	· Savings
· Utilities	· Taxes
· Food	· Personal Needs
· Transportation	· Basics, such as clothing or school supplies
· Insurance	· Gifts/Contributions
· Recreation/Entertainment	
· Debt Payments	

Step three: keeping track

Now that you've got a grip on your *planned* income and expenses, you must keep track of your *actual* income and expenses. You can track your spending by making a simple spreadsheet or by writing it down in your notebook or organizer. This helps you understand any "budget variances"—the difference between the amount you budgeted and what you actually spent. Don't worry if it takes a few months to get it fine-tuned.

Fact: The fastest growing group of people filing for bankruptcy are people under the age of 25!

Step four: tweaking and targeting

After a month or so, you may find that your budget needs some tweaking. Cutting back or trimming expenses can be a lot easier than trying to cut things out completely. So if you're spending a lot more on movies than you planned, you'll know where you can cut back.

Saving a few dollars here and there can really add up.

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Chapter Highlight

Balance your budget

Always balance your income and your expenses monthly. Are you spending more money than you're making? Keep in mind where you can cut back. Entertainment bills are easy to trim; rent and utilities are harder. If you get paid by the hour, maybe you can pick up an extra shift without sacrificing your class work. Learning to balance your budget is the most important step on the road to your financial future.

College Budget Planner

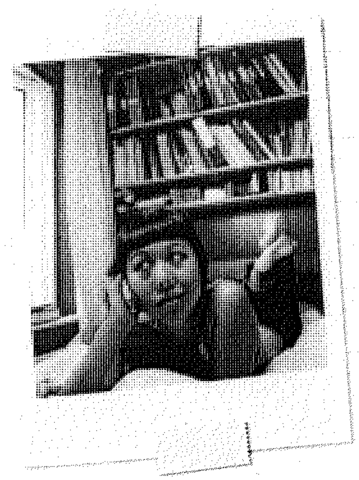
	Budget Amount	Actual Amount	Difference
INCOME:			
Wages and Bonuses			
Interest Income			
Investment Income			
Miscellaneous Income			
Total Income			
EXPENSES:			
HOME:			
Mortgage or Rent			
Homeowners/Renters Insurance			
Property Taxes			
Home Repairs/Maintenance/HOA Dues			
Home Improvements			
UTILITIES:			
Electricity			
Water and Sewer			
Natural Gas or Oil			
Telephone (land line, cell)			
FOOD:			
Groceries			
Eating Out, Lunches, Snacks			
FAMILY OBLIGATIONS:			
Child Support/Alimony			
Day Care, Babysitting			
HEALTH and MEDICAL:			
Health Insurance (medical, dental, vision)			
Out-of-Pocket Medical Expenses			
Fitness (yoga, massage, gym)			
DEBT PAYMENTS:			
Credit Cards			
Student Loans			
Other Loans			

	Budget Amount	Actual Amount	Difference
TRANSPORTATION:			
Car Payments			
Gasoline/Oil			
Auto Repairs/Maintenance/Fees			
Auto Insurance			
Other (tolls, bus, subway, taxi)			
ENTERTAINMENT/RECREATION:			
Cable TV/Videos/Movies			
Computer Expense			
Hobbies			
Subscriptions and Dues			
Vacations			
PETS:			
Food			
Grooming, Boarding, Vet			
CLOTHING:			
INVESTMENTS and SAVINGS:			
401(k) or IRA			
Stocks/Bonds/Mutual Funds			
College Fund			
Savings			
Emergency Fund			
MISCELLANEOUS:			
Toiletries, Household Products			
Gifts/Donations			
Grooming (hair, makeup, other)			
Miscellaneous Expense			
Total Expenses			
Total Income			
Total Expenses			
Income Minus Expenses			

Identity Theft Summary

Overview

Identity fraud is one of the fastest growing types of crime. But how does someone steal your identity anyway? And what do they do with it once they steal it? Identity theft is a crime that happens when someone obtains your personal information and uses it for their own personal gain. Depending on the type of information obtained, a thief can open bank accounts, buy things with your credit cards, get cash, rent an apartment, open new credit card accounts in your name and damage your credit rating.



Fact: According to a study in July 2003, approximately seven million people were victims of identity theft during the prior 12 months. That's 19,178 per day, 799 per hour, 13.3 per minute.

Here are a few things you can do to help prevent identity theft:

Check your credit reports often. Identity theft happens fast, so be sure to check your reports regularly.

Get your credit report from all three credit bureaus. Keep an eye out for unauthorized or fraudulent accounts opened in your name. Even a misspelled name or wrong address could be a sign of trouble, so look for anything suspicious. There are three major credit bureaus: Equifax, TransUnion and Experian.

Watch your statements. Watch out for any unauthorized charges on your monthly credit card statements and for any unauthorized checks, ATM withdrawals or debit card charges on your checking account statement.

Use online banking to keep current with all your recent transactions and keep an eye out for fraudulent transactions.

Keep Identity Information to yourself. Never give out your social security number, credit or debit card number, or other personal information over the phone, by mail or on the Internet, unless you trust the company. If you do need to share your personal information with a company, it is recommended that you initiate the call—some thieves can pose as someone you trust, like your bank or credit card company. One type of scam is called Phishing. That's when someone tries to get you to provide your personal information—like credit card numbers, passwords or account details—under false pretenses. They usually claim to be from a trusted company and contact you over the phone or online.

Identity Theft Summary (continued...)

Reporting identity theft

If you believe you are a victim of identity theft or fraud, below are steps you can take:

Step 1: Contact one or more of the consumer credit reporting companies. The contacted company is required to contact the other two bureaus. When you contact the credit bureau, tell them you believe you are an identity theft victim and ask them to place a "fraud alert" on your file. This will prevent a thief from opening additional accounts using your personal information and doing more damage to your credit. Review your credit reports carefully to make sure there aren't any fraudulent accounts.

Step 2: Close the accounts that you know or believe have been tampered with or opened fraudulently. Your creditors can include credit card companies, utilities, banks and other lenders. When you call each creditor, ask to speak to someone in the security or fraud department. Open new accounts using new PINs and passwords that only you know.

Step 3: File a report with your local police or the police in the community where the identity theft took place. Once you've filed a police report, get a copy for your records in case your bank, credit card issuer or other creditors need proof of the crime. Having a copy of the police report can help protect you legally when dealing with creditors, even if the police never catch the criminal.

Identity Theft Hotline: 1-877-IDTHEFT

Step 4: Finally, you should file a complaint with the Federal Trade Commission:

- Call the Identity Theft Hotline (toll free), 1-877-IDTHEFT, or
- Mail the Identity Theft Clearinghouse, Federal Trade Commission, 600 Pennsylvania Avenue, NW, Washington, DC 20580 or
- Online at www.consumer.gov/idtheft

Chapter Highlight

Keep a close eye on your credit report

Make sure to review your credit reports often. You're entitled to one free report every 12 months from each of the three nationwide consumer credit reporting companies. It's as easy as going to annualcreditreport.com. Request a free report every 12 months from Equifax, TransUnion and Experian.

Equifax	TransUnion	Experian
www.equifax.com (800) 685-1111	www.transunion.com (800) 916-8800 or (800) 888-4213	www.experian.com (888) 397-3742

Credit Rating Lab

Overview

Your credit score is a very important number in your financial life. It's the result of a complex calculation that tells potential creditors whether you're likely to repay your debts based on your credit history. Your credit rating doesn't mean you get an automatic "yes" or "no" when you want to get credit, rather it's how creditors find out about your spending and payment history.

So your credit score can have a big impact on whether you get approved for a credit card or loan and what the interest rates will be. Each creditor gets to determine its own criteria and will look at your total outstanding debt, including your credit card balances and your credit limits, in addition to your credit rating. It's a simple concept. Creditors want to know how you've managed your financial obligations to date. It helps them to know if you are responsible and pay bills on time.

Credit rating (credit score)

Your credit rating isn't just one number on a report. It's actually a whole file of information.

Here's how they work:

Each credit bureau collects information it receives from the credit-granting community: banks, finance companies, department stores, tax authorities, landlords and other credit grantors. Three nationwide consumer credit reporting companies (Equifax, TransUnion and Experian) compile credit reports. The report is a file of information from all the companies you have done business with. It will show your open accounts with balances and credit limits; whether you pay on time and in full, make late payments or miss payments; whether any of your accounts have been turned over to a collection agency; any suits, judgments or tax issues, etc. Basically, it's your entire financial history, so it gives creditors and companies a good idea of how well you pay your debts.

What can a good credit history do for you?

A look at your financial past (credit history) can give a clear picture of your financial future. Starting out on the right foot financially by establishing good credit can help you use financial services, like credit cards, to your advantage. A strong credit history can help you get loans, insurance and an apartment when you need them—even potential employers may review your credit history.

Credit Rating Lab (continued...)

Credit score

The higher your credit score, the less risk you pose for potential lenders. In general, your score can affect you as follows:

720-850: Lenders see you as a moderate to low risk, and are more likely to give you a competitive interest rate on loans they provide.

620-719: In this range, you will be considered a fair to good risk, but interest rates on loans provided may be higher. You should work to improve your score by paying your bills on time and reducing your credit balances.

350-619: You may have difficulty obtaining credit cards, lines of credit, or loans you need for a new car, a home, etc. So improving your score should be a priority.

Establishing good credit

Your credit history is a financial profile. So if you manage money well, banks and businesses will want to do business with you.

Here are a few things that can help you build a strong credit history:

- Pay off credit cards, loans and service payments in full as soon as they are due. Avoiding late payments is a great start to your credit history.
- Budget for expenses like rent and utilities.
- Balance your checking and savings accounts to avoid overdrafts or bounced checks.
- Know and keep track of your total outstanding debts.
- Know how much credit you have available on your cards and how much you owe.

Fact:
Missing even one credit card payment can knock 50 to 100 points off a good credit score!

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Credit Rating Lab (continued...)

The 3 C's of credit

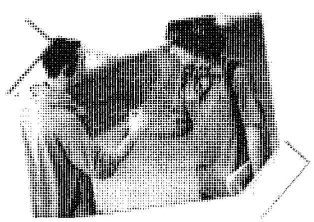
The 3 C's of credit are Character, Capital and Capacity. Creditors ask themselves these three questions to decide if they want to do business with you.

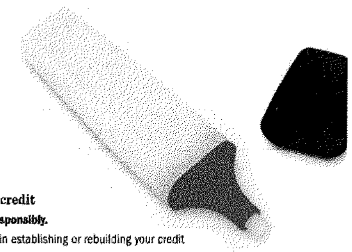
Character. Are you honest and reliable enough to repay the debt?

Capital. Do you have any valuable assets (like real estate, savings or investments) that you could use to repay credit debts if needed?

Capacity. Are you able to repay the debt? Do you have a reliable job that provides enough income to support your spending?

Someone can turn you down for credit (a loan, insurance or employment) for many different reasons. If part of that decision was based on something in your credit report, they are required to share that with you. You should immediately write to the consumer credit reporting company that created the report and ask for a copy. If you ask for it in writing within 60 days after being turned down for credit, by law, the company has to give you a free report. This will help you to identify problem areas in your credit history so you can work to correct them for the future. Remember, if there's an error on your credit report, make sure you dispute it promptly.





Chapter Highlight

The do's and don'ts of credit

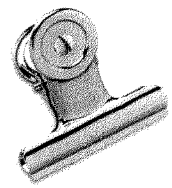
Use credit wisely and responsibly.
The most important step in establishing or rebuilding your credit score is to pay all your bills on time. In addition, carrying a credit card with a small line of credit can help—particularly if you've never had a credit card or other loan before.

Shop around. Check out a variety of credit products and services from various institutions to determine which offerings best meet your needs.

Understand your contract. Don't rush into anything. Read the contract carefully and make sure you understand the fine print, like penalties for missed payments and what effect they could have on your interest rate. When you do sign a contract, get a copy for your records in case you have questions later.

Know the "real" cost. Figure out how much something really costs when you buy it with credit. Be sure to add the interest and fees. Pay off as much of your balance as you can to pay as little interest as possible. Be sure to consider all other possibilities before buying on installment credit, and don't be tricked into thinking small payments are always easy to make.

Quick References



Student Aid and Loans
- US Department of Education
  www.ed.gov

Student Loan Guide
- Bank of America
  www.bankofamerica.com/studentloans
  800-344-8382

Annual Credit Report Request Service
  www.annualcreditreport.com
  877-322-8228

Consumer Credit Reporting Companies
- Equifax
  www.equifax.com
  800-685-1111

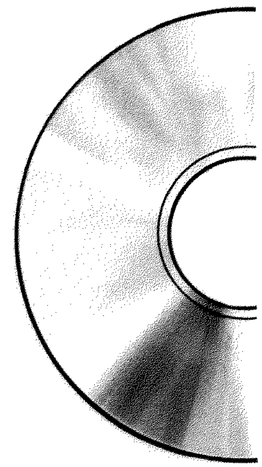
- TransUnion
  www.transunion.com
  800-916-8800
  800-888-4213

- Experian
  www.experian.com
  888-397-3742

Identity Theft
- Federal Trade Commission
  www.consumer.gov/idtheft
  1-877-IDTHEFT

Financial Planning Help
  www.practicalmoneyskills.com

Notes



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Notes

Notes

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RESPONSES TO SUPPLEMENTAL QUESTIONS FOR THE RECORD
FROM THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

to

RICHARD J. SREDNICKI

Chief Executive Officer
Chase Bank USA, N.A.

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON

CREDIT CARD PRACTICES:
FEES, INTEREST RATES, AND GRACE PERIODS

March 7, 2007

1. **During the hearing, Chase indicated that it should have handled Mr. Wannemacher's credit card account differently. In meetings with Subcommittee staff, Chase indicated that, in addition to forgiving the credit card debt, it intended to correct Mr. Wannemacher's credit history to show that he had paid the entire credit card debt owed to Chase as of February 2005, when he made the settlement offer. Has Chase, in fact, contacted the three credit reporting agencies to correct Mr. Wannemacher's credit reports and show that his credit card debt was paid in full as of February 2005? Have the requested corrections actually been made to Mr. Wannemacher's three credit reports?**

   Mr. Wannemacher's records at the three (3) national credit bureaus have been updated to indicate that his account with Chase was paid in full, with a last payment date of February, 2007, as this was the date on which we reached agreement with Mr. Wannemacher concerning his balance. We thought it best to indicate this as his last payment date because it is true and accurate. We believe this indication of recent payment activity on his account is important to reflect accurately, as it may be considered in the event he seeks credit in the future.

2. **At the Subcommittee hearing, Senator McCaskill indicated that her credit card bills often arrive so late in the mail that, to avoid missing the specified payment due date, she pays the bill electronically. The Subcommittee has heard from other consumers that the time period between when they receive a bill and the specified payment due date is increasingly short, and that the date of the month on which the payment is due is unpredictable.**

   a. **What is your policy, if any, regarding the minimum number of days that should be available between the date on which you place a credit card bill in the mail to a customer and date on which payment is due from that customer?**

Permanent Subcommittee on Investigations
EXHIBIT #8a

Customers have their payment due date set a minimum 20 days from the statement date and bills are promptly sent to ensure customers have as much of that time as possible to pay. As a result, we believe all our customers have ample time to pay their credit card bills.

For example, if a customer's statement date is the 1st day of every month, a statement file is produced and delivered to the statement production group on the morning of the 2nd day of the month. Statements are printed, and prepared for mailing. All statements are mailed by the end of day 3 (or 4 if one of the 3 days is a federal holiday).

Assuming the postal delivery takes 3 days, customers with billing dates of the 1st of every month should have their USPS-delivered statement no later than the 6th of the month. Those customers would have a payment dues date of the 20th of the month. They would therefore have 14 days to pay their bills.

If a customer has elected to receive electronic statements, the email alerting the cardmember that his statement is ready for viewing is delivered on the 4th day of the month

b. What procedures do you have, if any, for determining when a credit card bill is placed in the mail to a customer?

Chase utilizes a workflow application that tracks each credit card bill throughout the fulfillment process. As part of this process, a cycle-to-mail report is generated daily and used to validate the following:

- Every bill/statement that should have been mailed was in fact mailed, and
- Every bill/statement is mailed within thc three (3) business day deadline.

c. Are your credit card bills routinely postmarked on the day they are placed in the mail to the customer? If not, please explain.

Due to our daily mail volumes, Chase utilizes an Indicia Permit on all mail (no postmark). Use of the permit streamlines operational processes and automates postal reporting. Our piece-level tracking application creates reporting of mail dates for each statement generated.

To expedite mail delivery, JPMC utilizes a presort vendor to facilitate presentment of credit card bills to the USPS. Utilizing USPS software, the vendor sorts the bills and determines the quickest route to the customer. Bills are packaged as such and presented to the USPS multiple times throughout the day. Presentment of mail in this manner requires less handling by the USPS, resulting in a highly efficient process.

d. **What is your policy, if any, for setting customer payment due dates? Is a customer's bill due on the same date of every month?**

Customers are randomly assigned to statement dates when accounts are opened. We support 28 cycles, i.e. statement processing dates corresponding to 28 billing cycles. Payment due dates are set at 20 to 25 days from statement date at the time of account booking, based on customer payment patterns, including whether they pay in full each month. If changes are made to the due date, statement messages call attention to the change. Customers are able to select their due date either through the Chase website or by contacting customer service. Once a customer selects his/her due date, that date will not change.

e. **Do you have a policy or practice that makes a relatively shorter time period available for the payment of a credit card balance for customers who usually pay their credit card bill on time and in full each month?**

All new cardmembers start with a 20 day payment grace period and may move to as much as 25 days, depending on their payment patterns, including whether they pay in full every month. We do not change the due date for customers who have selected a specific due date themselves.

f. **If you have such a policy, how are consumers notified of the potential for the change in their grace period?**

The due date is noted on every statement, and we also include a special message directly on the statement, alerting customers to the change.

