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TESTIMONY OF

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COMPTROLLER OF THE CURRENCY

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

OF THE

U.S. HOUSE OF REPRESENTATIVES

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The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

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INTRODUCTION

Chair Maloney, Ranking Member Gillmor, and members of the Subcommittee, I welcome this opportunity to appear before you today to discuss current issues affecting the credit card market. This is a timely opportunity to discuss important concerns that have been raised in the Subcommittee's letter of invitation, as well as other related issues. To do that, my testimony is organized in four parts.

Part I provides an overview of the current credit card market. Before discussing concerns that have been raised about certain current market practices, it is important to provide context on the evolution of credit cards and the range of benefits they provide to consumers today. Given their open-ended nature, credit card accounts require ongoing and prudent risk assessment and management, and credit card issuers use pricing as one important way to balance these risks. Risk-based pricing has become very sophisticated and today allows card issuers to offer credit products with lower rates to consumers with lower risk attributes, and to make available, at higher rates, credit products to consumers with higher risk attributes who previously might not have been able to obtain credit at all. The ability to manage credit risk inherent in credit card lending through appropriate risk-based pricing mechanisms is very important to the soundness of banks' credit card business.

Part II describes the program of the Office of the Comptroller of the Currency (OCC) for supervising the credit card operations of national banks. The OCC has a strong and comprehensive risk-based program for supervision of these operations, which include most, but not all, of the largest credit card issuers in the market today. OCC experts – retail credit, credit card, and compliance specialists – conduct ongoing examination and oversight of credit card operations at national banks. In addition, the OCC has been a leader in providing supervisory and compliance guidance on key credit card issues, including account management practices, negative amortization, universal default, and re-pricing disclosure issues; in our consumer complaint analysis and resolution function; and in our enforcement actions to reform unlawful credit card practices.

Given the longstanding and primary role of disclosures in the regulation of consumer credit under federal law, Part III discusses the need for better and more effective credit card disclosures, particularly in the context of certain credit card practices that have been the focus of public complaints recently, such as universal default, unilateral change-in-terms provisions, and double-cycle billing. Effective disclosure provides three important consumer benefits: informed consumer choice; healthy card issuer competition to provide consumers the terms they want; and increased transparency that makes it more difficult for issuers to withstand public criticism of practices that are especially aggressive. But, consumer disclosures for credit cards have not kept pace with significant changes in the market over the past decade or so that have affected credit card terms, practices, and pricing structures. The Government Accountability Office (GAO) recently studied this area and has called for comprehensive reform of credit card disclosure rules. In this regard, the Federal Reserve Board has recently proposed very substantial revisions to its disclosure regulations for credit cards under the Truth in Lending Act (TILA). My statement describes our preliminary reaction to the Board's proposal. In a nutshell, we are both encouraged and pleased that it appears to be responsive to a number of the recommendations we previously made in a formal comment letter to the Board, particularly with respect to the importance of employing consumer testing to develop effective consumer disclosures, and the use of standardized and simplified disclosure formats. Nevertheless, based on our considerable experience in supervising credit card operations, we are likely to suggest improvements to the proposal after we study it more carefully.

Finally, Part IV provides some brief concluding remarks regarding our thoughts on the potential benefits of an updated disclosure regime and whether it will be adequate to address concerns raised about current practices. It also addresses the need for uniform approaches when addressing all these concerns, and it notes the challenges we face in seeking to modify specific market practices today when those practices are not generally restricted by current federal law or regulations.

I. BACKGROUND/EVOLUTION OF THE CREDIT CARD MARKET

Credit cards are ubiquitous in our society, with almost three-fourths of American households owning and using a credit card. Credit cards also are one of the most convenient, and commonly used, payment vehicles today. There are a number of consumer benefits to owning a credit card, including the security and convenience of not having to carry cash, the ability and ease of making payments for on-line purchases, and the ability to spread out payments for purchases over time.

Indeed, because of their convenience, security, and widespread acceptability, credit cards are used for billions of consumer purchases every year.[1] The GAO reports that, in 2005, there were more than 691 million credit cards in the market used for consumer transactions, and the value of these transactions exceeded $1.8 trillion.[2] Bank-issued credit cards are by far the

[1] The Nilson Report, February 2004, Number 805, pp. 6-9.
[2] "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, (GAO Report), p. 9.

predominant type of credit card, accounting for over 80 percent of the cards in the market.[3] Although more than 6,000 institutions issue credit cards, accounts are now concentrated among the ten largest issuers.[4] Together, these issuers hold 90 percent of the total market, with outstanding balances in excess of $700 billion.[5]

The evolution of the credit card market has been a remarkable development – from a novelty in the early 1960s available just to a small number of individuals, to an essential payment device today that offers convenient and instant access to credit to hundreds of millions of consumers, almost anywhere at almost any time. More than 40 percent of existing cardholders use their credit cards as a free means of access to the electronic payments system. These consumers pay no interest or other finance charges on their transactions because they pay their credit card balances in full each month. In the words of the GAO, convenience users "avail[ ] themselves of the benefits of their cards without incurring any direct expenses."[6]

Like other consumer credit markets, the credit card market is highly competitive, and growth is a key market objective. Card issuers have responded aggressively to increasing market competition, with innovations in card products, marketing strategies, underwriting, account management practices, and pricing strategies. The primary goals of these product and marketing innovations have been the establishment of new customer relationships and related revenue growth, issuer efficiency, and consumer convenience. In this market, credit card issuers are competitively disadvantaged when they are subject to regulatory costs that are not imposed uniformly on all issuers.

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[3] "Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances," Brian K. Bucks, Arthur B. Kennickell, and Kevin B. Moore, *Federal Reserve Bulletin* 2006, p. A31.
[4] GAO Report, p. 10.
[5] CardFlash, May 8, 2007, p. 2.
[6] GAO Report, p. 32.

Competition for customers has also led to greater credit availability through greater product and pricing choice. Over the years, consumers have been able to choose and obtain credit cards much more easily from different issuers, and certain simplified disclosures such as the so-called "Schumer box" have enabled consumers to better compare key features of credit cards. As a result, although pricing structures have evolved and become more complex, competition in recent years has led to generally lower interest rates and the elimination of most annual fees. It has also made it easy for consumers to transfer card balances to a new card and obtain more favorable terms, including temporary zero percent interest rates on transferred balances. In fact, given the maturity of the credit card market and the relatively finite number of potential new customers, the fiercest competition among card issuers appears to be in the area of balance transfers, where consumers move from one lender to another.

Interest rates on credit cards are higher than most other types of consumer lending because credit card lending is riskier. Credit card loans are unsecured, available to large and diverse segments of the population, and are repayable on flexible terms at the cardholder's convenience. Moreover, unlike closed-end loans that have fixed amounts lent and due, credit card loans are open-ended: the consumer can increase the amount of credit extended at any time up to a specified limit, and issuers generally do not separately underwrite each advance.

