American Financial Services Association

February 19, 2013

Monica Jackson
Office of the Executive Secretary
Bureau of Consumer Financial Protection
1700 G Street, NW
Washington, DC 20552

Re: Request For Information Regarding Credit Card Market (Docket No. CFPB-2012-0048)

Dear Ms. Jackson,

The American Financial Services Association ("AFSA") welcomes the opportunity to respond to the Consumer Financial Protection Bureau's ("CFPB" or "Bureau") request for information regarding the credit card market ("Request"). AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. Its 350 members include consumer and commercial finance companies, auto finance/leasing companies, mortgage lenders, mortgage servicers, credit card issuers, industrial banks and industry suppliers.

Section 502(a) of the Credit Card Accountability Responsibility and Disclosure Act of 2009 ("CARD Act") requires the CFPB to conduct a review of the consumer credit card market, within the limits of its existing resources available for reporting purposes. In connection with conducting that review, and in accordance with Section 502(b) of the CARD Act, the CFPB has asked for information about a number of aspects of the consumer credit market.

AFSA emphasizes that the precise impact of the CARD Act cannot be evaluated due to the interplay of other developments. For example, before the CARD Act took effect, card issuers had changed or begun to change practices prior in anticipation of the Federal Reserve Board's credit card Unfair or Deceptive Acts or Practices rule. To a large extent the requirements of the CARD Act mirror the Federal Reserve Board's rule. Moreover, changes in consumer behavior (e.g. applications for credit, use of outstanding credit lines, payment behavior) were impacted by economic downturn that coincided with CARD Act's enactment and it is not possible to attribute them solely to the CARD Act.

However, we do have some observations on the issues on which the CFPB seeks comment.

(a) *The Terms of Credit Card Agreements and the Practices of Credit Card Issuers*

The substantive terms and conditions of credit card agreements have changed following the CARD Act, and these changes have had impacts on consumers that are not always positive. Issuers have changed their pricing (most cards today have variable interest rates), eliminated fees, changed marketing strategies (e.g., reduced the availability of introductory interest rates, reduced the duration or attractiveness of balance transfer offers, reduced offerings to consumers under age 21), modified underwriting practices (e.g., more stringent standards for new accountholders, and credit line increases). Since re-pricing is no longer a tool available to address risk which develops in the future life cycle of an account, issuers must address that potential risk earlier in the account life cycle by either offering higher rates (to all borrowers, not just those who later display increased risk characteristics) or using lower credit lines so less outstanding balance is subject to the risk, or a combination of both strategies or others which raise the cost of credit or restrict the availability of credit. This has had a negative impact on most cardholders (i.e. the majority who manage accounts responsibly). As issuers have been required to establish card terms at account opening that are difficult to change thereafter, we believe that interest rates for these customers have risen, credit line increases have decreased in volume and dollar amounts, and balance transfer offers have become less widespread and/or generous. Consumers with higher risk profiles and those without an established credit history are less likely than in the past to be offered credit.

The CFPB should also note that issuers have voluntarily (outside the requirements of the CARD Act) made changes that have had a positive impact on card issuers, such as simplifying their credit card agreements and other disclosures.

Another example of a CARD Act change is the restriction on offering credit cards to individuals under age 21 ("independent ability to repay"/cosigner over age 21). As the CFPB has acknowledged, offers to those under the age of 21 have decreased and because of the ability to pay restrictions, it is more difficult for these consumers to obtain credit. We suggest that the Bureau study this reduction in credit further. To what extent has this reduced the number of young adults who are able to obtain cards on their own? Is there any evidence that those who can meet the independent ability to pay or cosigner requirements are better able to manage credit card accounts than those who, in the past, were not required to do so? To what extent have the new restrictions negatively impacted the ability of these individuals to gain experience with consumer credit at an early age and to establish independent credit histories, especially full histories (as opposed to "thin files") that are needed to qualify for favorable credit terms as they start careers, households and families? To what extent has the change increased the number of young Americans who, when they reach age 21, are not able to obtain credit or have to pay more for it? How many have been forced to rely on credit histories of cosigners that are blemished, a reliance that can have long term effects after the consumer reaches age 21? Anecdotally, we are aware of many individuals who appreciated the opportunity to establish credit as young adults when they were living away from their parents as students, or would have been unable for one reason or another to easily use them as co-signers. We suggest the Bureau study this phenomenon, which we suspect represents a majority of pre-CARD Act experiences for individuals 18-21 years old.