3. **At the Subcommittee hearing, Senator McCaskill asked about credit card companies that have sponsorship agreements with universities. Please provide the following information:**

a. **Do you have sponsorship agreements with any colleges and universities and, if so, how many?**

Chase has such arrangements with colleges or universities. There are 13 relationships pursuant to which Chase conducts active marketing.

b. **How many of these institutions are public universities or colleges?**

Ten (10) are public universities.

c. What are the names of the public universities and colleges with whom you have sponsorship agreements?

Chase regards this as a trade secret, the disclosure of which would significantly benefit Chase's competitors in a very competitive industry. Chase is, however, anxious to cooperate fully with the Committee and would be happy to discuss methods by which this information might be disclosed on a confidential basis.

d. Are the universities or colleges paid in exchange for agreeing to this sponsorship agreement?

Yes.

e. In general, what duties does a sponsorship agreement entail, both for you and for the university or college?

Such contracts are negotiated on an individual basis. They generally provide that the university or college will permit the use of its name in the marketing of Chase credit cards. The university or college generally provides a list of the names and addresses of its alumni so that direct mail campaigns can be conducted. Less often, the university or college will supply a list of names of its students, age 18 and over, as well as their home or campus address for direct marketing. Chase is usually granted permission to market its credit card at the athletic venues of the schools when events are taking place.

In return, Chase agrees to a revenue sharing agreement with the university or college. The formula for such agreements is always heavily negotiated but generally includes as an element the success Chase has in originating new accounts by its marketing efforts.

citigroup

Jane C. Sherburne
General Counsel
Global Consumer Group

Citigroup Inc.
399 Park Avenue
2nd Floor
New York, NY 10022

Tel 212 793 4942
Fax 212 793 0258
sherburnej@citigroup.com

April 3, 2007

Hon. Carl Levin, Chairman
Permanent Subcommittee on Investigations
Committee on Governmental Affairs
United States Senate
SR-193 Russell Senate Office Building
Washington, D.C. 20510-6262

Hon. Norm Coleman, Ranking Minority Member
Permanent Subcommittee on Investigations
Committee on Governmental Affairs
United States Senate
SR-193 Russell Senate Office Building
Washington, D.C. 20510-6262

Dear Chairman Levin and Senator Coleman:

Our responses to the supplemental questions you presented following the Subcommittee's March 7, 2007 hearing on Credit Card Practices: Fees, Interest Rates, and Grace Periods, are as follows:

1. **During the hearing, you stated that Citi has a policy of charging multiple, over-limit fees for a maximum of three consecutive times. How long has that policy been in place? In what instances after three consecutive over-limit fees have been charged can a customer incur another over-limit fee? For example, can Citi charge another over-limit fee two months later if the customer has not used the card? What if the customer's balance drops under the limit but then exceeds the limit again at a later date due to fees and interest, but the customer has not made any new purchase using the card?**

   Beginning in October, 2004, Citi Brands implemented a policy to limit over-limit fees to no more than three consecutive monthly assessments per account when the Cardmember's account balance exceeds his or her credit line.

Permanent Subcommittee on Investigations
EXHIBIT #9

Hon. Carl Levin, Chairman
Hon. Norm Coleman, Ranking Minority Member
4/3/2007
Page 2

If a Cardmember pays down his/her balance under the credit limit, but then in a later period exceeds the limit by more than $15 with additional charges or by incurring additional finance charges or fees, the Cardmember will be assessed an over-limit fee.

Our over-limit disclosures explain to the Cardmember that he/she must maintain their account within the credit limit assigned to them to avoid over-limit fees and describes each circumstance under which such a fee could be assessed.

2. **During the hearing, a credit card industry practice was discussed involving the charging of interest on debt which is carried over from a prior month, but which the cardholder then pays on time and in full during the following month. The industry practice is to charge interest, compound daily, from the date that the relevant billing statement was issued until the date that the on-time, in-full payment was received. This type of interest was described during the hearing as "trailing interest." Using the example in the hearing, suppose a customer owed debt from a prior month, received a bill on February 1st for $55.21, and paid the entire amount requested by the due date of February 15th. Would the customer's next bill reflect interest charges from the period from February 1st to 15th? Does Citi follow this industry practice and charge trailing interest, compound daily?**

   Because of the size of interest charge (less than $1.00) in the example, our Cardmember would not be billed for the interest that accrued from the statement date to the date payment is received and no amount would be due. Nevertheless, there are circumstances where a Cardmember has paid the statement balance in full but would be charged interest that accrued on the statement balance until the payment date. Consistent with terms of the our Card Agreement, finance charges accrue from the date a charge is added to the daily balance and continues to accrue until payment in full is received. Those Cardmembers who pay in full each month can avoid all periodic finance charges on purchase transactions.

3. **At the Subcommittee hearing, Senator McCaskill indicated that her credit bills often arrive so late in the mail that, to avoid missing the specified payment due date, she pays the bill electronically. The Subcommittee has heard from other consumers that the time period between when they receive a bill and the specified payment due date is increasingly short,**

Hon. Carl Levin, Chairman
Hon. Norm Coleman, Ranking Minority Member
4/3/2007
Page 3

and that the date of the month on which the payment is due is unpredictable.

(a) What is your policy, if any, regarding the minimum number of days that should be available between the date on which you place a credit card bill in the mail to a customer and date on which payment is due from customer?

Citi Brands exceeds the regulatory requirements by mailing Cardmember statements generally at least 20 days prior to the statement due date.

(b) What procedure do you have, if any, for determining when a credit card bill is placed in the mail to a customer?

Citi Brands utilizes an end-to-end production control system to track all in-house processing of Cardmember statements. This production control system includes the tracking of the statement production processes during the print, insertion, and presort processing stages. Upon completion of the presort process, the statements are handed to the US Postal Service, which accepts our mail on-site at presort processing locations.

(c) Are your credit card bills routinely postmarked on the day they are placed in the mail to the customer? If not, please explain.

For mailed Cardmember statements, Citi Brands uses the USPS's permit mailing process for statement delivery. Permit mail is not postmarked. As a result 99.9% of the statement mail processed by Citi Brands does not have a postmark. The remaining statement volume (0.1%) consists of flats (mail over 5 pages that needs to be placed in larger envelopes), overnight packages, and exception mail. These items are postmarked and dated the day they are placed in the mail to the Cardmember.

(d) What is your policy, if any, for setting customer payment due dates? Is a customer's bill due on the same date of every month?

For Citi Brands, Cardmember payment due dates are determined by account usage. Notwithstanding the above, all Cardmembers have at least 20 days from the statement closing date to the due date. Unless there are changes in account behavior, payment due dates fall around the same date of the month, each month. We do not schedule due dates on weekends and holidays to avoid Cardmember inconvenience so the due date may change slightly month-to-month without changes in account behavior.

Cardmembers are able to request a change in due date to better accommodate their financial situation by simply calling customer service. Although a Cardmember might request a specific due date, we explain that the due date will fall on a slightly different date each month. When a Cardmember requests a change in due date, that change is processed for the next statement period.

(e) Do you have a policy or practice that makes a relatively shorter time period available for the payment of credit card balances for customers who usually pay their credit card bill on time and in full each month?

The number of days between the statement closing date and the due date may fluctuate from Cardmember to Cardmember based on Cardmember usage. Accountholders who pay on time and in full each month have at least 20 days from statement closing date to payment due date; and accountholders who carry a balance that is not paid in full have approximately 25 days from statement closing date to payment due date. All Cardmembers may make their payments prior to the due date without penalty.

(f) If you have such a policy, how are consumers notified of the potential for the change in their grace period?

Those Cardmembers who pay in full each month have until the due date on the current statement to pay the previous month's charges in full without finance charges. Therefore, the grace period is reflected in the statement due date; no additional messaging is supplied to the Cardmember. If we were to reduce the grace period below 20 days, we would issue a change in terms notice to all affected Cardmembers. As mentioned in our testimony, as long as the Cardmember complies with the terms of our Card Agreement, Citi Brands will not voluntarily increase the rates and fees or change other terms of the Card Agreement until the card expires, typically in two years. Of course, that does not apply to changes required by law, our regulators, or our network providers.

4. **At the subcommittee hearing, Senator McCaskill asked about credit card companies that have sponsorship agreements with universities. Please provide the following information:**

Hon. Carl Levin, Chairman
Hon. Norm Coleman, Ranking Minority Member
4/3/2007
Page 5

a. Do you have sponsorship agreements with any colleges and universities and, if so, how many?

We have no sponsorship agreements with any colleges and universities.

b. How many of these institutions are public universities or colleges?

N/A

c. What are the names of the public universities and colleges with whom you have sponsorship agreements?

N/A

d. Are the universities or colleges paid in exchange for agreeing to this sponsorship agreement?

N/A

e. In general, what duties does a sponsorship agreement entail, both for you and for the universities or college?

N/A

Please let me know if you have further questions.

Sincerely yours,

Jane Sherburne

RESPONSES FROM AMERICAN EXPRESS TO QUESTIONS FROM THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS IN CONNECTION WITH THE MARCH 7, 2007, HEARING ON CREDIT CARD PRACTICES: FEES, INTEREST RATES, AND GRACE PERIODS

1. During the hearing, the Permanent Subcommittee on Investigations examined a credit card industry practice involving the charging of interest on consumer debt that is paid on time but not in full. This practice arises when a cardholder has no balance at the beginning of a billing cycle, makes a purchase during the billing cycle, and then pays the bill for that billing cycle on time, paying part of the entire amount owed. In this situation the industry practice is to charge interest, compounded daily, on the entire balance owed by the cardholder from the previous billing cycle from the first day of the new billing cycle until the date the partial payment was received. After the partial payment is received, interest continues to be charged on the outstanding balance. Using the example from the hearing: a bill for $5,020 is sent in January for December charges. $5,000 is paid on January 15th. The bill sent in February includes the $20 balance, interest at 17. 99% on $5,020 from Jan 1-15 ($34.78), and interest on $20 from January 16 to 31 ($0.43). This practice means that interest is charged even on the portion of the debt that was paid on time. Does American Express follow this industry practice and charge interest on debt that is paid on time but not in full?

   Response:

   American Express offers consumers wide choices in terms of credit and charge card products, so that consumers can select the product that best meets their needs. Whether interest is charged, and how interest is computed, differs from product to product, and also depends on the specific behavior on the particular account.

   In general, when an American Express Cardmember chooses to carry a balance as in the Subcommittee's example, we use the "average daily balance" method of computing interest. This means that interest is computed on the average amount outstanding each day during the billing period. Interest is compounded daily, which means that interest is charged each day during the billing period on the amount outstanding on that day, including new transactions (*e.g.* charges and payments) posted to the account on that day. For credit cards issued by American Express, Cardmembers can avoid paying interest on purchases by paying their balance on time and in full every month.

   American Express offers charge cards that are pay-in-full products, upon which no finance charges are assessed. We also offer qualifying charge Cardmembers the flexibility to revolve certain charges they make.

Permanent Subcommittee on Investigations
EXHIBIT #10

March 30, 2007

We offer Clear from American Express, a credit card with no fees – no annual fee, no overlimit fee, no late fee, no fee for balance transfers, no returned check fee. The product also gives customers a full month to pay their balance.

We offer One from American Express. This card deposits 1% of each purchase into a high-yield savings account. The One card offers a full month's grace period on all new purchases—even when carrying a balance. In the Subcommittee's example, a customer using One from American Express would not be charged interest.

2. The hearing also examined a credit card industry practice involving the charging of interest on debt which is carried over from a prior month, but which the cardholder then pays on time and in full during the following month. The industry practice is to charge interest, compounded daily, from the date that the relevant billing statement was issued until the date that the on-time, in-full payment was received. This type of interest was described during the hearing as "trailing interest". Using the example in the hearing, suppose a customer owed debt from a prior month, received a bill on February 1st for $55.21, and paid the entire amount requested by the due date of February 15th. Would the customer's next bill reflect interest charges from the period from February 1st to 15th? Does American Express follow this industry practice and charge trailing interest, compounded daily?

Response:

Whether interest is assessed on an account depends upon the specific behavior on that account. Generally speaking, when an American Express Cardmember chooses to carry a balance from one month to another, and then pays that balance in full the next month as in the Subcommittee's example, interest would be charged using the average daily balance method as described above until the balance is paid in full. Any unpaid interest, referred to in the Subcommittee's example as "trailing interest," would be reflected on the next billing statement.

Again, American Express offers consumers wide choices in terms of credit and charge card products, so that consumers can select the product that best meets their needs. A Cardmember using a One from American Express account in the Subcommittee's example would not be charged "trailing interest." Also, an American Express charge Cardmember who chooses to revolve certain charges as in the Subcommittee's example would not be charged "trailing interest."

3. The hearing also examined credit card industry practices related to cardholders who exceed a credit card limit due to purchases or cash advances. Once a cardholder exceeds the card limit, some credit card issuers have a policy of not charging that cardholder more than three consecutive over-limit fees; others charge the cardholder an unlimited number of over-limit fees. What is American Express's policy regarding charging multiple, consecutive over-limit fees?

   Response:

   While American Express does not have a specific limit on consecutive overlimit fees, we provide a number of products and have in place a number of policies that help customers avoid incurring these fees. We offer charge card products which have no pre-set spending limit and no overlimit fees. We offer Clear from American Express which has no fees, including no overlimit fees. In addition, we offer One from American Express which has no pre-set spending limit and no overlimit fees.

   For other cards issued by American Express, we assess an overlimit fee only if the account is overlimit at the end of the billing period. If an account goes overlimit during the billing period, but a payment is made that brings the balance at the end of the billing period within the credit limit, we do not charge an overlimit fee.

   In addition, American Express offers customers the ability to sign up for free account alerts which notify Cardmembers when they are approaching their credit limit. Only a small percentage of American Express accounts are overlimit in a given month, and a majority of those are not charged an overlimit fee.

4. At the Subcommittee hearing, Senator McCaskill indicated that her credit card bills often arrive so late in the mail that, to avoid missing the specified payment due date, she pays the bill electronically. The Subcommittee has heard from other consumers that the time period between when they receive a bill and the specified payment due date is increasingly short, and that the date of the month on which the payment is due is unpredictable.

   a. What is the policy, if any, regarding the minimum number of days that should be available between the date on which you place a credit card bill in the mail to a customer and date on which payment is due from that customer?

      Response:

      American Express maintains stringent standards to ensure billing statements are mailed promptly. Currently, approximately 99% of American Express billing statements are mailed within 3 days of the end of the billing period, with the balance mailed within the next 2 days. American Express also offers a number of alternative payment channels to our Cardmembers, including pay-by-phone and pay-by-computer. We do not charge a fee for using any of our payment channels.

b. What procedures do you have, if any, for determining when a credit card bill is placed in the mail to a customer?

Response:

American Express uses a sophisticated, state of the art automated system to track and control billing statement production and facilitate mailing timeliness. Billing statements are printed and mailed around the clock, 365 days a year. American Express is USPS Mail Preparation Total Quality Management (MPTQM) certified, indicating the highest degree of mail production quality. We have a USPS Detached Mail Unit onsite at our mail production facility. Mail is picked up 12 times daily (including weekends), and is booked on the first available flights using the USPS Postal One system. This system enables us to place mail on planes promptly and efficiently.

c. Are your credit card bills routinely postmarked on the day they are placed in the mail to the customer? If not, please explain.

Response:

American Express utilizes outer envelopes with a preprinted permit, which enables us to enter mail into the USPS system around the clock, 365 days a year. This process facilitates timely mailing and receipt of billing statements. We do not postmark individual envelopes because that would increase the time it takes to place billing statements into the mail.

d. What is your policy, if any, for setting customer payment due dates? Is a customer's bill due on the same date of every month?

Response:

The payment due date for American Express credit cards is set at the product level. The payment due date for a given product is calculated in the same manner each month and is 20 or 25 days after the closing date of the billing period, depending on the credit card product. For Clear from American Express, the payment due date is the last day of the following billing period (approximately 28-31 days).

e. Do you have a policy or practice that makes a relatively shorter time period available for the payment of a credit card balance for customers who usually pay this credit card bill on time and in full each month?

Response:

No. Payment due dates do not change based on whether a Cardmember carries a balance or pays in full each month.

f. If you have such a policy, how are consumers notified of the potential for the change in this grace period?

Response:

Not applicable. See responses to 4d and 4e.

5. At the Subcommittee hearing, Senator McCaskill asked about credit card companies that have sponsorship agreements with universities. Please provide the following information:

a. Do you have sponsorship agreements with any colleges and universities and, if so, how many?

Response: American Express does not have any sponsorship agreements with any colleges or universities.

b. How many of these institutions are public universities or colleges?

N/A

c. What are the names of the public universities and colleges with whom you have sponsorship agreements?

N/A

d. Are the universities or colleges paid in exchange for agreeing to this sponsorship agreement?

N/A

e. In general, what duties does a sponsorship agreement entail, both for you and for the university or college?

N/A

RESPONSES TO QUESTIONS FOR THE RECORD
FROM THE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
to
JORY BERSON
President, US Card
Capital One

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
CREDIT CARD PRACTICES:
FEES, INTEREST RATES, AND GRACE PERIODS
March 7, 2007

Submitted March 30, 2007

1. During the hearing, the Permanent Subcommittee on Investigations examined a credit card industry practice involving the charging of interest on consumer debt that is paid on time but not in full. This practice arises when a cardholder has no balance at the beginning of a billing cycle, makes a purchase during the billing cycle, and then pays the bill for that billing cycle on time, paying part of the entire amount owed. In this situation, the industry practice is to charge interest, compounded daily, on the entire balance owed by the cardholder from the previous billing cycle from the first day of the new billing cycle until the date the partial payment was received. After the partial payment is received, interest continues to be charged on the outstanding balance. Using the example from the hearing: a bill for \$5,020 is sent in January for December charges. \$5,000 is paid on January 15th. The bill sent in February includes the \$20 balance, interest at 17.99% on \$5,020 from Jan. 1-15 (\$34.78), and interest on \$20 from January 16 to 31 (\$0.43). This practice means that interest is charged even on the portion of the debt that was paid on time. Does Capital One follow this industry practice and charge interest on debt that is paid on time but not in full?
Yes. The credit card is a flexible financial tool that acts as an open-ended and unsecured loan, a safe and convenient way to make transactions, or both. For customers who use their cards as loans, we assess finance charges for the period between the purchase and the payment. For customers who use their cards only for transactions, we give the customers a grace period between their purchase and payment. During this period of time, we do not assess finance charges to the customer, even though we pay interest on the funds we obtain in the market place (e.g., deposits, wholesale funding) to loan to the customer during that time period.

