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before the

SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW
Judiciary Committee
U.S. House of Representatives

"Consumer Debt: Are Credit Cards Bankrupting Americans?"

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Chairman Cohen, Ranking Member Franks and Members of the Subcommittee, my name is Brett Weiss and I am a bankruptcy attorney in Greenbelt, Maryland. I appear before you today on behalf of the National Association of Consumer Bankruptcy Attorneys (NACBA).[1] I appreciate the opportunity to offer our comments on how it is that abusive and unfair credit card practices contribute to the growing number of personal bankruptcies in the United States. My testimony is based on over 25 years experience representing consumers in financial distress. It also is informed by the collective experiences of colleagues across the country who represent a broad range of families and households affected by current credit card practices.

INTRODUCTION

Credit cards have become a fixture of U.S. economic life. They provide a tremendous convenience for many consumers who increasingly use credit cards to pay for a range of products and services. For consumers who use a credit card simply for convenience and pay off the balance in full each month, the cards generally work well. The main problems occur when a consumer cannot pay off the full amount due, carries forward a balance, and gets caught in a downward spiral of exorbitant interest rates, fees and penalties, and other billing practices that simply wring more fees out of consumers, driving them further into debt.

There is a strong tendency to believe that individuals or families with credit card debt simply are living beyond their means, making purchases they cannot afford. While societal pressures to consume -- to acquire certain goods and to achieve a certain lifestyle -- have their place in a discussion of credit card debt, the experience of bankruptcy attorneys is that the vast majority of consumers use credit cards as a safety net, to make essential purchases that they are unable to pay in full on a cash basis. Living paycheck to paycheck, these consumers often lack savings to cover unexpected expenses. In a recent survey of indebted low- and middle-income households, seven out of 10 households of all ages reported using their credit cards in this way, relying on cards to pay for car repairs, basic living expenses, medical expenses or house repairs.[2]

It is my experience that few consumers borrow money on credit cards without intending to pay it back. The Federal Reserve Board acknowledges this in its report requested by Congress after enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) which concludes: "Very few households borrow money without intending to repay it; generally it is only after adverse events with serious financial implications that borrowers tend to miss payments and, eventually, seek bankruptcy protection." [3]

[1] The National Association of Consumer Bankruptcy Attorneys (http://www.nacba.org) is the only national organization dedicated to serving the needs of consumer bankruptcy attorneys and protecting the rights of consumer debtors in bankruptcy. Formed in 1992, NACBA now has more than 3,700 members located in all 50 states and Puerto Rico.

[2] Center for Responsible Lending and DEMOS, "The Plastic Safety Net: The Reality Behind Debt in America," (October 2005), available at http://www.responsiblelending.org/pdfs/DEMOS-101205.pdf.

[3] Board of Governors of the Federal Reserve System, "Report to the Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and Their Effects on Consumer Debt and Insolvency," June 2006, p. 16, accessed at http://www.federalreserve.gov/boarddocs/rptcongress/bankruptcy/bankruptcybill study200606.pdf.

These plans to repay, however, easily change, often due to unforeseen, adverse events such as an illness or job layoff. Other consumers fall into traps set by credit card companies and are not always aware or do not understand how it is that penalties, fees and escalating interest rates can quickly transform manageable debt into unaffordable debt.

CREDIT CARD PRACTICES TRAP CONSUMERS IN DEBT

Deregulation of the credit card marketplace, in which state laws limiting interest rates and fees were nullified by two Supreme Court decisions in 1978 and 1996,[4] has drastically changed the way issuers market and price credit cards to consumers of all ages. It is clear that in recent years credit card companies have become far more aggressive in their fees and interest rate practices. The result is that penalty interest rates, high and accumulating fees and interest on fees can push consumers over the financial edge. In fact, consumers in debt trouble sometimes owe as much or more in fees and penalty interest charges as in principal. For the growing numbers of consumers who are unable to make more than the required minimum monthly payments on their cards, industry practices often push them into unmanageable credit card debt.

It is the customer who sometimes misses a payment, or sends a payment late or simply pays the minimum due each month who generates the real profits for credit card companies. In 2005, interest and penalty fee revenues alone added up to a staggering $79 billion. By some estimates, nearly eight out of every 10 dollars of revenue for the credit card companies comes from customers who cannot pay off their bills in full every month.[5]

In a more rational market, lenders would limit their risk by restricting the credit available to consumers with riskier credit records or histories, rather than increasing the risk by imposing higher charges on consumers who may be in significant financial distress. But that is what credit card companies appear to be doing; consumers who get in trouble are allowed to continue borrowing, but at higher and higher interest rates and with more and more fees imposed on the account.

