Comments

of the

Center for Responsible Lending

on the

Proposed Rule

Regarding

Unfair or Deceptive Practices with Respect to Credit Cards

Federal Reserve Board: Reg. AA, Docket R-1314
OTS: Docket ID. OTS-2008-0004
NCUA: RIN 3133-AD47
73 Fed. Reg. 28904 (May 19, 2008)

August 4, 2008

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(revised)

The Center for Responsible Lending (CRL) is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, which consists of a credit union and a non-profit loan fund.

For the past 28 years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to purchase homes. Self-Help has provided over $5 billion in financing to more than 60,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across the United States. Self-Help's responsible lending practices keep its annual loan loss rate under one percent.

Self-Help has operated a credit union since the early 1980s. Beginning in 2004, Self-Help Credit Union (SHCU) merged with three community credit unions that offer a full range of retail products,[1] and it now services over 3,500 checking accounts and approximately 20,000 other deposit accounts.[2] Additionally, Self-Help Credit Union has recently inaugurated a credit card program.

CRL joins with other groups in comprehensive comments filed separately today on the proposals regarding unfair and deceptive credit card practices.[3] These supplemental comments briefly discuss proposals regarding penalty rates and fees, a matter of special concern to us, and address some of the arguments made in opposition to these rules.

The proposed rules would also define unfair practices regarding overdrafts. We have submitted our comments with respect to this portion of the proposal separately. *See* Comments of the Center for Responsible Lending on the Proposed Rule Regarding Unfair Practices Regarding Overdraft Services, August 4, 2008.

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[1] SHCU merged with Wilson Community Credit Union and Scotland Community Credit Union in 2004 and with Cape Fear Community Credit Union in 2006.

[2] These include traditional savings accounts, money market accounts, certificates of deposits, and individual retirement accounts.

[3] *See* Comments of the National Consumer Law Center (on behalf of its low-income clients) and other organizations to the Board of Governors of the Federal Reserve System, Office of Thrift Supervision, and National Credit Union Administration on Proposed Rulemaking: Unfair or Deceptive Acts or Practices in Connection with Consumer Credit Card Accounts and Overdraft Loans, Docket Nos. R-1314 (FRB); 2008-0004 (OTS), 12 CFR Part 7706 (NCUA) (August 4, 2008)

I. INTRODUCTION

We are in uncertain times: financial markets are skittish, financial institutions face mounting losses on their loans and investments, and the majority of American households are experiencing a tightening squeeze resulting from a long trend of no- or low- income growth on the income side and rising costs for basic needs like health care on the expense side. Some results? Some 85% of Americans think the economy is "seriously off track," and the portion that fear for their own financial security doubled in the last year – to nearly half of the respondents to a recent national poll.[4] For a nation that depends on household spending for 70% of its economic activity,[5] a drop in consumer confidence may presage problems just as does a drop in investor confidence.

For nearly three decades, regulatory policy regarding consumer credit has reflected a judgment that less regulation is always better: to do otherwise is, as the argument goes, to risk "unintended consequences" and to reduce access to credit. However, the mortgage crisis has proven beyond reasonable dispute that a too-light regulatory hand also can have unintended -- and very unhealthy – consequences. Though credit card debt pales in comparison to the trillions of dollars of mortgage debt, we believe that some basic lessons to be learned from that debacle are equally applicable to other types of consumer credit, not the least of which is that some practices must simply be out of bounds.

We believe that adopting the Agencies' proposals will have a positive impact, so long as they are enacted at least as strong as proposed, or, preferably, strengthened. They could help millions of American households recognize significant savings -- dollars that the economy is relying upon for stimulation. Equally important, they will restore some semblance of fairness to a segment of the consumer credit market from which it has largely disappeared. The rules should help curb the excesses of a market that has increasingly been marked by arbitrariness and made possible by increasing concentration.[6] That, in turn, may be one step in helping restore confidence of the roughly 87 million US cardholding households in the industry that claims to serve them.

The industry's primary objections to reform appear to boil down to the fear that the rules might indeed succeed in their goal. Curbing excess may indeed reduce income from unfairly imposed fees and rates. But the legal test for unfairness requires balancing the benefits and the costs, and allows for considerations of public policy.[7] By widespread practice of tactics that are the opposite of true competitive, transparent market conduct, the card industry has engaged in harmful unfair practices with its customers, much of it in

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[4] *Dents in the Dream*, Time, p. 41-42 (July 28, 2008).

[5] *See, e.g.* Peter S. Goodman and Amanda Cox, *A Slowdown With Trouble at Every Turn,* A1, New York Times (July 19, 2008); Dean Baker, *Recession Looms for the U.S. Economy in 2007*, p. 9 (Center for Economic and Policy Research, November, 2006).

[6] *See* Section III-A, below.

[7] See 15 USC § 45n.

the name of "risk-pricing." Few outside the industry believe that the practices addressed in this rule are actually about true "risk-pricing." As the economy takes its toll on financial institutions, card issuers may well seek to bolster their balance sheets by resorting even more to some of the unfair practices, as we discuss in these comments, making it all the more crucial that the proposed – or improved – regulations be put in place. To do otherwise, we fear, would be to lose sight of how failure to assure fairness will assuredly hurt millions of cardholders, and may further erode their confidence in their financial security.

In these supplemental comments, we first discuss the credit card sector generally, including current trends regarding delinquency and profitability. (Section II). We then discuss briefly the legal standards for a determination of unfairness, and address some of the arguments made in opposition to the proposal. (Section III). Finally, we supplement the groups' comments with additional discussion of the three proposals relating to penalty rates and fees, which we believe are particularly critical to reform. (Sections IV and V).

At the end of the comments, we include an appendix that may seem far afield from the specific question at hand. In the context of a $13 trillion market for household debt, rules about just seven practices of just one sector that is less than $1 trillion pale by comparison to housing finance. But, of course, credit cards – their users and their issuers -- are part of the larger economy whose interwoven threads we are beginning to newly appreciate. And many people are feeling a sense of unease that the threads may be fraying. There are some long-term trends affecting American households that we believe may underlie that unease, some of which, in turn, are relevant generally to policies relating to all types of household debt. As is always the case, opponents of reform argue that it will restrict access to credit, but at some point, we all must ask hard questions: Have we paid sufficient attention to the quality of credit offered *to* consumers? Have we become too dependent on selling debt without sufficient attention to whether the debt sold is sustainable? Clearly these are issues about which consensus is unlikely for years to come, and clearly are far beyond these rules. Yet over the course of the past few decades, assumptions about just such issues have formed the underpinnings of decisions on just such rules as these. For that reason, we include a brief report card on household balance sheets, as a lens through which this, and other proposed credit market reforms may be viewed.

