

EMBARGOED UNTIL DELIVERY

STATEMENT OF

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on

**IMPROVING CREDIT CARD CONSUMER PROTECTION: RECENT
INDUSTRY AND REGULATORY INITIATIVES**

before the

**SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT**

of the

**FINANCIAL SERVICES COMMITTEE
U.S. HOUSE OF REPRESENTATIVES**

**June 7, 2007
2128 Rayburn House Office Building**

Chair Maloney, Ranking Member Gillmor and members of the Subcommittee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding consumer and regulatory issues related to credit card practices.

The credit card has been a landmark innovation in consumer finance, allowing consumers unprecedented flexibility to access credit. This flexibility, in turn, has fueled economic growth by making it more convenient for consumers to purchase goods and services. Yet, like all credit, credit cards can create economic hardship if not properly managed or if consumers are confused or misled regarding the terms and conditions of use.

My testimony will discuss recent trends in credit card lending, as well as the FDIC's role as insurer and supervisor of institutions engaged in this activity. I also will discuss credit card practices that have raised concerns at the FDIC.

Credit Card Industry Trends and Statistics

Beginning in the late 1970s, interest rate deregulation, combined with the development of credit scoring models and risk-based pricing, allowed lenders to price credit for a wider range of borrowers. In addition, consumer loan securitization increasingly provided wholesale funding for credit card lending. These developments helped spur rapid growth in the credit card industry through the 1980s and 1990s.

Revolving consumer credit outstanding -- which is made up primarily of credit card debt -- nearly quadrupled during the 1980s, and then almost tripled in the 1990s. The growth rate was as rapid as 27 percent a year in the mid-1980s. As of first quarter 2007, revolving credit outstanding was approximately \$888 billion (seasonally adjusted), up 7.56 percent from the first quarter of 2006.¹ This was the fastest growth since 2001, although relatively slow by historical standards.²

Credit card lines have been part of a trend of rising household debt in recent decades. The ratio of total household debt to disposable personal income has more than doubled over the last 20 years, climbing to more than 125 percent.³ Much of the rise in household debt is due to mortgage obligations, but credit card debt grew from 2.7 percent of annual personal disposable income in 1980 to 9.2 percent in 2006.⁴ Revolving credit, including credit cards, became an increasingly important component of consumer credit during this time. Revolving credit as a share of total consumer credit⁵ outstanding grew from 16 percent in 1980 to 37 percent in 2006.⁶

¹ Revolving consumer credit outstanding includes revolving consumer credit held by finance companies, credit unions and non-finance companies in addition to insured commercial banks and savings institutions and a pool of securitized assets. Combined, finance companies, credit unions and non-finance companies held approximately \$107 billion of revolving consumer credit in the first quarter of 2007 on a non-seasonally adjusted basis. Federal Reserve Statistical Release G.19 Consumer Credit.

² The average year over year rate of growth of revolving consumer credit outstanding between 1980 and 2006 was 11.1 percent. The average year over year rate of growth was 14.9 percent between 1980 and 1989, 11.3 percent between 1990 and 1999, and 5.4 percent between 2000 and 2006. See Federal Reserve Statistical Release G.19 Consumer Credit.

³ Household debt comprises (1) loans secured by real estate, such as mortgage loans, home equity loans, and home equity lines of credit, and (2) consumer debt, either revolving or nonrevolving, incurred to purchase a good or service, including automobiles, mobile homes, trailers, durable goods, vacations, and other purposes. FDIC calculation based on Federal Reserve (Flow of Funds and G.19) and Bureau of Economic Analysis data.

⁴ FDIC calculations based on Federal Reserve Statistical Release G.19 Consumer Credit and Federal Reserve Flow of Funds data.