These unique features of credit card loans – open-ended, unsecured credit – create a unique set of risks for card issuers. One important tool they use to compensate for these risks is pricing. As noted above, pricing structures for credit cards have evolved and become more complex in recent years. At the same time that average interest rates have declined and annual fees have virtually disappeared, card issuers have adopted risk-based and penalty pricing. They have also imposed a range of fees for such transactions as balance transfers and foreign currency conversions – although despite this increased use of fees, most credit card revenue continues to be derived from interest charges, including penalty interest charges. Moreover, as noted in the GAO report, the net effect of these changes in pricing structures on card issuer profitability has generally been neutral, with profits remaining relatively stable over time.[7]

II. OCC SUPERVISION OF CREDIT CARD ISSUERS

The OCC has a robust and comprehensive risk-based program for supervising national banks' credit card operations. Our supervision focuses both on compliance with applicable consumer protection standards and safety and soundness. Through our supervision, we can address emerging risks on an institution-by-institution or broader basis and, where necessary, require correction of consumer protection or safety and soundness problems that we may find. There are four primary tools that we use to accomplish these objectives: examinations, complaint analysis, supervisory guidance, and enforcement actions. Each is discussed below.

A. Examinations of Credit Card Operations in National Banks

The OCC conducts thorough examinations of national bank credit card operations. These examinations monitor whether credit card lending complies with applicable consumer protection laws and regulations; is conducted in a safe and sound manner; and is consistent with OCC guidance.

The OCC has a large network of retail credit, credit card, and compliance specialists located throughout United States who have supervisory responsibility for the consumer compliance and safety and soundness aspects of national banks' credit card lending operations.

[7] GAO Report, pp. 69, 75.

The number of our specialists has increased significantly in the past ten years due to the growth, concentration, and increasing complexity of these operations in national banks. These examiners primarily work in the parts of the OCC that focus on supervision of large banks, mid-size banks, and specialized credit card banks.

At the largest national banks, which include many of the major credit card issuers, the OCC has resident, on-site examination teams engaged in continual supervision. At the mid-size and credit card banks, the OCC has staff dedicated to the stand-alone credit card operations. The time and attention that examiners devote to the credit card activities of other banks is directly related to the nature and complexity of the bank's operations and the associated risks. As a result, we provide more scrutiny to high-risk and complex credit card operations, with more frequent examinations than are contemplated by the general 12- to 18- month examination schedule for other banks.

The starting point for a credit card bank's examination generally is an assessment of the bank's risk profile. This assessment identifies particular risks facing the bank, as well as any emerging industry-wide risks, based on information available to the examiners and risk assessments conducted by the bank. The examination process includes a review of fundamentals such as the reasonableness of the bank's credit card business model and strategic planning; the effectiveness of the bank's controls; financial strength; and compliance with laws, regulations, and relevant supervisory guidance. Examiners assess the adequacy of policies and procedures through reviews of various functions including marketing practices, underwriting, account management, collections, and loss mitigation. In addition, examiners review the bank's use of credit scoring and other models, and, as warranted, bring in quantitative analytical specialists to assess model development and validation.

In addition to ongoing monitoring, our large bank resident examiners complete periodic targeted reviews throughout the year. These reviews are used to test and validate the integrity and reliability of management's control processes, including compliance with bank policies and procedures, laws and regulations, and regulatory guidance. In the largest credit card operations, it is common for examiners to complete several targeted reviews within a 12-month cycle.

Targeted reviews typically include a sample of individual accounts to assess the adequacy of the bank's systems, controls, legal compliance, and compliance with OCC regulatory policies or guidance. For example, in the past two years, examiners completed in all large bank and specialized credit card operations targeted reviews of credit card disclosures for compliance with laws, regulations, and OCC guidance, and account level transaction testing in the areas of account management and collections. Other targeted reviews included evaluation of new account underwriting processes and compliance with privacy requirements. If potential consumer compliance issues surface in the course of these examinations or are otherwise brought to examiners' attention through consumer complaints or other sources, examiners and other OCC personnel assess whether the practices in question violate applicable laws and regulations or OCC guidance and standards.

In this context, let me emphasize one very important point: the OCC's supervisory process can result in significant reforms to bank practices and keep banks on a proper course *without the need to resort to formal enforcement actions.* OCC examiners have significant supervisory authority and influence over the activities of national banks. The flow of communication between the bank and OCC examiners is open and continual. The traditional confidentiality of the bank examination process facilitates this free flow of information. Bank management is expected to be open and forthcoming, and examiners expect to get the information they need to evaluate whether the bank is operating in accordance with applicable law and in a safe and sound manner. Examiners, in turn, are direct and frank in expressing any concerns they have about the bank and in describing any corrective actions they believe are needed.

Indeed, the supervisory process is a continual process of communication between the OCC and the banks we supervise; it does not depend on discrete “compliance” examinations that occur at particular intervals during a multi-year period, nor does it rely in the first instance on formal enforcement actions. OCC supervision results in adjustments, corrections, and remediation on an ongoing basis by national banks. When our examiners identify an issue, they expect it to be resolved in a timely manner. Examiners use a wide range of measures to obtain desired results. These include nonpublic memoranda of understanding as well as communications in a confidential examination report of “matters requiring attention” of bank management and boards of directors. The bank’s corrective action in response to these documents is closely monitored by supervisory staff.

The supervisory process can be especially effective in addressing problems early, before they become more widespread. Moreover, because the supervisory process can effect swift change in bank practices without the need to resort to formal enforcement actions, it is a highly valuable tool that is unavailable in “enforcement only” regimes. Because bank supervision involves confidential communications with regulated institutions, however, and because much of the problem identification and corrective measures occur “behind the scenes” and without public fanfare, the process is often not well known or fully understood. While the OCC does not hesitate to bring an enforcement action when appropriate, in practice, the need to do so is relatively infrequent. In the supervisory process of comment and response, banks typically agree to changes and remediation recommended by examiners and, thus, we are able to address supervisory concerns much more quickly than would be the case if we relied first and foremost on formal enforcement actions.

Based on our supervisory experience, we believe that the vast majority of the credit card issuers supervised by the OCC are complying with consumer protection laws and regulations, are operating in a safe and sound manner, and are striving to balance their business objectives with customer needs. But credit card issuers are not perfect. National bank credit card issuers hold over 300 million credit card accounts. Mistakes can happen. And, as noted earlier, the credit card market is highly competitive, and on occasion, some issuers may adopt aggressive changes to their credit card programs and products, and marketing and account management practices, without fully addressing all of the related risks to consumer protection and safety and soundness or without fully anticipating the potential for systems problems associated with those changes.

The OCC can address many of these issues and achieve corrective action as part of our supervisory process. Indeed, through this process, national banks have changed their practices and provided financial relief to customers to address specific concerns identified by the OCC. These have included revisions to minimum payment requirements; credit line increase and workout programs; over-limit authorization and fee assessment procedures; and the timeliness of posting payments. And of course, as described in more detail below, where the supervisory process by itself is not effective in producing necessary change, the OCC can and will turn to its broad range of formal enforcement tools to achieve the desired result.

There are limits, however, to what can be accomplished through OCC's supervision and enforcement. We have been successful in achieving changes in bank policies and practices through supervisory actions where such policies and practices fail to comply with consumer protection requirements that the OCC has been charged with implementing, raise safety and soundness risks, or risk violating prudential standards – such as the prohibition on unfair and deceptive practices. Our ability to effect change is more limited, however, if a practice does not put a bank at risk of violating applicable laws and regulations – and in some cases may even be specifically permitted by them (such as double-cycle billing), and does not present safety and soundness risks. And, of course, our supervisory activities cannot direct the practices of credit cards issuers that are not subject to OCC supervision.

