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Committee on Homeland Security and Governmental Affairs

Carl Levin, Chairman
Norm Coleman, Ranking Minority Member

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Opening Statement of Senator Carl Levin
U.S. Senate Permanent Subcommittee on Investigations Hearing on
Credit Card Practices: Fees, Interest, and Grace Periods
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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%, 30%, 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% 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%, 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 – hold on – 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%. 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% doubled, from 5% to 11% of all accounts. The number of accounts subject to the three highest interest rates also doubled, going from 29% to 57%. That means, in 2005, 57% of the accounts at the six largest credit card issuers had interest rates from 15% to more than 30%.

Credit card issuers like to point out that they often offer new customers very low introductory interest rates, such as 0 or 1%. 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% 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.

# # #

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

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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**	

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