⁵ Consumer credit includes most short- and intermediate-term credit extended to individuals. Consumer credit is the sum of revolving credit (credit card credit and balances outstanding on unsecured revolving lines of credit) and nonrevolving credit (such as secured and unsecured credit for automobiles, mobile

At the same time, revolving credit has not grown substantially as a share of total household debt. Consumer credit reports show that credit card balances represented only 11 percent of total reported household debt in the fourth quarter of 2006. This figure has been relatively steady since the early 1990s.⁷

Meanwhile, mortgage debt grew from 66 percent of total household debt at the beginning of 1992 to 75 percent by the end of 2006.⁸ The Tax Reform Act of 1986 stimulated demand for mortgage debt by retaining the deduction for home mortgage interest while eliminating the deduction for nonmortgage consumer debt, such as car loans and educational loans. The tax-deductible status of debt secured by homes made mortgage debt a more attractive after-tax financing option than nondeductible consumer debt.⁹ In recent years, many consumers may have been using home equity loans or cash-out mortgage refinancing to pay credit card balances. A 2002 Federal Reserve survey found that approximately 26 percent of mortgage refinance funds were used to pay off other debt.¹⁰ The switch from consumer debt to mortgage debt in recent years was evident in that growth in home equity lines of credit outstripped growth in credit card debt, even though the average interest rate for credit cards declined.

homes, trailers, durable goods, vacations, and other purposes). Consumer credit excludes loans secured by real estate (such as mortgage loans, home equity loans, and home equity lines of credit).

⁶ FDIC calculations based on Federal Reserve Statistical Release G.19 Consumer Credit.

⁷ TransUnion LLC., TrenData database. All data received were depersonalized and aggregated from consumer credit reports.

⁸ *Ibid.*

⁹ “Breaking New Ground in U.S. Mortgage Lending”, *FDIC Outlook*, Summer 2006.

¹⁰ Glenn Canner, Karen Dynan, and Wayne Passmore, “Mortgage Refinancing in 2001 and Early 2002,” *Federal Reserve Bulletin*, December 2002.

The expansion of credit card lending has touched households across the credit spectrum. Today, more households are using credit cards than ever before. Data from the Federal Reserve's Survey of Consumer Finances show that 75 percent of households have some type of credit card. The share of households with credit card balances has also risen, climbing from 40 percent in 1989 to 46 percent in 2004, while the median level of indebtedness for households with credit card debt grew from \$1,300 to \$2,200 (in 2004 dollars).

Growth in credit card ownership and usage has been especially significant among lower income households and young people. Nearly 30 percent of households in the lowest income quintile¹¹ held credit card debt in 2004, up from 15 percent in 1989. Almost one-third of households in the lowest income quintile report that they hardly ever pay their entire balance in full, and 16 percent admit having had a debt payment 60 days or more past due.¹²

Data show that young adults today are more indebted than previous generations were at the same ages and appear less likely to make timely debt payments than other age groups. The average credit card debt held by young adults ages 18 to 24 and 25 to 34 grew by 22 percent and 47 percent, respectively, between 1989 and 2004.¹³ In 2004,

¹¹ The income level at this bottom twenty percent of household income bracket was \$18,900 at the time of the survey. Federal Reserve 2004 Survey of Consumer Finance.

¹² Federal Reserve 2004 Survey of Consumer Finances.

¹³ Demos, "Generation Debt: Student Loans, Credit Cards, and Their Consequences," Winter 2007.

more than three quarters of undergraduate students started the school year with a credit card, and only 21 percent of college students pay off their entire balance each month.¹⁴

Banks and Credit Card Lending

The role of commercial banks in credit card lending has become much more significant over the last three decades. In 1970, although 51 percent of households had a credit card of some type, only 16 percent of households had a bank-issued credit card.¹⁵ Today, 95 percent of households that have some type of credit card hold at least one issued by a bank.¹⁶ As of the first quarter of 2007, FDIC-insured institutions held on their balance sheets \$346 billion in credit card loans outstanding, which represented about 5 percent of the banking industry's total loans.¹⁷

An additional \$368 billion in credit card receivables were securitized by FDIC-insured commercial banks and state-chartered savings banks.¹⁸ Over the last 10 years, financial institutions that issue credit cards have securitized approximately half of credit

¹⁴ Nellie Mae, "Undergraduate Students and Credit Cards in 2004: An Analysis of Usage Rates and Trends," May 2005.

¹⁵ Board of Governors of the Federal Reserve System, "Report to the Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and their Effects on Consumer Debt and Insolvency," June 2006.

¹⁶ Bucks, Brian K., Kennickell, Arthur B., and Moore, Kevin B., "Recent Changes in US Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances," Federal Reserve Bulletin, 2006.