B. OCC Consumer Complaint Process

1. *Description of CAG Operations and the Number and Source of Consumer Complaints*

The OCC's Customer Assistance Group (CAG) provides assistance to customers of national banks and their subsidiaries by fielding inquiries and complaints from, or on behalf of, these customers. CAG also supports our supervision of bank credit card operations. Many complaints received by CAG concern credit card products. CAG's complaint processing and analysis often helps to address individual problems and educate consumers about their financial relationships. It also frequently leads to resolution of the complaints by the bank and secures compensation or other relief for customers who may not have a more convenient means for having their grievances addressed.

CAG integrates skilled professionals and effective use of up-to-date technology to address bank customer concerns, and our significant investment in the success of this operation has resulted in its becoming a leader among government complaint analysis and resolution functions.[8] CAG is staffed by customer assistance specialists who have backgrounds in consumer law, compliance, and bank supervision, and who can process written complaints and telephone calls in both English and Spanish. Additionally, other OCC personnel, including attorneys in the OCC Law Department, regularly assist CAG staff with more complex issues or problems.

CAG processes approximately 70,000 complaints and inquiries each year on a multitude of consumer issues that are received through a variety of channels, including orally and in writing. Many of the complaints are received directly from consumers. But there are numerous other sources as well, including Congress, federal agencies, state attorneys general, state banking departments, or other state agencies. For instance, CAG receives thousands of complaints each year in referrals from state entities.

In this regard, I am very pleased about the significant progress we have made in working with our state counterparts to improve consumer complaint information sharing. A few months ago, the OCC and the Conference of State Bank Supervisors (CSBS) agreed on a model Memorandum of Understanding (MOU) that is intended to facilitate the sharing of customer complaints. The MOU provides that we will direct complaints to the appropriate agency – for example, complaints about non-national bank companies will be directed by the OCC to the appropriate state regulator, and state agencies will refer national bank complaints to CAG. In addition, the MOU permits state agencies to obtain periodic reports from us on the disposition of complaints they have referred to CAG, without compromising consumer privacy.

[8] *See* "Remarks by John C. Dugan before the Exchequer Club and Women in Housing and Finance," (January 17, 2007) (discussing the sophisticated systems used by CAG in connection with the complaint resolution process), www.occ.gov/ftp/release/2007-4a.pdf.

With the assistance of CSBS, we are in the process of entering into complaint information sharing agreements with individual states, and the process is moving along very well. We have executed 18 agreements since November, beginning with the New York State Banking Department, and others are on the horizon. I am also very encouraged by the progress of work that we have underway to put in place new technology systems to facilitate complaint information sharing and route consumers to the appropriate state or federal regulator to assist in resolution of their complaints.

2. *Credit Card Complaints and CAG's Role in Assisting Consumers*

In each of the last few years, credit card issues accounted for approximately 40 percent of the total complaints and inquiries received by CAG. Roughly 10,000 written complaints out of a total of 27,000 received by CAG in 2006 concerned credit cards. Almost 14 percent of the complaints about credit cards we received in 2006 concerned changes to existing account terms. About seven percent of credit-card related complaints concerned fees and other charges, such as the amount of over-limit and late payment fees, late fees assessed in error, allegations of "bait and switch" tactics in connection with fee increases, and the adequacy of fee disclosures. Less than one percent of credit card complaints concerned allocation of payments issues – generally in connection with balance transfer situations. The remaining credit card complaints dealt with a variety of issues, including periodic statements, advertisements and solicitations, and credit balances.

When CAG receives a signed written complaint, it contacts the national bank involved and requests a response regarding the consumer's complaint or inquiry and, if relevant, supporting documentation. CAG evaluates the bank's response, consults with other OCC personnel, requests additional information from the bank or consumer as necessary, reaches a final conclusion regarding the matter, and notifies the consumer or other complainant of its findings.

Over the last five years, CAG has generated almost $9.5 million in financial relief for national bank customers with complaints about their credit cards. CAG cannot always provide the relief requested by the consumer, however. In some instances, the consumer’s complaint may hinge on the resolution of factual disputes, which the OCC simply is not in a position to adjudicate. In other cases, the basis for the consumer’s grievance is that he or she is simply unhappy with the terms of his or her contract with the credit card issuing bank. This can include contract provisions governing the amount of fees, changes to the terms, and balance calculation methods.

3. *Impact of Consumer Complaint Information on Bank Supervisory Activities*

In addition to providing relief and assistance to individual consumers, data derived from the CAG process plays an important role in identifying problems – at a particular bank or in a particular segment of the industry – that warrant further investigation by examination teams, enforcement action, or supervisory guidance to address emerging problems.

OCC supervisory guidance requires examiners to consider consumer complaint information when assessing a bank’s overall compliance risk and ratings, and when scoping and conducting examinations. The complaint data collected by CAG are summarized and distributed to OCC examiners to help them identify issues that warrant further review. Examiners have nearly real-time access to an electronic database that stores consumer complaints and other relevant data for use in bank examinations. Examiners may use this information in assessing risks at the banks they examine, as well as in planning and scoping examinations to target areas of potential concerns. CAG specifically alerts examiners if the volume, patterns, or types of complaints concerning a particular bank appear to warrant immediate attention. When complaints indicate potentially inappropriate or unfair or deceptive practices, OCC lawyers become involved, and we have taken enforcement actions to address these issues. Moreover, as discussed more fully below, an important component of OCC supervision is the guidance we issue to alert national banks to emerging risk areas. CAG information also informs OCC policy personnel on the need for additional supervisory guidance, such as guidance related to credit card marketing practices.

Finally, OCC guidance requires national banks to monitor and address consumer complaints that they receive, whether from consumers directly or through CAG. To encourage banks to address the underlying factors that may be contributing to consumer complaints, CAG provides aggregate feedback to banks on credit card practices that, based on complaint volume received, need improvement. CAG is in contact with banks with large complaint volumes regularly, through telephone and email exchanges, and through annual meetings with bank management.

C. OCC Supervisory Guidance

The OCC does not have legal authority to issue regulations under the primary consumer protection statutes governing credit card activities; instead, such authority is vested in the Federal Reserve Board. Nevertheless, an integral component of OCC supervisory activities is the issuance of guidance to national banks on emerging and significant risks. We use joint agency issuances and OCC guidance to explain regulatory requirements. In areas where regulations have not kept pace with the changes and complexities in credit cards terms and marketing practices, we also have used OCC guidance to alert national banks to practices that pose consumer protection or safety and soundness risks, and to give guidance on how to manage these risks and prevent problems from arising. And, the OCC follows up through the supervisory process to assess national banks' implementation of the recommendations contained in our guidance.

The OCC has been actively engaged in developing supervisory guidance on credit card issues, and this guidance has led to real improvements in credit card practices.[9] For example, we have issued a number of supervisory guidance documents over the last five years, including:

- OCC Bulletin 2003-1, Credit Card Lending: Account Management and Loss Allowance Guidance (January 2003)
- OCC Advisory Letter 2004-10, Credit Card Practices (September 2004)
- OCC Advisory Letter 2004-4, Secured Credit Cards (April 2004)

Each of these guidance documents is discussed below.