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EXHIBIT #11

We provide a grace period only for those customers who pay in full every month. This policy is fully disclosed in the Schumer Box and again on the back of every statement. We would note that despite having among the longest grace periods in the industry (a minimum of 25 days), we do not market this feature to consumers. In our experience, it has not proven to provide any competitive advantage for us in acquiring new customers or encouraging existing customers to use their Capital One card rather than a competing product.

2. The hearing also examined a credit card industry practice involving the charging of interest on debt which is carried over from a prior month, but which the cardholder then pays on time and in full during the following month. The industry practice is to charge interest, compounded daily, from the date that the relevant billing statement was issued until the date that the on-time, in-full payment was received. This type of interest was described during the hearing as "trailing interest." Using the example in the hearing, suppose a customer owed debt from a prior month, received a bill on February 1st for $55.21, and paid the entire amount requested by the due date of February 15th. Would the customer's next bill reflect interest charges from the period from February 1st to 15th? Does Capital One follow this industry practice and charge trailing interest, compounded daily?

Yes. Finance charges are assessed on any day where the balance is unpaid. This is true not only for credit cards, but also for closed-end loans such as car loans. The payoff amount for a loan includes not only the principal, but also the interest that has accrued since the last payment. Customers are able to call us to determine their approximate full payoff amount; this will be inexact due to variance in transaction and payment timing. As a matter of policy, we will typically waive any such interest if it amounts to only a few dollars.

3. At the Subcommittee hearing, Senator McCaskill indicated that her credit card bills often arrive so late in the mail that, to avoid missing the specified payment due date, she pays the bill electronically. The Subcommittee has heard from other consumers that the time period between when they receive a bill and the specified payment due date is increasingly short, and that the date of the month on which the payment is due is unpredictable.

a. What is your policy, if any, regarding the minimum number of days that should be available between the date on which you place a credit card bill in the mail to a customer and date on which payment is due from that customer?

b. What procedures do you have, if any, for determining when a credit card bill is placed in the mail to a customer?

c. Are your credit card bills routinely postmarked on the day they are placed in the mail to the customer? If not, please explain.

d. What is your policy, if any, for setting customer payment due dates? Is a customer's

bill due on the same date of every month?
e. Do you have a policy or practice that makes a relatively shorter time period available for the payment of a credit card balance for customers who usually pay their credit card bill on time and in full each month?
f. If you have such a policy, how are consumers notified of the potential for the change in their grace period?

a. In accordance with Regulation Z, we ensure that all statements are postmarked no later than 14 days prior to the statement due date. While this is our official policy, we strive to ensure that the majority of statements are mailed well in advance of this deadline. The current agreement with our supplier calls for an average turnaround time from delivery of statements to the vendor to the time the statements are mailed of 3 days. This process allows for the majority of our statements to be mailed over 20 days in advance of the payment due date. Our due dates are a minimum of 25 days from the billing date.

b. We use a multi-step process for monitoring our third party processor's adherence to service level agreements and overall compliance. We have an internal reconciliation team that monitors file delivery from our core billing system to our third party processor, and daily processing reports from the third party processor. That team reports out the working turnaround time on a daily basis, and monitors each statement billing cycle for 100% completeness. Our supplier uses an account-level reconciliation process to ensure that all statements are mailed within the Capital One contracted service level.

c. Due to the high volume of mail we send to our customers, we mail statements using USPS indicia envelopes which do not receive postmarks. The USPS monitors mail processing reports at our third party processor to ensure that all mail entering the USPS mail stream is dated for that day.

d. Customers are billed on the same date every month. Each customer's due date is a minimum of 25 days from the billing date and is on or about the same date each month. It may be adjusted slightly from time to time for system shutdown reasons. Additionally as a convenience for our customers we offer customers the ability to pick a specific due date by contacting us directly.

e. No, the due date or statement mailing date is not adjusted based on customers' payment behavior.

f. We do not have such a policy. Our grace policy is clearly disclosed in the Schumer Box and again on the back of each statement. Our credit card business is based in Virginia and thus governed by Virginia law. Under Virginia law, we must provide at least 25 days grace period for those customers who pay their bills in full each month. Thus, some months, a grace period will be longer than 25 days; it can never be shorter.

4. At the Subcommittee hearing, Senator McCaskill asked about credit card companies that have sponsorship agreements with universities, Please provide the following information:
a. Do you have sponsorship agreements with any colleges and universities and, if so, how many?
b. How many of these institutions are public universities or colleges?
c. What are the names of the public universities and colleges with whom you have sponsorship agreements?
d. Are the universities or colleges paid in exchange for agreeing to this sponsorship agreement?
e. In general, what duties does a sponsorship agreement entail, both for you and for the university or college?

a. No, we do not have sponsorship agreements with universities relating to our credit card acquisition or customer management activities.

We also do not market physically on college campuses - e.g., through table displays offering free gifts at sporting events or at other campus facilities. To the extent that we market our products to college students, we do so in the same manner as our broader customer base - primarily through direct mail and the Internet.

We have signed agreements with the 12 colleges and universities that participate in the Capital One All-America Mascot Team promotion. The schools change from year to year. The agreement solely pertains to their involvement in the competition and the national media we create and run in support of the competition. In return, each school receives a $5,000 scholarship and a chance at winning an additional $5,000 if their mascot wins the competition or an additional $1,000 if their mascot is a runner up. As part of the agreement with the schools we promise that we will not promote any Capital One products, and the voting and mascot challenge resides on a separate website from our corporate website. Our affiliation with the school is never used in conjunction with selling a product.

We also have financial education programs with select colleges and universities called MoneyWi$e University. Developed in partnership with Visa and first introduced on campuses in 2002, the MoneyWi$e University curriculum — Practical Money Skills for Life — touches on the financial challenges young adults face during the college years and educates them about the fundamental aspects of credit and budget management. Covering the financial "basics" like budgeting, using credit responsibly, reading a credit report and understanding the difference between financial "needs" vs. "wants", MoneyWi$e University arms students with the financial knowledge they can use now to establish a lifetime of healthy financial habits.

RESPONSES TO QUESTIONS FOR THE RECORD
FROM THE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
to
DAVID W. NELMS
Chairman
Discover Financial Services, Inc.

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
CREDIT CARD PRACTICES:
FEES, INTEREST RATES, AND GRACE PERIODS
March 7, 2007

1. During the hearing, the Permanent Subcommittee on Investigations examined a credit card industry practice involving the charging of interest on consumer debt that is paid on time but not in full. This practice arises when a cardholder has no balance at the beginning of a billing cycle, makes a purchase during the billing cycle, and then pays the bill for that billing cycle on time, paying part of the entire amount owed. In this situation, the industry practice is to charge interest, compounded daily, on the entire balance owed by the cardholder from the previous billing cycle from the first day of the new billing cycle until the date the partial payment was received. After the partial payment is received, interest continues to be charged on the outstanding balance. Using the example from the hearing: a bill for $5,020 is sent in January for December charges. $5,000 is paid on January 15th. The bill sent in February includes the $20 balance, interest at 17.99% on $5,020 from Jan. 1-15 ($34.78), and interest on $20 from January 16 to 31 ($0.43). This practice means that interest is charged even on the portion of the debt that was paid on time.

   a. Does Discover follow this industry practice and charge interest during the billing cycle on debt that is paid on time but not in full?

      <u>RESPONSE</u>: *Balance Calculation.* The example provided in the question appears to be intended to describe the average daily balance computation method. Discover uses the average daily balance method to compute finance charges for purchases on some of the cards we issue.

   b. In addition, with respect to the portion of the debt that was paid on time, does Discover charge interest on the component purchases made during the prior billing cycle, calculating the interest from the date on which each such purchase or cash advance was incurred during the prior billing cycle and compounding it daily to the last date of the prior billing cycle? Does Discover have any plans to discontinue its use of this two-cycle billing method?

      <u>RESPONSE</u>: The two-cycle balance computation method applies to the bulk of Discover's accounts, but it results in additional interest payments only in a relatively small number of cases, and usually in a small dollar amount.

<u>Permanent Subcommittee on Investigations</u>
EXHIBIT #12

Customer Impact. The two-cycle computation affects only purchase transactions, and only those made on accounts with no prior balance and, as described below, only when the customer decides to pay less than the full balance. It does not increase the interest owed on cash advance balances, on balances transferred from other lenders, or on new purchase transactions made by customers who did not repay the full balance in the prior month. These balances, on Discover - and other lenders' - accounts, accrue interest from the date of the transaction. (The reference in Q. 1(b) to "cash advances" incorrectly assumes that the two-cycle computation method results in a higher interest payment for cash advance transactions).

Two-cycle balance computation affects a very small percentage of Discover accounts each month: customers with no previous balance who do not pay the full balance on the payment date (i.e., a customer who previously used the account for short-term borrowing but elects to become a longer-term borrower by "revolving" a balance). As a result, the two-cycle computation does not increase the interest due on most accounts: those held by "convenience users" (who always pay their account in full and receive both an interest-free loan and a Cashback Bonus reward), and accounts held by "revolvers" (who do not pay the full balance by the payment due date and therefore pay interest on purchases beginning on the date the purchase transaction is posted to their account).

Moreover, the two-cycle computation does not generally affect an account repeatedly. If an individual affected by a two-cycle computation continues to carry a balance in the following billing period, or again begins paying the balance in full, the two-cycle balance calculation does not affect the amount of finance charges.

Illustration of Impact on Discover Customer. We have previously furnished to the Subcommittee an example of the two-cycle balance computation as used by Discover. To illustrate the impact of this computation on "real life" Cardmembers, the example is based on a typical balance amount of a Discover account that is affected by two-cycle billing, and shows an APR and purchase and payment amounts, as well as purchase and payment dates, that are typical for such an account. While the example uses the format that was utilized in the GAO report (Figure 6 in GAO-06-929), it yields a distinctly different result. (The GAO example shows an atypical "worst case" scenario: a hypothetical consumer who makes a high-dollar purchase very early in the first month, followed by a repayment of 99.9% of the balance within a week of receipt of the billing statement in the second month. The example displayed at the Subcommittee's hearing was similar.)

The example in our calculation yields an additional interest charge of $3.99, to cover the 18 days in the first month during which funds were borrowed. The example also shows the $5.76 Cashback Bonus reward the customer would have earned for the purchase transaction, an amount that, in this example, significantly exceeds the additional interest that was incurred when the customer elected not to repay the full balance during the first cycle, triggering the two-cycle computation.

Impact of Changing the Two-Cycle Method. Discover utilizes the two-cycle method of balance computation as one component of a pricing strategy that, like other issuers' strategies, is not based on a single element, but rather on the full complement of pricing elements and card features. There are various costs and risks associated with extending credit to consumers, and costs incurred in offering reward programs and other benefits. Lenders utilize different means of recovering these costs and compensating for risks including APRs, annual fees, penalty fees for late payments, and the length of grace periods. With no annual fee on all our Cashback Bonus rewards cards and being one of only two major credit card issuers to offer at least a 25 day grace period (rather than the industry standard 20), Discover believes that its current terms and conditions are among the most customer-centric in the industry.

Because the impact of two-cycle calculation is determined by the way the cardholder elects to use the card - and can be avoided by all users - moving away from this method of computing finance charges would not necessarily be beneficial. As the Federal Reserve cautioned two decades ago (in response to proposed legislation to require all card issuers to use the average daily balance or a "more favorable" method):

> *"[R]egulating the balance computation area might result in restricted credit availability, the elimination of grace periods, or higher interest rates, annual fees or merchant discounts. It is uncertain, therefore, whether the benefit of having a uniform balance computation method would exceed the associated costs to consumers after such adjustments have taken place."* (Statement of Emmett J. Rice, Member, Board of Governors of the Federal Reserve System, to Senate Banking Committee, Financial Institutions Subcommittee, May 21, 1986; S. Hrg. 99-951).

Evaluation of Change in Balance Computation Method. While Discover has not made a decision to change its balance computation method, we continually re-evaluate all of the features of our card programs, and make appropriate alterations to respond to changes in customer purchasing and payment behavior, customer feedback, the competitive environment, and other factors. The balance calculation method is one of the features subject to such evaluation, along with such other elements as finance charges, grace periods, fees, customer service levels, reward programs, and payment options. Within the last year, this process resulted in changes that included a reduction in the fee charged to customers who elect to pay their bills by telephone calls to "live" operators, and a significant reduction in the number of accounts on which residual or "trailing" interest is billed. We also introduced a new card that encourages customers to avoid late fess and lower interest costs by rebating a months' interest each time the customer makes six consecutive on-time payments. As noted previously Discover has introduced cards that do not use the two-cycle computation.

Consumers understand that both the benefits and costs of using a particular credit card depend on how the card is used, and on the full range of card features, not on a single fee or practice. Evaluating a credit card based solely on how its balance computation method or a particular fee might affect some users makes no more sense than evaluating an automobile based solely on whether a radio or other component is

included as a "standard" feature (built into the car price) or is provided at an extra cost.

2. The hearing also examined a credit card industry practice involving the charging of interest on debt which is carried over from a prior month, but which the cardholder then pays on time and in full during the following month. The industry practice is to charge interest, compounded daily, from the date that the relevant billing statement was issued until the date that the on-time, in-full payment was received. This type of interest was described during the hearing as "trailing interest." Using the example in the hearing, suppose a customer owed debt from a prior month, received a bill on February 1st for $55.21, and paid the entire amount requested by the due date of February 15th. Would the customer's next bill reflect interest charges from the period from February 1st to 15th? Does Discover follow this industry practice and charge trailing interest, compounded daily?

   RESPONSE: ***Trailing Interest.*** **In the example provided, the customer would not be billed by Discover for additional interest. Discover waives (and does not bill) "trailing" interest (which we refer to as "residual interest") if the amount of such interest is less than $20. (This threshold was recently increased from $10.) The policy means that, on a monthly basis, residual interest will be billed to about 0.25% of Discover's active accounts.**

3. The hearing also examined credit card industry practices related to cardholders who exceed a credit card limit due to purchases. Once a cardholder exceeds the card limit, some credit card issuers have a policy of not charging that cardholder more than three consecutive over-limit fees; others charge the cardholder an unlimited number of over-limit fees. What is Discover's policy regarding charging multiple, consecutive over-limit fees?

   RESPONSE: ***Overlimit Fees.*** **Discover has worked with its bank regulators to address the issue of multiple overlimit fees, and has instituted predictive models and an "intervention" program to work with customers whose behavior demonstrates risk of the assessment of repeated overlimit fees. The vast majority of our customers who are assessed an overlimit fee, self-cure within a short time. We have developed predictive models to identify customers at risk for repeated overlimit fees and low likelihood of self-curing. We proactively contact those customers to discuss measures that will enable the customer to avoid incurring additional fees. Relief may be offered in the form of fee waivers, interest forgiveness, reduced APRs or other concessions. This program has generally been effective in curtailing multiple overlimit fees. We think it is more effective than automatically capping fees without customer contact, because the direct customer communication is more likely to prevent a recurrence of the multiple fee cycle.**

   In addition, Discover Cardmembers have the opportunity to receive e-mail reminders that they are approaching their credit limits so that they can avoid overlimit fees. Customers can arrange to have e-mails sent when their account balance exceeds an

amount that they specify or when their account balance is within a specified amount of their credit limit. Our incidences of overlimit fees have substantially decreased over the past several years as a result.

4. At the Subcommittee hearing, Senator McCaskill indicated that her credit card bills often arrive so late in the mail that, to avoid missing the specified payment due date, she pays the bill electronically. The Subcommittee has heard from other consumers that the time period between when they receive a bill and the specified payment due date is increasingly short, and that the date of the month on which the payment is due is unpredictable.

   a. What is your policy, if any, regarding the minimum number of days that should be available between the date on which you place a credit card bill in the mail to a customer and date on which payment is due from that customer?

      RESPONSE: Discover's procedures are designed to provide a minimum of 21 days from the statement mailing date until the payment due date. In practice, the average is 26 days. Regulation Z requires that Discover mail its statements at least 14 days prior to the payment due date.

   b. What procedures do you have, if any, for determining when a credit card bill is placed in the mail to a customer?

      RESPONSE: Discover's billing statements show a "Closing Date" – the date used to calculate purchases, credits, payments, finance charges and fees incurred in the billing cycle. Discover's statements are usually mailed within two days of this date, although an additional one or two days is occasionally needed. (The additional time is needed when a Closing Date falls on a weekend, since statement processing is not done then). Before "mailing" (i.e., the time at which the US Postal service picks up the statements at Discover's facilities), Discover presorts the statements by Postal Zip Codes, eliminating the need (and the extra time) for the Postal Service to perform this function at its facilities. Discover uses internal codes on its statement mailings to monitor compliance with its mailing policy.

      The growing number of Cardmembers who have elected to receive online notification of their billing statements have access to their statements at an earlier date. E-mail reminders (advising Cardmembers that their statements are immediately available online) are generated from the same data that is used to create printed statements, so e-mail reminders are sent before the paper statements are even printed, and are not susceptible to events, like bad weather, that can delay receipt of mailed statements. Cardmembers can also elect to use email notification and other online services to receive reminders that payments are due, pre-authorize automated payments on a date they select, schedule a single payment in advance, or pay the current account balance with free same-day posting, provided the payment is made by 5:00 p.m. EST. This makes it unnecessary to await the arrival of paper statements in the mail, and some customers elect to forego receipt of mailed statements.

c. Are your credit card bills routinely postmarked on the day they are placed in the mail to the customer? If not, please explain.