¹⁷ Bank Reports of Condition and Income and Thrift Financial Reports. To avoid double counting, the total excludes approximately \$8.6 billion in balances held by banks that are subsidiaries of other reporting institutions.

¹⁸ Total amount of credit card receivables securitized by all FDIC-insured institutions is likely to be greater than this figure. FDIC-insured thrifts that file Thrift Financial Reports do not regularly report the amount of loans that are securitized. As of the first quarter of 2007, there were 135 insured thrifts that had credit card loans on their balance sheets totaling \$42.4 billion.

card receivables. In the first quarter of 2007, about half of all revolving consumer credit outstanding was held by pools of securitized assets.¹⁹

From the perspective of many financial institutions, credit card lending has been an important and generally profitable line of business. While charge-offs have been consistently higher among the 27 institutions the FDIC has identified as credit card lending specialists²⁰ than for other types of specialty banks or for the banking industry overall, profits have also been higher. Credit card lenders had a return on assets of 3.70 percent in the first quarter of 2007, while the banking industry overall had a return on assets of 1.21 percent. In the first quarter of 2007, the ratio of noninterest income (which includes fee income) to average assets was 9.61 percent for credit card specialists, versus 2.09 percent for all insured banks and thrifts.

Applicable Laws and Regulations

Two key federal statutes that govern lender credit card practices and protect consumers in the use of credit cards are the Truth in Lending Act (TILA)²¹ and the Federal Trade Commission Act (FTC Act).²²

¹⁹ Federal Reserve Statistical Release G.19 Consumer Credit. Data not seasonally adjusted.

²⁰ Institutions that exhibit both of the following characteristics are considered to be a specialized credit card lender: (1) credit card loans plus securitized and sold credit cards divided by total loans plus securitized and sold credit cards exceed 50%, and (2) total loans plus securitized and sold credit cards divided by total assets plus securitized and sold credit cards exceed 50%.

²¹ 15 USC 1601, et seq.

²² 15 USC 45.

Truth in Lending Act

The primary statute and regulation affecting credit card lending are TILA, enacted in 1968, and its implementing regulation, the Federal Reserve Board's Regulation Z. TILA is mainly a disclosure statute that requires creditors to provide consumers with the cost and terms of credit so that consumers can compare credit offers and thereby choose the credit card that best suits their needs.

While much of the emphasis is on disclosure, TILA and Regulation Z also provide important consumer protections regarding prompt crediting of payments, treatment of credit balances, and protections to cardholders -- including limits on consumer liability for unauthorized or unlawful credit card use and the right of a cardholder to assert claims or defenses against a credit card issuer. Provisions also address billing resolution procedures, requiring credit card issuers to respond to certain credit card billing errors within a specified period.

The Federal Reserve Board has exclusive authority to promulgate regulations to implement TILA. While they lack rulemaking authority, other Federal banking agencies enforce compliance by their supervised institutions of TILA and Regulation Z, and use their enforcement authority pursuant to section 8 of the Federal Deposit Insurance Act (FDI Act) to address violations.

On May 23, 2007, the Federal Reserve Board proposed amendments to Regulation Z.²³ The notice of proposed rulemaking on Regulation Z contains significant advances in credit card disclosures. The proposed amendments would require important changes to the format, timing, and content requirements in documents provided to consumers throughout the life of a credit card account, including changes in solicitations, applications, account opening documents, change-in-term notices, and periodic billing statements. These proposed amendments will assist consumers in better understanding key terms of their credit card agreements such as fees, effective interest rates, and the reasons penalty rates might be applied, such as for paying late. In addition, the Federal Reserve's proposal would increase, from 15 to 45 days, the advance notice given before a changed term can be imposed on consumers, to better allow consumers to obtain alternative financing or change their account usage.

Federal Trade Commission Act

Credit card issuers are subject as well to the FTC Act prohibition against unfair and deceptive acts and practices (UDAP). The UDAP prohibition applies to every stage and activity of credit card lending, including product development, marketing, servicing, collections and the termination of the customer relationship.

