OPENING STATEMENT OF
SENATOR CARL LEVIN (D-MICH), CHAIRMAN
U.S. SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
CREDIT CARD PRACTICES: UNFAIR INTEREST RATE INCREASES

December 4, 2007

This hearing is the second in a series of Subcommittee hearings examining unfair credit card practices. Today's focus is on credit card issuers who hike the interest rates of cardholders who play by the rules – meaning those folks who pay on time, pay at least the minimum amount due, and wake up one day to find their interest rate has gone through the roof – again, not because they paid late or exceeded the credit limit, but because their credit card issuer decided they should be "repriced." To add insult to injury, credit card issuers apply those higher rates retroactively to consumers' existing credit card debts, which were incurred when lower interest rates were in effect.

Let me give you a few examples taken from the Subcommittee investigation into the interest rate practices at the five major credit card issuers who handle 80% of U.S. credit cards. These examples are also summarized in a set of eight case histories in Exhibit 1, that is a part of the hearing record.

Janet Hard of Freeland, Michigan is a registered nurse, married with two children, whose husband is a steamfitter. She has had a Discover credit card for years. In 2006, out of the blue, Discover increased the interest rate on her card from 18% to 24%.

Discover took that action, because Ms. Hard's FICO score had dropped. FICO scores, developed by the Fair Issac Company, are numbers between 300 and 850 that are generated by a complex mathematical model designed to predict the likelihood that a person will default on their credit obligations within the next 90 days. FICO scores are compiled by credit bureaus who supply them upon request to credit card issuers seeking the scores of their cardholders. Discover's policy is to put more weight on a computer-generated FICO score than on the fact that, for years, Ms. Hard had always paid her Discover bills on time, never exceeded her credit limit, and always paid at least the minimum amount due.

After increasing her rate, Discover even applied the higher interest rate to her existing credit card debt, which in my book fits the definition of a retroactive rate increase. The 24% rate boosted her finance charges and the minimum payment she was required to make each month. It took Ms. Hard some months to realize that, despite making larger payments, her debt was hardly decreasing. When she saw her interest rate had been hiked to 24% and complained, Discover lowered it to 21%, still above where she started.

The higher interest rates have made it more difficult for Ms. Hard to pay off her debt. Under her old rate of 18%, when she made a $200 payment, about $148 went to pay for the finance charges and $52 went to pay down her debt. With the 24% interest rate, out of that same

$200 payment, about $176 went to finance charges and only about $24 – less than half the amount previously – went to pay down the principal debt.

This chart, Exhibit 2(a) shows the result. Over the last twelve months, Ms. Hard has kept her credit card purchases to less than $100 and has made steady monthly payments of $200 to reduce her debt. At the end of a year, her payments totaled $2,400, but due to those high interest rates of 21 to 24%, almost all of her money went to pay for finance charges. In fact, out of her $2,400, about $1,900 went to finance charges and she was able to pay down her principal debt by only about $350.

Millard Glasshof of Milwaukee, Wisconsin, is a senior citizen living on a fixed income. For years he faithfully made a $119 monthly payment to Chase to pay off a credit card debt that is now about $4,800. In December 2006, a year ago, out of the blue, Chase decided to hike his interest rate, from 15% where it had been for years, to 17% and then in February to 27%.

Why? Chase had decided to conduct an automated review of all its closed credit card accounts where balances were being paid off. Because that automated review found that Mr. Glasshof's FICO credit score had dropped, it hiked his rate. Think about that. His account was closed. He made no new purchases. All he did for years was send in his payments like clockwork. But his interest rate was automatically hiked from 15 to 27%. Not only that, to rub salt in the wound, the new 27% rate was applied retroactively to his existing credit card debt, and his finance charges skyrocketed.

Under the 27% interest rate, out of his $119 monthly payments to Chase, about $114 went to pay for finance charges and only $5 a month went to pay down his principal debt. And even those $5 reductions were wiped out by sky-high fees. For example, Mr. Glasshof was often charged a $39 per month over-the-limit fee, until at our last hearing in March Chase ended its policy of charging repeated over-the-limit fees for going over the credit limit once. In addition, in August 2007, Mr. Glasshof got a confusing letter from Chase indicating that his minimum payment would change. He called Chase, was advised he could pay $111 instead of his usual $119, paid it, and got hit with a $39 fee for not paying enough.

The end result, as shown in this chart, Exhibit 2(b), was that, over the last twelve months, Mr. Glasshof made payments totaling about $1,300, but was charged about $1,100 in interest and $200 in fees, which meant that none of his $1,300 in payments reduced his debt at all.