II. CREDIT CARD PROSPECTS

The questions at hand relate to only a comparatively small slice of today's $13.8 trillion of household debt.[8] As of this spring, revolving consumer debt remained under the trillion dollar mark, at $961.8 billion.[9] Nevertheless, credit card policies have a

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[8] Federal Reserve Board Flow of Funds Z.1, Table D.3 (June 5, 2008).

[9] Federal Reserve Board statistical release for May, 2008. G.19 (July 8, 2008). Credit card debt is estimated to account for approximately $820 - $866 billion of the revolving debt. Testimony of Travis B. Plunkett, *Hearing on H.R. 5244, The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers,*Before the Subc. on Financial Institutions and Consumer Credit, U.S. House of Representatives, at p.3, note 3. (April 17, 2008), (hereafter "Plunkett Testimony")

broad impact on American households: nearly three-fourths of all American families had at least one credit card by 2004,[10] and credit card debt increased 75% in the last decade.[11] A nation of 300 million people of all ages carries nearly 709 million credit cards in its collective wallet.[12]

Cards have been a star for the banking sector, with a return on assets triple that for commercial banks overall since 1995.[13] After-tax profits for Visa/MC-brand issuers were $18.08 billion in 2007, a 2.79% after-tax return on assets.[14] But the degree to which the mortgage crisis might weigh directly on credit card performance going forward is uncertain.

Prior to 2007, fundamental problems in the subprime mortgage market were disguised by the easy availability of "exit ramps" for troubled borrowers -- refinancing or sale. It remains to be seen whether this same phenomenon made credit card performance appear somewhat more solid than it was. On average, some $50 billion in non-mortgage debt, including a significant amount of credit card debt, was repaid from "home equity extraction" each year from 1991-2005.[15] But that average disguises a real jump in that source for repayment in recent years. The five years between 2000 and 2005 *doubled* that annual average: the 1991-2000 average was $25 billion. The portion of non-mortgage consumer debt repaid through equity extraction increased four-fold from 1991 to 2005.[16] How much of that represented stressed card holders who no longer have the exit ramp of a cash-out refinancing, we do not know. We do know, however, that a great many homeowners who took on subprime mortgages were sold on refinancing by the notion that debt consolidation mortgages were a wise financial move -— "paying off that high cost credit card debt with a lower-rate and tax-deductible mortgage loan."

Clearly stresses facing the card holders will impact the card issuers, as the mortgage crisis morphs into a more general slow-down. Though still comparatively low, credit card delinquencies and defaults are on the rise. Capital One, one of last years most profitable cards recently announced that 6.26% of its accounts were in default, up

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[10] Kristie M. Engemann and Michael T. Owyang, *Extra Credit: The Rise of Short-Term Liabilities*, p. 12, The Regional Economist (April 2008).

[11] Nilson Report, *Credit Cards and Total U.S. Debt*, p. 1, 9 (Issue 901, April 2008).

[12] Nilson Report, *Visa & Mastercard – U.S. 2007*, p 1, 9 (Issue 902, May, 2008).

[13] Plunkett Testimony, note 9, above, at 12.

[14] Jeffrey Green, *Bankcard Profitability: Annual Report*, Cards & Payments 36, 37 (May 2008), (hereafter *Bankcard Profitability: 2007*).

[15] Alan Greenspan and James Kennedy, *Sources and Uses of Equity Extracted from Homes*, pp. 2 (considerable portion of refinances and home equity loans used to repay non-mortgage debt, "largely credit card loans"), 9, 17 Table 2, Federal Reserve Board Working Paper 2007-20 (March, 2007).

[16] 1991 - .0147%; 2001- .0352%; 2005-.0644%, *Id* at Table 2, p. 16

from 3.56% just a year ago.[17] Delinquencies among securitized accounts were at 4.5% this spring, up from 3.6% in March, 2006, and charge-offs rose from 3.1% to 5.7% in that period.[18] Loss rates increased by 30% since July, 2007, though that 5.7% remains below the highest 3-month average loss rate of 7.5% in this decade.[19]

As losses in other sectors mount and the impact of a general slow-down is felt, it would be surprising if the banks did not turn to tried and true methods to try to make up some of those losses from the wallets of its credit card holders.[20] Indeed, that has already started: Discover may apply its newly-hiked 31% penalty rate for exceeding a credit limit twice in 12 months; three other major issuers are reported to have as much as doubled the rate on some of their customers – including ones where increased risk is hard to discern.[21] The proposed rules would at least eliminate the unfair practice of applying these increased rates to balances incurred under a lower rate.

Though the slow-down is poised to reduce net profits for card issuers in the near term, the argument that revenues will fall due to reform and therefore reform should not occur is, first, speculative, since a level playing field will cause all issuers to act in more transparent ways that may not reduce overall net income, and second, certainly no reason to allow unfair practices to continue to harm consumers. To the contrary, in fact, the need for reform is more urgent now. That the industry has chosen to ramp up the very conduct that has been the subject of so much consumer backlash and legislative opprobrium demonstrates the need for these rules to be enacted in a strong form.

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[17] *See* "Top Ten Most Profitable Issuers", The Nilson Report, No. 898 (March, 2008) (for 2007 data); Zachary A. Goldfarb and Alejandro Lazo, *Capital One's Profit Plunges 40%*, Washington Post, (July 18, 2008). *See also* Robin Sidel, *AmEx Feels Further Pains*, p. C8, Wall Street Journal (July 14, 2008)(defaults and charge-offs rising at AmEx).

[18] Standard and Poor's, *U.S. Credit Card Quality Index: Charge-Offs Kept Rising In March, But Overall Trust Performance Was Strong*, p.3 (May 5, 2008), www. Standardandpoors.com/ratingsdirect

[19] Iidiko Szilank, *Credit Card ABS Sector Review* p. 15 Standard and Poor's (May 22, 2008)

[20] Kathy Chu, *Credit card rates hustle higher,*" USA Today (April 28, 2008) ("If one end of your business is suffering, you look to the other end to pick up the slack," quoting Bill Hardekopf).

[21] Kathy Chu, *Credit card rates hustle higher*, USA Today (April 28, 2008); David Lazarus, *What rate cuts? Use of plastic gets pricier*, LA Times (February 10, 2008)(also noting the increasing use of "market conditions" as a trigger for rate hikes); Robert Berner, *A Credit Card You Want to Toss*, Business Week (February 7, 2008).

SECTION III: THE PROPOSED RULES REFLECT A CAUTIOUS BALANCE IN APPLYING UNFAIRNESS STANDARDS

A. Dynamics in the credit card market provide a fertile ground for unfair practices

The Agencies succinctly summarized the test for unfairness under the FTC rule that governs this rule-making: there must be:

- substantial consumer injury,
- not outweighed by benefits to consumers or competition, and
- not reasonably avoidable by the consumer.