²³ See <http://www.federalreserve.gov/boarddocs/press/bcreg/2007/20070523/default.htm>

Under the FTC Act,²⁴ an "unfair" practice is one that: (1) causes or is likely to cause substantial injury to consumers; (2) cannot be reasonably avoided by consumers; and (3) is not outweighed by countervailing benefits to consumers or to competition. Situations that meet the statutory definition of unfair are less common than situations that are deceptive.

A "deceptive" practice occurs when a consumer is either misled or is likely to be misled on a material issue.²⁵ An issue is material if it is likely to affect a consumer's decision regarding a product or service. Notably, omitting information may be deceptive if disclosure of the omitted information is necessary to prevent a consumer from being misled. In determining whether an act or practice is misleading, the FDIC considers whether a consumer's interpretation is reasonable in light of the claims made.

The Federal Trade Commission is primarily responsible for the application and enforcement of the FTC Act. The FTC does not, however, have rulemaking or enforcement authority over banks, thrift institutions, or credit unions. The Federal Reserve Board has the authority to promulgate regulations defining unfair and deceptive acts or practices of banks, while the Office of Thrift Supervision and the National Credit Union Administration enjoy similar rulemaking authority for thrift institutions and credit unions, respectively. Other Federal banking agencies, including the FDIC, may use their

²⁴ See 15 USC §45(n).

²⁵ The definition of deception has been developed through policy guidance issued first by the Federal Trade Commission, see FTC Policy Statement on Deception, October 14, 1983, and later by the banking agencies, see, e.g., "Abusive Practices" section of FDIC Compliance Handbook, <http://www.fdic.gov/regulations/compliance/handbook/html/chapt07.html#Federal>.

enforcement authority pursuant to the FDI Act to address unfair and deceptive acts and practices engaged in by their supervised institutions, but they have no rulemaking authority.

The FDIC has taken a number of steps to ensure that the state chartered banks we supervise understand how the FTC Act relates to their activities. Nearly five years ago, the FDIC confirmed that the FTC Act prohibition against unfair or deceptive practices applies to the activities of state chartered banks.²⁶ Together with the Federal Reserve Board, the FDIC issued more detailed FTC Act guidance applicable to all state chartered banks three years ago.²⁷ This guidance explained the standards used to assess whether an act or practice is unfair or deceptive, as well as the interplay between the FTC Act and other consumer protection statutes. It also offered suggestions for managing risks related to unfair and deceptive practices. Two years ago, the FDIC issued procedural guidance to its examiners to ensure that they have the tools to identify whether unfairness or deception has occurred in a credit card portfolio.²⁸

Credit Card Supervision

As of March 31, 2007, the top ten insured bank issuers of credit cards had reported credit card receivables outstanding of \$662 billion, or nearly 93 percent of all institutions' reported credit card receivables, and the top three issuers controlled just over 65 percent of the institutions' reported receivables. The FDIC is the primary federal

²⁶ See FIL-57-2002, issued on May 30, 2002.

²⁷ See FIL-26-2004, "Unfair or Deceptive Practices by State Chartered Banks," issued on March 11, 2004.

²⁸ See "Abusive Practices" section of FDIC Compliance Examination Handbook, published on the FDIC website at: <http://www.fdic.gov/regulations/compliance/handbook/manual%20389.pdf>.

regulator for just two organizations in the top ten: Discover Financial Services, which has a market share of approximately 6.4 percent; and American Express Centurion Bank, which has about 5.7 percent.²⁹

The FDIC also supervises a number of smaller credit card issuers. As of the first quarter of 2007, 1,091 FDIC-supervised institutions reported credit card loan portfolios. As a percentage of total loans, credit card loans ranged from less than 1 percent to 100 percent of these banks' respective loan portfolios. FDIC-supervised banks have \$104 billion of reported credit card receivables, or about 15 percent of the total for all banks. Of that total, \$78 billion are at the FDIC-supervised institutions of Discover and American Express. Excluding those two, FDIC-supervised institutions have \$26 billion of reported credit card receivables, or about 4 percent of the total for all banks. The total for all FDIC-insured institutions was \$713.4 billion as of March 31, 2007.

