Remarks by
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It is a pleasure to be here today, and I'm very happy to see so many familiar faces in the audience. This is certainly a perfect time for the Roundtable to hold a conference on the "intersection of politics and policy," as this meeting is styled, because there's certainly a lot going on in both spheres, with plenty of intersection. Nowhere is this intersection more evident than in the area of consumer protection, including the topic I want to focus on today: credit card practices and meaningful consumer choice. In particular, I believe that one type of credit card practice – penalty rate pricing – generally requires more than robust disclosure to provide consumers with that kind of choice. As I will discuss in a moment, I believe that, when it comes to that kind of sharp increase in interest rates, consumers should generally have the right to opt out.

Before doing so, however, I want to touch very briefly on current credit market conditions, a topic still very much in the news. As I testified before the House Financial Services Committee three weeks ago, the worst problems arising from the current market disruption – insufficient liquidity, declines in capitalization, and business failures – have generally occurred outside the commercial banking system. Although banks are by no means immune to current stresses, they have weathered current conditions well due to their strong sources of funding, diverse lines of business, and solid levels of capital. From our perspective at the OCC, we believe the national banking system remains safe and sound.

Of course, the current problems in the market were sparked by record levels of delinquency and default in subprime mortgages. All of us remain very concerned about the ability of subprime borrowers to shoulder sharply escalating mortgage payments, not to mention the potentially negative effects that rising foreclosures could have on the housing market more generally. As a result, the OCC and the other federal banking regulators are using all the tools at our disposal to encourage lenders and borrowers to work together to keep borrowers in their homes, except where foreclosure is the only prudent course of action. And we continue to encourage responsible lending to all creditworthy borrowers, subprime or not.

Let me return now to credit cards. When I testified on this topic last June, it gave me the opportunity to do a "deep dive" on the history and evolution of the credit card market, and on the OCC's role in supervising credit card issuers. I won't repeat all that I said that day, though I believe our written statement provides a comprehensive overview of that market and the key public policy issues it presents.

I will, however, reiterate just a few key facts and observations to put my remarks today in context. It will come as no surprise to you that the credit card market is huge and growing. While a credit card was essentially a novelty item in the early 1960s, today, it is anything but that. Almost three-fourths of American households have a credit card, and they use them for billions of transactions every year. Total dollar volume for credit cards approached two trillion dollars in 2006.

As this product has evolved over time, so has the way it is priced. Issuers have moved away from fixed annual fees and uniform interest rates to more complicated pricing strategies. One important aspect of these strategies is to impose extremely high penalty interest rates on loan balances – in some cases exceeding 30 percent – when the borrower's creditworthiness has deteriorated based on some internal or external measure.

In general, the government's role in regulating credit card activities has been limited to safety and soundness supervision, the regulation of consumer disclosures, and, in extreme circumstances, intervention to stop unfair and deceptive practices. In terms of the OCC's role, virtually all credit card activities are conducted by regulated banks, and over 75 percent of such activities are conducted by national banks. The OCC is the primary supervisor for these national bank credit card activities, though despite that role, we do not have authority under the Truth in Lending Act or the Federal Trade Commission Act to write rules governing credit card disclosures or practices – that belongs to the Federal Reserve.

As I mentioned, in the consumer protection area for credit cards, Congress has not been inclined to regulate much beyond the sphere of disclosure. As a result, there is little substantive regulation of the costs and terms of credit card activities, such as interest rates, fees, grace periods, and the like. Instead, the primary focus of regulation has been on providing consumers, through mandated disclosures, with meaningful notice of the costs and terms of a credit card, generally leaving lenders free to set costs and terms as they see fit. The underlying theory of this approach to regulation is a familiar one: if consumers are provided adequate information about products, they will choose the ones they want and like best, and banks will compete and innovate to structure these products, without government interference, to best meet that demand.

By many measures, this paradigm has worked phenomenally well. Looking at one side of the coin, consumers love their credit cards, and for obvious reasons. They are an exceptionally convenient substitute for cash as a payment mechanism. They are also an exceptionally convenient means for borrowing money, and for the savvy shopper, they can also provide a relatively cheap short-term means of doing so. Moreover, their collateral benefits and awards programs – frequent flyer miles, rebates, college loan savings plans, and rental car insurance, just to name a few – are much prized by consumers around the country.