1. *Account Management and Loss Allowance Practices Guidance*

In January 2003, the federal bank and thrift regulatory agencies issued guidelines to address concerns with credit card account management practices. The interagency guidance, *Credit Card Lending: Account Management and Loss Allowance Guidance*, the development of which was led by the OCC, addressed five key areas: 1) credit line management, 2) over-limit practices, 3) minimum payment and negative amortization, 4) workout and forbearance practices,

[9] These issuances supplement our examination handbooks and procedures on credit card and retail lending.

and 5) income recognition and loss allowance practices. The issues covered by the guidance initially surfaced in the subprime credit card market, but follow-up examinations identified similar concerns involving several prime credit card lenders.

In particular, through the examination process, examiners had identified concerns with practices for assigning the initial credit lines to borrowers and increasing existing credit lines. In some instances, borrower credit lines were increased without the proper underwriting analysis to support the increases. Some borrowers who then increased their credit card charges were unable to make their payments, which led to an increase in delinquencies and losses. The guidance describes the agencies' expectations for banks when they establish initial credit lines for customers and when they increase those credit lines.

Examiners also identified weaknesses in income recognition and loss allowance practices. Because of the revolving nature of the credit card product and low minimum payment requirements, a portion of the interest and fees were being added to the balances and recognized as income. The agencies' guidance reiterated the principle that generally accepted accounting practices require that loss allowances be established for any uncollectible finance charges and fees. The agencies also directed credit card lenders to ensure that loss allowance methodologies covered the probable losses in high-risk segments of portfolios, such as workout and over-limit accounts. Based on our observations, the industry responded quickly to this portion of the guidance and increased their loss allowances where needed.

Prior to the guidance, examiners also had observed that loan workout and forbearance practices varied widely, and in some instances raised safety and soundness concerns. These workout programs were often not adequate to enable consumers to repay the amounts owed. In particular, some workout programs extended repayment periods with only modest reduction in the interest rates being charged. To address the concerns raised by these practices, the guidance reminded the industry that workout programs should be structured to maximize principal reduction, and it also stated that repayment periods for workout programs should not exceed sixty months. To achieve this, banks now typically lower interest rates and stop assessing fees.

Over-limit practices, where a borrower exceeds the credit limit on the account, can raise both safety and soundness and consumer fairness concerns. Examiners had observed that credit card accounts had been allowed to remain in over-limit status for prolonged periods with recurring monthly over-limit fees. The guidance directed banks to establish reasonable controls and ensure timely repayment of amounts that exceed credit limits, to promote responsible credit management.

Finally, examiners had become concerned about an industry trend toward declining minimum payment requirements, particularly at a time when credit lines, finance charges, and fees were increasing. Some borrowers who made only the required minimum payments were unable to meaningfully reduce their credit card balances. Others who made such required minimum payments would actually see their principal balance <u>increase</u>. This occurred through the process of "negative amortization," *i.e.*, where the minimum payment was insufficient to cover the finance charges and other fees imposed, including over-limit fees, and the amount unpaid was added to the total outstanding debt. In other words, credit card lenders were allowing borrowers to make minimum payments that were so low that the borrowers' total amount of debt could increase each month even without new charges.

The guidance required banks to address these issues through a systematic reevaluation of payment requirements and fee assessment practices. In particular, the guidance provided that minimum payment requirements pay down balances over a reasonable period of time – amortize them – consistent with the unsecured nature of the underlying debt. The guidance also provided that prolonged negative amortization, inappropriate fees, and other practices that inordinately compound or protract consumer debt raise consumer fairness and safety and soundness concerns and are subject to examiner criticism.

The OCC followed up through our supervisory process to ensure that national banks conformed their practices to the guidance. In order to be clear that this occurred, the agency took the unilateral step of drawing a bright line: we directed banks to eliminate prolonged periods of negative amortization by raising their minimum payments to cover all accrued interest and late fees, <u>plus</u> at least one percent of the principal balance outstanding. In addition, we required banks to include other recurring fees (e.g., overlimit fees) in the minimum payment or waive them after three consecutive months. In general, these instructions mean that a consumer that makes his or her required minimum monthly payment will <u>decrease</u> his or her outstanding balance, not increase it.

Most national banks immediately addressed the changes in the guidance relating to credit-line management, workout programs, and loss allowance practices. Conforming changes to over-limit, minimum payments, and negative amortization practices were not immediately implemented, however, and met with stronger resistance from some credit card lenders. This resistance by national bank credit card issuers was based on, among other things, competitive concerns about an "unlevel playing field" with respect to non-national bank credit card issuers who might not be similarly required to implement the guidance. In these instances, the OCC nevertheless insisted on consistent implementation by national banks of the changes called for in the guidance.

2. *Credit Card Marketing and Change in Terms Practices Guidance*

Credit card practices involving marketing and changes in terms also have been the focus of OCC supervisory guidance because of our concern that they could expose national banks to substantial compliance and reputation risks. The OCC issued Advisory Letter 2004-10 in September 2004 to advise national banks about the risks that these practices may violate the prohibition in the Federal Trade Commission (FTC) Act against unfair or deceptive practices. The Advisory Letter provides that national banks should not:

- Increase a consumer's rate or other fees when the circumstances triggering the increase, or the creditor's right to implement that increase, have not been disclosed fully or prominently;
- Utilize advertising designed to catch a consumer's attention in advertising materials with promotional rates, commonly called "teaser rates," without also clearly disclosing material restrictions on the applicability of those rates; and
- Advertise credit limits "up to" a maximum dollar amount, when that credit limit is, in fact, seldom extended.

a. Universal Default, Unilateral Change in Terms, and Other Pricing Practices

Over the past several years, card issuers have used tools other than the initial interest rate to compensate for increased risks in a customer's profile over time. For instance, some credit card issuers impose a much higher "penalty rate" on a credit card for consumers who do not make timely payments on other obligations to the same lender or on obligations to other lenders – a practice sometimes referred to as "universal default" pricing. Such issuers argue that the increased interest rate is necessary to address the increased risk indicated by the borrower's default on other credit. But the practice has drawn sharp criticism from consumers – especially when they were unaware that their failure to make payments on other debts could affect the interest rate on their credit card. In the wake of this criticism, very few national banks continue to use universal default pricing. However, default pricing is still commonly used to address defaults on credit obligations with the issuing bank.

Card issuers may also raise the interest rate on a credit card to address other indicators of increased risk. Examples include high use of a consumer's credit line, failure to make timely payments, or a change in credit score (which may or may not reflect consumer behavior with respect to other credit obligations). This type of risk-based pricing is different from universal default pricing because it is typically based on a more sophisticated analysis of risk (rather than a failure to make payments due on other obligations to the card-issuing bank or to other lenders); results in a more calibrated rate increase when warranted; and requires advance notice before taking effect. In addition, most large national bank issuers provide consumers with the right to "opt out" of the increased rate on his or her pre-existing balance, but the ability to use the card for future charges is also generally curtailed. Such risk-based pricing, unlike universal default, is an increasingly common practice for credit card issuers, including national banks.