Examinations

Bank credit card practices are examined as part of both the safety and soundness examination and the compliance examination. In September 2005, the FDIC implemented a Relationship Manager program that emphasizes a comprehensive and coordinated approach among compliance, safety and soundness, and specialty examination areas in the assessment of the institution's risk profile and capitalizes on

²⁹ Bank Reports of Condition and Income and Thrift Financial Reports. Outstanding receivables include balances held on balance sheet plus credit card receivables securitized and sold. Totals include all subsidiary institutions in an organization, except for subsidiaries of other reporting financial institutions that would result in double counting. As noted previously, Thrift Financial Report filers do not regularly report amounts of securitized credit card loans.

information sharing whenever possible. Although separate Compliance/CRA examination cycles and reports have continued, the adequacy of the bank's compliance management program is considered in the overall assessment of the bank's management team for safety and soundness as well.

This coordinated approach is especially important in supervising credit card banks, where safety and soundness and consumer protection issues overlap considerably. Practices that violate consumer protection laws or otherwise harm consumers often have the effect of impairing the performance of credit card portfolios, thus affecting the financial condition of these institutions.

Safety and Soundness Examinations

Under the safety and soundness examination program, the overall focus is largely on asset quality, capital adequacy, and earnings. The analysis of operating policies and procedures is key to the examination of credit card banks and credit card operations. Since credit card lending is typically characterized by a high volume of accounts, homogeneous loan pools, and small-dollar balances, the review of individual accounts is not practical. Instead, examination procedures tend to focus on evaluating policies, procedures, and internal controls. The goal of the examination is not confined to identifying current portfolio problems, but also includes an investigation of potential problems that may result from ineffective policies, unfavorable trends, lending concentrations, or nonadherence to policies.

In recent years, safety and soundness examiners have focused their efforts on monitoring compliance with the Account Management and Loss Allowance Guidance for Credit Card Lending (Account Management Guidance) issued on January 8, 2003. The Account Management Guidance was issued by the federal banking agencies in response to observed instances of inappropriate account management, risk management and loss allowance practices. This guidance clarified that the agencies expect lenders to require minimum payments that will amortize the current balance over a reasonable period of time. The guidance also clarified documentation expectations for line increase programs, clarified expectations for over-limit practices, and revised the repayment period for workout accounts.

Compliance Examinations and Complaint Resolution

The compliance examination program is based on a broad range of laws and regulations. The goal is to assess how well a financial institution manages compliance with federal consumer protection laws and regulations.

A review of consumer complaints is part of the pre-exam process for every compliance examination. Complaints about particular practices indicate areas to target for review, either because there may be a breakdown in compliance with specific regulatory requirements or because there may be a broader problem with unfair or deceptive practices.

As the primary Federal regulator of state chartered non-member banks, consumers can contact the FDIC directly with their complaints. Every complaint is tracked and investigated with the issuing bank. How a bank handles and responds to complaints is a key component of a well-managed compliance program.

As shown in the table below, the FDIC receives a substantial number of complaints that relate to credit cards.

	2002	2003	2004	2005	2006	Total
All complaints received about FDIC-supervised banks	4,008	4,057	3,950	3,618	3,831	19,464
Complaints received about credit card issues for FDIC-supervised banks	2,184	2,073	1,608	1,241	1,318	8,424
Credit card complaints as a percent of total complaints received for FDIC-supervised banks	54%	51%	41%	34%	34%	43%

The large percentage of credit card complaints is related, at least in part, to the sheer volume of credit card transactions. As explained above, 75 percent of households have some type of credit card. In fact, many consumers have multiple credit cards that they use multiple times a month.

Questionable Credit Card Practices

A September 2006 report by the Government Accountability Office (GAO) identified practices that raise supervisory and consumer protection concerns even though they may not violate existing law when they are disclosed adequately for consumers to avoid them. These practices include:

- Double-cycle billing: The cardholder, with no previous balance, fails to pay the entire balance of new purchases by the due date and the issuer computes interest on the original balance that had previously been subject to an interest free period.³⁰ This can materially increase the cost of credit for consumers who have paid a large amount of their debt in the previous month.
- Universal default: The issuer increases rates when cardholders fail to make payments to other creditors or have an overall decline in their credit score. As a result, a cardholder who repays an issuer on time may be assessed a higher interest rate because the cardholder made a late payment to another creditor, or has incurred a significant amount of additional debt. Employing this practice may materially worsen a customer's financial condition and ultimately impair repayment ability on all of the customer's accounts.
- Payment allocation: In this practice, varying interest rates are tied to account usage, but issuer applies payments first to the portion of the account with the lowest rate. As a result, balances on different tiers may shrink or grow disproportionately as payments are made by a customer.
- Minimum payments: The issuer fails to provide for reasonable amortization in setting the required monthly minimum payment and negative amortization results. With large card issuers offering dozens or even hundreds of different card lines, each of which has tiered minimum payment requirements tied to a variety of factors (such as the amount of the current balance and whether that balance is over the credit limit), too low a minimum payment requirement can result in negative amortization for some cards.
- Inconsistent and punitive billing practices: The issuer uses a variety of strategies to raise rates when cardholders make late payments or incur charges beyond their credit limits.³¹ Some issuers impose these higher "default" rates

³⁰ See GAO Report at p. 28, Figure 6, "How the Double Cycle Billing Method Works".

³¹ See GAO report at pp. 24 – 27.

after one late payment or overlimit charge while others use default rates only after a cardholder has made six late payments.

The FDIC is currently reviewing to what extent concerns relating to practices such as double-cycle billing, universal default, excessive fees and penalties, and payment allocation, should be addressed through supervisory action, rulemaking based on safety and soundness authority, or whether rulemaking under UDAP may be required.

At the same time, the GAO Report found that credit card disclosures, "...were too complicated for many consumers to understand."³² Moreover, while TILA and Regulation Z require creditors to explain some pricing terms in a tabular format, questions have been raised about whether the format is being used effectively to provide information to consumers.³³ Recent research indicates that while consumers pay attention to interest rates when shopping for a new credit card, they do not give much consideration to the ways in which those rates will change if they make a late payment or incur charges over their credit limits.³⁴

As noted above, the Federal Reserve recently proposed amendments to Regulation Z. These amendments are intended to improve the quality of credit card disclosures rather than to prohibit any of the practices questioned in the GAO Report.³⁵ While improving existing disclosures is an important and positive step, the FDIC remains

³² Id. at p. 6.

³³ See GAO Report at p. 40.

³⁴ See GAO Report at p. 31.

³⁵ See May 23, 2007 release announcing amendments to Regulation Z, published at <http://www.federalreserve.gov/boarddocs/press/bcreg/2007/20070523/default.htm>

concerned about whether information can be provided in an effective way to mitigate the effect of practices noted above.

Subprime Credit Cards

While the practices in the prime card market described above have raised concerns, additional and more egregious practices often exist in the subprime credit card market. This is of particular concern since, as noted above, recent growth in credit card ownership and usage has been especially significant among lower income households. A substantial portion of this growth has been achieved by marketing cards to subprime borrowers, those individuals either with little or no credit history or who exhibit more than a normal risk of loss. Examinations of banks with credit card portfolios, particularly ones with subprime portfolios, have revealed a variety of consumer protection issues. These include inadequate or deceptive marketing and account disclosures, as well as credit products that have little or no credit availability left following the assessment of opening and other fees. Other programs include features and requirements that produce frequent and excessive fees and penalties that result in a debt spiral, along with abusive collection practices.

For example, in one case a bank advertised a credit card with no application or annual fees. However, consumers who received a credit card were charged a “refundable acceptance fee” that completely exhausted the available credit line. According to the card terms, the fee would be “refunded” in increments of \$50 every three months, assuming that the consumer made a monthly minimum payment. In addition, the bank

charged a monthly maintenance fee of \$10, along with interest at a rate of 20 percent against the outstanding balance. Account activity reports showed few purchases or charges on the accounts; the primary activity comprised the assessment of monthly fees, interest and other charges. The FDIC determined that the card program was in violation of the FTC Act, as the fees associated with the program made any benefit negligible, and the program was structured so that only a very small percentage of consumers would receive any meaningful credit.³⁶

In another case, a bank sent out billing statements to delinquent account holders with a prominent message that payment of a specific amount would allow them to avoid certain fees and further collection efforts. However, the amount stated in the message was only the amount past due, not the larger minimum payment, and payment of only the past due amount would leave the account in a delinquent status and result in additional charges. Although the minimum amount due was stated elsewhere on the billing statement, the bank's practice was deceptive because the prominent message directed the consumer's attention away from the correct minimum payment amount necessary to restore the account to a current status. The FDIC determined that this practice violated the FTC Act and took supervisory action.

