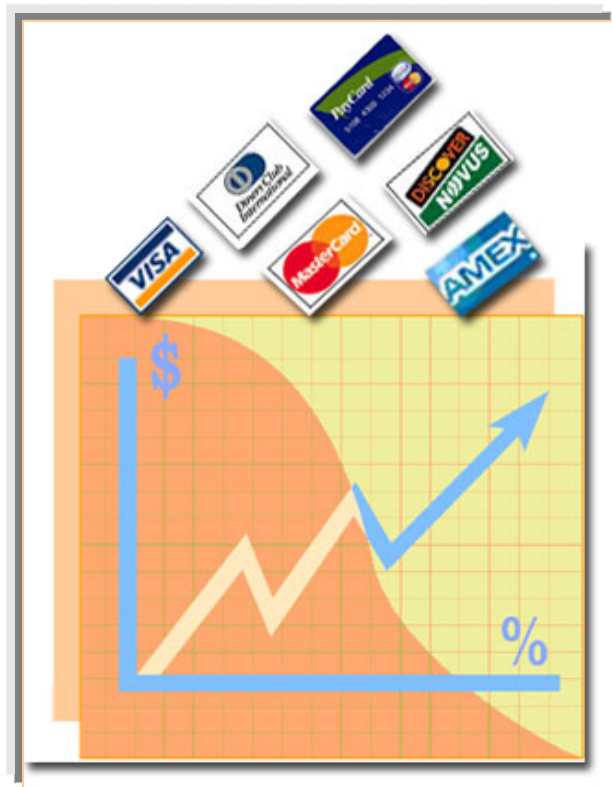

THE LIFE AND DEBT CYCLE



Part One:

The Implications of Rising Credit Card Debt Among Older Consumers

July 2006

NATIONAL
CONSUMER LAW
CENTER

77 Summer St., 10th Fl.
Boston, MA 02110
www.consumerlaw.org

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Part One:

The Implications of Rising Credit Card Debt Among Older Consumers

Written By:

Principal Author: Deanne Loonin

Contributing Authors
and Researchers:
Julia Devanthery
Steve Tripoli

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National Consumer Law Center is a non-profit organization with 37 years of working experience in consumer issues, especially those affecting low-income consumers. NCLC works with and offers training to thousands of legal-service, government and private attorneys, as well as community groups and organizations representing low-income and elderly people. Our legal manuals and consumer guides are standards of the field.

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EXECUTIVE SUMMARY

Older consumers have been increasing their debt loads at a time of life when debt is especially burdensome and fraught with peril. This report examines the extent and consequences of credit card borrowing by elders. A second, related report to be released in August 2006, focuses on the types of programs and resources available to help older consumers with credit card problems.

Credit Card Debt and Older Consumers

Older consumers generally hold less credit card debt than younger consumers. What is new is that elders are catching up. The average credit card debt for Americans between 65 and 69 years old rose a staggering 217% between 1992 and 2001, to \$5,844. Not surprisingly, given these and other trends, elders are filing bankruptcy in record numbers.

Consequences of Rising Debt Loads

It is not just that elders have more debt than before, but that many are buried in unaffordable debt. The danger is that older consumers that get into trouble will lose their security in order to service their debt.

Stories in this report from interviews with older consumers nationwide demonstrate how profoundly credit card debt affects older individuals.

Causes of Increased Credit Card Debt

Many older consumers are using credit cards as a plastic safety net, to make essential purchases that they cannot otherwise afford. Others make discretionary purchases at a time when they can afford those purchases or at least afford the minimum payments. Few households borrow money without intending to repay it. These plans, however, easily change, often due to unexpected, adverse events. This is particularly true for older consumers with diminished incomes after retirement or those who unexpectedly lose income due to disability or death in their households.

There is little margin for error with older populations. Those who lose income over time or who slip in and out of poverty have fewer working years, if any, to replace resources and save. A lack of financial knowledge exacerbates these problems. Researchers have found widespread financial illiteracy among older Americans.

This report documents key factors that explain the use of credit cards as a plastic safety net, including:

- **Shrinking Income:** The largest share of older Americans live on low incomes that stagnated or declined during most of the 90's, while their basic costs increased.
- **Higher expenses:** These include higher housing costs, rising out of pocket medical costs, increased energy and utility costs, and rising property taxes.
- **Creditor practices** that push consumers to borrow beyond their means.

Creditor Practices Push Consumers to Borrow Beyond Their Means

Credit cards provide a great convenience for many older consumers. The danger comes from the borrowing features of credit cards, the exorbitant costs of borrowing, and the downward spiral that hits consumers once they get into trouble.

Specific practices that harm consumers are summarized and discussed in this report, including:

- High Cost Credit
- Aggressive Solicitation and Lack of Real Underwriting
- Punitive Fees
- Penalty Rates and Universal Default
- Deceptive Marketing
- Changes to Credit Limits
- Debt Collection Abuses
- Use of Mandatory Arbitration Clauses
- Tiny Monthly Minimum Payments, and
- Change-in-Terms Provisions.

The report contains detailed policy recommendations to stem credit card debt, not necessarily credit card use, among older consumers. The report calls for reinstating substantive limits on the terms of credit and the cost of credit, including the interest rate and all fees and charges.

Specific Recommendations include:

- Promoting debit card use, but only if debit card users are afforded the same protections as credit card users.
- Prohibiting the most dangerous credit card terms and practices, and
- Improving disclosures.

**The Life and Debt Cycle:
The Implications of Rising Credit Card Debt Among Older Consumers
July 2006**

INTRODUCTION

Older Americans have been increasing their debt loads at a time of life when debt is especially burdensome and fraught with peril. Many older homeowners borrow against the equity in their homes, often repeatedly, in an effort to stay afloat. In unprecedented numbers, many others are turning to the plastic safety net of credit cards.

The Depression-era generation has traditionally been more averse to debt than their younger counterparts. It is increasingly clear that elders are changing these behaviors, often out of necessity. The Depression-era generation is joined by aging baby boomers, who tend to be more liberal in the use of consumer credit than their parents.¹ Many baby boomers who had children later in life end up paying for their childrens' higher education and other expenses into their retirement years and beyond. Many are also becoming caretakers for older parents. Overall, both the "younger" and "older" segments of the elder population are going into debt, filing bankruptcy, and in many cases losing their homes in greater numbers than ever before.

The increase in credit card borrowing is tied to a host of other social and economic policies. For many retirees, social security and pension income are simply no longer sufficient to meet day-to-day needs. In rapidly increasing numbers, elders are using credit to pay for necessities like groceries, prescription drugs, and urgent house repairs. Others fall into traps set by credit card companies and do not always know that they are borrowing at an unaffordable pace. Even small setbacks, such as using a credit card for a supply of prescription drugs, can send these older consumers into a spiral of late fees and increased rates that is impossible to escape.

Credit cards are a great convenience for many older consumers. Contrary to popular conception, older consumers are increasingly shopping on-line and using credit cards. They are becoming at ease with a cashless society, receiving Social Security through electronic deposit and regularly using ATMs. For those who are able to use their cards only for convenience, the advantages often outweigh the costs. For those who borrow, severe trouble and financial distress is often just one or two missed payments away.

OUTLINE OF REPORT

This report examines the extent and consequences of credit card borrowing by older consumers. A second, related report will focus on the programs and resources available to help older consumers with credit card problems. Unless otherwise specified, older consumers are defined as individuals age 65 and above. In some cases, we use data that includes younger age groups, mainly those over 50.