The impact on those under 21 has been recognized by academics: "At the same time that access to banks has shrunk, credit cards have become less available to many consumers as a result of the Credit CARD Act of 2009, which imposed new rules that directly restricted access to credit cards for consumers under the age of 21 and indirectly restricted access for many lower-income consumers."[1]

The CARD Act requirement to periodically review accounts of consumers whose interest rates have increased is another requirement that has imposed costs on issuers (and ultimately their customers) that far exceed the benefit of the requirement. The requirement to continue to review these accounts in perpetuity, until the rate is reduced back to the original rate is overly burdensome and without benefit to the consumer. AFSA recommends imposing a time limit on this requirement (e.g., 2 years) as most consumers would have received the benefit of any change in their credit profile or the competitive market within that time frame. Moreover, where an increase only applies to new transactions, the need for a rate review is obviated as customers can avoid the increase by not making new transactions and obtaining a different credit card.

(b) *The Effectiveness of Disclosure of Terms, Fees, and Other Expenses of Credit Card Plans*

One of the Congressionally-mandated objectives of the Bureau is to ensure that "outdated" or "unnecessary" regulations are "identified and addressed" (Dodd Frank Act, Section 1021(b)). The CARD Act mandated disclosures include provisions that we believe should be evaluated under this provision.

For example, we are not aware of evidence that the CARD Act's minimum payment warning has had a beneficial impact on consumer behavior, i.e. that it has motivated consumers to make payments larger than the minimum. Absent evidence that there has been a significant growth in the percentage of consumers who have changed their behavior, the Bureau should assess whether a retention of the disclosure requirement is warranted. In making this assessment, the Bureau should determine whether any increase in larger-than-minimum payments that may have occurred is a result of the new "warning" or is driven by other factors, such as consumers' interest in paying down debt during a prolonged economic downturn. Although the CARD Act did not require that the effectiveness of the warning be tested before its implementation, the CFPB should conduct such testing now to determine if the warning is having a positive impact on consumers, or if minimum payment behavior is related more to consumers' disposable income when bills come in, than to a lack of understanding about the consequences of regularly making minimum payments.

The Bureau should also assess whether the Regulation Z provision under the CARD Act that requires disclosure, on each periodic statement, of the year-to-date interest paid and year-to-date fees paid has had an observable beneficial impact on consumers (i.e., changes in consumer behavior that are known to have resulted from, or been influenced by, these disclosures). No testing of the potential benefits of these disclosures was required or conducted before they were implemented. The CFPB should study whether the disclosure is helping consumers, and propose a revision or even an elimination of the requirement if they are not. For example, does a

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[1] Zywicki, Todd J. *Working Paper 13-02, Economics and Regulation of Network Branded Prepaid Cards*. Mercatus Center, George Mason University School of Law. January 2013.

consumer who pays a single late fee or finance charge benefit or alter behavior by being reminded about the amount of the fee on 12 subsequent periodic statements?

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

While in the past, the volume of new credit card offers and favorable balance transfer offers has accelerated significantly as signs of economic recovery appeared, issuers have become more cautious this time in extending offers of credit and there has been a sharp decline in the number of pre-approved card offers and offers to apply for cards.

Since the CARD Act took effect, offers to subprime and marginal consumers have decreased and the percentage of cardholders who have lower credit scores has declined. The CARD Act has made it more difficult for such individuals to qualify for credit cards. Mike Taiano, a senior research analyst at the Telsey Advisory Group, has observed that the industry's shift away from risk may be structural rather than cyclical. The 2009 credit card reform law "undermined riskier underwriting" focusing card issuers on "customers who pay their balances off each month."[2]

(d) *Has the CARD Act impacted the safety and soundness of any credit card issuers?*

There is no evidence that the safety and soundness of card-issuing banks has been enhanced by the enactment of the CARD Act. The CARD Act's limitations on overlimit fees, and late fees, and the inability to increase interest rates on existing account balances as a cardholder's credit quality declines have reduced bank revenues and increased the risk of offering credit to consumers without spotless credit histories.

Mark Furletti, with the Payment Cards Center at the Federal Reserve Bank of Philadelphia, wrote a paper entitled, *Credit Card Pricing Developments and their Disclosure.* The paper contains a number of statistics/estimations of the significant revenues issuers were making from fees that, as a result of the CARD Act, can no longer be charged. He includes this table in the paper:[3]