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[4] Credit card deregulation began in 1978, with the Supreme Court's decision in *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.* (Marquette Nat'l Bank of Minn. v. First of Omaha Serv. Corp., 439 U.S. 299, 99 S. Ct. 540, 58 L. Ed. 2d 534 1978). This case gave national banks the green light to take the most favored lender status from their home state across state lines, and preempt the law of the borrower's home state. As a result, national banks and other depositories established their headquarters in states that eliminated or raised their usury limits. In 1996, the U.S. Supreme Court paved the way for banks that issue credit cards to increase their income stream even more dramatically. In *Smiley v. Citibank (South Dakota), N.A.*, the court approved a definition of interest that included a number of credit card charges, such as late payment, over limit, cash advance, returned check, annual, and membership fees. As a result, national banks and other depositories can charge fees in any amount to their customers as long as their home state laws permit the fees.

[5] Elizabeth Warren, testimony before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, "Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry, and Their Impact on Consumers," January 25, 2007.

Specific Practices That Harm Consumers

Certainly, credit cards provide a great convenience for many consumers. The danger comes from the borrowing features of credit cards, the exorbitant costs of borrowing, and the downward spiral that hits consumers once they get into trouble. Specific practices that harm consumers include:

- Deceptive Marketing
- Aggressive Solicitation and Lack of Real Underwriting
- High Cost Credit
- Punitive Fees
- Penalty Rates and Universal Default
- Changes to Credit Limits
- Debt Collection Abuses
- Use of Mandatory Arbitration Clauses, and
- Change-in-Terms provisions.

Credit card companies push consumers into borrowing because they derive profits mainly from consumers that use their cards to borrow and not from convenience users who pay off their cards in full each month. As discussed above, income loss and increased expenses lead to shortfalls that many consumers attempt to make up by using credit cards. To make matters worse, credit card companies aggressively sell the borrowing features of the cards and push convenience users into borrowing. Companies do this by increasing credit limits, encouraging cash advances at high rates or to increase spending to get rewards and by sending blank checks. All of this is done with little attention to whether the consumer can actually afford to borrow at the rates associated with the borrowing.

While many of these practices alone or in combination can lead to financial trouble for consumers, the focus of this testimony is be on the punitive practices of card companies imposed on consumers when they are struggling to repay their debts and avoid bankruptcy. Rather than assist borrowers who honestly seek to pay off their debts, card companies often prefer to extract as much as they can from borrowers in interest and fees, even though this may make bankruptcy unavoidable.

Punitive Fees and Interest Rates

A significant contributor to snowballing credit card debt is the enormous increase in both the number and amount of non-periodic interest fees charged by card issuers. These punitive fees are imposed on cash advances, balance transfers, wire transfers, late payments and charges that exceed the card's spending limit. Credit card issuers have made these fees higher in amount, impose them more quickly, and assess them more often than previously was the case. Credit card companies now impose these fees not as a way to deter undesirable consumer behavior -- which used to be the primary justification for imposing high penalties -- but as a significant source of revenue. The average late payment fee has soared from $14 in 1996 to over $32 today. Average over-limit fees have similarly jumped from $14 in 1996 to over $30 today.

A penalty rate is an increase in the card's initial annual interest rate (APR) triggered by the occurrence of a specific event, such as the consumer's making a late payment or exceeding the credit limit. Penalty interest rates today can be as high as 30 percent to 40 percent. The new terms apply to the old balance, leaving consumers stuck to pay often significant balances at interest rates far higher than was originally agreed, often with devastating consequences. This practice is especially outrageous when applied retroactively.

So-called "universal default" policies are even more abusive. Under universal default, credit card issuers impose penalty rates on consumers not for late payments or any behavior with respect to the consumer's account with that particular issuer, but for late payments to any of the consumer's other creditors. In some cases, issuers will impose penalties simply if the card holder's credit score drops below a certain number, whether or not the drop was due to a late payment or another factor.

Creditor Practices Push Consumers Into Default

There are volumes of examples of consumers who play by the rules and try to pay their debts, but are driven hopelessly into default by their credit card company. Rather than work with consumers to reduce their debt by curbing excess fees and interest, card companies prefer to get as much out of consumers for as long as possible until they eventually stop paying or file bankruptcy. This was best described in a March 2005 speech by Julie Williams, chief counsel of the Comptroller of the Currency: "Today the focus for lenders is not so much on consumer loans being repaid, but on the loan as a perpetual earning asset."