<u>RESPONSE</u>: **Discover statements are mailed at First Class Automation Rates under a U.S. Postal Service First Class Permit. Stamps are not affixed to permit mail, and the Postal Service does not postmark this mail. This mail bypasses outgoing Postal Service mail sorts (including canceling operations), and travels in trays and containers through the Postal Service distribution system in an expedited fashion directly to mail processing facilities near the destination address. Thus, a Postal Service employee may not physically handle an individual statement envelope until it arrives at a USPS distribution facility near the Cardmember's home or the Post Office nearest the home. This helps speed the mail to Discover customers more quickly than if it were mailed at single piece First-Class Mail rates and required individual cancellation, sorting or other handling.**

d. What is your policy, if any, for setting customer payment due dates? Is a customer's bill due on the same date of every month?

<u>RESPONSE</u>: **Payment due dates are set based on Closing Dates. Generally, payment is due one day prior to the following month's Closing Date. There are 20 Closing Dates per month. These are used to even out the processing and mailing volume. Customers can elect to change their payment due date.**

e. Do you have a policy or practice that makes a relatively shorter time period available for the payment of a credit card balance for customers who usually pay their credit card bill on time and in full each month?

<u>RESPONSE</u>: **Periodically, the portfolio is evaluated to identify customers who routinely pay their account in full on a timely basis. The payment due date for these customers may be reduced by up to 5 days. However, they continue to receive an interest-free loan on their purchases for at least 25 days as long as they pay the balance in full by the payment date each month. These customers can "opt out" of the change by requesting another payment date.**

f. If you have such a policy, how are consumers notified of the potential for the change in their grace period?

<u>RESPONSE</u>: **Customers affected by a payment date change receive notification via letter, separate from their billing statement. A notice of the change also appears on the billing statement for 2 months prior to the change. It should be noted that while a change in the payment due date will change the number of days in the grace period, the grace period remains at a minimum of 25 days.**

5. At the Subcommittee hearing, Senator McCaskill asked about credit card companies that have sponsorship agreements with universities. Please provide the following information:

   a. Do you have sponsorship agreements with any colleges and universities and, if so, how many?

   b. How many of these institutions are public universities or colleges?

   c. What are the names of the public universities and colleges with whom you have sponsorship agreements?

   d. Are the universities or colleges paid in exchange for agreeing to this sponsorship agreement?

   e. In general, what duties does a sponsorship agreement entail, both for you and for the university or college?

   RESPONSE: Discover does not have sponsorship arrangements with any college or universities.

#

EXCERPTS FROM CORRESPONDENCE SENT BY MORE THAN 1,000 PERSONS NATIONWIDE IN RESPONSE TO THE SUBCOMMITTEE INVESTIGATION INTO UNFAIR CREDIT CARD PRACTICES

(Complete Text of Correspondence Follows Excerpts)

Exhibit 13a.

CONSUMER LETTER
-Cindy McCoy, of Osceola, Missouri

"I am writing to you in the hopes you can let [C]ongress know what is happening to many [A]merican families who have credit card debt. ...

"We have several credit cards that have risen to over 30% now and most are at 32%. Our monthly expenditure on credit cards now is as much as a house payment over and above our bills. ...

"They [the credit card issuers] never said if the economy goes south we will add on to your suffering by raising your payments, increasing your interest to 32%, and doing whatever we like. ... My husband and I are hard working [A]mericans. Something has to be done to stop what is going on in this country."

Exhibit 13b.

CONSUMER LETTER
-Gary Poliakoff, of Spartanburg, South Carolina, on behalf of Evelyn P. Scott, a 75 year old woman

"Her last charges on this [credit] card were approximately 4-5 years ago. She informs me that she charged approximately $2,000.00 on the card. She now owes more than $4,700.00 on the card, even though she has made no charges in 4 or 5 years. Despite her income being limited to $478.00 per month [from Social Security] she paid $77.00 per month for many months. Despite this, her payments continued to increase, rather than decrease, due to the astronomical interest rates which have been successively applied to her account. ... Many fees and costs were applied, also adding to the total indebtedness.

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EXHIBIT #13a. - m.

"In addition ... the persons associated with the creditor would telephone Mrs. Scott on many occasions, scaring and intimidating her to the point that she felt that something horrible would happen to her and her husband if she discontinued the payments."

RESPONSE BY CREDIT CARD ISSUER
-Chase Card Services

"In May 2007, we received correspondence indicating the customer's situation and began a review of her account history. In reviewing correspondence from the customer's attorney, we understood the financial hardship that the customer was experiencing. We also identified an opportunity to develop a better understanding of the customer's situation in September 2004 when we were contacted to cease collections activity. At that time, we could have probed to better understand the customer's situation. Had we done that, we would likely have placed the customer on a no or reduced interest payment program with no late or overlimit fees. As a result, we have treated Mrs. Scott's account as we would have any other customer's account: we have removed the fees and finance charges assessed since that time, her payments since then have reduced her balance to zero, and her credit report has been updated to delete her Chase account and the related negative payment history."

Exhibit 13c.

CONSUMER LETTER
-Terry Bradford, of Hilliard, Ohio

"I am a college-educated 55 year old ma[l]e .... Over the past 35 years as a consumer, I have always had good credit, never filed bankruptcy nor had write-offs or foreclosures. However, we have always lived on the edge financially ....

"In 2006, my wife and I were on the brink of financial disaster so we entered into a debt management program. Many of our debtors agreed to participate and they adjusted our interest rates to modest rates that were reasonable and would allow us to pay our debt down in 4-5 years.

"However, American Express, whom we owed $35,000, refused. ... [T]hey have refused to lower their interest rate below

30.24% and continue to add late fees every month, despite our paying $800 a month! ...

"Since I started making payments to American Express after going into the debt management plan, I have paid American Express over $7000 since mid-2006 and only approx. 0.056% or $392 has gone towards the principal. At this rate, I will not have paid the debt off for over 40 years and will have made payments in excess of $384,000 in interest on a $35,000 debt!"

RESPONSE BY CREDIT CARD ISSUER
-American Express

"We fully support the efforts of Cardmembers who enter into debt management programs in order to fulfill their financial obligations. [W]e have programs in place to assist Cardmembers, including repayment programs that offer reduced interest rates for eligible consumers. ... In certain cases where customers may not be eligible to participate in a workout program, we offer Cardmembers the opportunity to settle their account by paying a portion of the debt they owe over a set period of time. We believe that such an approach can be a better solution for both the Cardmember and American Express in certain situations. ... [W]e are committed to working with our Cardmembers who are facing financial difficulties to find the most equitable solution for their particular case."

Exhibit 13d.

CONSUMER LETTER
-Sid Vinyard, of Houston, Texas

"I was charged a 3% foreign country conversion fee of $11.10, even though there were <u>NO foreign conversion requirements</u> on this billing. The fee was also listed at the very end of the statement ... in the hope that it would be missed by the consumer. ... [T]his charge [$370 for a merchant based in Auckland, New Zealand] <u>was processed in US Dollars</u>, which means that absolutely NO conversion activity was required. However, when I contacted B of A [Barclays] to request a refund of this erroneous amount, I was told (quote): 'If a charge <u>includes the name of a foreign city and/or location</u>, we charge the fee and it is non-refundable.'" [Emphasis from consumer.]

RESPONSE BY CREDIT CARD ISSUER
-Barclays

"After receipt of the letter, [Barclays] conducted an internal investigation and determined that Mr. Vinyard was correct. The way the foreign transaction process had been set up, Barclays indeed did assess a foreign country transaction fee on all transactions with non U.S. merchants. ...

"As a result, Barclays has changed its policy so that the fee is only applied when there is an actual currency conversion. While it might have been legal to assess the fee where there was no currency conversion, we at Barclays believe that the right thing to do is assess the fee only where a currency conversion is involved."

Exhibit 13e.

CONSUMER LETTER
-Stanley Hazen, of Charlottesville, Virginia

"For years, I had a credit card issued by Fleet Bank N.A. ... In the summer of 2004, Fleet was bought out by Bank of America. ... My wife and I were in Italy and Austria in August, 2005. Fleet never assessed an additional fee for charge transactions that took place outside of the United States. Imagine my horror, then, when the monthly statement dated 18 August 2005 came from Bank of America, which assessed a "Foreign Currency Conversion Fee" of $79.08. I wrote to Bank of America on 23 August, protesting that fee, and pointing out that Fleet never charged such a fee. I paid the balance due in full, minus the Fee.

"Then next month's statement, dated 18 September 2005, contained a "Periodic Finance Charge" of $74.44. Obviously, Bank of America did exactly what *The News Hour* reported, that is, charged me a finance charge based on the entire amount of the month's charges, and not only on the unpaid "balance." ...

"I protested, in writing, each of the two bills from Bank of America, paying only the amounts of the purchases for the month. I returned all subsequent bills [to] Bank of America, unopened, marked "Refused; balance = zero."

"On 11 November 2006, I received the enclosed letter from [a collections attorney] ... in Richardson, Texas. I replied in writing .... Two days ago [March 14, 2007], the telephone rang.

… I asked who was calling. When the voice said [the collections attorney] … I hung up."

RESPONSE BY CREDIT CARD ISSUER
-Bank of America

"The assessment of foreign transaction fees are consistent with the card holder agreement and prior notice on this issue. … [B]ecause [Mr. Hazen] disagreed to these fees, he decided to subtract the fee amount from his monthly payment rather than pay the full outstanding balance. … All our credit card customers are provided a readily available means to assert a billing dispute. This information appears on every monthly statement. Mr. Hazen did not assert a billing dispute. Instead, he began paying less than the new balance total, and then stopped making payments all together."

Exhibit 13f.

CONSUMER LETTER
-Paul Davidson, of Albuquerque, New Mexico

From letter to Sen. Levin: "This is a very frustrating situation and one that should never have risen to the level where I am writing to CEOs and Senators about a trivial, but unauthorized, $51 charge that has grown to $300 and become a blight on my credit report. Not to mention the countless hours of frustration and telephonic hold time."

From letter to Capital One CEO: "For a number of years, I had a credit card with your company. ... In April of 2006 I paid this card down to a zero balance. …

"On July 17th, 2006, a $51 charge was placed on the card by a merchant. This was an unauthorized charge. Because I had moved (and apparently Capital One never received, or at least never posted the change of address card sent to you) I was not receiving statements for this card.

"The first I became aware of this problem was when your Recovery Group collection agency called me at my office and informed that I had a debt of almost $300.

"I have spoken to the merchant in question and they are perfectly willing to create a charge back for the $51 amount. They agree that the charge was not supposed to have been charged against your card. However, they have no way to create a charge back against the card because of the current status of the card.

"After having spent countless hours on the phone ... I have hit a wall. ... Capital One says: 'The Recovery Group is handling that account, we at Capital One cannot do anything once it is turned over to them. ...' (Let's ignore for the moment that both companies are under the same umbrella of COFC. And that this charge never should have been made.) The Recovery Group says 'We can only try to collect the amount due. You have to speak to Capital One and have them take the account back and make adjustments. We cannot do anything with the actual account.' When I call back Capital One, I either immediately get transferred to your Recovery Group, or if I am able to get a supervisor, I am told they can't do anything due to the account being over 220 days past due."

RESPONSE BY CREDIT CARD ISSUER
-Capital One

"I sincerely apologize and regret the frustration and inconvenience [Mr. Davidson] experienced. While Capital One always strives to provide the best service to all of our customers, sometimes we don't hit that mark. ...

"While we received your inquiry into Mr. Davidson's case in July, we previously received Mr. Davidson's letter directly. On May 10 we contacted him by phone and quickly eliminated the charges, fees and interest. In addition, we contacted the credit bureaus to correct his credit report. We offered our apologies to Mr. Davidson, and used the event as a learning experience to prevent future errors.

"Mr. Davidson's experience with us is regrettable, however, with over 30 million accounts mistakes will occasionally happen."

Exhibit 13g.

CONSUMER LETTER (Capitalization and punctuation added.)
-Frances Hirsch, of Levittown, New York

"You used to have 25 days to pay your bill. ... All my cards, [V]isa, [A]storia, [M]asters, [D]iscover now give you 2 weeks or less. The worst is American Express. I called them today to tell them I have not received this month's bill, & I don't want to incur a late fee or have my interest rate raised to some outrageous amount if I don't have time to get my payment to them on time. Their response 'your bill will be sent out today, take 7 to 10 days to reach you & is due July 8th.' Today is June 19th. If I receive my bill 10 days later, June 29th, I will have only 8 days to get payment to them. If I'm ill, have to go away for a week, or have any emergency I might be unable to do that. This is unacceptable for a consumer whom they claim has a 20 day grace period. ... The grace period does NOT include mail delivery time, & is therefore useless."

RESPONSE BY CREDIT CARD ISSUER
-American Express

"We believe that the grace periods we provide our customers are more than adequate to accommodate both the mailing of monthly statements to consumers and the remittance of payments from consumers. American Express maintains stringent standards to ensure the prompt mailing of periodic statements, which are printed and mailed around the clock, 365 days a year. ... For American Express Cardmembers who choose to pay by mail, we direct their payment to the closest of our regional remittance centers to speed the crediting process. In the event a Cardmember indicates that they have not received their statement, it is our policy to waive any resulting late fees and finance charges on the account."

Exhibit 13h.

CONSUMER LETTER
-Barbara Teberg, of Great Falls, Montana

"I have had the same Credit Card for 28 years. I always pay my monthly balance in full. I have never had a finance charge or a late fee, that is, until February, 2006.

"Here is a chart of what occurred in 2006 [describing checks mailed 5 days, 10 days, and 15 days before the due date, but posted by the credit card issuer as being received after the due date for the months of February, May, and August 2006.]

"In September, I spoke to a clerk at the Post Office and explained my problem with mail delivery [for my U.S. Bank credit card bill] taking 12 to 16 days from Montana to St. Louis, MO. She suggested using Priority Mail with Delivery Confirmation at a cost of $4.50. That would get my paid bill to the destination in 2 to 3 business days. That worked for three months. Then, in December, 2006, I again paid [my credit card bill] using Priority Mail with Delivery Confirmation on 12/6/2006. That payment was lost until 1/11/2007, when it was posted in St. Louis (by Visa).

"I had put a 'stop' on the check on 1/5/2007, since it had not surfaced for a month. Then I paid my bill by phone. Phone pay costs $10.00 per month.

"In Feb., May and August, 2006, I paid $221.09 in Finance Charges and Late Fees. In December I paid: Delivery Confirmation - $4.50, Phone Pay - $10.00, Stop Check - $29.00, Return Payment fee for stopped check- $35.00 = total (Dec.) $78.50. The Grand total for trying to pay my credit card bill on time in 2006 is $299.59 (+$13.50 Del. Conf. for Sept, Oct, & Nov). ...

"Considering the fact that for more than 25 years I had <u>no problem</u> and in 2006 things got so bad that I could not even pay my bill on time, as hard as I tried, something is very wrong. I am not willing to pay $10.00 per month to pay my bill by phone. I don't have the capability to pay on-line. Therefore, my only choice was to take my Credit Card business elsewhere, which I have done." [Emphasis from consumer.]

RESPONSE BY CREDIT CARD ISSUER
-U.S. Bank

"Consistent with U.S. Bank's disclosures to its cardholders, credit card payments mailed to U.S. Bank at the address provided on the cardholder's credit card statement are posted effective the date that they are received or, if a payment is received after the 1 p.m. Central cut-off time, it is posted effective the following business day. U.S. Bank cannot and does not delay posting timely credit card payments in order to generate late charges or to force customer business away. Any unexpected delay between the mailing of a payment and its posting could result from the time it took the payment to travel from Montana to our St. Louis processing facility or from some actual difficulty in the payment's posting.

"U.S. Bank does not keep a record of the postmarks on payments received, so we cannot confirm the mailing dates in Ms. Teberg's letter. However, according to Ms. Teberg's description, the payment she made in February 2006 was posted within only four business days of her mailing it. While our records indicate that she did not include her payment coupon with her check (which does require additional research by Bank personnel to ensure that the proper account is credited), there do not appear to be any facts in our records or in Ms. Teberg's letter to support a conclusion that this payment should have been posted any earlier.

"Ms. Teberg's August 2006 payment also arrived without her payment coupon, again requiring her payment to be pulled from the regular process in order to direct the payment to the proper account. …

"We considered Ms.Teberg to be a good and valued customer, and we would have liked to have kept her business. It is clear that she experienced a problem with her credit card payments, but the actual cause of that problem remains unclear in the absence of more facts."

Exhibit 13i.

CONSUMER LETTER
-Robert Begani, of St. Charles, Illinois

"Upon review of our [Chase] billing statement ending 3/19/07, my manager noticed a finance charge of $83.12. While trying to find the reason for this charge she noticed that the payment due from last month was $2299.87 and the payment admitted was $2266.87—a $33.00 entry mistake—as we always pay the total amount due.

"She called the customer service line to complain about the finance charge of $83.12 for a balance due of $33.00. She explained that she understood that there was a short payment, but the finance charge should be adjusted to reflect the short amount. She was told that there was nothing to be done, the finance charge calculation was explained and then told that problems like this would be avoided if we allowed the Credit Card Company to automatically deduct the amount due from our bank account."

RESPONSE BY CREDIT CARD ISSUER
-Chase Card Services

"When a customer pays less than the full balance on an account, finance charges are calculated based on the average daily balance for the billing period. This method is similar if not identical to the calculation used by most financial institutions to calculate the interest on an outstanding loan. This process would have assessed interest on the loan for the time it was outstanding, and finance charges would have stopped accruing on any payment made as of the date that payment was received and credited to the account."

Exhibit 13j

CONSUMER LETTER
-Carmen Flickinger, Fruitport, Michigan

"[My] previous balance of $4,003.39 was paid on 2/21/07 in the amount of $4,004.00. … [Y]ou will notice the 'Finance Charges' of $75.51 with a 'new' account balance of $74.81, after they deducted the .70 cent balance on the card after paying it off. …

"I withdrew money from an IRA account, which resulted in penalties filing my tax returns, in order to pay this account off with all of their fees included. Then, to add insult to injury, they charge me an additional $75+ using their rationale that I had an 'average daily balance' prior to payoff, calculating this ADB using a percentage rate of 32.24%. This percentage on an account that had a '0' balance and had just been paid off."