But there is an increasingly evident flip-side to this coin. As much as consumers love their credit cards, they also seem to hate important things about them. There has been a swelling of sharp complaints in recent years about such aggressive practices as eye-popping penalty interest rates, "universal default" provisions that trigger the higher rates, and ever-increasing fees. This hate part of the consumer's love-hate relationship with credit cards is not limited to a small number of consumers or based on the action of a few providers. It is instead a much more prevalent and intense concern than many would like to believe.

Why do I say this? In part because of the complaints we receive at the OCC via our Customer Assistance Group, which is where customers often go when they can't get their complaints resolved in the first instance by their banks. We have received roughly 30,000 credit card complaints during each of the past five years – which in 2006 was over 40 percent of total complaints from all national bank customers – and we are projecting a 25 percent increase for this year. Generally, between 10 and 20 percent of these complaints concern interest rate hikes, with consumers complaining that they don't understand why their rates have been increased.

That's not all. For other evidence that this is a real problem, you need only cast your gaze down Pennsylvania Avenue to the Capitol. The mood at the congressional hearing when I testified was strikingly negative about some of these practices, and member complaints were numerous, bipartisan, and evenly distributed by seniority. It was also clear that their complaints were prompted not just by bad personal experiences of constituents, but also of members themselves – never a good sign for those who hope that a problem will blow over after a few days of hearings.

My take on all this is that there is plainly a state of disequilibrium when it comes to consumer protection for credit cards, and the system needs fixing. Does that mean that the paradigm of disclosure-focused regulation needs this fixing? Not necessarily, but that's what I want to talk about today. In my view, the fixing ought to begin with credit card companies adjusting their own behavior, without being forced to do so by new laws or regulations – in recognition of the intensity of consumer complaints. I think that fixing process has indeed begun in important ways, as the majority of large issuers that the OCC regulates have eliminated or significantly scaled back such practices as double-cycle billing and true universal default, where the borrower's rate increases as a result of defaults unrelated to his or her repayment history on the card.

This is a good start, but it's not enough. The disclosure-focused model for consumer protection only works if disclosures are robust and understandable. Put another way, consumers need meaningful notice in order to be able to make meaningful choices about whether to obtain or reject a card based on its various features, including the extent to which terms can be changed. Meaningful notice therefore means disclosures that provide information relevant to meaningful choice. Unfortunately, the Truth in Lending Act disclosure rules for credit cards have not been revised in any material way since 1989, and as a result, disclosure regulation has not kept pace with recent changes in credit card features and marketing.

The Federal Reserve Board has undertaken an important rulemaking project to remedy this. Earlier this year, the Board published an extensive proposal to rewrite credit card disclosure rules to bring them current with today's market. I'm pleased to say that this new proposal reflects many of the recommendations suggested by the OCC based on our supervisory experience with this product, especially in the area of consumer testing. Based on such testing, the Board is proposing simplified disclosures that would be provided in standardized, easy-to-read tables.

But is enhanced disclosure by itself enough to address the consumer protection disequilibrium I've described? As I said in my testimony on credit cards, I hope enhanced disclosure is adequate to do the job, and I generally start from the premise that markets are better than the government in identifying optimal features of financial products for consumers.

But disclosure – even good disclosure – can have its limits, especially where, as with credit cards, the objectionable practices sometimes occur long after initial disclosures were made, and often come as real surprises to the consumer. What I am thinking about here are sharp increases to penalty interest rates that can take effect long after consumers have received their initial card disclosures – where the increased rate is <u>not</u> triggered by the consumer's failure to make timely payments on amounts owed on the card itself. In these circumstances, do initial disclosures, however robust, really provide the consumer with adequate notice that allows him or her to make a meaningful choice at the time the penalty rate is about to kick in?