As a bankruptcy attorney, one of the most frequent complaints I hear is that "I pay and pay and pay every month and my debt doesn't go down much" because of high interest rates and a slew of penalty fees. Consider the case of June Black, age 71, whose financial problems began when she put charges for a doctor visit, medical tests and prescription drugs on her credit card because she couldn't pay the full balance of about $300. Three years later, after a series of fees and finance charges were imposed, Black was more than $6,000 in debt. The Riverside, CA, woman sold her car, moved to a smaller and cheaper apartment and writes a $127 check each month to pay off a credit card she long ago cut up. With the 32.24 percent interest rate she is being charged, Ms. Black has little hope of ever climbing out of the debt. "It just keeps spiraling," Black said of her debt. "I figure I'm going to die before this gets taken care of."[6]

Not long ago the Senate Permanent Subcommittee on Investigations heard testimony of an Ohio resident who exceeded his credit card's $3,000 spending limit by $200 and triggered what wound up as $7,500 in penalties and interest. After paying an average of $1,000 a year for six years and making no additional purchases, the consumer still owed $4,400.

A bankruptcy case from Virginia tells another story of the impact of credit card fees and penalties on the ability of consumers to pay back that debt. During the two year period before she filed bankruptcy, a consumer made only $218.16 in new charges on her Providian Visa. After making $3,058 in payments, all of which went to pay finance charges (at the rate of 29.99%), late charges, over-limit fees, bad check fees, and phone payment fees, the balance on her account

[6] As reported by David Olson, The Press-Enterprise, "More Seniors Struggle with Debt," June 4, 2007.

increased from $4,888 to $5,357. On her Providian Mastercard for the same period, she made only $203.06 in purchases while making $2,008 in payments. Again, all of her payments went to pay finance and other charges, and her account balance increased from $2,020.90 to $2,607.66.

In yet another case, a bankruptcy court in North Carolina ordered a credit card company to itemize the claims it filed in several chapter 13 bankruptcy cases.[7] In its findings in support of the Order, the bankruptcy judge listed claims filed in 18 separate cases broken down between principal and interest and fees. On average, interest and fees consisted of more than half (57 percent) of the total amounts listed in the claims. In one case, the card company filed a claim in the amount of $943.58, of which $199.63 was listed as principal and $743.95 was listed as interest and fees. In another case, a claim of $1,011.97 consisted of $273.33 in principal and $738.64 in interest and fees. It is almost certain that pre-bankruptcy payments in these cases had more than paid off the actual purchases made by the consumer.

I could go on and on with examples from own practice and those of my colleagues from around the country of how consumers are pushed into a default position due in large measure to abusive and unfair billing practices by credit card issuers. I will not do that, because I believe the point has been made.

PROPOSALS FOR CHANGE

There is considerable evidence linking the rise in bankruptcy in recent years to the increase in consumer credit outstanding, and, in particular, to credit card debt. For example, research by Professor Ronald Mann of Columbia University has found that an increase in credit card spending in the United States and four other countries has resulted in higher credit card debt, which is strongly associated with an increase in bankruptcy filings.[8] To make matters worse, credit card companies have become far more aggressive in implementing questionable fees and interest rate practices in recent years. The upshot of these practices is that penalty interest rates, high and accumulating fees and interest on fees can push consumers with high debts over the financial brink into bankruptcy.

It is clear that in the midst of the serious economic recession we find ourselves in, that Congress should act to rein in these abusive practices. Although credit card lenders have recently cut back on the amount of new credit they offer and started reducing credit lines for some borrowers, years of aggressive and irresponsible lending have helped put borrowers in a very vulnerable financial position. The "tricks and traps" always have been unfair, but now, at a time of economic crisis when consumers can least afford it, they produce devastating financial repercussions. Moderate income families with little flexibility in their budgets, or those who have experienced a serious loss in income, are particularly hard hit if they have to pay more in unjustifiable fees and credit card interest.

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[7] *In re* Blair, No. 02-1140 (Bankrate. W.D.N.C. filed Feb. 10, 2004).

[8] Mann, Ronald J., "Credit Cards, Consumer Credit and Bankruptcy," Law and Economics Research Paper No. 44, The University of Texas School of Law, March 2006.

We are pleased that key committees in the House and Senate this week are considering measures to rein in some of the most egregious credit card billing practices. Likewise, rules issued by the Federal Reserve late last year and due to go into effect next year, also will go a long way toward curbing some of the most abusive practices.

NACBA also supports S. 257, the "Consumer Credit Fairness Act," introduced in the Senate by Senator Sheldon Whitehouse and colleagues. S. 257 would require that claims filed on "high cost consumer credit transactions," as defined in the bill, are subordinated to all other claims in a bankruptcy case, the bill would give the credit card industry an incentive to keep interest and costs below the definitional trigger. The legislation also provides that the means test under section 707(b) of the Bankruptcy Code would not apply if a consumer's bankruptcy filing resulted from a high cost consumer credit transaction. NACBA supports this provision as it would help some consumers avoid potential litigation costs in proving that a bankruptcy filing was not abusive.