Then there's Bonnie Rushing of Naples, Florida. She has two Bank of America cards, one of which is affiliated with the American Automobile Association ("AAA"). For years, she paid both credit card bills on time. For years, both cards carried an interest rate of about 8%. But in April 2007, out of the blue, Bank of America increased the interest rate on her AAA card – not by a handful of points but by tripling it from 8% to 23%. Bank of America tripled the rate, because Ms. Rushing's FICO score had dropped, and the bank used that FICO score to raise her

rate, ignoring the fact that, for years, she had paid her credit card bills to Bank of America on time.

Ms. Rushing, by the way, like Ms. Hard and Mr. Glasshof, doesn't know why her FICO score dropped. She speculates that it may have been because, in January and March 2007, she opened Macy's and J.Jill credit cards to obtain discounts on purchases -- 15% off some cosmetics and 20% off some clothes. She didn't realize then that simply opening those accounts and receiving those cards could negatively impact her FICO score and hike her interest rate.

When Ms. Rushing first saw the higher rate on her April billing statement, she called Bank of America, explained she'd never received notice of a rate increase, and wanted to opt out by closing her account and paying off her debt at the old rate. Bank of America personnel responded that she had already missed the opt out deadline and pressed her to accept a higher interest rate. Ms. Rushing resisted. She closed her account. She wrote to the Florida Attorney General; she wrote to this Subcommittee; and she called AAA. Bank of America finally agreed to restore the 8% rate on her closed account, and refunded the $600 in extra finance charges it had collected in just two months.

Linda Fox of Circleville, Ohio is a working grandmother. She has had a Capital One credit card for more than ten years. In April 2007, out of the blue, Capital One increased her interest rate from 8% to 13%. Capital One raised her rate, not because her FICO score had dropped (Capital One doesn't use FICO scores to raise rates), but because Capital One had decided to pass on so-called additional borrowing costs to its cardholders. Capital One's automated system selected accounts whose interest rates had not been increased in three years and had what the system deemed a "below market" interest rate. Ms. Fox's account was one of many selected, and the higher rate was applied retroactively to her existing credit card debt. She tried without success to opt out and get her old rate back. Six months later, in November, after a Subcommittee inquiry, Capital One allowed Ms. Fox to close her account and pay off her debt at the old 8% rate.

We have additional case histories, but I'll stop with just one more. In 2007, Gayle Corbett of Seattle, Washington was hit with interest rates hikes on three separate credit cards in three separate months. Bank of America increased her rate from 15% to 24%; Citi more than doubled her rate from 11% to 23%; and Capital One hiked her rate from 15% to 19%. Bank of America and Citi acted because her FICO score had dropped, while Capital One had selected her account as part of its practice to unilaterally pass on borrowing costs to its cardholders. After many calls, Ms. Corbett was able to convince each of the companies to partially or fully retract its rate increase. As a result, the interest rates on her three cards have settled for the moment at 10%, 19%, and 15%. She told the Subcommittee that contesting these multiple increases, none of which were her fault and all of which threatened her ability to repay her debts, had left her exhausted and worried about what happens next.

These case histories cause me a lot of worry too. In the United States, December is a big shopping month. Stores, advertisers, and sometimes even the President, are urging shoppers to spend more. But if you shop with a credit card, as most Americans do, dangers lurk that few consumers realize could damage their financial future.

Suppose, for example, you spend up to – but not over – the credit limit on your credit card. Most Americans don't realize that if they get too close to their credit limit, their FICO score could drop and trigger an interest rate increase on their credit cards – even for credit cards that they've paid on time for years – even for closed cards whose debts they're paying off. And the same lower FICO score could trigger interest rate hikes on more than one credit card, increasing the debt on each one. At least 50% of U.S. credit cards carry debt from month to month, and the average American family today has five credit cards. Interest hikes on multiple cards at once could spell financial disaster for working families.

Among the issues the Subcommittee has been investigating are who determines an individual's FICO score, who decides when a lower FICO score will trigger a higher credit card interest rate, and who actually sets those higher interest rates. What we found is that most interest rate decisions are not made by individual employees, but by computer systems programmed to react to credit scores.

It works like this. Take a look at this chart, Exhibit 2(c). FICO scores are generated by three so-called credit bureaus, Equifax, Experian, and TransUnion. To produce the scores, each credit bureau collects credit data from a variety of sources, including payment data from companies administering mortgages, car loans, utility bills, and credit card accounts, and information taken from bankruptcy and tax proceedings, debt collectors, and others. This credit data is fed into the credit bureaus' computer systems on a continuous basis.