RESPONSE BY CREDIT CARD ISSUER
-Citi

"This customer had an unpaid balance that exceeded $8,000. She paid approximately half of that balance in January 2007, leaving an unpaid balance of $4,003.30. Because she had not paid her account in full, she did not have the benefit of an interest free grace period and interest accrused on her $4003.03 unpaid loan balance.

"The customer made a payment of $4,004 on 2/21/07, which did not capture the $74.81 in interest that had accrued by that time. She was billed for this interest on her statement dated 2/28/07."

Exhibit 13k.

CONSUMER LETTER
-Cindy Moon on behalf of her mother, Joan Moon, of Washington, Michigan

"Detailed below is the history of events that occurred after my mother transferred a credit balance to Bank of America accepting a promotional offer of 0.00% APR until January 2008. Soon after opening the account, the offer was revoked and fees and finance charges were initiated due to a late payment, as a result of her **never receiving a statement requesting payment**. ... My mother received her first billing statement [in November 2006]. It shows initiation of the account but no record of an actual balance. ... My mother received her second billing statement [on January 12, 2007]. It now shows the initial transferred balance ... but also includes a 'Purchases and Adjustments' Fee of $39.00 and a 'Periodic Rate Finance Charge' of $178.08. My mother immediately called customer service and questioned these fees and charges. ... [Customer service] told my mother that the offer was revoked and the adjustment fee was to cover that conversion of account type and it was her fault because she was late in payment. My mother contested since she never received a statement for December therefore she did not know how much was owed and by when. ... We sent a letter [on January 15, 2007 stating] our intentions to close the account. A check equaling the new balance total of $14,637.08 was included. ... We received a letter [on January 25, 2007] stating that we had not made a payment. ... Immediately we called customer service .... [Customer service] confirmed that the check was received and it was accredited to the account. ... I asked for confirmation that the account was closed and that absolutely no further amount was owed. She said, *yes*. ... We received a billing statement [on February 13, 2007] with a new finance charge of $84.86. ... [Customer service] explained that these finance charges accumulated before the account was closed. ... We have a paid a total of $303.08 ... for nothing but dishonesty and poor service." [Emphasis from consumer.]

RESPONSE BY CREDIT CARD ISSUER
-Bank of America

"That [January 2007] statement reflected the $14,000 balance plus a Late Payment Fee and Finance Charges since the 0% promotional rate was lost due to non-payment of the December 2006 monthly billing statement. The credit card agreement specified that a late payment would result in loss of the 0% rate.

Ms. Moon contacted us by phone on January 12, 2007. ... If a customer has not received a statement, that customer may assert a billing error by writing to the bank at the address set out on each billing statement. As we state on our billing error notice, the customer may call us, but that does not constitute a formal notice of a billing error. ...

"A payment of $14,637.08 was received on January 18, 2007, which paid the New Balance Total listed on the January 2007 monthly billing statement in full. Correspondence was received from Ms. Moon requesting that we close the account, and the account was closed on January 25, 2007. However, because interest accrues daily, finance charges continued to accrue on the account between the statement date and the date the payment was received. As a result, when the February 2007 monthly billing statement closed on February 1, 2007, finance charges were assessed on the account totaling $84.86. ...

"Since the customer was mailed statements and no statements were returned, and the balance was paid in full and the account closed in good faith, the decision was made to waive the remaining finance charges assessed on the account, and a Credit Balance Refund check was sent to Ms. Moon for $85.04."

Exhibit 13l.

CONSUMER LETTER
-Jack Ware, of Flagstaff, Arizona

"I received one of these flyers from a credit card company (Advanta) saying I could borrow a large amount of money at a zero or low interest rate--it was an option on my part, which one I chose. A low interest rate for the duration of the loan or zero interest for a specified amount of time. I choose the zero interest.

"I had an outstanding balance at that time (from earlier charges in the month). When I received my statement and after talking with representatives of that company, I discovered that any payment I make would not apply to the previous charges until after I had paid in full the lower interest loan off. Therefore, I could not direct the company to apply my payments to the higher interest portion of my debt. They would only apply to the lower interest amount and I would continue to pay a high interest on over two thousand dollars---locking me into doing that."

[Advanta did not provide a written response.]

Exhibit 13m.

CONSUMER LETTER
-Jack Poore, of Springboro, Ohio

"While I have never had any problem with my own credit cards, I have recently dealt with a situation that can only be described as a son's worst nightmare involving credit card debt. My mother was the victim of a murder/suicide ....

"Unbeknownst to us, they [my mother and step-father] apparently started using credit cards to pay for daily activities. I can only assume that they thought it was a temporary solution. ... [T]his quickly turned into an unrelenting nightmare. Over-limit and late payment fees were being charged at the rate of $78 per month. Interest rates shot up to 36%! In a short period of time, the debt mounted to over $70,000! Monthly payments on four credit cards of basic interest and fees were over $2,000 a month, none of which was reducing the principal at any significant amount. ...

"On or about March 16 (the exact date cannot be determined), Jim [his step-father] decided to not only take his life but the life of my mother. ...

"To add insult to injury, we just received the credit card statement that lists the purchase of the gun used to kill our mother. Can you imagine the emotional issue with which we are now dealing? **Not only has out mother been murdered but we now have to pay from the estate for the purchase of the gun!!! And at a rate of 32% Interest!!!**" [Emphasis is from consumer.]

RESPONSE BY CREDIT CARD ISSUER
-Citi

"Given the personal tragedy described by Mr. Poore, we have determined not to pursue this debt against the estate. We have informed Mr. Poor that the debt has been forgiven and we have written it off. ... Payments were made on the account regularly each month, and there were no late fees, OCL [over the credit limit] fees or default interest rates applied to the account. All late fees and OCL fees occurred after the death of the cardholders, but before we were aware of that fact. When we were notified of their death in May, no further late charges were imposed."

# # #

[redacted] = Redacted by the Permanent Subcommittee on Investigations

From: creditcards (HSGAC)
Sent: Tuesday, October 16, 2007 3:58 PM
To: [redacted]
Subject: FW: credit card interest rates

From: Cindy Mccoy [mailto:[redacted]
Sent: Thursday, September 20, 2007 5:17 PM
To: creditcards (HSGAC)
Subject: credit card interest rates

Dear Senator Levin:

I am writing to you in the hopes you can let congress know what is happening to many american families who have credit card debt. We live in the center of the country near the Missouri, Kansas border. Our area of the country has been hard hit by economic woes since 911 when our economy here started to suffer.

Areas here were thriving before 911. There were jobs, the housing market was booming and people were having things done and spending money. We live in a small town about two hours south of Kansas City. We have more than 5 businesses that have closed in recent times due to the economic strain. People are told things are going great but that isn't so in our part of the country nor has it been for years. Our country is silently suffering.

In our family our income dropped at one time $10,000. Money that flowed freely before was gone and many times we could just make our debts. Other families we knew were in similar states and many of them had to to file bankruptcy. Many let their homes go back because their income had dried up.

Then came the new bankruptcy laws that said upper middle class families would not be able to file for assistance any longer because many had homes and were above the income guidelines. Most did not want to give up homes they had worked for for years anyway. Nor did they want to file for bankruptcy assistance anyway. They just wanted to pay their bills and go on.

When the economy started to suffer and people's income started to decline people started to be late on one thing or the other. There just wasn't enough income to go around. Then many had more than one credit card which were managable until present day. When things started to go bad in one area the credit card companies all started raising interest rates. We have several credit cards that have risen to over 30% now and most are at 32%. Our monthly expenditure on credit cards now is as much as a house payment over and above our bills.I consider this highway robbery. It is as bad as what a loan shark would charge.

The american family is in a corner. We have been handed debt beyond your wildest dreams overnight. Just getting up each day to an impossible mountain of debt you can't pay and you can't work out of is so hard. We see because of the new rate increases years of suffering and doing without. I believe if this keeps up we will all die paupers while working even while we are old to try to recover. I and my husband are baby boomers. I have an incurable illness, but I will never be able to retire because of this.

When most of us first got credit cards the companies said
You can borrow this much money for this payment at this interest. They never said if the ecomony goes south we will add on to your suffering by raising your payments, increasing your interest to 32%, and doing whatever we like. The mere fact that you may have several other credit card companies doing the same thing at the same time is unimportant. This is like in the old stock market days when people saw no way out and many didn't make it.

My husband and I are hard working americans. Something has to be done to stop what is going on in this country. Please pass this along to anyone who will listen to any of the groups you work with. Thank You!!!! Cindy McCoy

Permanent Subcommittee on Investigations
EXHIBIT #13a.

LAW OFFICES

Poliakoff and Associates, P.A.

215 Magnolia Street

Spartanburg, South Carolina 29306

MAILING ADDRESS:

P.O. BOX 1571

SPARTANBURG, SOUTH CAROLINA 29304

TELEPHONE: (864) 582-5472
(864) 582-8101

FACSIMILE: (864) 582-7280

GARY W. POLIAKOFF
atty@gpoliakoff.com
RAYMOND P. MULLMAN, JR.
rmullmanjr@aol.com
LARA PETTISS HARRILL
lpettissharrill@gpoliakoff.com

BERNARD B. POLIAKOFF
[illegible]
J. MANNING POLIAKOFF
[illegible]
MATTHEW POLIAKOFF
[illegible]

April 23, 2007

VIA FAX 202-224-1388 and U.S. MAIL
Honorable Carl Levin
United States Senator
269 Russell Office Building
U.S. Senate
Washington, DC 20510-2202

Re: Senate Committee on Credit Card Practices

Dear Senator Levin:

We represent Evelyn P. Scott, a 75 year old lady who has been sued by Chase Bank, USA for an alleged credit card debt. Mrs. Scott has been recently hospitalized on multiple occasions, and is in extremely poor health. Her husband is 77 years old, is battling cancer, and remains in extremely poor health. Mrs. Scott has an income of only $478.00 per month in Social Security benefits. She owns no real estate and has no assets of any appreciable value. I am handling her case on a Pro Bono basis, due to her indigence and due to the injustices related to the claim against her. Mrs. Scott has agreed for me to contact you and your committee, for the purpose of describing her personal situation, and for the purpose of demonstrating that it is necessary for the U.S. Congress to enact additional laws restricting the practices of this behemoth industry.

A number of years ago, Mrs. Scott obtained a credit card from Bank One, which account has now been ceded to Chase Bank USA. Her last charges on this card were approximately 4-5 years ago. She informs me that she charged approximately $2,000.00 on the card. She now owes more than $4,700.00 on the card, even though she has made no charges in 4 or 5 years. Despite her income being limited to $478.00 per month, she paid $77.00 per month for many months. Despite this, her payments continued to increase, rather than decrease, due to the astronomical interest rates which have been successively applied to her account.

Permanent Subcommittee on Investigations
EXHIBIT #13b.

For a number of years Mrs. Scott made regular payments on this account out of her $478.00 of Social Security each month. Despite the regular payments, her indebtedness continued to increase, and the interest rates continued to increase. Many fees and costs were applied, also adding to the total indebtedness.

In addition to making these payments for many years, the persons associated with the creditor would telephone Mrs. Scott on many occasions, scaring and intimidating her to the point that she felt that something horrible would happen to her and her husband if she discontinued the payments. More recently, she asked me to help her, and upon my advice, she has ceased making payments. Very shortly thereafter, Chase Bank USA sued her in arbitration. Again, we are defending this action Pro Bono for her and we have demanded to receive copies of all agreements allegedly signed by her, particularly including any arbitration agreements. We have also asked for detailed charge and payment history, to include all applications of interest rates, fees, penalties, and any other charges. Thus far we have received none of the above.

A few weeks ago I was able to see some of the hearing which your committee held on credit card practices, on C-SPAN. The plights of the victims who testified were all too common. Additionally, I saw the incredible sworn testimonies of the representatives of the 3 largest credit card companies, and their incredible assertions that their companies try very hard to help people avoid high interest rates and avoid all the pitfalls of increasing interest, penalties and fees. Part of their testimonies was laughable, and part was infuriating. Their testimonies were reminiscent of the testimonies of tobacco executives a few years ago, when they claimed that there was no evidence that tobacco caused any medical problems. I would hope that your committee would consider some type of sanctions on these persons and/or companies for offering such incredible testimony. The pitfalls and traps to ensnare debtors have been carefully and conscientiously designed by the industry to increase interest rates to unconscionable levels, and to add fees and costs to a large portion of the American public.

I believe that as the details of Mrs. Scott's situation emerge, her case will be further evidence of an industry out of control, unconscionably victimizing a large segment of the American public. Restraints upon this industry have become necessary due to the rampant excesses and greed of the industry, and its ability to exercise any reasonable control upon itself. Mrs. Scott is willing to testify or offer any evidence of her situation as your committee considers these issues.

I'm sending copies of this correspondence to the attorney for Chase Bank USA in the suit against Mrs. Scott, as well as to the National Consumer Law Center, and to Mrs. Scott. Also enclosed is a copy of the arbitration suit by Chase Bank against Mrs. Scott, and our Answer.

Thank you for your consideration and for your committee's attention to these matters.

[redacted] = Redacted by the Permanent Subcommittee on Investigations

With best regards, I am,

Yours very truly,

Gary W. Poliakoff
POLIAKOFF & ASSOCIATES, P.A.

GWP/tjd

Enclosures

cc: James D. Branton, Esq. (Attorney for Chase Bank USA) (w/enclosures) [redacted]
National Consumer Law Center (with enclosures) [redacted]
Mrs. Evelyn P. Scott (with enclosures) [redacted]

CHASE

Response from Chase Card Services

Evelyn Scott –

Response: This situation was under review prior to Chase receiving the forwarded letter from the committee. In May 2007, we received correspondence indicating the customer's situation and began a review of her account history. In reviewing correspondence from the customer's attorney, we understood the financial hardship that the customer was experiencing. We also identified an opportunity to develop a better understanding of the customer's situation in September 2004 when we were contacted to cease collections activity. At that time, we could have probed to better understand the customer's situation. Had we done that, we would likely have placed the customer on a no or reduced interest payment program with no late or overlimit fees. As a result, we have treated Mrs. Scott's account as we would have any other customer's account: we have removed the fees and finance charges assessed since that time, her payments since then have reduced her balance to zero, and her credit report has been updated to delete her Chase account and the related negative payment history.

[redacted] = Redacted by the Permanent Subcommittee on Investigations

:reditcards (HSGAC)

=rom:	tbradfor@[redacted]
Sent:	Monday, June 25, 2007 3:20 PM
To:	creditcards (HSGAC)
Subject:	Abusive Billing Practices of American Exppress
Attachments:	American Express [redacted]

American Express
[redacted]..

I am attaching a letter that I sent American Express regarding a debt that I have with them and my efforts to pay this debt fairly. As an fyi, I am a college educated 55 year old make, with a business designation which equates to a doctorate in the insurance business (CPCU). I have been married for 28 years and have two sons, 27 and 25, both who are college graduates. Over the past 35 years as a consumer, I have always had good credit, never filed bankruptcy nor had write-offs or foreclosures. However, we have always lived on the edge financially as a result of my getting two credit cards out of college and then constantly charging purchases, including furniture, with high interest rates. We also borrowed $85,000 in educational loans to send our sons to college. My wife and I earn approx.
$160,000 a year. We now have approx. $400,000 in debt, with approx.
$160,000 in unsecured debt.

In 2006, my wife and I were on the brink of financial disaster so we entered into a debt management program. Many of our debtors agreed to participate and they adjusted our interest rates to modest rates that were reasonable and would allow us to pay our debt down in 4-5 years.
However, American Express, whom we owed $35,000, refused. The attached letter outlines how they have refused to lower their interest rate below 30.24% and continue to add late fees every month, despite our paying $800 a month! As a result, Since Jan. 2007, I have paid American Express over $4500 and $4248 of that has gone towards interest and late fees. Only $252 has gone towards the principal!!!
Since I started making payments to America Express after going into the debt management plan, I have paid American Express over $7000 since mid-2006 and only approx. 0.056% or $392 has gone towards the principal. At this rate, I will not have the debt paid off for over 40 years and will have made paymen ts in excess of $384,000 in interest on a $35,000 debt!

As with many Americans, my wife and I brought this on ourselves, however we are intent on paying all our debts. However, once you get caught in the vicious cycle of usury interest rates and late fees, companies like American Express are intent on keeping their boot on your throat, sucking all the assets that they can out of you. They essentially have the right to bleed a person to death financially without any regard to a person's efforts to try and settle the debt fairly or without regard to the years of regular payments that I made American Express which helped enriched them.

I welcome any information that you may need on this matter and if asked, yes I would testify. I would welcome your inquiry of American Express of this matter because they have been unresponsive to my many letters and phone calls.

Regards,
Terry L. Bradford
[redacted]
Hilliard, Ohio [redacted]

Permanent Subcommittee on Investigations
EXHIBIT #13c.

American Express Company
Government Affairs Office
801 Pennsylvania Avenue, NW
Suite 650
Washington, DC 20004

October 22, 2007

The Honorable Carl Levin
Chairman
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate
SR- 199 Russell Senate Office Building
Washington, D.C. 20510-6250

The Honorable Norm Coleman
Ranking Minority Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate
SR-199 Russell Senate Office Building
Washington, D.C. 20510-6250

Dear Chairman Levin and Ranking Member Coleman:

American Express appreciates the opportunity to respond to the consumer complaint from Mr. Terry Bradford that was shared with us by the Senate Permanent Subcommittee on Investigations.

American Express makes every effort to work with Cardmembers who are facing financial difficulties. We fully support the efforts of Cardmembers who enter into debt management programs in order to fulfill their financial obligations. While we cannot comment directly on the specifics of the Cardmember's account due to consumer privacy considerations, we have programs in place to assist Cardmembers, including repayment programs that offer reduced interest rates for eligible consumers. We are constantly working to improve our programs to better serve our customers and, over the last several years, we have invested in a grant program to research best practices in credit counseling and debt management in partnership with a leading consumer group.