The first section of this report reviews the extent of credit card borrowing among older consumers. This section is followed by a discussion of key causes. The research is derived mainly

¹ See generally ROBERT D. MANNING, LIVING WITH DEBT: A LIFE STAGE ANALYSIS OF CHANGING ATTITUDES AND BEHAVIORS (2005), *available at* http://www.lendingtree.com/livingwithdebt/collateral/full_report.pdf.

from existing studies and data. We supplemented this information with interviews with older consumers and their advocates nation-wide. In-depth interviews were conducted with consumers living in New Hampshire, West Virginia, and New Mexico. We also interviewed advocates from legal services and senior support networks across the country as well as other experts in the field.

The second section focuses on credit card company practices and credit card terms which cause particular problems for consumers generally and for older consumers specifically. This section is followed by recommended policy fixes addressing the most abusive credit card practices as well as strategies to promote the use of credit cards and their related cousins, debit cards, for convenience without pushing consumers into dangerous and expensive borrowing.

CREDIT CARD DEBT AND OLDER CONSUMERS

Credit cards are everywhere. There are over 682 million general use credit cards in circulation or 2.3 credit cards for every man, woman, and child in the United States.² The share of households with at least one credit card rose from 70% in 1989 to 76% in 2001. The Federal Reserve Board attributes this increase in cardholding to the expansion of credit to riskier households--those what would not have previously qualified for a card.³

Between 1989 and 2001 credit card debt in America almost tripled from \$238 billion to \$692 billion. Worse, the savings rate steadily declined during this same time period and the number of personal bankruptcies filed climbed 125%.⁴ As of April 2006, the total revolving debt in the United States stood at just over \$806 billion.⁵

Older consumers generally hold less credit card debt than younger consumers. What is new is that older consumers are catching up. The average credit card debt for Americans between 65 and 69 years old rose a staggering 217 percent between 1992 and 2001, to \$5,844.⁶ Average self-reported credit card debt among the 23% of all seniors holding such debt increased by 89 percent in constant dollars, to \$4,041. During this same time period, among the 70 percent of all seniors over 65 with incomes under \$50,000, about one in five families with credit card debt was in debt hardship. This is defined by the non-profit research group Demos as spending more than 40 percent of their income on debt payments including mortgage debt.

In a 2006 study, AARP found that close to half of U.S. adults age 40 or older see their current level of debt as a problem. About 12% see it as a major problem. About 30% of retirees in the survey described their debt as a problem. Only 7% of retirees said they did not have any debt.⁷

Not surprisingly given these trends, older consumers are filing bankruptcy in record numbers. Although elders are still less likely than other age groups to declare bankruptcy, from 1992 to 2001, the

² Cardweb.com, *Carded Americans*, CardTrak, October 20, 2005, *available at* www.cardweb.com/cardtrak/news/2005/octoer/20a.html.

³ Kathleen W. Johnson, *Recent Developments in the Credit Card Market and the Financial Obligations Ratio*, FEDERAL RESERVE BULLETIN, Autumn 2005, at 474 *available at* http://www.federalreserve.gov/pubs/bulletin/2005/autumn05_lead.pdf.

⁴ TAMARA DRAUT & JAVIER SILVA, DEMOS, *BORROWING TO MAKE ENDS MEET; THE GROWTH OF CREDIT CARD DEBT IN THE 1990S* 9 (Sept. 18, 2003), *available at* http://www.demos-usa.org/pubs/borrowing_to_make_ends_meet.pdf.

⁵ FEDERAL RESERVE BOARD STATISTICAL RELEASE G.19 (June 7, 2006), *available at* <http://www.federalreserve.gov/releases/g19/current/default.htm>.

⁶ HEATHER C. MCGHEE AND TAMARA DRAUT, DEMOS, *RETIRING IN THE RED: THE GROWTH OF DEBT AMONG OLDER AMERICANS* 1 (2d ed. 2005), *available at* http://www.demos-usa.org/pubs/Retiring_2ed.pdf.

⁷ HANA HOLLEY, AARP, *RETIREMENT PLANNING SURVEY AMONG U.S. ADULTS AGE 40 AND OLDER* (May 2006), *available at* http://assets.aarp.org/rgcenter/econ/ret_planning.pdf.

number of older consumers filing for bankruptcy tripled.⁸ In a 2006 study by the Institute for Financial Literacy, over 20% of consumers seeking mandatory pre-bankruptcy counseling were over 55.⁹

CONSEQUENCES OF RISING DEBT LOADS

It is not just that elders have more debt than ever before, but that many are buried in unaffordable debt. The consequences can be devastating and include foreclosure, car repossession, collection lawsuits, and debt collection harassment. In addition, the more money elders devote to servicing their debt, the less there is available for savings and other resources to preserve income security and financial independence. The fewer private resources elders have available to pay for expenses as they get older, the more society has to pay or else allow its older citizens to suffer and do without basic necessities of life.

The Social Security program was established to ease the transition to retirement. It signaled our willingness as a society to take care of our elders. President Jimmy Carter described this obligation as a “...commitment as a society to the belief that workers should not live in dread that a disability, death, or old age could leave them or their families destitute.” President Ronald Reagan emphasized that Social Security is a monument to the “...spirit and compassion and commitment that unites us as a people.”

The danger is that older consumers that get into trouble will lose their security in order to service their debt. Over indebtedness threatens to undermine the key goals that consumers hold and continue to hold as they age. These are, according to an AARP survey, first and foremost to pay bills on time, followed by living at home as long as possible, being financially independent, and having enough to live well.¹⁰

The emotional, psychological and health costs must also be considered. Researchers are just beginning to quantify and capture some of the health and emotional consequences of debt.

The relationship between fiscal and physical health requires additional study, particularly research focusing on vulnerable communities, such as older consumers.

In researching this report, we interviewed older consumers throughout the country. In-depth interviews were conducted with elders living in New Hampshire, West Virginia, and New Mexico. Below are just a few examples of the ways in which credit card debt is deeply impacting this country's elders.

⁸Dr. Teresa A. Sullivan, Deborah Thorne and Elizabeth Warren, *Young, Old, and in Between: Who Files for Bankruptcy?*, NATIONAL BANKRUPTCY LAW ADVISOR, September 2001 Issue No. 9A, at 5.

⁹ INSTITUTE FOR FINANCIAL LITERACY, FIRST DEMOGRAPHIC ANALYSIS OF POST-BAPCPA DEBTORS 5 (April 2006), available at <http://www.financiallit.org/news/white/2006-04-16%20First%20Demographic%20Analysis%20of%20Post%20v.2.pdf>.

¹⁰ HANA HOLLEY, AARP, RETIREMENT PLANNING SURVEY AMONG U.S. ADULTS AGE 40 AND OLDER (May 2006), available at http://assets.aarp.org/rgcenter/econ/ret_planning.pdf.

HARD CHOICES

A 63 year old man in West Virginia, overwhelmed by life crises including two recent heart attacks, described how his credit card company told him to pay his minimum payments before paying his utility bills. Heeding this advice, the utilities in his trailer were shut off. He still owes arrearages to the utility company.

His credit is now ruined and although the trailer he lives in is deteriorating, he is unable to get an affordable loan to purchase a new trailer. His fragile health is growing worse due to the time he spends on the phone with collectors and credit card companies, trying to figure out whether he can meet his obligations.

The Executive Director of West Virginia Senior Legal Aid in Morgantown, Cathy McConnell, described many of her clients' economic sophistication as very low. When combined with a strong pay-what-you-owe ethic, she says that it makes them easy marks for credit card terms they do not understand even when the terms are abusive. "Seventy-five to 80 percent of our clients are women, and the generation in their late 60's to early 90's had really defined gender roles and zero financial skills," she told NCLC, "Some have no idea even what their income is until their husbands die. These are really proud people, so many of them won't tell you they can't even read. Then they get all these bills in the mail, and their instinct is to pay them and not prioritize or plan the rest of the month." She then described what happens when they realize they cannot catch up: "For them, it's a shocking moment. I've had women cry – some of them still think there are debtors' prisons."