The credit bureau computers take in, store, and organize the information so that a "credit report"can be called up for any one of hundreds of millions of individuals. Each credit report identifies the individual by name and address; lists what types of credit that person has, including any mortgage, car loan, or credit card; and describes whether the person is current or behind on the payments. The report also indicates whether that person has been the subject of debt collection efforts or has declared bankruptcy.

In addition to compiling the credit reports, the credit bureaus apply a complex mathematical model, developed by Fair Issac Company, to analyze the data in each report in an attempt to predict how likely the person is to default on their credit obligations in the next 90 days. The model focuses primarily on such factors as the extent to which a person is past due in paying their bills, the level of debt incurred, and the extent to which the incurred debt is close to the person's credit limits. Recent debt collection actions and bankruptcies are considered key factors that predict a greater likelihood of default. After analyzing the data in each credit report, the model assigns each person a FICO score, that number between 300 and 850 that is supposed to predict the likelihood of a default in the next 90 days.

Fair Issac has designed the FICO scoring system so that the lower the number, the more likely the person is to default in the next 90 days. A person with a 720 FICO score, for example, is seen as having odds of roughly 1 in 22 that they will default in the next 90 days; a person with a 680 score has 1 in 9 odds of defaulting; and a person with a 620 score is seen as having roughly 1 in 4 odds of defaulting. So the lower the score, the greater likelihood a person will default.

Major credit card issuers typically check the FICO scores of each of their cardholders every 30-90 days. Since each issuer has millions of cardholders, millions of FICO scores are fed into the issuer's computer systems on an automated basis. If a cardholder's FICO score drops, the issuer's own automated, risk analysis system automatically flags the account for additional review. The issuer's system then uses the person's FICO score and actual payment history at the issuer to generate an internal credit score evaluating the cardholder's likelihood of defaulting in the near future. If that internal credit score falls within designated criteria – even if that cardholder has a perfect record of making on-time payments to the issuer – the credit card issuer's computers use other criteria to select a higher interest rate for that cardholder. The system then sends a notice to the cardholder that the increased rate will be applied by a specified date, unless the cardholder follows certain procedures to opt out of the increase by closing the account.

The automated process I've described, capable of making credit decisions on millions of accounts, has been in operation for years. Today, in most cases, no human being is involved at any point in deciding who will get an interest rate increase, selecting the interest rates to be imposed, and notifying the affected cardholders. While human beings do program the computers and sometimes are brought in to decide a small portion of individual cases, the vast majority of credit card interest rate increases today are being decided and imposed on an automated basis. And those automated rate increases can and do hike the interest rates of people with excellent histories of on-time payments.

To make interest rate decisions, the issuers' automated systems are driven by numbers, primarily FICO scores. What the Subcommittee has learned is that the mathematical models generating the FICO scores are so complex that even experts have trouble predicting what actions will increase or lower an individual's score. Take, for example, the situation where a person opens a new credit card account in order to obtain a discount on a purchase. Opening a new credit card could increase a person's FICO credit score if they have only a few credit cards and don't use up a lot of the available credit on the new card. But the same action could lower another person's score if they already have a handful of credit cards and buy a big ticket item that uses up or comes close to the credit limit on the new card. As the FICO experts explain, every factor depends upon every other factor to determine a person's score, so it is difficult to predict how specific actions affect an individual's FICO score.

The Subcommittee also learned that, although credit bureaus typically transmit not only a person's FICO score, but also the underlying credit report containing the information justifying

that score, credit card issuers typically do not review or keep that credit report. The credit bureau does not retain the credit report either, because its automated systems are continually updating all of its credit information with the latest data streaming in. That means, unless a cardholder requests a credit report soon after a FICO score is transmitted to an issuer, the specific information used to generate the specific score may be lost.

In most of the case histories we examined, when a credit card issuer was asked by the Subcommittee to explain why a particular cardholder's interest rate was increased, the issuer pointed to the person's lower FICO score. When we asked why the FICO score was lower, usually the only information the credit card issuer provided was a list of up to four "reason codes" supplied by the credit bureau at the time the lower score was transmitted. These reason codes provide generic statements on why a score is reduced, using such phrases as "balance grew too fast compared to credit limit" or "total available credit on bankcards is too low," without identifying the specific facts that support or explain these statements.