Further, public policy may be considered, though is not determinative. As the Supplementary Information notes, it is generally the case that market imperfections allow the practices to flourish.[22]

As one academic has noted, "unfairness" often is applied more to the substance or performance of a contract previously made, while deception is more commonly applied to the formation stage of a contract.[23] The proposed rules follow that pattern, with the six "unfair" practices relating to the substance and performance of the card contract, and the proposed deceptive one relating to advertising.

The credit card market is one where market imperfections play a considerable role – and one especially vulnerable to the kind of "post-formation" abuses that are most suitable for application of the unfairness doctrine. The choice of a credit card is not a single-shot purchase of a service, but the choice to commit to a relationship of undetermined length. That makes it easy for the issuer to promise much upfront, and deliver less once the commitment is made: the shift in reliance from transparent, upfront interest rate pricing to back-end fees and pricing, and from front-end to back-end underwriting, is a predictable business dynamic in this context. Added to that, of course, is the complexity and opacity that permeates everything from accounting practices to what really "trips a trigger" for penalty fees and rates.

Getting out of a disappointing relationship for the consumer, of course, is harder. There are added costs to undoing the original decision. Certainly the credit card relationship, more than most, has developed in such a way as to allow these "post-formation" abuses to flourish. As has often been noted, it in fact bears little relationship to the traditional notions of contract. Instead, it operates more like a one-way contract: one side is able to change terms at will – increase rates (even on previously incurred balances), increase fees, change payment dates, payment amounts, credit limits,

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[22] The FTC Policy Statement on Unfairness and standards are discussed at 73 Fed. Reg. 28907-08.

[23] Michael L. Greenfield, *Consumer Law* §4.1, p. 161.

accounting rules -- and the other side is left to accept it, or scramble to pay the exit-costs, provided, of course, that a better alternative is available.[24]

Moreover, though it is often described as a competitive market, there is a high degree of market concentration in the card industry. Just three issuers control nearly 60% of card loans.[25] Nearly half (47%) of America's 708.6 million cards last year were issued by one of these three banks, and an astonishing 82% by just the top 10 issuers.[26] Testimony to a Congressional Antitrust Task Force last year noted that the credit card industry met Department of Justice merger guidelines for a "highly concentrated" industry.[27] An added gloss to this concentration is the "herding" behavior of issuers; they tend to move in the same direction on pricing and accounting practices.[28] Even in the rare circumstances when consumers might shop for back-end pricing, there is considerable similarity in the terms and practices of an industry marked by " 'cooptetition,' not competition." [29]

It is little surprise, then, that unfair practices like those at issue in this proposal have grown steadily over the course of the past decade or more, to the point where public outrage is significant and vocal.

B. Factoring in the costs from the injury and the benefits of reform

The primary reasons cited in opposition are the prospect of lost interest and fee revenue and the threat that the result would be to increase costs elsewhere.[30] It has become a mantra for public opposition that regulation would limit the industry's capacity

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24 Indeed, even seeking an alternative may impose costs in the form of a lowered credit score.

25 Michael McKinstry, *Big Trouble*, CardTrak (July 25, 2008), http://cardtrack.com/news/2008/07/25/big_trouble.

26 Calculated from Nilson Report, *Top Credit Card Issuers*, 1, 9 (Issue 896 February, 2008); Nilson Report, *General Purpose Cards – U.S. 2007*, 1, 9 (Issue 902, May 2008). *See also* Adam J. Levitin, *All But Accurate: A Critique of the American Bankers Association Study of Credit Card Regulation*, p. 20 (2007), (hereafter Levitin (2007) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1029191

27 Testimony of Edmund Mierzwinski, *Hearing on Credit Card Interchange Fees* Before the Antitrust Task Force of the House Judiciary Committee, p. 6 (July 19, 2007)

28 *See, e.g.* Mark Furletti & Chrisopher Ody, *Another Look at Credit Card Pricing and Its Disclosure: Is the Semi-Annual Pricing Data Reported by Credit Card Issuers to the Fed Helpful to Consumers or Researchers?*, at 19, 25 (documenting herding among large issuers on late fees); 73 Fed. Reg. at 28915 (the payment allocation system which is the subject of the proposed rule is almost uniformly the industry practice.)

29 Levitin, (2007), note 26, above, at 20.

30 *See, e.g.* 73 Fed. Reg. at 28912 (regarding the late fee timing); 28917 (retroactive rate increases).

to price for risk, and would force other consumers to "subsidize the risk of riskier borrowers."[31] These arguments are off the mark.

Of course unfair practices can be very remunerative, as are illegal practices: there would be little temptation to engage in them were they not. That reform will reduce the level of gains produced by the unfair practices is simply evidence that one prong of the test for unfairness is met – the conduct causes substantial consumer injury.

The proposed rules would in no way limit the ability of the industry to price for risk in a legitimate fashion. First, the proposed rules in no way limit the pricing at all. An issuer is free to charge whatever "risk" rates it chooses to whomever it chooses, and free to charge penalty fees in whatever amount it chooses. Second, the rules would not place any limits on the triggers that can trip a prospective rate increase – penalty rate or otherwise. Even the almost universally condemned "universal default" trigger is still permitted under these rules. (Indeed, we believe this is one of the weaknesses in the proposed rule.) Third, the issuers could engage in upfront underwriting, instead of back-end underwriting. In fact, were this change in practice to result, it would enhance competition by enhancing transparency, as this is the rate that consumers look for when shopping.

The argument that the proposal would impair their ability to price for risk is, then, without foundation. But the argument that it will result in other card holders "subsidizing" the riskier customers is not only a red-herring, but is extremely ironic, if not more than a little hypocritical.

There is already a lot of cross-subsidization in the system, some of it done under the guise of risk-pricing. There are a lot of players in the system who are not paying their fair share now. The industry has created a two-tiered system, one in which some pay too much, and others pay too little – or nothing. (Indeed, it has been said that the industry itself refers to those who pay upon billing each month and thus pay no finance charges as "deadbeats.") Some users are even paid – through rewards cards – to use the product! These players are subsidized by other card-holders' increased costs, and by people who do not use cards at all, in the form of higher prices that merchants charge to all customers to recoup the interchange and related card transaction fees. It is an oddity, even in the eyes of some business analysts.

> With credit cards, the customers most able to pay for the product get it for free. The customers least able to pay for the product pay full-price – a price high enough to compensate for giving the product away to wealthier people.
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> ….In the early 1990s, the card industry dropped most annual fees. As a result, wealthier credit card holders today borrow other folks' money for 25 days interest-free, paying nothing for the privilege. They only pay a little interchange (indirectly).