Through our interviews, we heard repeated stories of debt collection abuses, including credit card collectors calling neighbors and even a son at work. Many consumers got behind to try to pay medical expenses, including one consumer who used her credit card to purchase a hearing aid that cost much more than she originally thought. "If I had to do it again", she said, "I'd go without my hearing aid, and not even take a credit card."

TOO SICK TO WORK

One woman, now 61 and retired due to disability, worked for 19 years after her children were no longer young, usually two jobs at a time, as a waitress, laundress, at the local Dairy Queen and as an inspector at a nearby factory, until her emotional woes and several physical ailments overtook her.

Getting behind on her credit cards mainly due to medical expenses, she tried to get her creditors

to accept payments of \$50/month, but they would take no less than \$150. She says the balance had been about \$2,100 when she stopped using the card, "and I'm not sure how it went from there to \$3,500." She says she made payments of between \$68 and \$120 a month on the card for three or four years before she could no longer afford to on her \$620 monthly disability check.

These stories demonstrate how profoundly credit card debt affects older individuals, but the consequences go much deeper. Numerous researchers have highlighted the connection between the increase in credit card debt and increases in bankruptcy filings.¹¹ Another consequence commonly noted is the loss to the economy of the diminished productivity of people in financial distress.

¹¹ For an excellent summary of these studies and an analysis tracking the link between credit card debt and bankruptcy, see RONALD J. MANN, "CREDIT CARDS, CONSUMER CREDIT & BANKRUPTCY", THE UNIVERSITY OF TEXAS SCHOOL OF LAW,

Other researchers have described how overwhelming credit card debt and even just the fear of credit card burdens is driving many consumers to hand their equity back to mortgage lenders in the form of “cash out” refinances.¹² Between 2002 and 2004, Americans withdrew \$2 trillion of the equity in their homes. Cash-out refinances represented 47% of all prime mortgage refinances and 83% of subprime mortgage refinances in 2004.¹³ According to a 2005 report by the Center for Responsible Lending, outstanding credit card debt serves as a convenient hook for lenders to promote cash-out refinances to debt-loaded homeowners. For many, this refinancing does not live up to its promise. Many do not realize how much equity they will lose, the total costs of that loss, or that they are putting their home in jeopardy in order to temporarily repay unsecured credit card debt. This is especially devastating for elders, a population that is more likely to own a home than younger consumers and more likely to rely on home equity as their only asset.

CAUSES OF INCREASED DEBT

The interviews and surveys conducted for this report caution against a simple analysis of the causes of increased borrowing and debt loads among older consumers. It is clear that many consumers use credit cards as a plastic safety net, to make essential purchases that they cannot otherwise afford. In a recent national survey of indebted low and middle income households, seven out of ten households of all ages reported using their credit cards as a safety net, relying on cards to pay for car repairs, basic living expenses, medical expenses or house repairs.¹⁴

Less clear, but most likely a contributing factor, are older consumers borrowing from credit cards to make discretionary purchases at a time when they can afford those purchases or at least afford the minimum payments on their cards. Most of these consumers expect to pay back what they owe. The Federal Reserve Board acknowledges that very few households borrow money without intending to repay it.¹⁵ These plans, however, can easily change, often due to unexpected, adverse events. This is particularly true for older consumers with diminished incomes after retirement or those who unexpectedly lose income due to disability or death in their households. Although some of the consumers we interviewed had a sense of the cost of borrowing, none had any real comprehension of the disastrous costs and penalties that hit them when they got into trouble.

A lack of financial knowledge exacerbates the problem for many. Researchers in general have found widespread financial illiteracy among older Americans. Women, minorities and those without college degrees were particularly at risk.¹⁶ Yet even the most educated consumers will not necessarily understand intricate, complex credit card lender practices which heavily penalize users who fall into trouble.

LAW AND ECONOMICS RESEARCH PAPER NO. 44 (Revised March 2006), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=690701.

¹² LISA JAMES, JABRINA ROBINSON, CENTER FOR RESPONSIBLE LENDING, RISKING HOMES TO PAY OFF CREDIT CARDS, CRL ISSUE PAPER NO. 12 1 (November 2005), *available at* http://www.responsiblelending.org/pdfs/ip012-Risking_Homes_Credit_Cards-1105.pdf.

¹³ *Id.* at 1.

¹⁴ CENTER FOR RESPONSIBLE LENDING, DEMOS, THE PLASTIC SAFETY NET: THE REALITY BEHIND DEBT IN AMERICA 10 (October 2005), *available at* <http://www.responsiblelending.org/pdfs/DEMOS-101205.pdf>.

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” at 16 (June 2006), *available at* <http://www.federalreserve.gov/boarddocs/rptcongress/bankruptcy/bankruptcybillstudy200606.pdf>.

¹⁶ ANNAMARIA LUSARDI AND OLIVIA S. MITCHELL, FINANCIAL LITERACY AND PLANNING: IMPLICATIONS FOR RETIREMENT WELLBEING, UNIVERSITY OF MICHIGAN RETIREMENT RESEARCH CENTER WORKING PAPER 2005-108 3 (December 2005), *available at* <http://www.mrrc.isr.umich.edu/publications/papers/pdf/wp108.pdf>.

All consumers, including elders, find themselves forced to navigate an increasingly complex marketplace. According to AARP, consumer decision-making is difficult for several reasons, including:

- **Consumers have less time and more decisions.** In addition, special circumstances such as disabilities, poverty, discrimination, living alone, and language barriers often disproportionately affect the older population and their role as consumers and money managers.
- **The increasing complexity of products and services, and**
- **Low levels of financial literacy.**¹⁷

Most important, there is little margin for error with older populations. Those who lose income over time or who slip in and out of poverty have fewer working years, if any, to replace resources and save for retirement.

The consumers we interviewed used credit cards for small business expenses, basic necessities, medical needs, and in some cases discretionary purchases, including gifts. What stands out is the precariousness of this spending and borrowing. Most were able to muddle through, although often by paying just the minimum payments, until a triggering event upset this delicate balance. In some cases, the trigger was retirement and lack of sufficient savings. In other cases, a health crisis, failed business, or death of a partner caused the distress. The common theme was that once the trouble began, the creditors hit the consumers with late fees and increased rates and were generally unwilling to offer relief to those who asked. Some consumers sacrificed and kept paying. In most cases, they paid amounts in excess of what they originally borrowed, but due to fees and other costs, their balances barely diminished, if at all. This is the credit card trap. It is not only difficult for elders to get out of this trap, it is also difficult to find a helping hand once trouble begins.

The Plastic Safety Net

Shrinking Income

Despite high home ownership rates and a generational ethos of thrift, a study by the non-partisan public policy group Demos found that the largest share of older Americans “live on low incomes that stagnated or declined during most of the 90’s, while their basic costs increased.” “Critically,” Demos reports, “their most important bulwark against debt—savings and assets—also diminished.”¹⁸ Although many elder-headed households are able to save for retirement and live well as they age, median income on average is much lower for households headed by persons over 65. In 2004, median income for elder households was \$24,509 compared to \$50,923 for households headed by persons under 65.¹⁹

As a group, fewer older Americans live in poverty than individuals in other age cohorts. Social Security is often credited for reducing these rates over the years. However, leaving aside Social

¹⁷ AARP, BEYOND 50.04: A REPORT TO THE NATION ON CONSUMERS IN THE MARKETPLACE (2004), *available at* http://assets.aarp.org/rgcenter/consume/beyond_50_cons.pdf.

¹⁸ HEATHER C. MCGHEE AND TAMARA DRAUT, DEMOS, RETIRING IN THE RED: THE GROWTH OF DEBT AMONG OLDER AMERICANS 1 (2nd ed. 2005), *available at* http://www.demos.org/pubs/Retiring_2ed.pdf.

