Comments submitted by the Center for Responsible Lending

To the Consumer Financial Protection Bureau

In response to the Request for Information Regarding Credit Card Market

Docket No. CFPB-2012-0048

February 19, 2013

The CARD Act has successfully mitigated unfair and deceptive practices by credit card issuers. Before the Act, unfair credit card practices cost both consumers and issuers: they surprised consumers with unanticipated fees and rate increases; and they caused losses to issuers during the downturn. Post-CARD Act, consumers benefit from increased transparency in terms and pricing, improved ability to manage credit card debt, and decreased fees and penalties. Our research indicates that these CARD Act achievements have not increased credit costs to consumers, nor have they curbed issuers' ability to price for risk.

The Center for Responsible Lending has issued several research reports on the CARD Act. In response to the Bureau's Request for Information, we submit our reports *Credit Card Clarity: CARD Act Reform Works* (February 16, 2011) (attached as Exhibit A); *CARD Act Continues to Make Pricing Clearer Without Raising Rates* (June 2011) (attached as Exhibit B); *Predatory Credit Card Lending: Unsafe, Unsound for Consumers and Companies* (May 2012) (attached as Exhibit C); and the Credit Cards chapter *of The State of Lending in America* (December 2012) (attached as Exhibit D).[1]

[1] The reports are also available online:

- *Credit Card Clarity: CARD Act Reform Works* (February 16, 2011) http://www.responsiblelending.org/credit-cards/research-analysis/FinalCRL-CARD-Clarity-Report2-16-11.pdf
- *CARD Act Continues to Make Pricing Clearer Without Raising Rates* (June 2011) http://www.responsiblelending.org/credit-cards/research-analysis/Credit-CARD-Reform-Works.pdf
- *Predatory Credit Card Lending: Unsafe, Unsound for Consumers and Companies* (May 2012), http://www.responsiblelending.org/credit-cards/research-analysis/Unsafe-Unsound-Report-May-2012.pd
- Credit Cards chapter of *The State of Lending in America* (December 2012) http://www.responsiblelending.org/state-of-lending/credit-cards/credit-cards-chapter.html

Our reports are generally responsive to the RFI, and also respond to the specific RFI questions, as summarized below.

RFI 2(a): The terms of credit card agreements and the practices of credit card issuers.

Our research indicates that the new terms and practices mandated by the CARD Act have benefitted consumers. Before the CARD Act, unfair practices increased prices for consumers. *State of Lending* at 90-91; *Credit Card Clarity*. The CARD Act's mandated changes have resulted in significant savings, including:

- Reduction in total amount of late fees by more than half (from $901 million to $427 million). Fewer households pay any fees, and the average size of the fees has fallen. *State of Lending* at 97 (citing OCC and Demos research).
- An end to unfair terms that allowed issuers to manipulate the interest rate through "pick-a-rate" pricing, which increased consumers APRs by 0.3% and cost $720 million per year. *Id.* at 93.
- Increased rate transparency. The CARD Act has resulted in a closer match between the stated interest rates in credit card solicitations, and the actual rate charged to consumers. *Credit Card Clarity* at 5-9; *State of Lending* at 95-96. Before the CARD Act, consumers' actual interest rate was consistently higher than the rate stated in advertisements and solicitations, because issuers would raise rates after consumers signed up. Now, the gap between the actual and stated rate has narrowed greatly, indicating that issuers have reduced unfair practices that tended to result in unanticipated rate increases. *Id.* Consumers can now better anticipate the true cost of credit.

RFI 2(b): The effectiveness of disclosure of terms, fees, and other expenses of credit

The CARD Act has successfully helped consumers understand and manage the cost of credit by coupling affirmative disclosures with restrictions on deceptive pricing.

The affirmative disclosures mandated by the Act, such as informing consumers about how long it will take them to pay down balances, have helped consumers pay down balances faster. *State of Lending* at 94.

By ending unfair interest rate pricing practices, such as balance repricing, the CARD Act increased transparency in interest rates. Before the CARD Act, deceptive practices caused the actual interest rate charged to consumers to be higher than the stated interest rates in advertisements and solicitations. *Credit Card Clarity* at 5-9; *State of Lending* at 95-96. The CARD Act brought the actual rate in line with the stated rate. *Id.* Consumers now face fewer unanticipated costs, because their initial stated rate better represents what they will actually pay. *Id.*

The effectiveness of the CARD Act's deceptive pricing protections demonstrates that affirmative disclosures alone are not sufficient to create price transparency; substantive reforms are also needed.