[31] *See, e.g.* Alison Vekshin, *U.S. House Panel Approves Legislation to Limit Credit-Card Fees*, Bloomberg (July 31, 2008), quoting Ken Clayton, American Bankers Association.

> ….No other business works this way, as far as we know. Imagine General Motors tripling its retail price on Chevrolets, because it needs to make up for giving Cadillacs away free to anyone who can prove they have a high income. Sound nutty? We think so.[32]

This system is not a bad deal for the card users for whom there really is such a thing as a "free lunch", or at least a pretty cheap one. And it's not a bad deal for issuers, who can even compete for some customers by offering rewards, while passing many of the costs of those rewards onto others. One source of this subsidy is other card holders, who pay their own freight plus some extra for those cardholders.[33] The other source is the interchange fee and the additional fees (especially for reward card transactions) levied on the merchants.[34] Predictably, most merchants pass those costs onto their whole customer base. Admittedly, these type of users pay this card-tax in the form higher costs of the goods and services, but they do not pay full cost: they are subsidized by all the merchants' customers, including the ones that pay with old fashioned cash.

It rings hollow, then, for an industry that fosters and even relies upon cross-subsidization to complain about the proposed rules on the unsubstantiated claim that it will *create* subsidization. More importantly, the proposed rules would reduce unfair practices and encourage more rationality, more transparency and less unfair and perverse subsidization than in the current system. Then, possibly risk-pricing could actually be about pricing for risk.

III. PENALTY FEES: THERE IS NO LEGITIMATE ECONOMIC JUSTIFICATION FOR THE PENALTY FEE PRACTICES THAT WOULD BE PROHIBITED, AND THE PROVISIONS SHOULD BE STRENGTHENED.

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[32] SMR Research, *Credit Cards, 2005: The Outlook Dims*, p. 139 (2005).

[33] *Cf.* Sujit Chakravorti and William R. Emmons, *Who Pays for Credit Cards?* Federal Reserve Bank of Chicago, p. 17, 21-22 (February 2001)(model assumes that where cardholder benefits are paid, card issuers' decision to cross-subsidize depends on their ability to charge a higher-than-risk-based rate to other customers.)

Some, but not all, rewards cards do require payment of an annual fee. The rates for rewards cards are higher than other cards available, but for convenience users of reward cards, the rate is immaterial.

[34] A local small business owner recently audited his accounts, finding that the issuers' transaction fees had been creeping up, so that it now cost an average of 8.2% for him to accept a credit card payment. He found the rewards cards have the highest fees on top of the interchange, "to pay for the give-a-ways those cardholders get." The upswing in merchant litigation over interchange reflects a growing rebellion on the merchants' part.

Interchange fees continue to rise despite increasingly efficient technologies. *Cf* Zhu Wang, *Market Structure and Credit Card Pricing: What Drives the Interchange*, Federal Reserve Bank of Kansas City Working Paper 06-04 at 38, (December 20, 2006)(suggests oligopolistic card networks "likely to collude and demand higher interchange fees to maximize card issuers' profits as card payments become more efficient.); Testimony of Mallory Duncan, *Hearing on Credit Card Interchange Rates* Before the Antitrust Task Force of the U.S. House of Rep. Committee on the Judiciary, p. 4 (July 19, 2007)(noting that the anomaly raises challenging research questions.)

Since the Supreme Court effectively gave the card industry free rein on fees in *Smiley v. Citibank,*[35] penalty fees have grown dramatically. Total late fee revenues were at $1.7 billion in 1996; by 2007, penalty fees reached $18 billion.[36] The cost of an individual average late fee nearly tripled from $13 to $35.[37]

Late fees and over-the-limit fees are justified by the industry as part of "risk-based" pricing. But that is not the whole story. It is also part of move to a business strategy to "change the industry's over-reliance on interest income" by increasing penalty fees and interchange fees.[38] (Not coincidentally, that also reflects a shift away from the most transparent price tag.) The strategy has been successful: the share of fee revenues has more than doubled from about 16% at the time of *Smiley* to at least one-third of total revenue last year.[39]

Further evidence that these fees are not driven purely by true risk-pricing comes from a recent study. It suggests that customers of banks with greater market share, in effect, pay a surcharge as part of their penalty fees that is unrelated to risk.[40] In other words, a "concentration tax" may well be built into these fees.

Late Fees – proposed §___.22: A national survey found that 2 out of 5 cardholders missed at least one or two due dates in 2005-06, even prior to the recent downturn,[41] and

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[35] *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735 (1996).

[36] Mark Furletti, *Credit Card Pricing Developments and Their Disclosure*, p. 11, Federal Reserve Bank of Philadelphia, Payment Cards Center (January, 2003) (*hereafter* Furletti (2003)); Plunkett Testimony, note 9, above, at 12. "Penalty fees" include both late and over-the-limit fees.

[37] Mark Furletti, (2003), p. 11; *Profitability Report: 2007,* note 14, above, at p. 38.

[38] SMR Research, *Credit Card, 2005: The Outlook Dims*, p. 137-138 (2005). *See also* Beasley v. Wells Fargo Bank, N.A., 235 Cal. App. 3d 1383, 1329 (1992)(describing 1982 Wells Fargo task force proposal to increase penalty fees as a "good source of revenue – pursuant to a strategy of maximizing fee income", *internal quotations omitted*: the fees were raised to a minimum $3 late fee, maximum $10 and a $10 over-the-limit fee.)

[39] Furletti (2003) at 32, Fig. 6 (1996); 2007 figure calculated by CRL from data at Profitability Report: 2007, note 14, above, at 37 (Note: this is likely to be a conservative figure, as the 2007 figures are based on data from Visa and Master Card issuers only.)

[40] Nadia Massoud, Anthony Saunders, Barry Scholnick, *The Cost of Being Late: The Case of Credit Card Penalty Fees*, 32-33 (October, 2006), http://www.newyorkfed.org/research/conference/2006/Econ_Payments/Massoud_Saunders_Scholnick.pdf . *Cf.* Levitin (2007), note 26**,** above, at 6 (credit card pricing, including late fees, only "marginally sensitive to consumer credit risk") and 20 (on concentration.)