¹⁹ CARMEN DENAVAS-WALT, BERNADETTE D. PROCTOR, CHERYL HILL LEE, U.S. CENSUS BUREAU, INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2004 4 (August 2005), *available at* <http://www.census.gov/prod/2005pubs/p60-229.pdf>.

Security income, nearly one of every two people over 65 (46.8%) has income below the poverty line.²⁰ Elder reliance on Social Security is troubling given the likely reductions in Social Security over time and the decline in other retirement income, such as private pensions. Financial insecurity is especially acute among senior women. Compared to older men, older women are more likely to be single and live alone, more likely to face poverty and less likely to engage in full-time year-round work prior to retirement.²¹ With women's earnings reaching only two-thirds of men's among full-time year-round workers, women are more likely to receive lower median annual Social Security benefits than men, although Social Security is the most common source of income for both genders in retirement. Women are also less likely to receive pension benefits and those women who are entitled to them receive only half the amount received by men.²²

Higher expenses

Increased expenses among elders are due to a variety of factors including higher housing costs, health care, energy, property taxes, and transportation. Further, the positive trend toward greater life expectancies lead to more years of expenses as well as greater likelihood of long-term care and other health care costs. Increased life expectancy is also producing a whole new set of financial concerns for seniors. More seniors are taking care of their own aged parents, paying mortgages later in life, having children later, and thus paying for higher education later.

The key contributors to increased expenses for elders are discussed below.

Housing Costs

A 2005 study examining consumption patterns after retirement found that older adults, whether renters or homeowners, devote a larger share of their expenditures and income to housing than any other category of goods and services, including health care.²³ Utilities represented the largest housing spending category followed by property taxes, mortgage payments and housing maintenance, insurance, and rent.

²⁰ ARLOC SHERMAN, ISAAC SHAPIRO, CENTER ON BUDGET AND POLICY PRIORITIES, SOCIAL SECURITY LIFTS 13 MILLION SENIORS ABOVE THE POVERTY LINE: A STATE-BY-STATE ANALYSIS (February 24, 2005), *available at* <http://www.cbpp.org/2-24-05socsec.htm>.

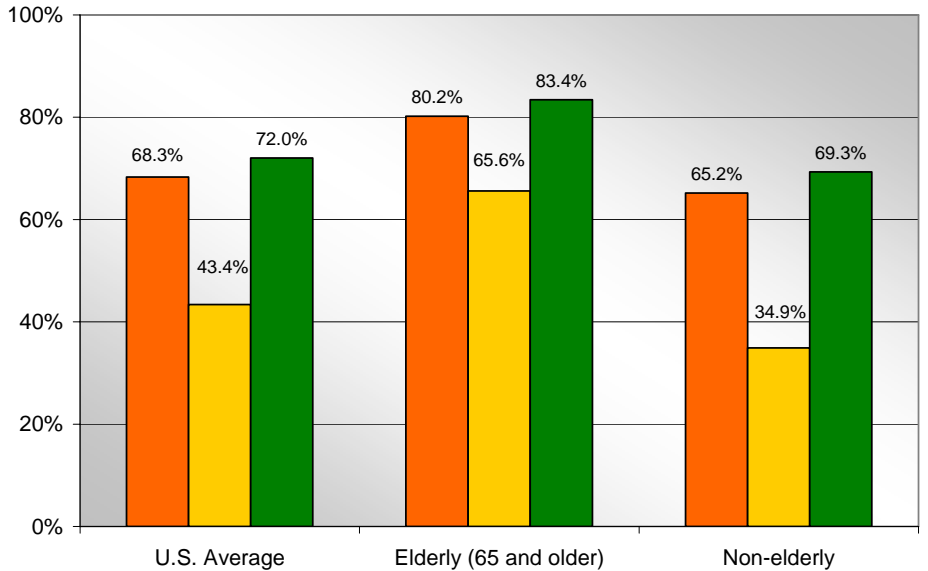
²¹ *Id.*

²² SUNWHA LEE AND LOIS SHAW, INSTITUTE FOR WOMEN'S POLICY RESEARCH, GENDER AND ECONOMIC SECURITY IN RETIREMENT 13 (2003), <http://www.iwpr.org/pdf/D456.pdf>.

²³ BARBARA A. BUTRICA, JOSHUA H. GOLDWYN, AND RICHARD W. JOHNSON, CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE, UNDERSTANDING EXPENDITURE PATTERNS IN RETIREMENT 3 (January 2005), *available at* http://www.bc.edu/centers/crr/papers/wp_2005-03.pdf.

CHART 1

Homeownership, Age and Income, 2003



Source:
U.S. Census Bureau: American Housing Survey: 2003.
Tables 2-1 & 7-1

■ All
 ■ Below FPL
 ■ Above FPL

*Federal Poverty Level (FPL)

Elders of all income levels are more likely to be homeowners than younger people. As displayed in Chart 1, in 2003, the average homeownership rate for all Americans was about 68.3%. The rate for all elder-headed households, in contrast, was 80.2%.²⁴ The disproportionately high level of homeownership among elders persists for the lowest income households as well. In 2003, the homeownership rate for elders living below the federal poverty line was 65.6%, compared to 43.4% for all Americans below poverty.²⁵

A major reason for rising housing costs is that elders are increasingly likely to hold mortgages later in life.²⁶ Mortgage debt owed by older Americans nearly quadrupled between 1989 and 2001, even after accounting for inflation.²⁷ In 2001 home mortgage debt accounted for 70 per cent of the total debt of homeowners aged 65 and older – up nearly 20 percentage points since 1989.²⁸

A 2005 study found that each succeeding generation appears to be carrying more mortgage debt into their older years. For example, only 41 per cent of owner households with heads aged 55 to 64 had paid off their mortgages in 2001, compared with 54 per cent of their same-age counterparts in

²⁴ U.S. Census Bureau, American Housing Survey (2003), available at <http://www.census.gov/prod/2004pubs/H150-03.pdf>.

²⁵ *Id.*

²⁶ See e.g., GEORGE S. MASNICK, ZHU XIAO DI AND ERIC S. BELSKY, JOINT CENTER FOR HOUSING STUDIES, HARVARD UNIVERSITY, EMERGING COHORT TRENDS IN HOUSING DEBT AND HOME EQUITY 1 (2005), available at <http://www.jchs.harvard.edu/publications/finance/w05-1.pdf>.

²⁷ Jennifer Bayot, *Tear Up the Mortgage? Not Yet: Elderly Face Rising Debt Load*, N.Y. TIMES, July 4, 2004.

²⁸ WILLIAM C. APGAR, ZHU XIAO DI, JOINT CENTER FOR HOUSING STUDIES, HARVARD UNIVERSITY, HOUSING WEALTH AND RETIREMENT SAVINGS: ENHANCING FINANCIAL SECURITY FOR OLDER AMERICANS 5 (2005), available at <http://www.jchs.harvard.edu/publications/finance/w05-8.pdf>.

1989.²⁹ At the same time, one in four (26.4%) of owner households with heads aged 65 or older had not yet retired their mortgage – nearly six percentage points higher than in 1989. Even more striking is the level of debt these older homeowners carry into their retirement years. After adjusting for inflation, the median mortgage debt of those older homeowners more than tripled from 1989 to 2001, to \$44,000, while the mortgage debt of slightly younger mortgage borrowers (aged 55 to 64) nearly doubled. In contrast, mortgage debt for homeowners of all ages rose during this period, but at a significantly slower pace than for older homeowners.