By law, credit card issuers who rely upon a credit score to increase an interest rate must inform the cardholder of the identity of the credit bureau who supplied the score, how to contact that bureau, and the cardholder's right to review their credit report and correct any wrong data. Issuers often include that information in the same notice that informs a cardholder of an upcoming interest rate increase. The Subcommittee's investigation has found, however, that few cardholders understand that their interest rate hike was caused by a lower credit score. And even for those who do make that connection, the investigation has found that it is difficult to look at the person's credit report and identify what factors caused their score to drop.

None of the cardholders contacted by the Subcommittee had known that their interest rates had been triggered by a lower FICO score. Janet Hard, for example, said she'd asked Discover why her interest rate had been increased but was never been informed that it was because her FICO score had dropped and so never requested or reviewed her credit report. In response to the Subcommittee's request, Discover provided the three reason codes transmitted by a credit bureau to explain Ms. Hard's lower score, which stated that the "proportion of balance to credit limit" was "too high" on her credit cards, she had too many "established accounts," and she had "accounts with delinquenc[ies]." But Discover didn't know what balances were "too high," how many accounts were too many, or what accounts had delinquencies. Ms. Hard felt the stated reasons were inaccurate, since she has always been careful to pay all her bills and is current on all of her accounts. When we examined Ms. Hard's credit report, we were also at a loss to explain these references, since her accounts are all paid up to date. We did notice that, just before her 2006 rate increase, the credit report showed she was 30 days late paying a J.C. Penny credit card bill, but it is unclear if that lowered her score. We had the same difficulty in the case of Bonnie Rushing; Bank of America was unable to confirm whether her credit score dropped because, in early 2007, she opened Macy's and J.Jill credit cards to obtain discounts on purchases. The bottom line is that the credit scoring process is at times akin to a black box; no one knows exactly how it works or what lowers a score, yet it has become the primary driver of interest rate increases for tens of millions of Americans.

To me, if a person meets their credit card obligations to a credit card issuer and pays their bills on time, it is simply unfair for that credit card issuer to raise their interest rates.

Equally offensive is the practice of credit card issuer's applying the higher interest rate, not just to future debt, but retroactively to a cardholder's existing debt. Take the case of Ms. Hard again, a woman who faithfully pays her bills on time. For the last year, she kept her purchases on her Discover card to less than $100 and paid $200 every month to reduce her debt. When Discover hiked her interest rate from 18% to 24%, it applied the higher rate to her existing debt. After she complained, Discover lowered her rate to 21%, but that was still above where she started. Over the past twelve months, she has paid Discover a total of $2,400 – more than a quarter of her $8,300 debt. But $1,900 of those dollars did not go to pay down her debt; they were eaten up by the sky-high interest rates. At the end of twelve months, despite paying $2,300, she reduced her debt by only $350. If that isn't unfair, I don't know what is.

One last point, which has to do with the appearance of arbitrary credit card interest rates. Credit card issuers have attempted to set up automated systems that assign interest rates using objective criteria based upon cardholders' credit risks, represented by their FICO scores. But look at the case histories we've investigated. Over the course of the last year, even though his credit circumstances didn't change, Mr. Glasshof's credit card with Chase was assigned interest rates of 15%, 19%, 27% and 6%. That 6% rate, by the way, came after the Subcommittee inquired about his account. Another case history, which we haven't mentioned so far, involves Marjorie Hancock of Massachusetts. She has four Bank of America cards, carries similar amounts of debt on each, and presumably presents each with the same credit risk. Yet all four cards have different interest rates, 8%, 14%, 19%, and 27%.

The bottom line for me is this: when a credit card issuer promises to provide a cardholder with a specific interest rate if they meet their credit card obligations, and the cardholder holds up their end of the bargain, the credit card issuer should have to do the same. That's why I've introduced legislation with Senator McCaskill and others, S. 1395, aimed at putting an end to these and other unfair credit card practices, and ensuring that cardholders who play by the rules are protected from unfair interest rate increases, including rate increases that are retroactively applied to existing credit card debt.

Senator Coleman, I would like to thank you and your staff for your ongoing participation in the Subcommittee's investigation into unfair credit card practices. That participation has greatly assisted in the Subcommittee's understanding of the industry practices being discussed today.