³⁶ The recently proposed amendments to Regulation Z will require credit card companies to inform customers if the initial fees or security deposits exceed 25% of the initial credit limit. (See proposed 12 CFR section 226.5a(b)(16); see also Appendix G-10(c)) If these provisions had been in effect at the time that the bank had advertised the card described above, additional disclosures would have been required. However, depending on the facts, the program might still have been carried out in an unfair or deceptive manner.

FDIC Response to Questionable Practices

The FDIC uses its examination program to continually monitor and address issues in the credit card industry and the banks we supervise. Credit card examiners are highly trained specialists who use the full complement of supervisory and enforcement tools at the FDIC's disposal to take action when they find practices that violate the FTC Act, TILA, other consumer protection regulations, or safety and soundness principles. As described above, this includes taking action where practices are unfair or deceptive.

Generally, when problems or violations are identified to bank management, they are corrected as part of the examination process without the need for enforcement action.³⁷ However, when the problem is especially significant or bank management lacks the willingness or ability to correct inappropriate practices, enforcement action becomes necessary. The FDIC has various formal and informal enforcement tools which are utilized to prescribe recommended courses of action to address practices, conditions, or violations that could result in risk of harm to consumers or loss or damage to a financial institution.

Formal actions are notices or orders issued by the FDIC against financial institutions and/or individual respondents pursuant to section 8 of the Federal Deposit Insurance Act. The purpose of formal actions is to correct noted safety and soundness deficiencies, ensure compliance with Federal and state banking laws, assess civil money

³⁷ For credit card lenders, the most common violations of law involve lack of compliance with TILA or the FTC Act.

penalties, and/or pursue removal and prohibition proceedings. Formal actions are legally enforceable, and final orders are available to the public after issuance.

Informal actions are voluntary commitments made by an insured financial institution's board of directors. Such actions are designed to correct less serious safety and soundness deficiencies or violations where it is believed that management has both the willingness and ability to effect correction. Informal actions are not legally enforceable and are not available to the public.

To determine the volume of enforcement activity involving FDIC-supervised credit card banks, records of the eleven FDIC-supervised banks designated as credit card lending specialists and of the five banks with the most credit card complaints filed with the FDIC were reviewed. Between 2002 and 2006, the FDIC issued formal and informal enforcement actions against five of the sixteen banks in this group. These actions addressed practices, conditions, or violations that could result in risk of loss to a financial institution or that could cause significant financial harm to consumers. FDIC enforcement actions against banks with credit card portfolios have required correction of both safety and soundness deficiencies and violations of consumer protection laws, as well as requiring the payment of restitution to consumers harmed by the involved practices. For example, an FDIC examination of a State nonmember bank disclosed that a credit card program offered by the bank violated section 5 of the FTC Act. The bank agreed to a Memorandum of Understanding with the FDIC that required corrections to

disclosures and marketing and required restitution by reversing the acceptance fee, finance charges and monthly participation and late fees.

In many instances, however, troubling practices do not rise to the level of violating law or regulation. Although particular issuers often change their practices in response to supervisory recommendations, such action does not appear to result in industry-wide changes.

Conclusion

Credit card activities, while increasingly concentrated in a handful of very large banks, are generally a significant and complex activity in any bank engaged in the various aspects of this consumer lending business. The FDIC is aware of these complexities and closely monitors credit card lenders under its supervision for adherence to safe and sound business practices as well as consumer protection laws and regulations. However, current industry practices and continual innovation in this business line present significant challenges in maintaining a balance between profitability and the principles of consumer protection and fairness. The FDIC is currently reviewing to what extent concerns relating to practices such as double-cycle billing, universal default, excessive fees and penalties, and payment allocation, should be addressed through supervisory action, rulemaking based on safety and soundness authority, or whether rulemaking under UDAP may be required.

This concludes my testimony. I will be happy to answer any questions the Subcommittee may have.