Lenders have sought to justify risk-based pricing as more reflective of increased risk than simple universal default pricing. They have used similar arguments to justify raising the cost of credit in other ways, such as shortening the period allowed for payments and increasing cash advance, over-the-limit, late payment, or similar fees. In such instances, lenders point particularly to the fact that the risks associated with open-end unsecured credit can increase substantially over time, and that failure to use risk-based pricing could well result in higher upfront interest charges, more limited credit availability, and shorter terms for card renewals (with increased use of lender options not to renew). While such arguments may well be valid, the increased fees and higher interest rates that accompany risk-based pricing have also been the object of significant public criticism. Risk-based pricing related issues are the source of many consumer complaints the OCC has received – with the sharpest arising from those who were unaware of the circumstances that could trigger such increased costs of credit.

It is important to note that federal law, including TILA, does not restrict the ability of creditors to include provisions in credit card contracts permitting "default" or penalty interest rates, other changes in interest rates, or other changes in the terms of the account. Indeed, Regulation Z implicitly recognizes that penalty rates may be charged in that it requires such rates to be disclosed in solicitations – although the manner of disclosure currently required may not effectively alert customers to these terms. For example, except in certain transactions, the disclosure of when penalty rates will apply is not required in the existing "Schumer box" disclosures, and need not be as detailed as the explanation later provided in the account opening disclosures. Moreover, current Regulation Z rules contain notable anomalies: in contrast to sometimes detailed disclosures provided to consumers about a credit card's costs, Regulation Z currently does not require a disclosure about the material fact that a creditor has reserved the right to change, unilaterally, these costs and any other credit terms.

The OCC addressed compliance and reputation risks that accompany change in terms practices in AL 2004-10. We made clear that, to avoid consumer misunderstanding and complaints of unfairness, we expect national banks to do more than merely comply with the technical requirements in Regulation Z. The OCC guidance states that national banks should disclose, fully and prominently in promotional materials, the specific circumstances under which the card agreement permits the bank to increase the consumer's APR, fees, or other costs (such as for late payment to another creditor). Additionally, if national banks reserve the right to change the APR, fees, or other credit terms for any reason at the bank's discretion, the OCC advisory provides that this fact should be disclosed fully and prominently in both marketing materials and account agreements.

The OCC advisory does not restrict the ability of a bank to base initial credit pricing decisions, and subsequent changes to pricing, on events of "default" or other risk factors. Indeed, changes in terms can be appropriate ways to manage credit risk in credit card accounts and, as noted above, TILA does not prohibit these actions. But, because of the heightened risks of unfair and deceptive practices involving re-pricing – in particular, when it may not be apparent to a consumer that the increased rate can apply retroactively to existing balances and not solely to new balances – we have advised national banks that they should always fully and prominently disclose this material information before a consumer commits to a credit card contract.

The OCC's experience here is a good example of the significant potential effects of improved consumer disclosures. We believe that, in part because of the disclosures required by our guidance -- and frankly, in part because of the scrutiny of this Subcommittee in its deliberations on the Fair and Accurate Credit Transactions Act of 2003 (FACT Act) -- national banks moved away from the practice of simple universal default pricing. Not only did the disclosures provide consumers with more choice, but they also "shined the spotlight" on the practice, making it more transparent for the public, critics, and members of Congress – and that combination of consumer choice and transparency seemed to have a palpable effect on issuer behavior. Indeed, the GAO noted in its 2006 report that around the time that the OCC issued AL 2004-10, many issuers stopped using universal default provisions.[10]

b. *Teaser Rate Marketing and Balance Transfer Solicitations*

A common marketing technique used in credit card solicitations involves teaser rates. Frequently, teaser rates are used in promotions seeking to induce new and existing customers to transfer balances from other credit cards. The promotional rate, almost always highlighted prominently in the marketing materials, is usually in effect for a limited period after the account is opened or the relevant balance is transferred. Other important limitations on the availability of the promotional rate, or on the consumer's ability to take advantage of that rate, often apply – although they may not be disclosed prominently. For instance, the lower, promotional rate may apply only to balances that are transferred, and a higher rate may apply to purchases and other credit transactions during the promotional period. Frequently, a consumer's payments during the promotional period are applied first to the transferred balance, and only after this low-rate balance is paid off will payments be applied to balances that are accruing interest at a higher rate. There also may be other costs, such as balance transfer fees, that affect whether the consumer will benefit from accepting a promotional rate offer.

In some circumstances, consumers can lower their credit costs when they transfer balances to a new account with an introductory rate. The costs and limitations on these rates and accounts, by themselves, are not unlawful or inappropriate – but it is vital that the consumer understands the terms of the transaction. Problems arise when consumers accept offers without understanding the true terms. This, in turn, can lead to increased complaints and increased

[10] GAO Report, p. 26.

exposure to claims of "bait and switch," especially when the consumer accepts the offer without knowing the circumstances in which the creditor can change the terms, including unilaterally.

The Federal Reserve Board's Regulation Z governs many aspects of promotional rate offers. Direct mail credit card solicitations must display prominently in a tabular format each APR that will apply to purchases and balance transfers. However, Regulation Z currently does not restrict the ability of a creditor to highlight only the teaser rate in other materials included in the mailing without noting any limitations on the offer (or to do so only in fine print).[11] Further, Regulation Z currently requires no disclosure of the order in which payments will be applied to various balances. Finally, while balance transfer fees must be disclosed in solicitations, they are not required under existing rules to be disclosed in a "prominent location," even in solicitations expressly offering the consumer a promotional rate on a balance transfer.

The OCC's AL 2004-10 provides guidance on how to "fill in the gaps" in these rules for the responsible use of promotional rate advertising. The guidance advises national banks to disclose fully and prominently the categories of balances or charges to which the promotional rate will not apply. The advisory also states that a national bank should not fail to disclose fully and prominently other material limitations, such as the period the rate will be in effect and any circumstances that could shorten the promotional rate period, and related costs. Moreover, if applicable, a national bank should disclose fully and prominently that payments will be applied first to promotional rate balances.

[11] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 amended TILA in several respects to address disclosures affecting credit card accounts, including disclosures related to "introductory rates," minimum payment disclosures, and payment due dates where the creditor may impose a late payment fee.

c. *Marketing Based on Maximum Credit Limits – "Up-to" Offers*

Another marketing practice that the OCC has monitored concerns promotions based on the highest attainable credit limit – such as "you have been pre-approved for credit up to $5,000." We became concerned when we observed that this marketing might be targeting consumers with impaired or limited credit history, and potentially enticing them to accept a credit card based on an illusory "firm offer" of a specific amount of credit. Instead of receiving the credit line that was promoted, these consumers would instead receive a "default credit line" (the minimum credit line) that was significantly lower than the maximum. All too often in marketing of this type, the possibility that a significantly lower credit line might be extended was either not disclosed or disclosed only in fine print or in an obscure location. When initial fees were charged that were high in relation to the credit line extended, consumers who accepted the offer would end up with little initial available credit and little card utility.