[41] Walechia Donrad, *How Americans Really Feel About Credit Card Debt*, Bankrate.com http://www.bankrate.com/brm/news/Financial_Literacy/Feb07_credit_card_poll_national_a3.asp?caret=11a, (Feb. 20, 2007). The incidence of middle-class families – those in the middle quintile – with payments more than 60 days late on debt payments doubled in the 15 years between 1989 and 2004. *See*, Brian Cashell, *Rising Household Debt: Background and Analysis* p. 12, CRS Report for Congress, December 20, 2006) (hereafter, *Cashell* (2006).)

thus would be subject to late fees. A 40% rate is striking: it may signal a considerable level of financial stress even before the current downturn, it may signal a lot of "inattentive" card holders,[42] *or* it may signal that those due dates were in fact designed by issuers to trip the trigger often in order to maximize the late fee revenue.

There is no legitimate business purpose for the latter – no benefit to consumers or to competition. And the proposed rule is very narrowly tailored address that situation. It would not do anything to interfere with the steady increase in the amount of late fees: under new tiered-fee pricing schemes, the average high-tier fee is now approaching $39, according to Consumer Action's 2008 survey. With no limits on the amount of the fee, there can be no credible claim that the modest proposal in these rules would interfere with legitimate risk-pricing.

Indeed, we believe that this is a weakness in the proposal, and urge the Agencies to consider requiring that the amount of fees be reasonably related to costs. A long tradition in the law treats late fees that cross the line into punitive amounts as unenforceable, [43] and there is no legitimate reason that this rule should not apply to credit cards.

Over-the-limit fees – proposed §___.25: The proposed rule prohibiting OTL fees triggered by merchant holds is an improvement, though a minimal one. The NCLC comments, in which CRL joins, contains recommendations to strengthen the rule in several important ways.

To support the recommendations made in those comments for a rule against OTL pyramiding and multiple fees, we offer an example of the unfair OTL practices.[44]

- A consumer's bill included an over-the-limit fee, with instructions to "please remit the over-the-limit amount immediately." She did so. However, the issuer imposes its OTL charges at the beginning of the billing cycle, so her next bill included another OTL fee (because of the OTL fee), before she even got the bill with the first one on it. Indeed, the second OTL fee was probably imposed before the first bill even left the mailing house. She recognized with the second bill that following the issuer's instructions would not suffice, so she tried to guess, and sent in an amount 30% higher than she was told she must pay, but, again, too late for

[42] The "inattentive" cardholder also may not represent a real default risk. *See* Nadia Massoud, Anthony Saunders, Barry Scholnick, *Who Makes Credit Card Mistakes?* (August 2007), http://www.philadelphiafed.org/econ/conf/consumercreditandpayments2007/papers/Scholnick_Who_Makes_Credit_Card_Mistakes.pdf For such late payments, the legitimate reason for a late fee is compensation for the delay in that payment, not a "risk" premium, much less any additional "concentration tax."

[43] *See, e.g.*, National Consumer Law Center, *The Cost of Credit*, § 7.2.4.2.2 (3rd Ed. 2005).

[44] This example was a consumer complaint received by the Iowa Attorney General's office, and was forwarded to appropriate regulators at the time.

the third OTL fee. (She had made no additional charges on the card since two days before the first OTL fee was imposed.)

The proposal would leave such accounting tricks and traps in place. There is no legitimate reason for such practices. Pyramiding late fees has already been declared an unfair practice under the credit practices rule,[45] and there is no reason for OTL fees to be treated differently.

We also emphasize our support for the recommendation made in the comprehensive group comments that it should be unfair for issuers to impose OTL fees on transactions that they approve. In contractual terms, it is no breach when the other party agrees to it.[46]

IV. THE PROPOSED RULE AGAINST RETROACTIVE RATE INCREASES SHOULD BE STRENGHTHENED, NOT WEAKENED.

The prohibition, in most cases, of retroactive application of rate increases is one of the most welcome and needed proposals in these rules. This is one of the most egregious misuses of the one-sided nature of today's credit card contract. However, it is disappointing that the rules do not go further to limit the grounds upon which issuers can arbitrarily change the terms on a prospective basis, or prohibit retroactive rates at all.

Our focus in these supplemental comments is to emphasize our opposition to weakening this proposal by expanding the exceptions to the prohibition. The current proposal would permit retroactive application of an increased rate if the issuer has not received the minimum payment due within 30 days after the due date. This exception should not be expanded, as some are requesting, to circumstances where there are two late pays – by even just one day and for whatever reason -- in a 12 month period, or just one NSF check. The penalty rates are already far higher than a true "risk-pricing" rate, and, by all appearances, are swung as a very blunt instrument.[47] Given the paucity of available evidence that penalty rates genuinely reflect risk-pricing, or that they are well-aimed at their target, there should be no expansion of the exceptions to this rule. (Indeed, we believe that a better rule would prohibit all retroactive application of rate increases, except in conjunction with index movement on variable rate cards.)

Penalty interest rates are not risk-rates: The available evidence is that penalty rates, which now are as high as 31%, are opportunistic, rather than real risk-pricing. One analysis describes the pricing practices as, in essence, looking for a sweet spot "sweatbox", where maximum fees and interest are paid, but the cardholder is not pushed

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[45] *See* 12 CFR § 227. 15 (FRB), § 535.14 (OTS)

[46] This issue was discussed in detail in the National Consumer Law Center's comments submitted in response to the FRB's advance notice of proposed rule-making on revisions to Regulation Z's open-end disclosures in March, 2005.

[47] *See, e.g.* sources cited in note 21, above.

over the line to default.[48] Another academic describes penalty rates as an example of the "common pool" problem. Where there are multiple creditors, if there is a scent of weakness, the first one is tempted to inflict maximum fiscal pain in the hope of being paid first.[49] Given that dynamic, "the likely outcome in the absence of threatened or actual regulation is inefficiently high penalty rates together with inefficiently broad and unforgiving universal default clauses."[50]

Ironically, industry representatives confirm the common pool dynamic at work when they say that the higher rate doesn't lead to higher defaults (at least for that creditor), but rather to faster payoffs.[51] What it might do to other creditors is precisely at the heart of the common pool problem. What it does to the cardholder, is, for purposes of deciding upon these rules, the regulators' problem

The impact of penalty rates on cardholders: In one view, from a macro perspective, the price of debt may not matter: "What for borrowers is a burden, is income for lenders….While [the debt] may constrain the discretionary spending of borrowers, they increase the resources of lenders."[52] But, as we discuss in the Appendix, in tough economic times, increased debt burden may not be the simple "transfer or exchange" assumed by that writer. One question is whether a hike pushes the household budget over the edge, pushing borrowers out of the "sweatbox" and into default. (And, with some 465,000 jobs lost in the last six months,[53] that may be a possibility for more families.) But in slow times, though, that may not be the only question, for the constrained discretionary spending may have broader implications, as well, as we discuss in the Appendix.