Rising Out-of-Pocket Medical Costs

Health care spending in general has increased by about 14% in recent years.³⁰ Medical bills account for a rising proportion of elder consumer debt, even for people with health insurance. AARP found that 19% of respondents in a survey of Americans 50 and older reported paying for health-related costs with savings that were supposed to be for other non-medical items, and 7% reported that their medical bills have caused them to cut back on basic necessities like food or housing.³¹

Older consumers averaged just over \$3,500 in out of pocket health care expenses in 2002, an increase of 45% since 1992.³² While nearly all persons 65 and older receive Medicare, Medicare recipients and other insured seniors are not insulated from medical debt problems. In the 2005 AARP survey, 24% of those with Medicare and 13% of those with other coverage reported financial problems from medical bills.³³ Equally alarming is the growing number of seniors with no health insurance or inadequate health insurance. As of 2004, about 6.6 million individuals aged 50-64 were uninsured.³⁴

An AARP Survey found that one-third of respondents who reported that their debt increased also reported having financial problems with medical bills.³⁵ Overall, out-of-pocket medical spending accounts for 22% of seniors' incomes on average, with low-income seniors spending even more.³⁶

In a survey of low and middle income households of all ages, 29% cited an illness or necessary medical expenses as contributing to their current level of credit card debt.³⁷ Medical debt may also be a key factor explaining the high rates of predatory loans among seniors.³⁸

A recent study of consumers of all ages investigating the link between medical expenses and bankruptcy filings found that over 25 percent of debtors surveyed cited illness or injury as a specific reason for filing for bankruptcy with about the same number of filers reporting uncovered medical

²⁹ *Id.* at 4.

³⁰ Jane J. Kim, *Retiree Health Costs Are Far Higher Than Expected*, WALL STREET JOURNAL May 13, 2004.

³¹ AARP, THE STATE OF 50+ AMERICA 40 (2005), available at http://assets.aarp.org/rgcenter/econ/fifty_plus_2005.pdf.

³² U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES, ADMINISTRATION ON AGING, A PROFILE OF OLDER AMERICANS 2003 13 (2003), <http://www.aoa.gov/prof/Statistics/profile/2003/2003profile.pdf>.

³³ AARP, THE STATE OF 50+ AMERICA 40 (2005), available at http://assets.aarp.org/rgcenter/econ/fifty_plus_2005.pdf.

³⁴ AARP, THE STATE OF 50+ AMERICA 28 (2006), available at http://assets.aarp.org/rgcenter/econ/fifty_plus_2006.pdf.

³⁵ AARP, THE STATE OF 50+ AMERICA 20 (2005), available at http://assets.aarp.org/rgcenter/econ/fifty_plus_2005.pdf.

Twenty percent of respondents overall reported medical bills to be a problem.

³⁶ HEATHER C. MCGHEE AND TAMARA DRAUT, DEMOS, RETIRING IN THE RED: THE GROWTH OF DEBT AMONG OLDER AMERICANS 6 (2D ED. 2005), available at http://www.demos-usa.org/pubs/Retiring_2ed.pdf.

³⁷ CENTER FOR RESPONSIBLE LENDING, DEMOS, THE PLASTIC SAFETY NET: THE REALITY BEHIND DEBT IN AMERICA 10 (October 2005), available at <http://www.responsiblelending.org/pdfs/DEMOS-101205.pdf>.

³⁸ See Robert W. Seifert, Fannie Mae Foundation, *The Demand Side of Financial Exploitation: The Case of Medical Debt*, 15-3 HOUSING POLICY DEBATE 785 (2004), http://www.fanniemae.foundation.org/programs/hpd/pdf/hpd_1503_Seifert.pdf.

bills of \$1000 and higher.³⁹ A 2006 study of consumers seeking counseling prior to bankruptcy found that about 30% cited illness or injury as a cause of financial distress.⁴⁰

Energy and Utility Costs

According to AARP, older Americans devote a higher percentage of total spending to residential energy costs than younger consumers. One of every four low-income older households spends 19% or more of its entire income on home energy bills. At a hearing before the United States Senate, a representative of AARP testified that 12% of elders said they have been forced to limit or do without food to pay higher energy bills, 11% have reduced or done without medical services, and 10% have gone without their prescription drugs.⁴¹

CHART 2

LIVING ON THE EDGE		
<p>MEDICAL & HEALTH CARE COSTS:</p> <ul style="list-style-type: none"> ▪ 19% of Americans 50 and older reported paying for health-related costs with savings that were supposed to be for non-medical items ▪ 7% of Americans 50 and older reported that medical bills have caused them to cut back on basic necessities like food or housing 	<p style="text-align: center; font-size: small;">IN AN AARP SURVEY OF OLDER AMERICANS OF EFFECTS OF INCREASED</p> <p>ENERGY COSTS:</p> <ul style="list-style-type: none"> ▪ 12% reported limiting or doing without food to pay increased energy costs ▪ 11% reported reducing or doing without medical services to pay increased energy costs ▪ 10% reported limiting or doing without prescription drugs to pay increased energy costs 	<p>HOUSING COSTS:</p> <ul style="list-style-type: none"> ▪ Older adults devote a larger share of expenditures to housing than any other category of goods & services ▪ Mortgage debt owed by older Americans nearly quadrupled between 1989 & 2001, even after accounting for inflation.
<p>Sources: AARP, <i>The State of 50+ America</i> (2005) Nelda Barnett, AARP, Testimony Before the U.S. Senate Special Committee on Aging, <i>The Impact of Energy Prices on Older Americans</i> (June 15, 2005) Barbara A. Butrica, Joshua H. Goldwyn and Richard W. Johnson, Center for Retirement Research at Boston College, <i>Understanding Expenditure Patterns in Retirement</i> (January 2005). William C. Apgar, Zhu Xiao Di, Joint Center for Housing Studies, Harvard University, <i>Housing Wealth and Retirement Savings, Enhancing Financial Security for Older Americans</i> (2005).</p>		

³⁹ David U. Himmelstein, Elizabeth Warren, Deborah Thorne, and Steffie Woolhandler, *Market Watch: Illness and Injury as Contributors to Bankruptcy*, HEALTH AFFAIRS-WEB EXCLUSIVE 4 (February 2, 2005), available at <http://content.healthaffairs.org/cgi/content/full/hlthaff.w5.63/DC1>.

⁴⁰ INSTITUTE FOR FINANCIAL LITERACY, FIRST DEMOGRAPHIC ANALYSIS OF POST-BAPCPA DEBTORS 10 (April 2006), available at <http://www.financiallit.org/news/white/2006-04-16%20First%20Demographic%20Analysis%20of%20Post%20v.2.pdf>.

⁴¹ *The Impact of Energy Prices on Older Americans*, Testimony Before the U.S. Senate Special Committee on Aging (June 15, 2005) (Statement of Nelda Barnett, AARP).

Property Taxes

Housing prices in the United States increased 28.87% between 1995 and 2000 and 52.6% between 2000 and 2005.⁴² Not surprisingly, as housing prices surged so did homeowners' property tax bills. Property tax increases are especially difficult to bear for low-income homeowners – those already most burdened by property taxes – because their incomes have not kept pace with the sharp increase in the value of their homes. On the contrary, in some areas property taxes have risen at two or three times the rate of inflation.