In certain cases where customers may not be eligible to participate in a workout program, we offer Cardmembers the opportunity to settle their account by paying a portion of the debt they owe over a set period of time. We believe that such an approach can be a better solution for both the Cardmember and American Express in certain situations.

Each year thousands of customers take advantage of the programs we offer to help them manage through financial hardships. While this represents only a small fraction of our overall customer base, we are committed to working with our Cardmembers who are facing financial difficulties to find the most equitable solution for their particular case.

Sincerely,

Arne L. Christenson
Arne L. Christenson
Senior Vice President

SELECT PARTICIPATIONS, INC.

[redacted] = Redacted by the Permanent Subcommittee on Investigations

[redacted]

March 8, 2007

US Senator Carl Levin
296 Russell Senate Office Building
Washington, DC - 20510

US Senator Norm Coleman
320 Hart Senate Office Building
Washington, DC -20510

Re: Hearing on Abusive Credit Card Practices

Dear Senators:

Absolute congratulations are in order to The US Senate, for taking on the unethical practices of these parasitic companies! They have refused to clean up their own acts, and they continue to prey upon the least vulnerable in our society.

Let me offer yet another perfect example of such abusive actions, which are sanctioned by their banking parent company owners, and are standard operating procedure. Even though these companies previously lost a class action lawsuit for not disclosing conversion fees based on foreign purchases, they continue to try to circumvent ethical and legal limits.

In this specific instance I will address actions by Bank of America's MBNA Division. An attached recent billing will show that the billing statements have been "re-designed to purposely hide" the fact that they are improperly continuing to collect such fees. As my attached B of A statement will confirm, I was charged a 3% foreign country conversion fee of $11.10, even though there were NO foreign conversion requirements on this billing. The fee was also listed at the very end of the statement at the bottom of page 2, in the hope that it would be missed by the consumer. Additionally, the fee WAS NOT referenced back to any specific charge on the statement, in a further attempt to confuse the consumer, and hide its purpose. This type of action clearly demonstrates the continuing "placement" approach by card companies, to confuse and hide such fee collections from consumers.

My statement will confirm that the "foreign country transaction fee", was incorrectly assessed, based upon a $370 purchase made to a pharmacy "based" in Auckland, NZ. However, this charge was processed in US Dollars, which means that absolutely NO conversion activity was reqnired. However, when I contacted B of A to request a refund of this erroneous amount, I was told (quote): "If a charge includes the name of a foreign city and/or location, we charge the fee and it is non-refundable". I simply canceled the account.

[redacted]

[redacted]
HOUSTON, TEXAS
[redacted]

Permanent Subcommittee on Investigations
EXHIBIT #13d.

= Redacted by the Permanent Subcommittee on Investigations

And this practice is not limited to B of A, since it is standard operating procedure for all credit card issuers. They continue to improperly and unethically collect millions of dollars in foreign conversion fees, many based on purchases that do not warrant such fees, but now go to great lengths to disguise and hide these assessments, since previously losing a class action lawsuit based on their non-disclosure of such fee collection.

The exact same unethical practices that they employ to victimize the less economically fortunate of our society. This is just another example of the way that they continue to engage in unethical business practices, to financially benefit from the pocketbooks of the less fortunate, while trying to purposely hide, conceal and skirt acceptable legal limits. These companies have zero shame for their actions, and they absolutely WILL NOT clean up their practices unless Congressional action forces them to do so. I can take care of myself, but I sincerely hope that Congress will take action on behalf of those who cannot.

Sincerely,

Sid Vinyard, CEO

cc: All US Senators
Washington, DC - 20510

Mr Richard Srednicki,
JP Morgan/Chase
[redacted]

Mr. Liam McGee
Bank of America
[redacted]

BARCLAYS

Clinton W. Walker
General Counsel
Tel 302-255-8700
CWalker@BarclaycardUS.com

October 11, 2007

Senator Carl Levin
Chairman, Permanent Subcommittee on Investigations
United States Senate
199 Russell Senate Office Building
Washington, DC 20510

Dear Senator Levin:

On behalf of Barclays Bank Delaware ("Barclays"), I am pleased to respond to Mr. Sid Vinyard's letter to you about an issue involving his Barclays credit card (his letter alleges that his card was issued by Bank of America, but it actually was issued by Barclays). In his letter, Mr. Vinyard alleges that he had been assessed a fee for a transaction with a merchant located in a foreign country even though the transaction had been processed in U.S. dollars.

After receipt of the letter, I conducted an internal investigation and determined that Mr. Vinyard was correct. The way the foreign country transaction process had been set up, Barclays indeed did assess a foreign country transaction fee on all transactions with non U.S. merchants. However, I further determined that only a very small percentage of those transactions (less than 0.02%) included transactions where there was no currency conversion.

As a result, Barclays has changed its policy so that the fee is only applied when there is an actual currency conversion. While it might have been legal to assess the fee where there was no currency conversion, we at Barclays believe that the right thing to do is assess the fee only where a currency conversion is involved.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Clinton W. Walker

CWW/cm

[redacted] = Redacted by the Permanent Subcommittee on Investigations

Stanley S. Hazen
[redacted]
Charlottesville, VA 22903–1248
[redacted]

16 March 2007

Hon. Carl Levin, Chairman
Homeland Security and Governmental Affairs Subcommittee
United States Senate
29 Russell Office Building
Washington, DC 201510–2202

Fax: (202)224–1388

Dear Sen. Levin: Re: Credit card company abuses

This follows up an electronic memo that I left on your Web site several days ago.

On Wednesday, 7 March, your subcommittee heard testimony about abusive tactics that credit card companies use toward their cardholders. That resonated strongly with me. I heard about it the following evening on *The News Hour with Jim Lehrer*.

For years, I held a credit card issued by Fleet Bank N. A., which did business in the northeast. (I lived in or near Rochester, New York, from 1957 until I moved to Charlottesville in 1997.) In the summer of 2004, Fleet was bought out by Bank of America. Bank of America took over all Fleet Bank accounts, both traditional banking accounts and credit card accounts.

My wife and I were in Italy and Austria in August, 2005. Fleet never assessed an additional fee for charge transactions that took place outside of the United States. Imagine my horror, then, when the monthly statement dated 18 August 2005 came from Bank of America, which assessed a "Foreign Currency Conversion Fee" of $79.08. I wrote to Bank of America on 23 August, protesting that fee, and pointing out that Fleet never charged such a fee. I paid the balance due in full, minus the Fee.

Then next month's statement, dated 18 September 2005, contained a "Periodic Finance Charge" of $74.44. Obviously, Bank of America did exactly what *The News Hour* reported, that is, charged me a finance charge based on the entire amount of the month's charges, and not only on the unpaid "balance."

By coincidence, an application for a credit card with U. S. Bank N. D. had come before we left for Europe. It had the benefit of returning a portion of the charges to me and to Boston University, where I attended graduate school on each anniversary of the account's opening. I opened that account at once, and have not used the Bank of America card since the U. S. Bank card arrived.

I protested, in writing, each of the two bills from Bank of America, paying only the amounts of purchases for the month. I returned all subsequent bills too Bank of America, unopened, marked "Refused; balance = zero."

Permanent Subcommittee on Investigations
EXHIBIT #13e.

03/16/2007 11:38AM

▬ = Redacted by the Permanent Subcommittee on Investigations

On 11 November 2006, I received the enclosed letter from Mr. Bamford, an attorney in Richardson, Texas. I replied in writing, by mail, stating (1) that I never owed Fleet a penny, and (2) I never had an account that had the number that he recited. That letter was never acknowledged. A second letter from Mr. Bamford was received on 21 November. I replied by fax to his office the following day. That letter was never acknowledged.

Two days ago, the telephone rang. The called asked for Stanley Hazen. As I never identify myself to strangers, I asked who was calling. When the voice said "the office of Thomas Banford," I hung up.

I hope that this gives you some help in pursuing the perpetrators of such unethical business practices.

If you require more details, I shall be happy to provide them.

Thank you for your attention.

Sincerely,

Stanley S. Hazen
Stanley S. Hazen

Bank of America

ınk Of America
ederal Government Relations

October 16, 2007

The Honorable Carl Levin
Chairman

The Honorable Norm Coleman
Ranking Member

Senate Permanent Subcommittee on Investigations
199 Senate Russell Building
Washington, DC 20510

Dear Chairman Levin and Senator Coleman:

This is in response to the letter from our customer, Mr. Stanley S. Hazen, which you brought to our attention.

Mr. Hazen had a Fleet Bank credit card and was assessed foreign transaction fees in August 2005 in the amount of $79.08 relating to purchases he made outside the United States. The assessment of foreign transaction fees are consistent with the card holder agreement and prior notices on this issue.

As Mr. Hazen describes in his letter to you, because he disagreed to these fees, he decided to subtract the fee amount from his monthly payment rather than pay the full outstanding balance. As with most credit cards, revolving a balance means that finance charges or interest accrues on the outstanding account balance until that balance is paid in full. As a result, his next monthly statement included the finance charges that accrued to his unpaid balance.

Mr. Hazen continued to subtract the foreign transaction fees and all finance charges from future payments, paying only the amounts of new purchases for the month. As a result, his payments continued to be less than the new balance total, and finance charges continued to accrue on balances until paid and on those not paid. At some point, he began returning all subsequent bills, unopened and marked "Refused balance = zero."

All our credit card customers are provided a readily available means to assert a billing dispute. This information appears on every monthly statement. Mr. Hazen did not assert a billing dispute. Instead, he began paying less than the new balance total, and then stopped making payments altogether.

Thank you for bringing Mr. Hazen's letter to our attention and providing an opportunity to explain the circumstances. If you have any questions or concerns, please do not hesitate to contact us.

Sincerely,

John Collingwood
Senior Vice President
Government Affairs
Bank of America

Tel: 202.351.0112 · Fax: 202.785.1426

▬ = Redacted by the Permanent Subcommittee on Investigations

April 18, 2007
Paul K Davidson
[redacted]
Albuquerque, NM [redacted]

Sent via Fax, Page 1 of 3

The Honorable Senator Carl Levin
Chair, Senate's Permanent Subcommittee on Investigations
448 Russell Building
Washington D.C., 20510
[redacted]

Reference: Capital One Credit Card, Catch 22 situation– Acnt # [redacted]

Dear Senator Levin:

First, I applaud your tireless work in the Senate for the American consumer and in reference to you recent hearings on the egregious acts of credit card companies I can only say, "thank you, thank you, thank you. It is about time someone called these robber barons to task for their un-ethical and immoral practices."

I have followed with interest your recent hearings regarding Credit Card issues and their effect on consumers.

Attached please find a letter I have recently sent to Mr. Richard Fairbank, the CEO of Capital One.

I am sending a copy to you because I think in your capacity as chair of your recent hearings into Credit Card Company actions, you should be aware of the "smaller" issues that consumers face in America today. Especially those perpetrated by the credit card companies. It is to easy for them to place roadblocks in front of consumers that make it impossible to deal with "trivial" situations. Clearly the intent of these megalithic financial institutes is to make it easier for the consumer to pay off their extortive charges rather than to take the time to correct an unjust situation.

This is a very frustrating situation and one that should never have risen to the level where I am writing to CEOs and Senators about a trivial, but unauthorized, $51 charge that has grown to $300 and become a blight on my credit report. Not to mention the countless hours of frustration and telephonic hold time.

I am hoping that Capital One will do the right thing and take care of this egregious situation. Perhaps once this situation is corrected, and I can communicate with you in more detail regarding the issue of Adult ADHD and how the credit card companies have a long history of taking advantage of those of us with this condition. In this case, I thought I was doing everything I should to insure that my ADHD did not affect this credit card or my credit history.

Thank you for your continuing fight for the American consumer.

Paul Davidson

Permanent Subcommittee on Investigations
EXHIBIT #13f.

04/25/2007 3:46PM

▬ = Redacted by the Permanent Subcommittee on Investigations

April 18, 2007
Paul K Davidson
[redacted]
Albuquerque, NM[redacted]

Sent via Fax Page 1 of 2
and via Federal Express

Richard D Fairbank
CEO/Chairman of the Board/President/Director
Capital One Financial Corporation
7000 Goodlet Farms Parkway
McLean, Virginia
[redacted]

Reference: Capital One, Catch 22 situation– Acnt #[redacted]

Mr. Fairbank:

As a small businessman, I've learned that the best way to deal with a problem situation is to go directly to the person most able to correct a situation. For Capital One, that sir, would of course be you. Therefore, I hope you will take the time to read this letter and to help me clean up a most frustrating situation.

For a number of years, I had a credit card with your company, account # above. In April of 2006 I paid this card down to a zero balance. Because I suffer from Adult ADHD, it was important to me to pay this card off so that I would no longer have to be concerned about it's status.

On July 17th, 2006, a $51 charge was placed on the card by a merchant. This was an unauthorized charge. Because I had moved (and apparently Capital One never received, or at least never posted the change of address card sent to you) I was not receiving statements for this card.

The first I became aware of this problem was when your Recovery Group collection agency called me at my office and informed that I had a debt of almost $300.

I have spoken to the merchant in question and they are perfectly willing to create a charge back for the $51 amount. They agree that the charge was not supposed to have been charged against your card. However, they have no way to create a charge back against the card because of the current status of the card

After having spent countless hours on the phone listening to Musak and going back and forth between your Recovery Group and struggling to speak to supervisors actually at Capital One, I have hit a wall. Neither group is able to think outside anything other than the scripted scenario of a large corporation. Capital One says: "The Recovery Group is handling that account, we at Capital One cannot do anything once it's turned over to them... No, we cannot take the account back." (Let's ignore for the moment that both companies are under the same umbrella of COFC. And that this charge never should have been made.) The Recovery

= Redacted by the Permanent Subcommittee on Investigations

Group says "We can only try to collect the amount due. You have to speak to Capital One and have them take the account back and make adjustments. We cannot do anything with the actual account." When I call back Capital One, I either immediately get transferred to your Recovery Group, or if I am able to get to a supervisor, I am told they can't do anything due to the account being over 220 days past due.

When I ask about the fact that the account in reality is not past due because the charge was unauthorized I am told that I have to discuss this with the Recovery Group.

When I again call back Capital One to ask how we work it out so that the merchant can credit back this charge, I am told once again that they can do nothing.

I am certain of two things. One, *you can do something*. And I am hoping that you will. Second, *this situation should never have arisen*. And once it arose, there should be some method at Capital One for dealing with such a situation.

Why don't I just pay the $279 to make this go away and get this hit off my credit report ? Because, I don't owe that money. And paying it off will still leave the initial hit on my credit report and that's not fair. And I've always had a problem in my life dealing with unjust situations.

Please see if you cannot find some way for a merchant to credit back a charge to a card that is closed so that I can get this balance down to zero where it was and where it belongs.

And then please see that the hit on my credit report is removed.

I had a second Capital One card that had a very similar situation but the unauthorized charge happened in November of 2006 so it was still in the hands of Capital One and we were able to clean that up.

It is unclear to me why Capital One cannot take this account back from the Recovery Group, allow the merchant to create the credit, and clean this situation up.

Capital One has a problem with their processes when such a trivial matter requires such extra-ordinary efforts. I apologize for bothering you with such a trivial matter, but I am extremely frustrated and unfortunately have gotten no satisfaction from those under you. I would also think that you would be interested in knowing about problems within your organization.

Thank-you

Paul Davidson

cc: Gary Perlin, CFO, Capital One
Senator Chris Dodd, Chair, Senate Banking Committee
Senator Carl Levin, Chair, Senate's Permanent Subcommittee on Investigations

Capital One

October 15, 2007

The Honorable Carl Levin
United States Senator
269 Russell Building
Washington, DC 20510

Dear Senator Levin:

Thank you for your inquiry on behalf of Mr. Davidson. I sincerely apologize and regret the frustration and inconvenience he experienced. While Capital One always strives to provide the best service to all of our customers, sometimes we don't hit that mark. In this case, a merchant erroneously placed a charge on Mr. Davidson's account. Because he had moved from his previous residence, he did not receive the account statement we sent to that address. He was therefore unaware of the charge and unable to inform us that it was not authorized.

While we received your inquiry into Mr. Davidson's case in July, we previously received Mr. Davidson's letter directly. On May 10 we contacted him by phone and quickly eliminated the charges, fees and interest. In addition, we contacted the credit bureaus to correct his credit report. We offered our apologies to Mr. Davidson, and used the event as a learning experience to prevent future errors.

Mr. Davidson's experience with us is regrettable, however, with over 30 million accounts mistakes will occasionally happen. Unfortunately, these anecdotal stories tend to overshadow the attractive products and consumer friendly policies of Capital One. We would like to put this incident in context with our full record.

First, it is a long-standing practice that Capital One does not use universal default:

- We do not default-reprice a customer based on the customer's behavior on an account with another creditor.
- We do not default-reprice a customer's account based on that customer's behavior on a different account with Capital One.
- We do not default-reprice a customer based on changes in the customer's credit report, including the customer's credit score.

Indeed, Capital One will not default-reprice a customer unless the customer pays late by at least 3 days, twice in a 12-month period. After the first 3-day late payment the customer will receive a notice that the second such instance may trigger a higher interest rate. Additionally, a customer who is repriced and who pays on time for 12 months thereafter will automatically revert to the pre-default interest rate.

- We do not reprice for overlimit events.
- We do not reprice for returned checks.
- A single late payment will not result in repricing.
- And, as noted above, a customer will not be repriced because of behavior on another account, even another account with Capital One.

In addition, Capital One has never calculated finance charges using the "double-cycle" billing method.

Furthermore, to help customers avoid late fees, we send customer statements at least 20 days prior to the due day (possibly the earliest in the industry). Like most in the industry, we provide customers multiple ways to pay their bills on time – by mail, over the internet, by ACH, at our branch locations, and by phone.