The impact of penalty rates – which might double the interest rate -- is significant. Retroactive rate increases should not be permitted at all, or, if they are, they should not be able to be tripped easily, such as by the industry's proposal of one NSF check or 2 late

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[48] Mann, Ronald , J.,Bankruptcy Reform and The 'Sweat Box' of Credit Card Debt. U of Texas Law, Law and Econ Research Paper No. 75, available at SSRN: http://ssrn.com/abstract=895408. *See also* Levitin, (2007), note 26, above.

[49] Lawrence M. Ausubel and Amanda E. Dawsey, *Penalty Interest Rates, Universal Default, and the Common Pool Problem of Credit Card Debt,* appendix to Testimony of Lawrence M. Ausubel Before the Subc. On Financial Institutions and Consumer Credit of the Committee on Financial Services, U.S. House of Representatives, Hearing on *The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers*, (March 13, 2008). (It does suggest intriguing possibilities for an episode of Nature for public television.)

[50] Ausubel Testimony, note 49, above, at 2.

[51] Meeting of industry representatives at the Federal Reserve Board (May 6, 2008)

[52] Brian W. Cashell, *Rising Household Debt: Background and Analysis,* at 12-13 (CRS Report for Congress, December 20, 2006).

[53] Peter S. Goodman and Amanda Cox, *A Slowdown With Trouble at Every Turn*, A1, New York Times (July 19, 2008).

pays in 12 months – no matter how late or what the reason. (Lenders, of course, already are compensated for these transgressions in the form of late fees and NSF fees.)

While we do not know precisely who pays penalty rates, research suggests that these penalty rates are disproportionately paid by families who can least afford it. A DEMOS report indicated that in 2004 approximately 1/3 of cardholders were paying interest rates above 20%. That might be a (very) rough proxy for penalty rates, though a rate bucket above 20% would not exclusively consist of penalty rates. Those high rate-payers are more likely to be single women, African-Americans, Latinos and those in the bottom two income quintiles.[54]

Doubling the interest rate can indeed, add considerably to the "constraint" on discretionary income. How would that hit play out on a household below the median national income, as is the case for all of those groups found to be more likely to be paying rates above 20% in 2004?[55]

<u>Assume \$8500 balance,[56] and a minimum payment of interest + 1% of principal[57]</u>

At 13% interest -- \$ 92.08 interest + \$85 = \$177.08
At 25% interest -- \$177.08 interest + \$85 = \$262.08

That payment at 25% interest would take over half of the discretionary income left to the family with a \$40,000 income, after the most basic household expenses.[58] To put it another way, paying that rate differential for one year would nearly wipe out four years of income gains for that family.[59] To come out of the penalty box, the family has to

[54] Jennifer Wheary and Tamara Draut, *Who Pays? The Winners and Losers of Credit Card Deregulation* , 5 (DEMOS, undated)

[55] Census data for 2006 places the median income for a female-householder / no husband present at \$32,000, Latino household at \$37,800, and African-American households at \$32,000. The average income within the second quintile was \$28,770. The national median was \$48,451.

[56] Hearing: The Credit Cardholders' Bill of Rights: New Protections for Consumers, Before the Subc. on Financial Institutions and Consumer Credit, U.S. House of Representatives, *Testimony of Elizabeth Warren,* p. 8 (March 13, 2008) (the average debt per household for those who carry debt in 2006 was \$8,467.

[57] Agency guidelines caution against negative amortization, and require minimum payments to amortize the balance in a reasonable time. *See, e.g.* OCC Bulletin 2003-1, *Credit Card Lending.*

[58] After-tax and Social Security income: \$2,966; Household expenditures (food, clothing, housing/utilities, transportation and healthcare), \$2,528. Discretionary income left: \$438. These were 2006 figures, so the recent increases in food and gas, of course, would not be reflected. (Calculated from Center for Responsible Lending, *Financial Quicksand* and 2006 Bureau of Labor Statistics Consumer Expenditure Survey.)

[59] A year's worth of that rate difference is about \$1000 (\$966). The average inflation-adjusted income gains for the "bottom" 90% of American households for 2002 – 2006 was \$1000. See Aviva Aron-Dine, *New Data Show Income Concentration Rose Again in 2006*, at 1- 2 (Center on Budget and Policy Priorities, March 27, 2008).

make 6 – 12 on-time consecutive payments, if the card issuer lets them out at all.[60] The bigger the bite, of course, the harder it will be for the consumer to meet the requirements to qualify for the "return-to" rate, putting the family on a downward spiral.

Penalty rate shocks are a stress that families do not need. A 2005 survey indicated that 7 out of 10 low- and middle-income households used their cards as a safety net.[61] Now, with a simultaneous slow-down in the economy and rise in basic, recurring expenses like gas and food, easily-tripped retroactive penalty rate triggers are the last thing they need.

These proposals include no limitations on the amount of penalty rates, and no restrictions on what can trigger those rates on a prospective basis. Given the absence of limits on what they can do on a prospective basis, there is no reason to allow greater exemptions to the prohibition on retroactive application of penalty rates.

CONCLUSION

The Agencies need no reminder that these are unusual and uncertain times. In considering these proposed rules, obviously banking regulators must keep one eye on the health and soundness of the banks that issue credit cards. But they must keep the other eye on the health and soundness of the cardholders, for the economy depends upon the soundness of America's households as well. Restoring more fairness to the marketplace is good for card holders, for consumer confidence, and will be good for the economy. And that, in the end, will be good for the card issuers.

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[60] *See* Consumer-Action 2008 Credit Card Survey for results on the "return-to" policies of surveyed lenders. http://www.consumer-action.org/news/articles/2008_credit_card_survey/#Topic_09

[61] *The Plastic Safety Net*, p. 10 (DEMOS and Center for Responsible Lending, 2005).

APPENDIX

The Context for Credit Reform:
A Financial Report Card on American Households

For the first time, the federal financial regulators initiated reforms relating to household credit to curb unfair and deceptive practices in the marketplace this year, first with respect to mortgages, now to credit cards.[62] One perennial reason for opposing reform has been that it will reduce access to credit. This year, that argument is sometimes considered strengthened by adding "…at a time when we already have a credit crunch."

But what we have seen in the past few years – in both mortgages and credit cards – is emphasis on maintaining and growing the volume of credit at any terms. There has been much less emphasis on the quality of the credit products and services sold *to* consumers, and, as we are now seeing -- on whether that credit is sustainable in the long run.

For the latter, a renewed emphasis on the basics – common sense underwriting – is key. But we believe that it is also critical that we take a step back and look at the context in which policy decisions about household debt will play out.

A. The "bottom" 90% of American households have not seen much growth in their real income from the economy's growth and productivity gains over the past generation.