Every state has enacted special property tax abatement schemes or exemptions that relieve at least some taxpayers of a portion of their property tax liability by virtue of age, disability, income level, or personal status. All states have approved tax relief for elderly homeowners as well. However, many of those eligible are unaware of the benefits offered by these programs, and budget shortfalls on the local level cause local governments to pare down the relief.⁴³

Creditor Practices

The Push to Borrow

The seniors' strong ethic of paying what they owe is precisely what the [credit card] companies exploit; how deeply inhumane.”—Cathy McConnell, Executive Director West Virginia Senior Legal Aid

Credit card company practices may be inhumane, but they are profitable. Card issuer profits, though declining somewhat from 1995 to 1998, steadily increased between 1999 and 2004. These profits rose from 3.1% in 1999 to 4.5% in 2004.⁴⁴ Researchers have shown that these profits remain, and often grow, even when delinquencies are high.⁴⁵

Credit cards provide a great convenience for many consumers, including elders who increasingly use credit cards to pay for a range of products and services. The danger comes from the borrowing features of credit cards, the exorbitant costs of borrowing, and the downward spiral that hits consumers once they get into trouble.

The convenience of credit cards is part of the problem. Consumers get cards at a point in time when they may not be thinking about borrowing. Cards are issued and priced based on the consumer's financial circumstances at that time. Borrowing, however, takes place later when consumers may be in much worse shape financially. They are usually allowed to borrow and it is very convenient to do so, but the costs are high.⁴⁶

⁴² Freddie Mac, Conventional Mortgage Home Price Index, Q3 2000 and 2005 releases (reporting the annualized 5-year change).

⁴³ DAVID BAER, AARP PUBLIC POLICY INST., AWARENESS AND POPULARITY OF PROPERTY TAX RELIEF PROGRAMS V (Feb. 1998), available at http://assets.aarp.org/rgcenter/econ/9803_tax.pdf.

⁴⁴ Cardweb.com, *Card Profits 04* (Jan. 24, 2005), available at <http://www.cardweb.com/cardtrak/news/2005/january/24a.html>.

⁴⁵ See Lawrence M. Ausubel, *Credit Card Defaults, Credit Card Profits, and Bankruptcy*, 71 AM. BANKR. L.J. 249-70 (Spring 1997), available at <http://www.ausubel.com/creditcard-papers/ablj.pdf>.

⁴⁶ See generally, RONALD J. MANN, CREDIT CARDS, CONSUMER CREDIT & BANKRUPTCY, THE UNIVERSITY OF TEXAS SCHOOL OF LAW, LAW AND ECONOMICS RESEARCH PAPER NO. 44 (Revised March 2006), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=690701.

Consumers appear to assume that they will not borrow on their cards or that they will not get in over their heads if they borrow. Creditors exploit these biases. Professor Oren Bar-Gill refers to consumers' underestimation of their future borrowing as the central failure in the credit card market.⁴⁷

Credit card spending leads very easily into borrowing. The borrowing that takes place is so easy, according to Professor Ronald Mann, "...that borrowers fail to appreciate the risks they would see if they borrowed the money in more traditional way."⁴⁸ Researchers have described the phenomenon of consumers sliding into debt, almost imperceptibly. They describe consumers who would never dream of seeking a \$5000 loan running up \$5000 in charges of \$50 at a time.⁴⁹ Once they start to borrow, many credit card companies push them to borrow more, often to the breaking point and beyond.

This is especially felt by older consumers, most of whom want to pay back their debts. Many of those we interviewed in fact made monthly payments that far exceed the amounts borrowed. These types of scenarios came up repeatedly in our interviews with older consumers and their advocates.

For example, Deborah, age 80, was paying hundreds a month to keep all her cards current right into early 2005 and not telling anyone of her predicament. Her daughter, who has been helping Deborah untangle her mess, showed us an October 2001 statement from Bank of America, whose 29.99% interest card had the largest balance. Four years and many thousands in payments later, the balance on that card had actually gone up a bit. Deborah had been paying for years, without adding any new charges, and still ended up further behind.

Deborah, a New Hampshire resident, has a business degree. Thirty-three of her working years were spent in just two jobs. But none of that allowed her to see this deep crater of credit card trouble coming. Her biggest mistake appears to be that she simply did not foresee how quickly her card payments would overwhelm her income once she finally retired at age 75.

Creditors push consumers into borrowing because creditors derive profits mainly from consumers that use their cards to borrow ("revolvers"), not from convenience users who pay off their cards. The revolvers essentially subsidize the convenience users. This works well if you are able to avoid borrowing, but many people are unable to do that. As discussed above, shrinking income and increased expenses lead to shortfalls that many consumers attempt to make up by using credit cards. Further, credit card companies aggressively sell the borrowing features of the cards and push convenience users into borrowing. Companies do this by allowing consumers to charge beyond credit limits or take cash advances at high rates or even by encouraging more spending to get rewards. All of this is done with little attention to whether the consumer can actually afford to borrow at these rates.

Financially secure customers generate no interest income, no late or overlimit fees, nothing except annual fees and interchange revenues. The latter fees make up about 20% of credit card revenues.⁵⁰ Sustained profitability begins when consumers stop paying the full balance each month.

⁴⁷ See generally Oren Bar-Gill, *Seduction By Plastic*, 98 NW. U. L. REV. 1373 at 1410 (Summer 2004), *available at* http://www.law.nyu.edu/faculty/homepages/bargill/papers/Bar-Gill_Seduction-by-Plastic.pdf.

⁴⁸ RONALD J. MANN, GLOBAL CREDIT CARD USE AND DEBT: POLICY ISSUES AND REGULATORY RESPONSES, THE UNIVERSITY OF TEXAS SCHOOL OF LAW, LAW AND ECONOMICS WORKING PAPER NO. 049 at 2 (April 2005), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=705141.

⁴⁹ Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, *As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America* 178 (Beard Books 1989).

⁵⁰ RONALD J. MANN, BANKRUPTCY REFORM AND THE "SWEAT BOX" OF CREDIT CARD DEBT, LAW AND ECONOMICS RESEARCH PAPER NO. 75 10 (April 2006), *available at* <http://www.utexas.edu/law/faculty/rmann/info/IllinoisPaper2.pdf>.

This strategy succeeds because the companies charge so much and push so hard once the consumer gets behind and because consumers have so few choices once they get in trouble.

In order to subsidize convenience users and make money, creditors charge fees to revolvers that are often far beyond the original amount borrowed. For example:

In May 1997, Ruth Owens stopped using her credit card, made no further purchases or cash advances, and tried to pay off her debt to Discover Bank. At that time, she owed \$1,963. Over the next six years, Ms. Owens made \$3,492 in payments to Discover Bank. One might assume this was enough to pay off her debt. After all, if Ms. Owens had made the same payments on a \$2,000 loan with interest at 21% annual percentage rate (the usury limit in many states), her debt would be paid off.

From May 1997 until her account was sent for collection in May 2003, not one penny of Ms. Owens' \$3,492 in payments went to reduce her debt. During this time, Discover Bank charged Ms. Owens various fees that consumed all of her payments and caused her debt to grow even larger. The following fees and interest were charged to Ms. Owens' account:

Fees and Interest

Over-limit Fees	\$ 1,518.00
Late Fees	\$ 1,160.00
Credit Insurance (CreditSafe) ⁵¹	\$ 369.62
Interest and Other Fees	\$ 6,008.66
Total	\$ 9,056.28

Despite having received substantial payments for six years from Ms. Owens (all that she could really afford), Discover Bank claimed that she still owed \$5,564 when it filed a collection lawsuit against her in an Ohio court. ***In other words, after having paid \$3,492 on a \$1,963 debt, Ms. Owens' balance grew to \$5,564.***

In this case, Ms. Owens would have been far better off if she simply stopped paying Discover Bank years earlier and had them sue her in state court. If Discover Bank had obtained a court judgment for \$2,000, all of the card fees and high-rate interest would have stopped and Discover would have then been entitled to 10% or less interest per year under Ohio law. Rather than have her debt increase, Ms. Owens' payments would have paid off the debt in full in approximately 4 years.

When Discover Card sued Ms. Owens in state court, she submitted the following handwritten statement to the court:

I would like to inform you that I have no money to make payments. I am on Social Security Disability. After paying my monthly utilities, there is no money left except little food money and sometimes it isn't enough. If my situation was different I would pay. I just don't have it. I'm sorry.