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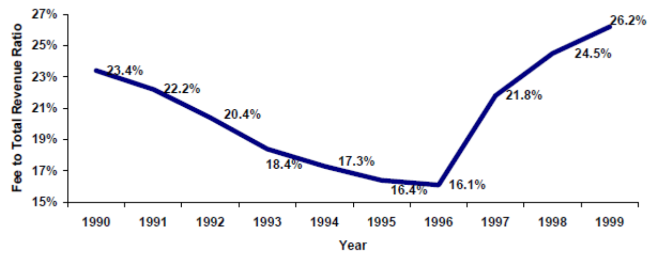
[2] *Loss Rates Suggest Card Issuers Still Focused on Prime Borrowers*. **American Banker**. Dec. 12, 2012. http://www.americanbanker.com/issues/177_242/loss-rates-suggest-card-issues-still-focused-on-prime-borrowers-1055280-1.html

[3] Furletti, Mark. *Credit Card Pricing Developments and Their Disclosure.* **Payment Cards Center – Federal Reserve Bank of Philadelphia.** Jan. 2003. http://www.philadelphiafed.org/consumer-credit-and-payments/payment-cards-center/publications/discussion-papers/2003/CreditCardPricing_012003.pdf

Figure 6

Fee Income as a Percentage of Total Revenue*
1990-1999



* Fee income does not include fees from securitization. Ratio is calculated by dividing credit card fee income for industry by the sum of the credit card interest income for the industry and the total credit card fee income for industry as reported by CardWeb.

Source: October 1999 and July 2000 issues of CardTrack, CardWeb.com

Such hits to the bottom line surely have a negative safety-soundness impact. Moreover, these revenue losses have had to be addressed by other means: higher interest rates and fewer risk-prone borrowers.

(e) *Has the CARD Act affected the use of risk-based pricing?*

Yes. The CARD Act has significantly restricted the ability to adjust interest rates of individual accounts based on delinquencies and other signs of default risk. AFSA reminds the Bureau of the importance of risked-based pricing, which benefits all borrowers. Those with a good credit history present a smaller possibility of default and, therefore, typically pay lower rates. Likewise, risk-based pricing enables borrowers with higher risk factors to have access to affordable credit.

Gregory Elliehausen, a Federal Reserve economist, Thomas Durkin, a former Federal Reserve economist, and professors Michael Staten and Todd Zywicki describe the history and benefits of risk-based pricing:

> Risk scoring, and especially generic bureau scores, provided the catalyst for widespread adoption of risk based pricing for credit accounts. Until the late 1980s, the consumer loan decision typically focused on application approval or denial: the price of the loan was fixed as part of the loan package for which the borrower applied. But, the greater precision in estimating borrower risk made possible through credit scoring has facilitated a decoupling of the loan acceptance and loan pricing decisions. Since the late 1980s, consumer lenders have relied on statistical credit scoring models to set loan interest rates appropriate for a borrower's risk. This practice, known as risk-based pricing, attempts to tailor the price of a loan to a borrower's estimated likelihood of repayment. Borrowers who are less likely to become delinquent on a loan pay lower interest rates.
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> It is no coincidence that the expansion of credit to consumers in the United States over the last two decades occurred simultaneously with the widespread adoption of risk-based pricing, first by bank credit card issuers (beginning around 1989), automobile lenders (by 1990), and eventually mortgage lenders (since the mid 1990s). The practice has expanded credit availability to higher risk borrowers, lowered prices for low

> risk borrowers and led to a broader array of loan products available to all risk and income groups (see Edelberg 2006). In addition, banking regulatory agencies encourage lenders to adopt risk-based pricing to protect the safety and soundness of financial institutions as they broaden credit availability to include higher risk borrowers.[4]

The footnote to this section states, "The Credit Card Accountability, Responsibility, and Disclosure Act (CARD Act) of 2009 among other things restricted risk based penalty pricing for credit cards, however. This has tended to increase underlying rates on accounts deemed to have high risk of default. The act limited interest rate increases and required credit card companies to provide 45 days notice before increasing rates."

Furletti also wrote about the benefits of risk-based pricing, "The lowest risk customers, who once paid the same price as high-risk customers, now enjoy rate discounts that can reach more than 800 basis points. At the other end of the risk spectrum, these strategies have enabled issuers to grant more people (e.g., immigrants, lower income consumers, those without any credit experience) access to credit, albeit at higher prices. Former Federal Reserve Governor Lawrence Lindsey has referred to this phenomenon as 'the democratization of credit' (Black and Morgan, 1998)."[5]

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We look forward to working with the CFPB on these issues. Please contact me by phone, 202-466-8616, or e-mail, bhimpler@afsamail.org, with any questions.

Sincerely,

Bill Himpler
Executive Vice President
American Financial Services Association

[4] Durkin, Thomas, Gregory Elliehausen, Michael Staten, and Todd Zywicki. *Consumer Credit and the American Economy*. Oxford University Press. Forthcoming 2013

[5] Furletti. *Credit Card Pricing Developments and Their Disclosure.*