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Summary of Janet Hard Account

(November 2006 to October 2007)

Owed as of October 2006:	$8,330
Total interest charges:	$1,900
Total purchases:	$100
	$10,330
Total payments:	$2,400
Owed as of October 2007:	$7,980
Total reduction in debt after one year:	$350

Source: Discover credit card statements. Figures have been rounded.
Prepared by U.S. Senate Permanent Subcommittee on Investigations, December 2007

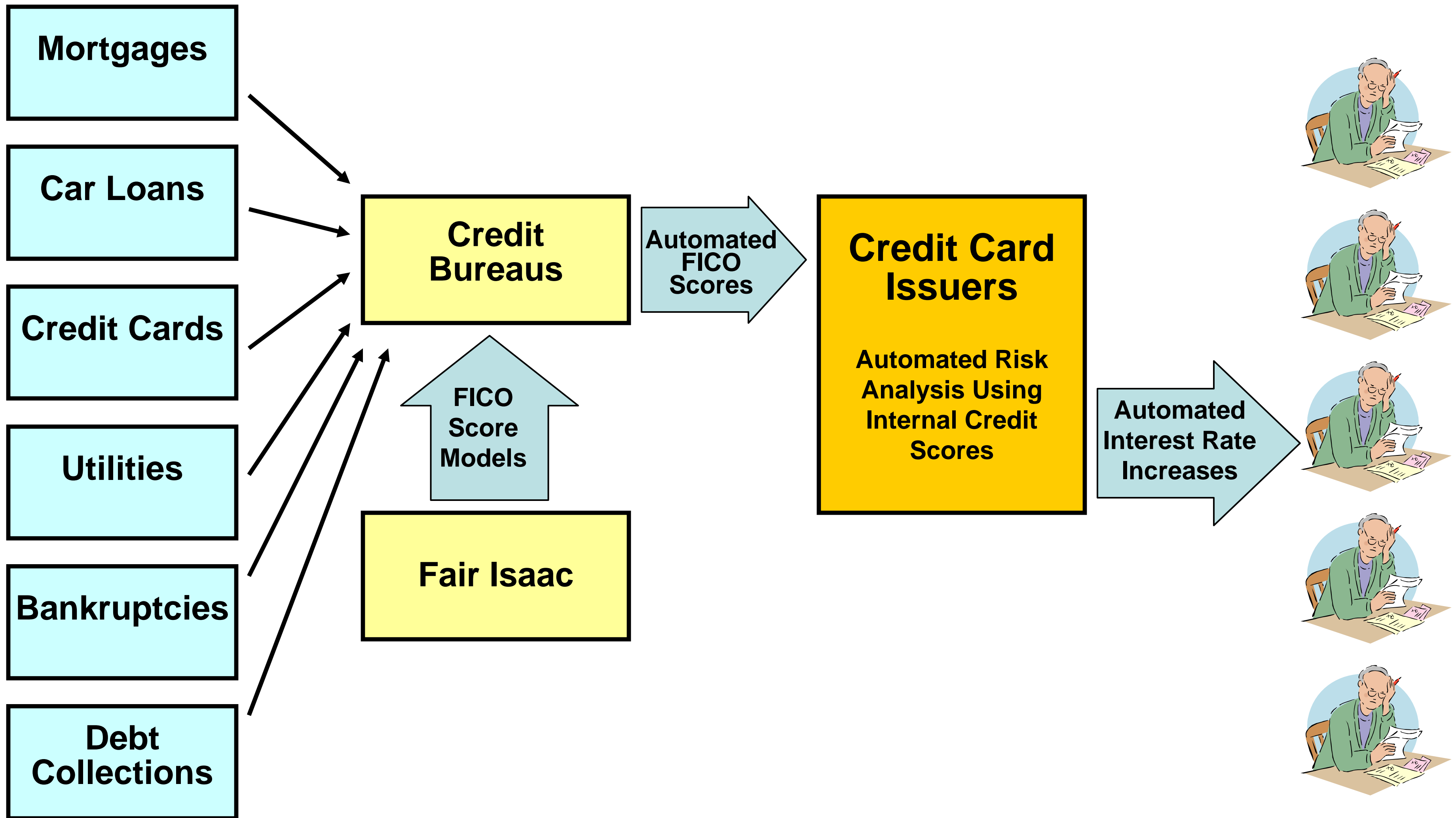
Summary of Millard Glasshof Account

(November 2006 to October 2007)

Owed as of October 2006:	$4,800
Total interest charges:	$1,100
Total fees:	$200
Total purchases:	$0
	$6,100
Total payments:	$1,300
Owed as of October 2007:	$4,800
Total reduction in debt after one year:	$0

Source: Chase credit card statements. Figures have been rounded.
Prepared by U.S. Senate Permanent Subcommittee on Investigations, December 2007

Automated Repricing of Credit Card Interest Rates



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