⁵¹ Like many card customers, Ms. Owens was being charged for one of the numerous insurance-like products sold by card companies. Often, these products are sold through high-pressure telemarketing sales. In this case, Ms. Owens was charged approximately \$10 per month for a Discover card product called CreditSafe Plus, which apparently provided for a suspension of payments and finance charges if Ms. Owens became unemployed, hospitalized, or disabled. Since Ms. Owens was already on Social Security Disability and unemployed, the CreditSafe product presumably would apply only if she became hospitalized. Ms. Owens was no doubt paying for a product that would likely never benefit her.

The Ohio judge assigned to the collection case rightly found that Ms. Owens was not a deadbeat. He stated that her “instincts were always that she wanted to plug away at meeting her financial obligations. While clearly placing her on the moral high road, that same highway unfortunately was her road to financial ruin. How is it that the person who wants to do right ends up so worse off? It is plain to the court that the creditor also bears some responsibility.”⁵²

In barring Discover Card from collecting any more money from Ms. Owens, the Ohio judge stated: “This court is all too aware of the widespread financial exploitation of the urban poor by overbearing credit-card companies. [Ms. Owens] has clearly been the victim of plaintiff’s unreasonable, unconscionable and unjust business practices.”

Card companies make huge profits off customers like Ms. Owens. Rather than work with these consumers to reduce their debt by curbing the excess fees and interest, card companies prefer to get as much out of consumers for as long as possible until they eventually stop paying or file bankruptcy.

Professor Mann describes this profit-making scenario by comparing the credit card lender’s cost of funds with the charges. In one scenario, a consumer starts with a balance of \$2,000 and makes no new purchases and the lender’s cost of funds is 3%. The lender charges interest of 18%/month for the first three months, 24% for the next three and 30% thereafter. The consumer makes minimum payments and pays late or over-limit charges every month starting with the seventh month of minimum payments. In this scenario, after 25 months, the consumer still has a balance of \$1270 (more than half the original loan). Based on the cost of funds to the lender, the loan has been repaid at the 25 month point with \$6 to spare. Even if the consumer makes a \$100 purchase every three months, the loan would be repaid in 34 months with \$26 to spare, but the balance would still be over \$2,000.⁵³

These scenarios challenge the theory that creditors must set rates high as a response to high default rates. If the main concern is that consumers might default, creditors would consider shutting off or limiting the supply of credit to risky consumers rather than beating them up with fees and costs. The creditors act as if they know that high-risk consumers will be forced to stop paying or declare bankruptcy, but they will squeeze them as hard as they can for as long as they can.

In addition, there is very little competition based on the terms that should be most important to consumers. Instead of competing to bring down interest rates and eliminate fees, competition revolves mainly around short-term benefits, such as annual fees, teaser rates, and benefits programs. There have been a few attempts to compete on terms of concern to consumers, such as late fees. For example, major lenders have promoted cards without late fees, but they still reserve the right to impose penalty rates for late payments.

For most consumers, the long-term costs of credit cards outweigh short-term benefits such as teaser rates and mileage programs. Card issuers have acknowledged that consumers’ insensitivity to long-term costs of credit card pricing drives their business strategy.⁵⁴ Survey evidence also suggests

⁵² Discover Bank v. Owens, 822 N.E.2d 869 (Ohio Mun. 2004).

⁵³ RONALD J. MANN, BANKRUPTCY REFORM AND THE “SWEAT BOX” OF CREDIT CARD DEBT, LAW AND ECONOMICS RESEARCH PAPER NO. 75 16-17 (April 2006), available at <http://www.utexas.edu/law/faculty/rmann/info/IllinoisPaper2.pdf>

⁵⁴ Oren Bar-Gill, *Seduction By Plastic*, 98 NW. U. L. REV. 1373 at 1410 (Summer 2004), available at http://www.law.nyu.edu/faculty/homepages/bargill/papers/Bar-Gill_Seduction-by-Plastic.pdf.

that more than a third of all consumers consider an attractive introductory rate to be the prime selection criterion in credit card choice.⁵⁵

More effective consumer education would likely help consumers make better choices. The second report in this series will review the types of financial literacy programs that can be successful, especially if targeted for older consumers. Financial literacy is also important for younger consumers as they will become tomorrow's retirees.

Financial education, however, is far from a panacea. Even well-educated consumers have difficulties predicting future financial trouble and understanding the types of penalties credit card lenders will impose if they do get into trouble.

Below is a summary of the practices that are most detrimental to consumers.

Specific Practices That Harm Consumers

1. High Cost Credit

Credit card deregulation, and the corresponding spiraling of credit card debt for Americans, began in 1978, with the Supreme Court's decision in *Marquette National Bank of Minneapolis*. The *Marquette* decision allows banks to charge out-of-state consumers the interest rate permitted in their home states.⁵⁶ As a result, national banks established their headquarters in states such as Delaware and South Dakota that eliminated or raised their usury limits, giving them free rein to charge whatever interest rate they wanted.

2. Aggressive Solicitation and Lack of Real Underwriting

Many card issuers make offers of credit based solely on the consumer's credit score. Credit scores measure the propensity to repay and the ratio of revolving credit used, but they don't measure whether the consumer's income is adequate to repay a new debt or include a debt-to-income ratio that would show if the consumer is already overextended.

As a result card issuers often grant new credit cards to consumers who are already overextended. Federal regulators have issued guidance urging card issuers to consider repayment capacity when granting new credit, but this guidance is not mandatory or enforceable by injured consumers.⁵⁷

As evidenced with a number of consumers we interviewed, it is especially common to offer credit, often high rate credit, after a consumer has discharged debts in bankruptcy. For example, an elderly couple in New Mexico had gone bankrupt fairly recently, in 1999, with one of their debts a Capital One card on which they'd owed \$2,700. But the husband says that within three weeks of that bankruptcy being resolved "we had a new Capital One card with a \$3,200 limit."

⁵⁵ DAVID S. EVANS AND RICHARD SCHMALENSEE, *PAYING WITH PLASTIC: THE DIGITAL REVOLUTION IN BUYING AND BORROWING* 225 (MIT Press 1999).

⁵⁶ *Marquette Nat'l Bank of Minn. v. First of Omaha Serv. Corp.*, 439 U.S. 299, 99 S. Ct. 540, 58 L. Ed. 2d 534 (1978).

⁵⁷ FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL, *CREDIT CARD LENDING ACCOUNT MANAGEMENT AND LOSS ALLOWANCE GUIDANCE* (Jan. 2003), available at <http://www.federalreserve.gov/BoardDocs/press/bcreg/2003/20030108/attachment.pdf>.

Even though the couple has been bankrupt, and even though they have been forced to walk away from debt on nine additional cards, and even though their Social Security pays them just over \$19,000 a year, they have been pre-approved for “a platinum card membership from a Dallas company, with a \$10,000 credit line. Learning from their past problems, they passed on this offer.

3. *Punitive Fees*

A significant contributor to snowballing credit card debt is the enormous increase in both the number and amount of non-periodic interest fees charged by card issuers. These punitive fees include cash advance, balance transfer, wire transfer fees, late and over-limit fees.

Credit card issuers have made these fees higher in amount, they impose them more quickly, and assess them more often. Banks now impose these fees not as a way to curb undesirable behavior from consumers – which used to be the primary justification for imposing high penalties – but as a significant source of revenue for the bank.

In *Smiley v. Citibank (South Dakota), N.A.*, the court approved a definition of interest that included a number of credit card charges, such as late payment, over-limit, cash advance, returned check, annual, and membership fees.⁵⁸ As a result, national banks and other depositories can charge fees in any amount to their customers as long as their home state laws permit the fees and so long as the fees are “interest” under the *Smiley* definition (which makes the fees “exportable”).