The OCC addressed "up to" marketing in AL 2004-10. The advisory states three general guidelines for managing risks and avoiding unfair or deceptive practices in these promotions. First, we advised national banks not to target consumers who have limited or poor credit histories with solicitations for credit cards advertising a maximum credit limit that is far greater than most applicants are likely to receive. Second, we advised national banks to fully and prominently disclose the amount of the default credit line and the possibility that the consumer will receive it, if it is likely that consumers will receive substantially lower default credit lines. Finally, we advised national banks not to promote cards on the basis of card utility if the initial available credit most consumers receive is unlikely to allow those uses.

As noted above, the OCC follows up through the supervisory process to ensure that national banks are addressing risks identified in agency guidance and making changes as appropriate to address those risks. Shortly after we issued AL 2004-10, the OCC reviewed direct marketing materials and credit agreements from eleven national banks with credit card operations, including the largest issuers, to compare how their disclosures on promotional rates and changes in terms conformed to the standards in our advisory letter. In general, we found that most of the banks surveyed disclosed restrictions on teaser rates and the possibility of changes in credit terms, but that the prominence and completeness of these disclosures needed to be improved. The materials we reviewed also generally did a good job of telling the consumer what constitutes a "default" that will give rise to higher default pricing. The materials typically did not warn the consumer, however, about the other types of circumstances – short of "default" – that could result in a change of terms. We provided feedback to the banks we surveyed, and all of the banks concerned addressed the issues we identified.

While AL 2004-10 includes general guidance as well as a number of specific recommendations and requirements, I want to emphasize what it does not do. It does not prohibit universal default, risk-based pricing, or unilateral change-in-terms contract provisions, nor does it define any practice as *per se* unfair or deceptive. While the advisory cautions banks that such practices may involve unfair or deceptive acts or practices or other violations of law, particularly if consumers fail to receive appropriate disclosures of these material contract terms, it does not restrict the ability of a bank to base initial credit pricing decisions, and subsequent changes to pricing, on risk factors. Indeed, as I noted earlier, these practices are not barred by federal law or Regulation Z, and if fairly disclosed and implemented, risk-based pricing and other changes in terms can be appropriate ways to manage credit risk in credit card accounts.

3. *Secured Credit Cards*

The OCC also has issued supervisory guidance that focuses on discrete issues affecting credit card products, such as our guidance on secured credit cards. These cards require a borrower to pledge collateral as security for the credit line extended. The borrowers who receive these cards typically are individuals with limited or blemished credit histories who cannot qualify for an unsecured card. In some respects, these products can benefit these consumers by allowing them to establish or improve their credit histories.

Traditionally, secured credit cards have required that borrowers pledge funds in a deposit account as security for the amounts borrowed under the credit card account. In the event of default, the deposited funds may be used to help satisfy the debt. Over time, however, some issuers began to offer secured credit cards that did not require the consumer to pledge separate funds in a deposit account as collateral in order to open the credit card account. Instead, the security deposit for the account would be charged to the credit card itself upon issuance. This practice resulted in a substantial decrease in the amount of credit that was available for use by the consumer when the account was opened. Unsecured credit card products also have been offered with similar disadvantages, except that account opening fees, rather than a security deposit, are charged to the account and consume much of the nominal credit line assigned by the issuer.

These developments in secured credit card programs – in combination with marketing programs targeted at subprime borrowers that often did not adequately explain the structure or its likely consequences – meant that consumers were misled about the amount of initial available credit, the utility of the card for routine transactions, and the cost of the card. Again, existing

Regulation Z disclosures generally do not provide information to consumers about credit limits and initial available credit. Moreover, while account opening disclosures prescribed by Regulation Z require, if applicable, a general disclosure pertaining to security interests, there is no such requirement for credit card solicitations or advertisements. Thus, these rules omit disclosure of key information that would provide consumers, at a decision point, a full understanding of a secured credit card product's cost and terms. They also offer little guidance to lenders that may have wished to present such information in a comprehensible and responsible manner.

The OCC reviewed marketing materials and found significant omissions of material information about the likely effect that charging security deposits and fees to the account would have on the low credit line that was typically extended, and about the consequent impairment of available credit and card utility. While these marketing practices generally complied with the specific credit cost disclosure requirements of TILA and Regulation Z, the OCC determined that they raised considerable compliance risks under the FTC Act as deceptive practices. We also reviewed whether the practice of charging substantial security deposits and fees to a credit card account and severely reducing the initial credit availability could also be found to be unfair within the meaning of the FTC Act. Evidence available to us indicated that consumers were materially harmed by these practices when the product received by most consumers fails to provide the card utility and credit availability for which consumers have applied and incurred substantial costs. Based on this review, the OCC concluded that this practice also posed considerable compliance risks under the FTC Act.

To address these concerns, the OCC issued Advisory Letter 2004-4, "Secured Credit Cards." The advisory directs national banks not to offer secured credit card products in which security deposits (and fees) are charged to the credit card account, if that practice will substantially reduce the available credit and the utility of the card. The OCC also advised that national banks should not offer unsecured credit cards that present similar concerns as a result of initial fees charged to the card.

As a result of our advisory letter, supervisory suasion, and enforcement actions described below, we believe that the significant supervisory concerns we had relating to secured credit card products offered by national banks have been addressed.

D. OCC Enforcement Actions

As noted earlier, when our examiners identify an issue, they expect it to be fixed in a timely manner, without having to resort to a formal enforcement action. National banks typically agree to address deficiencies identified in the examination process, and formal enforcement actions are not the first tool we look to in order to achieve corrective action and remediation. Occasionally, however, a bank may dispute the action sought, and a formal action may be needed, or a formal action may be appropriate based on a failure to take the action sought or on the nature and gravity of the issue. In such cases, the OCC will take a formal enforcement action. The OCC has authority to address unsafe and unsound practices and to compel compliance with any law, rule, or regulation, including TILA, the Fair Credit Reporting Act, the Equal Credit Opportunity Act, and the prohibition on unfair or deceptive practices in section 5 of the FTC Act – the principal federal statutes that provide specific protections for credit card applicants and borrowers. This authority allows the OCC to require national banks to cease and desist from engaging in unsafe or unsound practices or actions that violate consumer protection laws. Further, the OCC may seek restitution for affected consumers in these and other appropriate cases, and assess civil money penalties against banks and their "institution-affiliated parties."

In particular, the OCC was the first federal banking regulator to use its general enforcement authority in combination with the prohibition in section 5 of the FTC Act against unfair and deceptive practices to bring an enforcement action against a national bank in connection with the bank's credit card lending operations. This use of section 5 of the FTC Act was initially greeted with skepticism, but the OCC believed it was both necessary and lawful to address practices that the agency concluded were unfair and deceptive. This enforcement position has since been adopted by all the federal bank regulatory agencies.

Our very first use of this authority in May 2000 led to a consent order that required the bank to, among other things, provide at least $300 million in restitution for deceptive marketing of subprime credit cards and ancillary products; cease engaging in misleading and deceptive marketing practices; and take appropriate measures to prevent such practices in the future, including by modifying its policies and telemarketing scripts to ensure the accurate disclosure of all fees, charges, and product limitations before a consumer purchases a product.

Since that time, we have taken seven additional unfair and deceptive enforcement actions specifically relating to credit card practices, most involving subprime credit card issuers, which are described in Appendix A. In total, these enforcement actions have provided hundreds of millions of dollars in restitution to consumers harmed by unfair or deceptive credit card practices, and have required changes to reform a variety of credit card practices. As a result of our actions, few, if any national banks today specialize in subprime credit card lending.