RFI 2(c): The adequacy of protections against unfair or deceptive acts or practices relating to credit card plans

Unfair and deceptive practices still occur in the credit card market. We recommend that the CFPB focus on the following areas:

- **Add-Ons:** The CFPB should address aggressive and deceptive marketing of "add-on" products, such as debt protection and credit insurance, and ensure that such products are actually beneficial to consumers. *State of Lending* at 101.
- **Fee Harvesters: "**Fee harvester" cards, which target consumers with impaired or no credit history, should be reformed with a new or supplemental rule and appropriate enforcement actions. *State of Lending* at 99, 101. The rule should:
    - Include pre-account fees in the calculation of the maximum fees that may be charged in the first year. Pre-account fees should be refundable if the account is cancelled.
    - Include all required fees assessed in the first year and in subsequent years in the tests for abusive fee harvester cards.
    - Enforce the CARD Act's ability-to-repay requirements with respect to fee harvester cards.
    - Take action against unfair, deceptive and abusive cards targeted to consumers with poor credit records that harm credit-worthiness; are unaffordable for target audience; or do not improve credit scores as claimed.
    - Require that fees be reasonable and proportional.

RFI 2(d): Whether implementation of the CARD Act has affected the cost and availability of credit, particularly with respect to non-prime borrowers?

The CARD Act has not increased the price of credit, nor has it reduced availability. *State of Lending* at 94-98. Cardholders are not paying more for credit. First, consumers now pay fewer fees and penalties. *State of Lending* at 97. Second, the CARD Act has not increased the actual interest rate. Our research indicates that the CARD Act did not have a statistically significant impact on the actual rates, although the unemployment rate and the prime rate did. *Id; CARD Act Continues to Make Pricing Clearer Without Raising Rates*. At the same time, the rates stated in solicitations have risen, bringing them closer in line with actual rates. *Id.* at 95-96. This means that consumers have a better idea of what they will actually pay, and indicates that fewer unanticipated and unfair increases are being hidden by artificially low stated rates.

According to our research, the CARD Act has not restricted the availability of credit in the overall market. *State of Lending* at 98; *Credit Card Clarity* at 9-11. We looked for evidence about the availability of credit by examining the volume of new direct mail solicitations for credit cards. Our analysis indicated that direct-mail offers have been extended at a volume and rate consistent with economic conditions, and have not been slowed by the CARD Act. *Id.*

RFI 2(e): Has the CARD Act impacted the safety and soundness of any credit card issuers?

Our research demonstrates that unfair credit card practices *increase* issuer losses and could negatively impact issuer safety and soundness. *Predatory Credit Card Lending: Unsafe, Unsound for Consumers and Companies* (May 2012). Before the CARD Act, issuers engaging in the most unfair practices suffered the most severe losses in the recession. *Id.* at 10-13. Unfair practices were a statistically significant and powerful predictor of loss; and the worse the issuers' practice, the worse its losses during the downturn. *Id.* at 10-11. In fact, we found that <u>unfair practices were the best single predictor of losses during the recession</u>. *Id.* at 11. Such losses could have been significant enough to affect the institution's safety and soundness. *Id.*

RFI 2(f): Has the CARD Act affected the use of risk-based pricing?

The CARD Act did not hinder legitimate risk management. The Act did restrict some unfair practices that issuers claimed they used for risk-based pricing -- in particular, repricing existing balances with a high penalty interest rate. But the unfettered penalty repricing practiced before the CARD Act bore little relationship to legitimate risk management. As our research demonstrates, penalty repricing was not used to manage risk, but rather to extract short-term revenue. *Predatory Credit Card Lending* at 12-14. Issuers subjected consumers who did not have a high risk profile to penalty repricing for very minor infractions, such as being just one day late. Issuers also sometimes manipulated due dates in order to increase the likelihood that consumers would pay late and incur the increase. Furthermore, the rate increases were greatly disproportionate to any risk. *Id.* Clearly, penalty repricing was not being used as a risk-management tool.

The CARD Act banned other unfair practices that under no interpretation could have been used for risk-based pricing. For example, the Act banned "pick-a-rate" manipulations of interest rates, where issuers looked backwards to pick the highest past prime rate to calculate a variable rate pegged to prime. *Id.* at 13. Such manipulations have nothing to do with adjusting prices to reflect risk. Other banned practices, such as double-cycle billing, also bear no relationship to risk-based pricing.

Post-CARD Act, issuers are in a better position to manage risk. As discussed above in response to RFI 2(e), unfair practices like balance repricing actually *created* risk of loss and a threat to safety and soundness. *Id.* at 10-11. In addition, the CARD Act requires issuers do legitimate risk management by requiring that they assess ability to repay before extending credit. The CARD Act not only protects consumers, but also encourages better risk management by issuers.