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.