III. CREDIT CARD DISCLOSURES: EXISTING PRACTICES AND NEED FOR CHANGE

A. Benefits of Effective Disclosure and Shortcomings of Existing Practices

The GAO has observed that disclosures are the primary source of consumer protection for credit card customers under federal law.[12] The OCC agrees with that observation, although, as indicated above, there have been particular circumstances in which the agency has directed card issuers to take particular actions in addition to disclosures to avoid unfair and deceptive practices or for safety and soundness reasons. We believe that truly effective disclosure of credit card fees, costs, and material terms has three fundamental benefits.

First, it provides consumers with meaningful choice, as it allows them to fairly compare the terms of available credit products.

Second, it causes card issuers to engage in healthy competition on the terms disclosed in order to affect those consumer choices, with more firms seeking to provide the terms that consumers really want. Indeed, one can make a strong argument that the simplified disclosures provided in the "Schumer box" as the result of legislation in 1989 helped stimulate the competition that resulted in today's prevailing practice of lower interest rates and the virtual elimination of annual fees.

Third, it makes card issuer practices more transparent, and the glare of publicity can itself affect issuer behavior in ways that benefit consumers. Public scrutiny and criticism of the most aggressive credit card practices, including congressional hearings like this one today, have plainly been a factor in causing a number of card issuers to move away from such practices. Meaningful, effective disclosure facilitates this process – and can cause issuers to think long and hard before engaging in a new type of aggressive practice that will be exposed immediately to public view.

These, then, are the potential benefits of effective public disclosure. But as this hearing demonstrates, the past few years have witnessed increasing public concern about whether credit card disclosures are in fact truly effective. These increased concerns coincide with – and possibly reflect – significant changes in the way credit card accounts are marketed and managed by card issuers. Indeed, the GAO recently concluded that the disclosures about credit cards currently required by federal regulations have not been effective in protecting consumers against inaccurate and unfair credit card practices.[13] Among other things, the GAO found that disclosures were:

- Written at a level that is not likely to be understood by many consumers;
- Poorly organized and formatted; and
- Overly complex and detailed.

The GAO determined that federal regulations also have not been effective in helping consumers understand certain material terms and conditions of their credit card accounts, including default interest rates, other penalty rate increases, late payment fees, cash advance fees, grace periods, and balance computation methods.

In addition to issues of disclosure quality, a number of credit card practices in existence today have been criticized as inappropriate, misleading, or even unfair to consumers, and some

[12] GAO Report, p 33.
[13] GAO Report, p. 33.

have called for the federal banking agencies – or Congress – to flatly prohibit the practices. For example, practices such as universal default, unilateral change in terms, and the two-cycle average daily balance computation method ("double-cycle billing") have been singled out for particular criticism.

As described above, universal default provisions are triggered and permit a creditor to impose higher rates of interest on new and/or existing credit card balances where the consumer is delinquent on another obligation to the same institution or to another lender. Unilateral change-in-terms provisions, which are common in open-end credit card agreements, permit a lender to change any terms on a credit card account, including the interest rate, for any reason and at any time, most frequently based on indicators of change in the consumer's risk profile, subject to advance notice to the consumer. Double-cycle billing permits a creditor to compute the finance charge based on two billing cycles if a consumer, with no prior balance, makes only a partial payment of the balance by the payment due date. In effect, with double-cycle billing, the "grace period" for making payments without incurring a finance charge is retroactively eliminated. (To illustrate, if a consumer who made $1,000 in purchases in month one pays only $990 of the balance by the payment due date, $10 is carried over into the month two billing cycle. If the credit card issuer uses the double-cycle billing method and no new transactions are made in month two, finance charges on this account would be calculated taking the average daily balance of $1,000 in month one and $10 in month two, instead of calculating it on just the average daily balance of $10 in month two.)[14]

Absent effective disclosure, particular practices may not only be unexpected, but also perceived by the consumer as unfair, such as imposing a penalty rate on existing balances when the consumer assumed that the rates in effect when the transactions were made would apply until the balances were paid in full, or eliminating the grace period if the consumer's payment is less than the entire outstanding balance when the consumer assumed that it would apply to the extent of any payment made.

As already described, the OCC has taken a number of steps to address the issues raised by inadequate and ineffective disclosure of credit card practices, as well as practices that raise safety and soundness issues or may be characterized as unfair or deceptive under the FTC Act. The tools we use include comprehensive examinations, complaint resolution, and enforcement actions. In addition, we have taken a number of supplementary steps – including issuing preventive guidance – to address issues particular to credit card activities that are not specifically addressed by federal laws or regulations, specifically including inadequate and ineffective disclosure. And, we have seen real improvements in credit card operations as a result of our supervisory activities and corrective steps taken – at our behest – by national banks.

But there are limitations to what can be accomplished through unilateral OCC supervision, supervisory guidance, and case-by-case enforcement actions to change disclosure practices across a highly competitive industry where we do not have rule-writing authority and where some major participants are not subject to OCC supervision. Moreover, the OCC is limited in what we can do where the practices at issue have not been specifically restricted by Congress or existing regulations, and indeed, in some cases are implicitly authorized by Regulation Z in that the regulation expressly prescribes how such practices must be disclosed.

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[14] GAO Report, at pp. 27-28.

B. Federal Reserve's Proposed Changes to Regulation Z

That is why the Federal Reserve Board's undertaking to review and revise its Regulation Z disclosure rules is such an important step. Changes to Regulation Z would set new, uniform standards for all credit card issuers, not just national banks. This provides the opportunity to give all credit card customers the key information they want, at the times that they need it, in a form they can readily understand and use.

The Board's current rulemaking is its first major proposed revision to the Regulation Z rules on credit card disclosures since its implementation in 1989 of the Fair Credit and Charge Card Disclosure Act. The features of credit card products that were determined to be most important to consumers then are not necessarily the most important today, given the substantial changes in marketing and product structure and pricing. Thus, the Board's pending rulemaking provides an important and timely opportunity to address industry developments over the past eighteen years, and to develop disclosure rules applicable to all credit card issuers that are effective in helping consumers understand material terms and conditions of credit card products, without undue compliance burden.

Given our supervisory responsibilities, the OCC has a strong interest in the Board's review and revision of the Regulation Z disclosure rules, and we are encouraged that the Board's recent proposal appears to reflect the type of new approach to consumer disclosures that the OCC has been advocating.

In 2005, the OCC submitted a detailed comment letter in response to the Board's Advance Notice of Proposed Rulemaking. Among other things, the OCC urged the Board to employ both qualitative and quantitative consumer testing,[15] such as the consumer testing process used by the Food and Drug Administration to develop the "Nutrition Facts" label, to ensure that credit card disclosures:

- Focus on key information that is central to the consumer's decision making (with supplementary information provided separately in a fair and clear manner);
- Ensure that this key information is highlighted in such a way that consumers will notice it and understand its significance;
- Employ a standardized disclosure format that consumers can readily navigate; and
- Use simple language and an otherwise user-friendly manner of disclosure.