It is difficult to separate the financial health of American households from the health of the economy, with household spending composing 70% of gross domestic product.[63] Not surprisingly, reports on the state of the economy follow closely consumer sentiment and consumer spending.[64] Maintaining or increasing spending levels is viewed as positive; reined-in spending as worrisome. Indeed, the recent stimulus package was designed simply to encourage spending.

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62 The only other UDAP rules were promulgated in 1985, pursuant to the mandate in 15 USC 57a(f), to apply the Federal Trade Commission's credit practices rule to the institutions under federal banking agencies' jurisdiction.

63 *See, e.g.* Peter S. Goodman and Amanda Cox, *A Slowdown With Trouble at Every Turn*, A1, New York Times (July 19, 2008); Dean Baker, *Recession Looms for the U.S. Economy in 2007*, p. 9 (Center for Economic and Policy Research, November, 2006

64 *See, e.g.* Ben Bernancke, *SemiannualMonetary Report to Congress* Before the Committee on Banking, Housing and Urban Affairs, U.S. Senate (July 15, 2008), *available at* http://www.federalreserve.gov/newsevents/testimony/bernanke20080715a.htm

Yet household spending as a pillar of a national economy presents some logical challenges. Most fundamental is that the households must not only be willing to spend, but that spending must be affordable. If borrowing sustains that ability to spend, then eventually debt payments will constrain spending as the debt is repaid. Further, consumers must both *be* able to pay the debt back, and they must *feel* confident that they will be able to pay it back. They must feel confident about their own financial future, and confident that the institutions furnishing the lending will treat them honestly and fairly. Both kinds of confidence, unfortunately, are eroding.[65]

As to the former, there are reasons why many Americans may feel financially shaky. After a half century of decreasing inequality in the middle of the last century, the last twenty-five to thirty years has seen a trend to widening income inequality. The benefits of much-vaunted productivity gains have overwhelmingly flowed to the very top part of the top quintile.[66] Over the course of that period, the real-after tax income gains in the bottom four quintiles have ranged from 6% (bottom) to 30% (4th), while the top quintile saw an 80% change and the top 1% saw a 228% gain.[67] Or, to put it another way, the "bottom" 90% saw an average income growth of 92% in the thirty years from 1946 – 76, but only 10% growth in the thirty years from 1976-2006.[68]

Average Household Income Growth		
	"Bottom" 90%	Top 1%
1946-1976	92%	25%
1976-2006	10%	239%

A recent study of income gains between 2002 and 2006 sheds some light on what the majority of American families are feeling: 75% of all income gains between 2002

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65 *See, e.g. Dents in the Dream*, Time, p. 41-42 (July 28, 2008) (85% of Americans think the economy is "seriously off track"), and Testimony of Travis B. Plunkett, *Hearing on H.R. 5244, The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers,* Before the Subc. on Financial Institutions and Consumer Credit, U.S. House of Representatives, at p. 19 (April 17, 2008) regarding credit card industry practices.

66 Ian Dew-Becker and Robert J. Gordon, *Where Did the Productivity Growth Go? Inflation Dynamics and the Distribution of Income*, Discussion Paper No. 5419, Center for Economic Policy Research (January, 2006), www.cepr.org/pubs/ds/DP5419.asp. *See also* Clive Crook, *The Height of Inequality,* p 36-37, The Atlantic Monthly (September 2006).

67 Arloc Sherman, *Income Inequality Hits Record Levels, New CBO Data Show*, Center on Budget and Policy Priorities, (December 14, 2007), http://www.cpp.org/12-14-07inc.htm

68 Aviva Aron-Dine, *New Data Show Income Concentration Rose Again in 2006: Average Income Rose by $73,000 for Households in the Top 1%, Only $20 for Those in the Bottom 90%,* p. 2 (Center on Budget and Policy Priorities, March 27, 2008); based on Emmanual Saez & Thomas Piketty, *Striking it Richer: The Evolution of Top Incomes in the United States*, (update using 2006 preliminary estimates, March 15, 2008), *updating* work of same title, Pathways Magazine, Stanford Center for the Study of Poverty and Inequality, Winter 2008, Winter 2008, 6-7.

and 2006 went to the top 1% of American households – those making more than $382,600 a year.[69]

Average Income Gains: 2002-2006	
"Bottom" 90%	$1000 (3%)
Top 1%	$335,000 (44%)
Top 0.1 of 1%	$1.9 million (60%).

To place those gains in terms of actual dollars, the following chart shows the 2006 average incomes *within* each quintile.[70]

	Bottom 5th	Second 5th	Middle 5th	Fourth 5th	Top 5th	Top 5%
Average 2006 income	$11,352	$28,777	$48,223	$76,329	$168,170	$297,405

Median incomes for minorities remain stubbornly low, notwithstanding gains: $32,372 for African Americans and $38,747 for Hispanics, compared to the white median of $52,375 in 2006.[71]

Compounding the impact of rising inequality is less predictability. Incomes have become increasingly volatile, which is quite likely to heighten feelings of insecurity.[72] Volatility, of course, can mean that next year could be better – but it also may be worse.

Meanwhile, that slow real-income growth has not been matched by equally slow growth in many of the big-ticket cost items on the expense side of household balance sheets. The longer term pressures from rising costs for health care and health care financing, child care, education, transportation and housing have, of course, now been joined by the rising costs in food and fuel.

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69 Justin Fox *How the Next President Should Fix the Economy*, 37, 38 TIME (May 26, 2008). *See* also Aviva Aron-Dine, "*New Data Show Income Concentration Rose Again in 2006*", Center on Budget and Policy Priorities (March 27, 2008).

70 U.S. Census Bureau, Historical Income Tables, *Mean Household Income Received by Each Fifth and Top 5%*, Table H-3, http://www.census.gov/hhes/www/income/histinc/h03ar.html.

By way of comparison, the projected 2008 median federal salary for the DC area is $90,698, Stephen Barr, *Area Federal Workers Get 4.49% Raise*, Washington Post, D01 (January 5, 2008), http://www.washingtonpost.com/wp-dyn/content/article/2008/01/04/AR2008010402402.html. This median is approaching the lower bound for the top quintile, ($97,030)**.** U.S. Census Bureau, Percent Distribution of Households , By Selected Characteristics Within Income Quintile and Top 5%, Table HINC-05, http://pubdb3.census.gov/macro/032007/hhinc/new05_000.htm. Maryland's median income was the highest in the nation in 2006, Virginia the 8th highest, and DC ranked 16th,, US Census Bureau, *Income, Earnings, and Poverty Data From the 2006 American Community Survey*, p. 4-5 (August, 2007).