I think not. But I'm pleased to say that the Federal Reserve has proposed a very constructive measure to address this concern through the use of subsequent notice. That is, once a consumer obtains a credit card with an initial interest rate, the proposed regulation would generally prohibit a subsequent increase in interest rate, for any reason – even if that reason is adequately disclosed in the initial disclosures to the consumer – unless the consumer receives notice 45 days before the proposed change in the rate. Such subsequent disclosure would indeed provide meaningful notice to the consumer, so that he or she could avoid the rate increase by choosing to pay off the card or roll over the outstanding balance to a different card that charges a lower rate. This proposed measure would mark a significant improvement over current law, and indeed, along with consumer-tested disclosures, may be the most important area in which the Federal Reserve has broken new ground in its proposed rule.

But would such enhanced, meaningful notice really be enough to offer most consumers in these circumstances a meaningful choice? What if the consumer was current in his or her payments on the card and the rate increase was triggered by something unrelated to the account, like a lower credit bureau score? What if the consumer had a large outstanding balance at the time the rate changed that he or she could not afford to pay off? And, what if no other card company would be willing to roll over the balance at a lower rate?

In these circumstances, which are by no means far fetched, would subsequent notice alone really provide the consumer with a meaningful choice? The practical reality is that the consumer would get stuck paying the higher rate on the full amount of his or her outstanding balance, because there would be no realistic alternative. He or she could very well complain that the rate increase was totally unexpected, and would undoubtedly believe that the higher rate was being applied “unfairly” and “retroactively” to balances the consumer accrued when the lower rate was in effect. In circumstances like these, I think the disgruntled consumer has a point.

But what is the appropriate remedy? Should the government jump in and ban penalty pricing? I don’t think so. But, I think there is an additional step that could be taken to provide meaningful choice in the circumstances I’ve described – while at the same time avoiding the slippery slope of the government defining, prohibiting, or restricting particular product terms.

Specifically, a consumer that receives a subsequent notice that his or her rate will surge to a penalty rate on all charges – including the outstanding balance consisting of previous charges – could be given the general right to “opt out” of the rate increase. There would, however, be a few reasonable exceptions. Such an opt-out would not be available where the increase resulted from the consumer’s default on payments for that card, because a rate increase in that circumstance is much more understandable so long as the initial disclosures were adequate. The opt-out also would not be available with respect to rates that increase based only on the passage of time, such as a lower rate offered for the first year, to be followed by a higher rate thereafter. In those circumstances, again assuming the initial disclosures were robust, the customer has chosen a card with a full understanding of the scheduled rate increase. And of course, where the opt-out did apply, it would not mean that the credit card issuer would be obliged to allow the consumer to make <u>new</u> charges on the card using the old rate.

But the opt-out would allow the consumer to keep the balance outstanding on the card at the old rate, with a requirement to pay off that balance or roll it over to another card within a reasonable period. Along with robust disclosures, such a right to opt out would give the consumer much more meaningful choice about whether to agree to the higher interest rate on outstanding balances of previously charged amounts as a cost of continuing to use the card – or whether to say “no thanks” and make other credit arrangements.

What would be the effect of such an opt-out? Well, fewer consumers would pay the higher rate, but if they did, they would have no legitimate ground to complain. If most consumers exercised the right to opt out, it might result in the card companies marketing fewer products that depend on steep subsequent increases in interest rates as the primary or exclusive means to make a particular card profitable – in other words, fewer cards with initial periods of zero percent or deeply discounted interest rates. But the cost of foregoing such a pricing strategy, even though clearly valued by some consumers, might well be outweighed by eliminating one source of bitter consumer complaints in the area of so-called “gotcha” or “retroactive” pricing – not to mention the potential collateral benefit of dampening the urge to legislate substantive restrictions on credit card costs and terms.

Indeed, I think the Federal Reserve Board’s proposed rulemaking is a good place to address this issue. That’s why the OCC will be submitting a comment letter recommending that the Board’s final rules for credit cards provide for the opt-out option I’ve just outlined. Many national banks already provide some sort of opt-out to their credit card customers, and adding the type of opt-out I’ve described to the Truth in Lending regulations would ensure that, when it comes to penalty pricing on outstanding balances, all credit card lenders consistently give their customers not only meaningful notice, but meaningful choice as well – and that would be a meaningful improvement over current law.

Thank you very much.