We also encouraged the Board to reconsider Regulation Z's historical reliance on prescriptive disclosure requirements, and to evaluate whether this approach is best suited to consumer and industry needs in today's rapidly evolving consumer credit markets.

In addition to these general themes, the OCC's comment letter described a number of specific anomalies currently in Regulation Z, and we highlighted certain issues that we believe should be included in any revisions to the rules. For example, we urged the Board to consider whether amendments to Regulation Z could address some of the confusion and concern regarding universal default and unilateral change-in-terms re-pricing. Regulation Z currently addresses the various ways in which an account may be re-priced in very different – and perhaps anomalous – ways. For example, the current Schumer box disclosure requirements do not treat all re-pricing mechanisms the same:

[15] Eight federal agencies, including the federal banking agencies, recently published a proposed model privacy notice that was developed following in-depth consumer testing. *See* 72 FR 14940 (March 29, 2007).

- *Variable Rates.* The issuer must specifically disclose the fact that the rate may vary and provide an explanation of how the rate will be determined, and must comply with detailed rules about the actual numerical rate that is disclosed.

- *Promotional Rates.* The issuer must specifically disclose the promotional rate and provide a large print disclosure of the rate that will apply after expiration of the promotional rate is required. There is no requirement, however, to disclose the different circumstances under which the promotional rate will be or may be terminated.

- *Penalty Rates and Universal Default*. While the issuer must provide specific disclosure of the increased penalty rate that may apply upon the occurrence of one or more specific events, the disclosure of those events is not required to be particularly detailed, or necessarily prominent. Moreover, no disclosure of the duration of the penalty rate is required.

- *Unilateral Change in Terms*. The issuer is under no obligation to disclose its reservation of a unilateral right to increase the interest rate, fees, or any other terms of the account.

Based upon our preliminary review of the Board's proposal, we believe the new approach to disclosures reflected in the Board's proposal is very constructive and consistent with a number of the suggestions that we made. We particularly endorse the Board's extensive use of consumer testing to guide the design of effective disclosure material and the Board's commitment to further testing after it receives comments from the public on the proposal. The proposal also takes steps to address various change-in-terms issues that are the source of many consumer complaints. We also commend the proposal's approach to use standardized formats for disclosures in various contexts, such as account opening, periodic statements, and change-in-terms notices. As we study the proposal further, we expect to have further comments and suggestions on it. For example, we believe that the Board should explore the possibility, consistent with its legal authority, of providing consumers with the right to opt-out of unilateral changes in terms that increase pricing on existing credit balances. As noted above, the ability to opt-out of changes in terms is already provided by most large national banks to their credit card customers. Of course, we are still in the process of reviewing all of the details of the proposal in light of our recommendations, our existing guidance, and our supervisory experience with credit card issuers, and we look forward to working with the Board on these issues as their rulemaking progresses.

IV. CONCLUSION

In a relatively short time, credit cards have become a credit and payment access device that is used by a majority of Americans. Credit cards provide substantial benefits to consumers, including convenience, security, and worldwide acceptance. And, they generate substantial benefits to the economy.

Credit card terms, marketing, and account management practices have been changing in recent years in response to intense market competition for customers and revenue. While these market innovations have resulted in benefits to consumers, the beneficial impact has not always been uniform. Developments in account management and pricing practices have made the terms of credit cards more complex and difficult for consumers to understand. The OCC has addressed some of these risks through our supervision of national bank credit card operations, our enforcement actions, and our supervisory guidance, but there are limits to what the OCC can do, alone, across a highly competitive industry where some major participants are not subject to OCC supervision.

Although there have been calls for legislative and regulatory restrictions on certain credit card practices, the focus of today's hearing is on the role of consumer disclosures in regulating the credit card market. It is clear that current disclosures are not working well. That is why the Board's undertaking to review and revise its disclosure rules under Regulations Z is so important. Changes to Regulation Z would set new standards that apply to all participants in the credit card industry. And improved disclosure industry-wide can have multiple benefits for consumers: informed consumer choice; issuer competition to provide consumers the terms they want; and transparency that would "shine the spotlight" on credit card practices making it more difficult for issuers to withstand public criticism of those practices that are especially aggressive.

Will such improved disclosure be sufficient to address the fundamental issues raised by current credit card practices? We certainly hope so, and we believe the proposed changes to Regulation Z, along with other sound changes that likely will be suggested during the comment period, show real promise of addressing many important issues that have been raised in the current debate. Moreover, we would note that – partly due to public criticism raised by members of Congress and others – most national bank issuers have already moved away from such practices as universal default and double-cycle billing. We also believe, however, that since credit card practices are regulated primarily through consumer disclosures, more frequent reviews of, and updates to, the applicable Regulation Z disclosure rules than has been the case in the past would be beneficial.

In addition, there are potential costs associated with going beyond disclosure, which has been the cornerstone of federal consumer protection regulation for credit card users. As I noted at the outset, open-end credit such as credit cards, where each transaction is a new extension of unsecured credit that is not separately underwritten, requires ongoing and prudent risk management. Banks need to have the tools to contain their credit risk on credit card accounts due to risk factors such as fluctuations in the rate environment, adjustments in business strategy, market developments, and changes in a borrower's creditworthiness. This can be done in part by closing accounts, shortening account expiration dates, and/or limiting further credit advances. But, risk-based pricing is also an effective tool used by card issuers to target and manage such risks – so long as it is effectively disclosed. Proposals to restrict this tool could have unintended consequences regarding banks' ability to manage risks, or in the alternative, on the availability and affordability of credit cards more generally.

As Congress continues to weigh these issues, the OCC stands ready to provide additional information that the Subcommittee may need based on the OCC's supervision of national banks.

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Appendix A

- (Consent order – September 25, 2000). Bank required to discontinue its misleading and deceptive advertising of credit cards and to take appropriate measures to prevent the recurrence of such advertising.
- (Consent order – May 3, 2001). Bank required to provide restitution of approximately $3.2 million for deceptive credit card marketing, to discontinue its misleading and deceptive marketing practices, and to make substantial changes in marketing practices.
- (Consent order – December 3, 2001). Bank required to provide restitution of at least $4 million for misleading and deceptive credit card marketing, to discontinue its misleading and deceptive advertising practices, and to make substantial changes in its marketing practices and consumer disclosures.
- (Formal agreement – July 18, 2002). Bank required to discontinue its misleading and deceptive advertising practices, and to take appropriate actions to prevent deceptive advertising concerning credit lines and the amount of initial available credit.
- (Consent order – January 17, 2003). Bank required to provide restitution of at least $6 million for deceptive credit card marketing practices, to obtain prior OCC approval for marketing subprime credit cards to non-customers, to cease engaging in misleading and deceptive advertising, and to take other actions.
- (Formal agreement – March 25, 2003). Bank required to provide restitution for deceptive practices in connection with private label credit cards, resulting in a pay out of more than $6 million to date, and to make appropriate improvements in its compliance program.
- (Formal agreement – July 31, 2003). Bank required to make restitution of approximately $1.9 million for deceptive credit card practices.
- (Consent order – May 24, 2004). Bank required to make at least $10 million in restitution for consumers harmed by unfair practices, and prohibited from offering secured credit cards in which the security deposit is charged to the consumer's credit card account.