71 Census Bureau, *Income, Earnings, and Poverty Data from the 2006 American Community Survey*, p. 3 (August, 2007).

72 Peter Gosselin, "The New Deal: If America is Richer, Why Are Its Families Much Less Secure?" Los Angeles Times (October 10, 2004). *See generally* Jacob S. Hacker, *The Great Risk Shift.*

Perhaps not coincidentally, the savings rate has plummeted since 1982.[73] Though more people have money invested in the market for retirement, the amounts are modest, and, of course, stock market investments are not "safe" savings, and their returns, too, are uncertain. The result is that the wealth data does not significantly improve the picture for the majority of American households. Net wealth is even more concentrated at the top than income, with the "bottom" 90% sharing less than a third of total net worth, and the "bottom" half of the population by wealth distribution holding only 2.5% of total wealth.[74]

B. Debt – Might the Engine of Growth Become a Drag on Growth?

Though debt has always been a double-edged sword, in recent years it has been treated as though one edge has been dulled, leaving only unmitigated positive effects. The spread of debt has been welcomed as an integral part of the engine of growth.

> Instead of being a harbinger of economic hard times, rising household debt has been found to be associated with a growing economy. Changes in consumer debt tend to be a leading indicator of consumer spending, and thus of overall economic growth. One reason for this may be that increases in consumer borrowing are an indication of confidence in the economy, both on the part of borrowers and lenders.[75]

But then again, it is possible that debt-driven growth may be more unstable (*especially* unfair and unsustainable debt): "the higher the leverage, the greater the vulnerability to any given shock becomes."[76] A United Kingdom central banker posed the question four years ago, considering whether the "debt build-up" might at some point have implications for monetary policy, as that "could make demand more susceptible to external shocks." That maybe even more complicated when the demand is fueled by asset appreciation:

> But what would happen if external events broke the cycle of asset price increases, particularly in relation to house prices? A sudden realization that the wealth cushion supporting levels of secured debt was deflating could trigger behaviour that would reduce demand.[77]

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73 Bureau of Economic Analysis, National Income and Product Accounts, Personal Income and its Distribution, http://www.bea.gov/national/nipaweb/Nipa-Frb.asp

74 Arthur B. Kennickell, *Currents and Undercurrents: Changes in the Distribution of Wealth, 1989-2004*, at 10 (Federal Reserve System, January 30, 2006).

75 Brian W. Cashell, *Rising Household Debt: Background and Analysis,* at 14 (CRS Report for Congress, December 20, 2006).

76 Sir Andrew Large, "Puzzles in today's economy – the build-up of household debt," Speech to the Association of Corporate Treasurers, March, 2004, reported in Bank of England Quarterly Bulletin, at 233 (Summer, 2004.)

77 *Id* at 232-233

Demand might further be suppressed if people whose consumption had been financed by borrowing decided to cut back, or, if people began saving more than buying.[78]

Insecurity about the near- and mid-term financial capacity may be compounded by the amount of leverage. One study suggests that "[f]luctuations in unemployment expectations have a greater impact on durable spending in a deregulated economy with high debt burdens compared with a more credit-constrained economy" perhaps because "the inevitable surge in debt heightens consumers' reactions to adverse effects."[79]

And certainly American households are at record levels of debt. The debt-to-disposable income ratio of American households more than doubled between 1980 and 2007: from 60% to 133%.[80] Ignoring the impact of the top and bottom quintiles, *the debt to income ratio for the middle three quintiles – for literally middle- class America – was 141% in 2004*.[81]

The change in the relative degree of leverage that Americans have accumulated over the course of the last three decades is dramatic. It may be, as some have charged, that recent opinion polls reflect unwarranted pessimism, but it also may be that the financial state of households as reflected by the figures below – a non-standard measure of debt though it may be – underlies the growing sense of unease.[82]

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78 *Id*. There is something troubling about the notion that we are so dependent upon household spending that families increasing their savings rate can represent a problem.

79 Discussed in Andrew Kish, *Perspectives on Recent Trends in Consumer Debt*, at 16, (Federal Reserve Bank of Philadelphia, June, 2006)(findings suggest that "consumption smoothing becomes more difficult, not less difficult, when credit restraints are removed.") In other words, there is a possibility that debt bubbles, as well as asset bubbles, may burst.

80 Dean Baker, *Dangerous Trends: The Growth of Debt in the U.S. Economy*, at 4, Fig 1 (2004); Stephen Roach, *Comment: America's Inflated Asset Prices Must Fall*, Financial Times, January 8, 2008.

81 Edward N. Wolff, *Recent Trends in Household Wealth in the United States: Rising Debt and the Middle Class Squeeze*, p. 21, 24 (Levy Economics Institute at Bard College & Department of Economics, NYU) (June 2007.)(wealth quintiles)

82 The following chart obviously masks considerable complexity. But some of those complexities make this even more striking, for example, the 2006 income is far more mal-distributed than the 1975 income. And wealth doesn't improve the picture: less than 30% of America's 2004 net worth was held by the "bottom" 90%. Much of that was held in the form of tangible assets (primarily homes), the value of which, as we have learned, is also more volatile than we had assumed. And, of course, the debt taken on to acquire that asset must be sustainable. (Net worth figures are from Jared Bernstein, *The State of Working America: 2006/2007*, p. 249-51. (Economic Policy Institute.)

	1975	1998	2006
Aggregate annual income to households[83]	$2.7 trillion	$5.4 trillion	$7.7 trillion
Aggregate household debt[84]	$734.3 billion	$5.9 trillion	$12.9 trillion
Ratio	27.2%	110%	168%

Indisputably, much household debt reflects productive credit. Unquestionably, embedded in the debt figures are rising homeownership rates and rising home values. Yet we also know that the debt must be fair and sustainable in order for its benefits to be realized. We also know that when it isn't, the consequences to the families directly involved are serious. And, since the New Economy depends so much on American households, shocks to the families ripple outward.

These are fundamental issues, which demand much broader, thoughtful consideration. But, as to the issue at hand, suffice it to say that we should have a heightened understanding that fair access to fair and sustainable credit is critical for an opportunity society, and for a vibrant economy. We also have a greater appreciation that fair and sustainable credit isn't something we can take for granted. Balanced regulation is necessary to make sure that there are some rules in the marketplace.

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83 Income figures for 1975 and 1998 from Lynn Drysdale and Kathleen Keest, *The Two-Tiered Financial Services Marketplace*, 51 So. Car. L. Rev. 589, 592 note 10. (The debt figures reflected in notes 7-9 there have been subsequently revised in the Flow of Funds historical data.) Income figure for 2006 by NIU Center for Governmental Studies, http://www.stateofworkingillinois.niu.edu/swil/2007data/chart_13_pg_20.pdf

84 Figures from Federal Reserve Board Flow of Funds Accounts Z.1, Table D.3 (June 5, 2008)