For customers who make only the minimum payment for 3 cycles in a row, we provide an alert on their statement that they will pay less interest and pay the balance sooner if they pay more than the minimum payment. We also direct them to an on-line calculator that enables them to see the effects of making different levels of payments.

For several years we have regularly provided customers with alerts on their statements about how to protect their credit, the importance of paying on time and staying under one's credit limit, and that lenders, landlords, and even employers check a consumer's credit score.

We are also enhancing our online tools to include a system to provide alerts to customers who are approaching their credit line or whose payment deadline is approaching.

We provide a number of online financial education tools including:

- How to maintain good credit
- How to get a copy of a credit report and how to understand what is in it
- How to protect personal information
- What to do if a customer suspects identity theft
- How to dispute a billing error
- Special guidance for college students and their parents on credit management, including how to develop a budget and stick to it, and track expenses

Many have raised concerns about marketing to college students. Capital One does not market on-campus and when we offer credit cards to college students (only those 18 or over) we use the same underwriting criteria that we use for any other customer segment.

As described above, comprehensive financial education materials and tools are available through Capital One's web-site and on many of our billing statements. In addition:

- In partnership with Consumer Action (since 2001), Capital One has provided more than 2 million financial education brochures in 5 languages, and provided "train the trainer seminars" to more than 450 community organizations across 30 states geared towards reaching low to moderate income adults.
- In partnership with Junior Achievement (launched 2006), Capital One developed a mobile financial education unit geared to middle school students. The focus is on teaching the students how to make sound financial decisions and develop a personal budget (strictly financial education with no product tie). The program includes 24 hour classroom instruction and a one day interactive learning experience on the mobile unit.
- Capital One associates across all business lines volunteered more than 30,000 hours in 2006 in their communities. Activities include teaching financial education, mentoring, redesigning libraries for local schools, working for Habitat for Humanity, and other community based organizations.

Senator Levin, thank you for the opportunity to respond to your inquiry and provide a more fulsome discussion of Capital One's policies.

Sincerely,

Larry Stein

Larry Stein
Senior Vice President
Policy Affairs

[redacted] = Redacted by the Permanent Subcommittee on Investigations

From: creditcards (HSGAC)
Sent: Tuesday, October 16, 2007 5:28 PM
To: [redacted]
Subject: FW: credit card entrapment

From: Fran Hirsch [mailto:[redacted]
Sent: Tuesday, June 19, 2007 12:11 PM
To: creditcards (HSGAC)
Subject: credit card entrapment

I've dealt with credit cards for over 50 years. they have set us up for entrapment.

you used to have 25 days to pay your bill.

example: all my cards, visa, astoria, masters, discover now give you 2 weeks or less.

the worst is american express

i called them today to tell them i have not received this months bill, & i don't want to incur a late fee or have my interest rate raised to some outrageous amount if i don't have time to get my payment to them on time.

their response ' your bill will be sent out today, take 7 to 10 days to reach you & is due july 8th. today is june 19th. if i receive my bill 10 days later, june 29th, i will have only 8 days to get payment to them. if i'm ill, have to go away for a week, or have any emergency i might be unable to do that.

this is unacceptable for a consumer whom they claim has a 20 day grace period. you not only can incur a late fee, & have your interest rates raised excessively, your other credit cards can do the same. the grace period does NOT include mail delivery time, & is therefor useless.

We need help with getting these usurers out our lives & pockets. please help.

thank you,

Frances Hirsch

[redacted]

Permanent Subcommittee on Investigations
EXHIBIT #13g.

Levittown, N.Y. [redacted]

[redacted]

[redacted]

[redacted] = Redacted by the Permanent Subcommittee on Investigations

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American Express Company
Government Affairs Office
801 Pennsylvania Avenue, NW
Suite 650
Washington, DC 20004

October 22, 2007

The Honorable Carl Levin
Chairman
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate
SR- 199 Russell Senate Office Building
Washington, D.C. 20510-6250

The Honorable Norm Coleman
Ranking Minority Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate
SR-199 Russell Senate Office Building
Washington, D.C. 20510-6250

Dear Chairman Levin and Ranking Member Coleman:

American Express appreciates the opportunity to respond to the consumer complaint from Mrs. Frances Hirsch that was shared with us by the Senate Permanent Subcommittee on Investigations.

We believe that the grace periods we provide our customers are more than adequate to accommodate both the mailing of monthly statements to consumers and the remittance of payments from consumers. American Express maintains stringent standards to ensure the prompt mailing of periodic statements, which are printed and mailed around the clock, 365 days a year.

Further, the growing popularity of electronic payment options is generally increasing the time consumers have to review and digest their periodic statements. To facilitate such payments, American Express does not charge a fee for any of our payment channels, including pay-by-phone or pay-by-computer. We also offer customers the opportunity to receive electronic alerts when their statement is available online, and we offer account alerts to remind them when a payment due date is approaching.

For American Express Cardmembers who choose to pay by mail, we direct their payment to the closest of our regional remittance centers to speed the crediting process. In the event a Cardmember indicates that they have not received their statement, it is our policy to waive any resulting late fees and finance charges on the account

Sincerely,

Arne L. Christenson
Senior Vice President

Senator Carl Levin
269 Russell Office Bldg.
Washington, D.C. 20510

3/9/2007

Dear Senator Levin,

When I learned that you were investigating Credit Card Companies, I decided to share my story with you.

I have had the same Credit Card for 28 years. I always pay my monthly balance in full. I have never had a finance charge or a late fee, that is, not until February, 2006.

Here is a chart of what occurred in 2006.

VISA		LATE FEE	FINANCE Charge
Check sent	2/9/06		
date due	2/14/06		
posted by VISA	2/15/06	$39.00	$36.60
check sent	5/5/06		
date due	5/15/06		
posted by VISA	5/17/06	$39.00	$30.32
check sent	8/1/06		
date due	8/16/06		
posted by VISA	8/18/06	$39.00	$37.17
sub-totals		$117.00	$104.09

total - $221.09

Permanent Subcommittee on Investigations
EXHIBIT #13h.

/ p. 2.

In September, I spoke to a clerk at the Post Office and explained my problem with mail delivery taking 12 to 16 days from Montana to St. Louis, Mo. She suggested using Priority Mail with Delivery Confirmation at a cost of $4.50. That would get my paid bill to the destination in 2 to 3 business days. That worked for 3 months. Then, in December, 2006, I again paid using Priority ~~Mail~~ Mail with Delivery Confirmation on 12/6/2006.

That payment was lost until 1/11/2007, when it was posted in St. Louis (by VISA).

I had put a "stop" on the check on 1/5/2007, since it had not surfaced for a month. Then I paid my bill by phone. Phone pay costs $10.00 per month.

In Feb., May and August, 2006, I paid $221.09 in Finance Charges and Late Fees. In December I paid: Delivery Confirmation — $4.50
Phone Pay — $10.00
Stop Check — $29.00
Return Payment fee for stopped check — $35.00
$78.50 total (Dec.)
(by VISA)

The Grand total for trying to pay my credit card bill on time in 2006 is $299.59. (+$13.50 Del. Conf. for Sept, Oct. + Nov.)

I realize this is a small amount, compared to what other people face with their Credit Card companies. However, I am sure there are

p. 3

thousands like me - and it adds up to a lot of money. Considering the fact that for more than 25 years I had no problem and in 2006 things got so bad that I could not even pay my bill on time, as hard as I tried, something is very wrong. I am not willing to pay 6^{00} per month to pay my bill by phone. I do not have the capability to pay on-line. Therefore, my only choice was to take my Credit Card business elsewhere, which I have done.

I know that people like me, who pay our balance in full each month are considered "deadbeats" by the Credit Card Industry. I believe that US Bank - VISA was trying to either force me out or at least make some money from me by holding my check for a few days to get the finance charges and late fees.

I did call the company after the second event in May, 2006. I was told that they cannot hold checks and they have very strict rules to follow. I do not doubt that they have rules to follow - I think the rules are ignored.

Until now, there has been no reason for them to follow the rules. I wish you success in reining in the credit card companies. It is high time.

Thank you,
Barbara Teberg

BARBARA TEBERG
[redacted]
Great Falls, MT [redacted]
[redacted]

[redacted] = Redacted by the Permanent Subcommittee on Investigations

U.S. Bank
Five Star Service Guaranteed
Retail Payment Solutions

U.S. Bank National Association ND

Payment Services

October 15, 2007

The Honorable Carl Levin
United States Senate
Washington, D.C. 20510-2202

Dear Senator Levin:

You have asked U.S. Bank National Association ND ("U.S. Bank") to comment concerning a letter you received from Barbara J. Teberg of Great Falls, Montana, detailing a variety of problems Ms. Teberg experienced in 2006 when making payments to her credit card account. U.S. Bank appreciates, and thanks the Subcommittee for, the opportunity to comment regarding Ms. Teberg's letter.

Because Ms. Teberg's letter is critical of a number of issues surrounding her frustrating experiences, including handling by and fees charged by entities unrelated to U.S. Bank, it is appropriate to state at the outset the intended scope of this response. Specifically, Ms. Teberg's letter details her dealings with her local post office regarding suspected mail delays and its sale of priority mail services to her, the subsequent loss of one of her priority mail packages by the U.S. Postal Service, and the charges imposed by her own depository bank for the resulting stop payment order. It would not be appropriate for U.S. Bank to speculate on or comment about those complaints, and we will not undertake to do so here.

As it directly relates to U.S. Bank, Ms. Teberg's letter describes her suspicion that three of her credit card payments during her more than 20 year relationship with the Bank may have been posted as late as a result of either intentional mishandling by U.S. Bank in order to generate fees or a purposeful scheme to get her to close her account, rather than from an actual delay in the receipt of those payments (*i.e.*, "I believe that [the bank] was trying to force me out or at least make some money from me by holding my check for a few days to get the finance charges and late fees."). We understand from discussions with the Subcommittee's staff that this is the issue on which the Subcommittee seeks U.S. Bank's response.

U.S. Bank did not improperly delay posting Ms. Teberg's payments in order to persuade her to close her account, to generate fees, or for any other reason. Consistent with U.S. Bank's disclosures to its cardholders, credit card payments mailed to U.S. Bank at the address provided on the cardholder's credit card statement are posted effective the date that they are received or, if a payment is received after the 1 p.m. Central cut-off time, it is posted effective the following business day. U.S. Bank cannot and does not delay posting timely credit card payments in order to generate late charges or to force customer business away. Any unexpected delay between the mailing of a payment and its posting could result from the time it took the payment to travel from Montana to our St. Louis processing facility or from some actual difficulty in the payment's posting.

U.S. Bank does not keep a record of the postmarks on payments received, so we cannot confirm the mailing dates in Ms. Teberg's letter. However, according to Ms. Teberg's description, the payment she made in February 2006 was posted within only four business days of her mailing it. While our records indicate that she did not include her payment coupon with her check (which does require additional research by Bank personnel to ensure that the proper account is credited), there do not appear to be any facts in our records or in Ms. Teberg's letter to support a conclusion that this payment should have been posted any earlier.

Ms. Teberg's August 2006 payment also arrived without her payment coupon, again requiring her payment to be pulled from the regular process in order to direct the payment to the proper account. U.S. Bank does encourage its customers to include their payment coupons with their payments in order to expedite processing, but our records do not include any indication that this particular payment was unduly delayed in posting once received.

It should be acknowledged that Ms. Teberg's letter does not rule out that the delay she encountered with her payments in May and August of 2006 resulted from some other more reasonable cause, such as a mail delay, rather than from a scheme on U.S. Bank's part. According to Ms. Teberg's letter, she too suspected that the delay was caused by the mail and complained to the post office that these two payments had taken 12 to 16 days to travel from Montana to St. Louis, Missouri. Her complaint was apparently met with a suggestion that she pay for faster delivery rather than by any assurance that a delivery could not have taken that long.

In Ms. Teberg's words, prior to these late payments, there was "no problem" with her credit card account for more than 25 years. U.S. Bank agrees with that assessment. We considered Ms. Teberg to have been a good and valued customer, and we would have liked to have kept her business. It is clear that she experienced a problem with her credit card payments, but the actual cause of that problem remains unclear in the absence of more facts. Our customer service records do not indicate any contact from Ms. Teberg describing the circumstances detailed in her recent letter to you. We regret that Ms. Teberg feels that she was mistreated in her relationship with us, and we would have appreciated the opportunity to assist in rectifying the situation. Regardless of the cause, we would be pleased to work cooperatively with any cardholder experiencing such an unusual problem.

Thank you again for allowing U.S. Bank the opportunity to comment.

Respectfully submitted,

Patrick Coll

Patrick J. Coll
Executive Vice President

ıt By: [redacted] [redacted] Apr-4-07 10:56AM; Page 1/2

[redacted] = Redacted by the Permanent Subcommittee on Investigations

Copy to Senator Carl Levin
[redacted]

Robert F. Begani
[redacted]
St. Charles, Illinois 60174
[redacted]

FAX MEMO

April 3, 2007
Total of 2 pages

Kelly Hannick
Customer Service Supervisor
Chase Bank Card Services
Fax 888-643-9628
United Mileage Plus Chase Mastercard account # [redacted]
Personal account name R F Begani- card holder for over 10 years

Upon review of our billing statement ending 3/19/07, my manager noticed a finance charge of $83.12. While trying to find the reason for this charge she noticed that the payment due from last month was $2299.87 and the payment submitted was $2266.87 – a $33.00 entry mistake - as we always pay the total amount due.

She called the customer service line to complain about the finance charge of $83.12 for a balance due of $33.00. She explained that she understood that there was a short payment, but the finance charge should be adjusted to reflect the short amount. She was told that there was nothing to be done, the finance charge calculation was explained and then told that problems like this would be avoided if we allowed the Credit Card Company to automatically deduct the amount due from our bank account. At that point my manager asked to be transferred to a supervisor. The Supervisor would not adjust the finance charge and reiterated the same thing as the customer service rep. There was nothing that my manager could say that would make any difference.

When I was informed of this situation, I immediately called the customer service number and told the same thing. I expressed my outrage on the excessive finance charges and commented that I wanted to lodge a formal complaint. I would think that Chase would like to keep a long standing customer happy.

I am sending a copy of this complaint to Senator Carl Levin as this is the type of excessive fees that are under scrutiny by Senator Levin's hearings on credit card practices.

Permanent Subcommittee on Investigations
EXHIBIT #13i.

04/04/2007 11:34AM

Sent By: [redacted] [redacted] Apr-4-07 10:56AM; Page 2/2

[redacted] = Redacted by the Permanent Subcommittee on Investigations

By copy of this letter I am keeping Carter Franke, chief marketing office of Chase Bank, aware of Chase's policies regarding excessive fees to long time customers. I am copying him at [redacted]

Looking forward to your comments,

Sincerely yours,

R. F. Begani

Copy to Senator Carl Levin
[redacted]

04/04/2007 11:34AM

CHASE

Response from Chase Card Services

Robert Begani –

Response: When a customer pays less than the full balance on an account, finance charges are calculated based on the average daily balance for the billing period. This method is similar if not identical to the calculation used by most financial institutions to calculate the interest on an outstanding loan. This process would have assessed interest on the loan for the time it was outstanding, and finance charges would have stopped accruing on any payment made as of the date that payment was received and credited to the account.

Mar. 19. 2007 2:02PM No. 1214 P. 1

▬ = Redacted by the Permanent Subcommittee on Investigations

March 19, 2007 [redacted]

Senator Carl Levin
US Senate
267 Russell Office Building
Washington, DC 20510-2202
[redacted]

ENTERED MAR 2 8 2007

and

Gerald R. Ford Federal Building
110 Michigan, N.W.
Suite 720
Grand Rapids, MI 49503-2313
[redacted]

RE: Unfair Credit Card Practices – Sears Credit Cards

Dear Mr. Levin:

I read with interest your article of March 16, 2007, "Unfair Credit Card Practices Pile Debt on American Families". I thought you would find my current situation especially abusive on the part of the Sears Credit Card company.

The attached is a copy of my most recent statement. You will note that the previous balance of $4003.30 was paid on 2/21/07 in the amount of $4,004.00. Then you will notice the "Finance Charges" of $75.51 with a "new" account balance of $74.81, after they deducted the .70 cent credit balance on the card after paying it off. Prior to paying the $4,004.00, I paid an additional $4,000.00 (the total to be paid was a little over $8,000.00).

I contacted this company in December, 2006 and January, 2007 expressing the difficulties my husband and I had been experiencing and asked if they would consider dropping the interest rate, the late fees, the over-limits fees (which resulted only from additional late fees added on, not due to my spending), or a combination of any of the 3. They simply would do nothing and their representative told me "they don't do anything to erase any of the debt unless someone is dying".

I withdrew money from an IRA account, which resulted in penalties in filing my tax returns, in order to pay this account off with all of their fees included. Then, to add insult to injury, they charge me an additional $75+ using their rationale that I had an "average daily balance" prior to payoff, calculating this ADB using a percentage rate of 32.24%. This percentage on an account that had a "0" balance and had just been paid off.

Permanent Subcommittee on Investigations
EXHIBIT #13j.

03/19/2007 2:09PM

[redacted] = Redacted by the Permanent Subcommittee on Investigations

I consider this to be an extremely abusive credit practice, with an extortion tactic added in. These companies use these types of tactics knowing that the customer will pay the erroneous fees or face a negative report to the credit bureaus, and additional late and over-limit fees if they refuse to pay, thus increasing the debt of the borrower once again.

The federal and state governments need to regulate these credit card companies and the amount of interest and late fees they are able to charge at present. At 32.24%, this is simply "loan sharking".

I appreciate the efforts of you and your office thus far on getting legislation drafted and submitted for passing in the Michigan legislature.

Sincerely,

Carmen Flickinger

Carmen Flickinger
[redacted]
Fruitport, MI [redacted]

Attachment

Sent via fax to both offices

cc: Sears Credit Cards
Michigan Attorney General

Jane C. Sherburne
General Counsel
Global Consumer Group

Citigroup Inc.
399 Park Avenue
New York, NY 10022

Tel 212 793 4942
Tel 212 793 0258

citi

November 2, 2007

Honorable Carl Levin, Chairman
Permanent Subcommittee on Investigations
Committee on Governmental Affairs
United States Senate
SR-193 Russell Senate Office Building
Washington, D.C. 20510-6262

Dear Mr. Chairman:

You have brought to our attention a letter you received from one of your constituents regarding finance charges on her Sears credit card. You have also provided the consent you received from this customer in which she agrees to let the Subcommittee use the correspondence she sent you in connection with your investigation but without personal identifying information. Accordingly, we provide the following background.

This customer had an unpaid balance that exceeded $8,000. She paid approximately half of that balance in January 2007, leaving an unpaid balance of $4,003.30. Because she had not paid her account in full, she did not have the benefit of an interest free grace period and interest accrued on her $4003.03 unpaid loan balance.

The customer made a payment of $4,004 on 2/21/07, which did not capture the $74.81 in interest that had accrued by that time. She was billed for this interest on her statement dated 2/28/07.

As a business practice, we encourage our cardmembers who are confronting serious financial difficulty to contact us so we can help develop arrangements that make their debt burden more manageable. Although we do not know the details of the exchange between the customer and our representative, we regret if we fell short of our expected practice in this instance.

Sincerely yours,

Jane Sherburne

▬ = Redacted by the Permanent Subcommittee on Investigations

March 12, 2007

ENTERED MAR 2 8 2007

TO: Mr. Bruce L. Hammonds
Chief Executive Officer of America Card Services
Bank of America
100 North Tryon Street
Bank of America Corporate Center, 23rd Floor
Charlotte, North Carolina 28255

CC: The Honorable Carl Levin
United States Senate
269 Russell Senate Office Building
Washington, D.C. 20510-2202

CC: Office of Attorney General
Consumer Protection Division
PO Box 30213
Lansing, Michigan 48909

JOAN MOON
[redacted]
WASHINGTON MI
[redacted]

Mr. Hammonds:

We would like to report to your attention the following accounts of questionable and dishonest practices committed by Bank of America.

These offenses occurred to my mother, Joan Moon. I, Cindy Moon, write this message on her behalf as English is her second language and have been involved to assist her.

Detailed below is the history of events that occurred after my mother transferred a credit balance to Bank of America accepting a promotional offer of 0.00% APR until January 2008. Soon after opening the account, the offer was revoked and fees and finance charges were initiated due to a late payment, a result of her **never receiving a statement requesting payment**. Subsequently, our attempts to payoff and close the account were met with inconsistent information, dishonest representation and unprofessional representatives:

Permanent Subcommittee on Investigations
EXHIBIT #13k.

November 2006

My mother transferred a credit balance of $14,420 to Bank of America with 0.00% APR until January 2008. A document describing the offer is enclosed as *Document A.*

November 2006

My mother received her first billing statement (enclosed as *Document B*). It shows initiation of the account but no record of an actual balance.

January 12, 2007 (Friday)

My mother received her second billing statement (enclosed as *Document C*). It now shows the initial transferred balance of $14,420, but it also includes a "Purchases and Adjustments" Fee of $39.00 and a "Periodic Rate Finance Charge" of $178.08. My mother immediately called customer service and questioned these fees and charges. The representative, named Adriana was rude and coercive. She told my mother that the offer was revoked and the adjustment fee was to cover that conversion of account type and it was her fault because she was late in payment. My mother contested since she never received a statement for December therefore she did not know how much was owed and by when. Considering the holidays and the amount of bills that arrive by mail throughout the month, she did not knowingly withhold payment, she truly was not aware that payment was due. My mother tried to point to her well standing credit history and asked for the offer to be reinitiated believing it was not her mistake, however Adriana warned that the account would be reported to a collection agency if she did not comply. My mother not knowing that this was illegally coercive, felt denied any other option then to pay. She decided to terminate the account and asked for my assistance to communicate.

From this point on, I was the party involved in the following exchanges, my mother being present.

January 15, 2007 (Monday)

We sent a letter (enclosed as *Document D*) to Bank of America explaining the dissatisfied and questionable service we received from their company and therefore our intentions to close the account. A check equaling the new balance total of $14,637.08 was included.

January 25, 2007 (Thursday)

We received a letter (enclosed as *Document E*) stating that we had not made a payment and to do so. Immediately we called customer service and the representative provided her name, Kathy. I explained that we sent a check for the full amount provided on the statement as well as the letter of intent to close the account and had proof that her company received those items via registered mail. She confirmed that the check was received and it was accredited to the account. I made her aware of the entire situation, that we were very intent on terminating any further business on this account. I asked for confirmation that the account was closed and that absolutely no further amount was owed. She said, *"yes"*.

February 13, 2007 (Tuesday)

We received a billing statement (enclosed as *Document F*) with a new finance charge of $84.86. Immediately we called customer service and the representative provided his name, Ramy. We expressed our confusion since we were promised that we had paid fully what was owed and that the account was closed. He explained that these finance charges accumulated before the account was closed. We explained the full situation and of our frustration with being misinformed. He stated that since the account was closed he could not fully negate these charges however he stated that the *"best I can do"* is take 50% off the finance charges. I let him know that although I appreciated his attempts to cooperate, these was after we were met with very little cooperation from his company in previous encounters and have already suffered consequences we felt were unfair. He then upped his offer to deduct 65% off the finance charges and take our name and number to pass along to his manager who would call us either that afternoon or the next day. He repeatedly stated this as his ultimate offer, so we felt no other option than to accept. He mentioned a late fee that would be removed and that we should expect a new statement reflecting this 65% deduction. We never received a call from anyone from Bank of America, but we took it in good faith that we should expect a new billing statement with the deduction applied, then we would pay the new amount and be done with it.

Also, on this day, we filed a complaint with the Federal Trade Commission (Reference Number 10011395).

March 9, 2007 (Friday)

We received a billing statement (enclosed as *Document G*). The 65% deduction in finance charges was not applied as promised and additionally we were charged a late fee of $15. Immediately we called customer service and spoke with Barbara McNeish and explained the situation in its entirety. She informed us that Ramy no longer worked at their company (at this point she had provided his full name of Abolfazi Ramt Nafar) and that his notes from the February 13th call did not contain any mention of a 65% deduction. She offered no other options than to remove the late fee of $15 but that we were to pay the full amount of finance charges. To end this fiasco, we requested to pay right away over the phone. She informed us of a $15 charge to pay over the phone however she offered to waive that fee. Therefore, we paid a total of $86.00 over the phone. Also, we were promised that to date, no reports to damage our credit were made.

Considering the dishonesty we've encountered with your representatives, we cannot help but feel victims of poor business practices demonstrated by your company; that an offer was made then a loophole was used to negate it; that by making the consumer contractually responsible for the knowledge of due dates and amounts allows the manipulation of good faith. We have paid a total of $303.08 to your company for nothing but dishonesty and poor service.

Furthermore, Mr. Hammonds, you recently were called before a Senate panel to explain your business practices towards consumers who are left with excessive charges because of lack of information and/or misinformation. Therefore, we find it prudent to report our personal experience with such unfair practices to our Senator Carl Levin as well as the Michigan State Attorney General's Office.

We do hope that ours is an anomalous situation, however, if this in fact a willful practice on the part of Bank of America with past or potential victims, we hope that this provides further information for any investigation into the matter.

Joan Moon

Joan Moon

Cindy Moon

Bank of America

Bank Of America
Federal Government Relations

October 16, 2007

The Honorable Carl Levin
Chairman

The Honorable Norm Coleman
Ranking Member

Senate Permanent Subcommittee on Investigations
199 Senate Russell Building
Washington, DC 20510

Dear Chairman Levin and Senator Coleman:

This letter is in response to the concerns your committee has brought to our attention regarding our customer, Ms. Joan Moon.

As the committee is aware, we previously corresponded with Ms Moon, apologizing for any confusion about her account and refunding the finance charges we waived in response to her concerns. In essence, Ms Moon had a promotional rate of 0% but that was lost because of a missed payment on her $14,000 balance. As the agreement with the card holder reflected, the contract rate was then applied to her account beginning with the next billing cycle. As a result and since she had a substantial cash advance, that cash advance accrued finance charges between the statement date and when payment was actually received. These finance charges posted on the next bill. While Ms Moon advised us that she had never received the statement in question, we were unable to verify non-delivery, noting that she had received all of her other statements. Nonetheless, we waived all the fees that were owed and provided Ms Moon with a refund. The details are as follows.

Our records indicate that the account was opened by Ms. Joan Moon on October 25, 2006 with a promotional introductory APR of 0%. Ms. Moon completed an ACH/Direct Deposit transaction totaling $14,000 which posted to the credit card account on November 2, 2006. The next monthly billing statement for that period closed on December 1, 2006, and a bill was mailed to Ms. Moon's home address in Washington, MI. No payment was received by the due date and the statement was not returned as undeliverable.

The following monthly billing statement (January 2007) closed on January 2, 2007. That statement reflected the $14,000 balance plus a Late Payment Fee and Finance Charges since the 0% promotional rate was lost due to non-payment of the December 2006 monthly billing statement. The credit card agreement specified that a late payment would result in loss of the 0% rate. Ms. Moon contacted us by phone on January 12, 2007. Notes of the conversation show that the customer was advised of the past due status of the account, which resulted in the loss of the promotional rate. The notes from the call do not reflect the customer advising us that she had not received a statement; if she had so advised us, our practice would be to reflect such a claim in the notes.

Tel: 202.351.0112 · Fax: 202.785.1426

Bank of America, DC9-920-07-01
1909 K Street, NW, 7th Floor, Suite 710, Washington, DC 20006

If a customer has not received a statement, that customer may assert a billing error by writing to the bank at the address set out on each billing statement. As we state on our billing error notice, the customer may call us, but that does not constitute a formal notice of a billing error

In general, if a customer does not file a billing error notice but calls us to assert that he or she did not receive a statement, we will confirm that accuracy of the billing information that we have on file, look to see if the statement was returned as undeliverable, and determine whether the customer received prior or subsequent statements. Generally speaking, if the billing address is error-free, the statement was not returned as undelivered, and the customer received other statements, then it is most likely that the statement in fact was delivered. Our process of making sure every statement is mailed is very rigorous as is the process for following up on statements that are returned to us by the Post Office.

A payment of $14,637.08 was received on January 18, 2007, which paid the New Balance Total listed on the January 2007 monthly billing statement in full. Correspondence was received from Ms. Moon requesting that we close the account, and the account was closed on January 25, 2007. However, finance charges continued to accrue on the account between the statement date and the date the payment was received. As a result, when the February 2007 monthly billing statement closed on February 1, 2007, finance charges were assessed on the account totaling $84.86. Ms. Moon contacted us on February 13, 2007, and spoke with the associate named in the complaint, but unfortunately, our records do not show any comments on the account or the nature of the call.

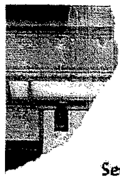
The March 2007 monthly billing statement closed on March 1, 2007. No payment was received for the February 2007 monthly billing statement, and a Late Payment Fee of $15.00 was assessed. Ms. Moon contacted us again on March 9, 2007. The associate that spoke with the customer documented the customer's claim that she had not received the December 2006 monthly billing statement. At that time, a payoff figure was provided, the Late Payment Fee and a portion of the Finance Charges were waived and the customer made a payment for the remaining balance.

Ms Moon then corresponded with us and her letter was immediately referred for special handling by our Executive Relations division. Since the customer was mailed statements and no statements were returned, and the balance was paid in full and the account closed in good faith, the decision was made to waive the remaining finance charges assessed on the account, and a Credit Balance Refund check was sent to Ms. Moon for $85.04. The refund was requested on March 29, 2007. Since we were unable to reach the customer by telephone, a letter was sent on March 29, 2007, apologizing for the service received and advising of our decision to waive the Finance Charges and send the Credit Balance Refund check.

Thank you for your time and consideration of this matter. If you have any questions or concerns, please do not hesitate to contact us.

Sincerely,

John Collingwood
Senior Vice President



WASH LETTER

Senator Carl Levin
Washington, DC

Dear Mr. Levin:

I applaud you on your hearings concerning credit card companies and their policys.

I would like to tell you of an incident which affected me about a year ago.

I received one of these flyers from a credit card company (Advanta) saying I could borrow a large amount of money at a zero or low interest rate--it was an option on my part, which one I chose. A low interest rate for the duration of the loan or zero interest for a specified amount of time. I choose the zero interest.

I had an outstanding balcnce at that time (from earlier charges in the month). When I received my statement and after talking with representatives of that company, I discovered that any payment I make would not apply to the previous charges until after I had paid in full the lower interest loan off. Therefore, I could not direct the company to apply my payments to the higher interest portion of my debt. They would only apply to the lower interest amount and I would continue to pay a high interest on over two thousand dollars--locking me into doing that. And that was because of everything happening in the same billing cycle--I was told. I was also told that I had been advised of this in paperwork I had received from the company when I first took out my card years earlier (in the fine print). They sent me a copy of that years old paperwork.

I also learned later that if I use the card after getting the zero interest loan, I would also pay the higher interest (previous) rate and again, no payment I make would apply to that higher interest rate until the zero interest amount was paid in full.

It is so wierd, when you buy a home or car you must sign a ton of paperwork and be advised of so many things but regulations do not even scratch the surface when you get a loan from a credit card company.

ANYTHING AFFECTING A LOAN WHEREBY DESCRIBED ABOVE, SHOULD HAVE TO BE

Permanent Subcommittee on Investigations
EXHIBIT #131.

WASH LETTER

ACKNOWLEDGED IN ADVANCE BY SIGNATURE AND THAT IS THE ONLY THING THAT SHOULD BE ALLOWED ON THAT FORM---NOTHING ELSE SO AS TO DISTRACT YOU FROM THE ACTUAL PURPOSE OF THE LETTER YOU MUST SIGN. EVERY-THING CONCERNING A PREVIOUS BALANCE OR CARD USAGE AFTERWARDS AND THE INTEREST INVOLVED SHOULD ALSO BE ON THE FORM LETTER. FULL DISCLOSURE SHOULD HAVE TO BE MADE.

It is about time the consumer in this country is treated fairly.

Thank You,

Jack Ware

cc: File

SHOULD BE POINTED OUT IN THIS LETTER.

[redacted] = Redacted by the Permanent Subcommittee on Investigations

April 4, 2007

[redacted]
Springboro, Ohio [redacted]

The Honorable Senator Carl Levin
269 Russell Office Building
US Senate
Washington, DC 20510-2202

Dear Sir:

I applaud your willingness to take on the credit card industry. While I have never had any problem with my own credit cards, I have recently dealt with a situation that can only be described as a son's worst nightmare involving credit card debt. My mother was the victim of a murder/suicide brought about by tremendous credit card debt.

My mother, Geri Chapman, had been married to Jim Chapman for over 28-years. My father died of heart problems seven years prior to her marriage to Jim. The marriage was one of love and respect. Neither my sister, my brother, nor I had ever heard them argue or fight. Approximately four years ago, Jim was between jobs when he was diagnosed with lymphoma cancer. Because he was between jobs, he had no health insurance. During the subsequent radiation treatments, Jim became very lackluster and lethargic. My mother, at the age of 74, became the bread winner for the family as an independent interior designer.

Unbeknownst to us, they apparently started using credit cards to pay for daily activities. I can only assume that they thought it was a temporary solution. As you are aware from the testimony you have already heard, this quickly turned into an unrelenting nightmare. Over-limit and late payment fees were being charged at the rate of $78 per month. Interest rates shot up to 36%! In a short period of time, the debt mounted to over $70,000! Monthly payments on four credit cards of basic interest and fees were over $2,000 a month, none of which was reducing principal at any significant amount.

Apparently the debt became too great. On or about March 16 (the exact date cannot be determined), Jim decided to not only take his life but that of my mother. He shot my mother twice in the head and then he shot himself once. The police report indicates that our mother was caught off guard and that she was not a willing participant in this act. We have been left to deal with the tragedy.

To add insult to injury, we just received the credit card statement that lists the purchase of the gun used to kill our mother. Can you imagine the emotional issue with which we are now dealing? **Not only has our mother been murdered but we now have to pay from the estate for the purchase of the gun!!! And at a rate of 32% interest!!!** (Although currently there is every indication the estate will be insolvent)

I know there is little or no help that you can give us. However, I would be more than willing to testify about what we are experiencing. This is a tragedy that could have been avoided. Thank you for your time and consideration. Should you wish to contact me, you can do so at: [redacted]).

Sincerely,

Jack Poore, Ed.D.

04/04/2007 11:22AM

Permanent Subcommittee on Investigations
EXHIBIT #13m.

Jane C. Sherburne
General Counsel
Global Consumer Group

Citigroup Inc.
399 Park Avenue
New York, NY 10022

Tel 212 793 4942
Fax 212 793 0258

citi

October 19, 2007

Honorable Carl Levin, Chairman
Permanent Subcommittee on Investigations
Committee on Governmental Affairs
United States Senate
SR-193 Russell Senate Office Building
Washington, D.C. 20510-6262

Dear Senator Levin:

You have brought to our attention the circumstances surrounding the credit card debt accumulated by Mr. Jack Poore's mother and stepfather, at least a portion of which was in a joint Citi account, after his stepfather was diagnosed with terminal cancer and before their tragic deaths.

Given the personal tragedy described by Mr. Poore, we have determined not to pursue this debt against the estate. We have informed Mr. Poore that the debt has been forgiven and we have written it off.

We note that from looking at account statements from December 2003 until March 2007 the account was not in default at any time during that period and the balance never exceeded its $25,000 credit limit. Payments were made on the account regularly each month, and there were no late fees, OCL fees or default interest rates applied to the account. All late fees and OCL fees occurred after the death of the cardholders, but before we were aware of that fact. When we were notified of their death in May, no further late charges were imposed.

Citi Cards encourages cardmembers who confront life events that dramatically alter their financial circumstances to contact us so we can help develop arrangements that make their debt burden more manageable.

Sincerely yours,

Jane Sherburne