Uncapping the amount of fees that credit card banks can charge nationwide has resulted in the rapid growth of and reliance on fee income by credit card issuers as well as a proliferation of the types of fees imposed. The average late payment fee has soared from \$14 in 1996 to over \$32 in 2004.⁵⁹ Average over-limit fees have similarly jumped from \$14 in 1996 to over \$30 in 2004.⁶⁰ Penalty fee revenue has increased nearly nine-fold from \$1.7 billion in 1996 to \$14.8 billion in 2004.⁶¹ The income from just three fees – penalty fees, cash advance fees, and annual fees – reached \$24.4 billion in 2004.⁶² Fee income topped \$30 billion if balance transfer fees, foreign exchange, and other fees are added to this total.⁶³

Below are just a few examples of how punitive fees affect older consumers, followed by sample credit card statements:

⁵⁸ *Smiley v. Citibank (S.D.)*, Nat’l Assn., 517 U.S. 735, 116 S. Ct. 1730, 135 L. Ed. 2d 25 (1996). The OCC definition of interest is found in 12 C.F.R. § 7.4001(a).

⁵⁹ Cardweb.com, *Late Fees* (Jan. 28, 2005), available at <http://www.cardweb.com/cardtrak/news/2005/january/28a.html>.

⁶⁰ Cardweb.com, *Overlimit Fees* (Feb. 2, 2005), available at <http://www.cardweb.com/cardtrak/news/2005/february/2a.html>.

⁶¹ Cardweb.com, *Fee Party* (Jan. 13, 2005), available at <http://www.cardweb.com/cardtrak/news/2005/january/13a.html>. “Penalty fees” include late and overlimit fees.

⁶² *Id.*

⁶³ *Id.* If merchant-paid fees are combined with consumer-paid fees, the total fee income is estimated at \$50.8 billion.

A TIDAL WAVE OF EXTRA CHARGES

With 8 kids, 13 grandkids and 10 great-grandkids, Elaine had a lot of gifts to buy and she really enjoyed buying them. She didn't mind working to pay for those gifts, either. She was going strong at age 71, working as a cleaning lady in the Manchester, New Hampshire, City Hall and sewing wedding gowns at home on the side. There was enough money to keep current on 10 credit accounts, each with small balances that she mostly used for gift buying. Eight of those accounts were credit cards.

"I had no plans to retire," she says, "I'd been working since I was 12 years old."

Then she had a stroke.

Two years later that illness leaves no obvious effects, but Elaine tires more easily now and it did end her 59-year working career. Simultaneously, it launched her on an all-too-familiar credit card trap even though the total owed on all 10 credit accounts was little more than \$8,000.

The big culprit in Elaine's case was a tidal wave of extra charges once she fell behind on her payments.

The amount owed is going up fast now even though there are no new charges on most of these, and it's easy to see why. One typical credit card tacks on a \$30 late fee, a \$30 over-limit fee and a \$3.50 account maintenance fee every month. The annual interest rate on that card, issued by Orchard Bank, is 27.74%.

The *average* interest rate on seven cards was over 26%, with none lower than 22.5%.

A Chase card carrying a 28.99% interest rate adds a late fee of \$39, an over-limit fee of \$35 and a finance charge of \$20.93 on a recent bill. That's \$94.93 in new debt on that one card in a single month, even with no new purchases added.

Elaine glances at a Capital One card statement for November 2005, listing \$66.96 in new penalty charges plus a "monthly member fee" of \$4 to go with its 27.74% interest rate. A Sears card statement shows a 29.15% rate. Penalty charges on all her accounts are tacking on hundreds a month in new debt.

Elaine says she managed to pay off two of her cards in full but was paying \$400 a month in minimum payments to keep the others going. She was on the verge of getting ahead on another card's balance when a \$69 annual fee put her back behind. On a fourth card a \$59 annual fee put her over her credit limit, triggering additional penalty charges.

In any event, payments of \$400 a month *that weren't denting her balances* clearly weren't going to be sustainable on her \$735 monthly Social Security check, her only income after the stroke. She has only \$70 in assets, and she's paying \$200 a month to live with her kids.

Asked if she'd do anything differently if she could start all over again with her cards, Elaine says: "I'd tell them that when I took your card I was aware of what I was doing, but they've gotta let people have a little slack when they run into trouble."

DEBT WOES DON'T STOP CREDIT FLOW

Alvah was 79 when he lost his part-time security guard job in the Albuquerque mobile home park where he lives. He'd been taking in \$600 a month for the work, enough to keep up with payments on the nine credit cards he and his wife Doris had.

Doris has been sick quite a bit – Alvah rattles off a list of four significant illnesses she's still battling – and he says the cards had been used mostly for her prescriptions, doctors' appointments and emergency room visits. "It wasn't a lot of frivolous stuff," he says. Alvah's security guard paycheck went exclusively to paying off the cards. He and Doris' \$1,600 in monthly Social Security was covering the rest of their living expenses, including the mortgage they're still paying on their 27-year-old mobile home.

The nine cards – six from Capital One, according to Alvah -- had about \$15,000 total in charges on them when the guard job ended in November 2004. Alvah says he immediately sent all nine lenders a letter saying he couldn't pay "and that made no difference at all to them."

With non-payment, their card interest rates were skyrocketing – Alvah says one card's rate jumped from 14% to 25% in a single month, while most of the others added significant rate hikes within two months. All that was topped by monthly late payment fees of \$35 per card.

So by January 2006 that \$15,000 debt, without any new charges added, had ballooned to \$30,000. The card issuers, and then their collection agencies, had been calling for about a year even though Alvah had cut up all the cards and sent them back shortly after getting into trouble.

SAMPLE CREDIT CARD STATEMENTS



OUNT

JAN 29 - FEB 28, 2005

Page 1 of 1

Account Summary

Previous Balance	\$3,979.27
Payments, Credits and Adjustments	\$0.00
Transactions	\$123.00
Finance Charges	\$90.34
New Balance	\$4,192.61
Minimum Amount Due	\$580.00
Payment Due Date	March 28, 2005
Total Credit Line	\$3,750
Total Available Credit	\$0.00
Credit Line for Cash	\$1,162
Available Credit for Cash	\$0.00

At your service

To call Customer Relations or to report a lost or stolen card:
1-800-903-3637

Send payments to:
Attn: Remittance Processing
Capital One Bank
P.O. Box 650007
Dallas, TX 75266-0007

Send inquiries to:
Capital One Services
P.O. Box 85015
Richmond, VA 23285-5015

Payments, Credits and Adjustments

Transactions

1	29 JAN	OVERLIMIT FEE	\$29.00
2	28 FEB	CAPITAL ONE MEMBER FEE	59.00
3	28 FEB	PAST DUE FEE	35.00

<<< Fees

Capital One is proud to support The Heart of America® Foundation, helping children learn to read, succeed, and make a difference in the world. In 2003, we gathered nearly \$1 million worth of books for children in need. To learn more about how you can help a child make reading a lifelong passion, visit www.heartofamerica.org.

You were assessed a past due fee of \$35.00 on 02/28/2005 because your minimum payment was not received by the due date of 02/28/2005. To avoid this fee in the future, we recommend that you allow at least 7 business days for your payment to reach Capital One.

Due to the past-due status on one or more of your Capital One account(s) ending in 6181, 9416, 0845, your charging privileges on these accounts have been suspended in accordance with your Customer Agreement(s). As soon as these accounts are back in good standing, charging privileges on these accounts will be restored within 7-10 days. For up-to-date payment-due information, you can call 1-800-955-7070. If you've already made your payment(s), please disregard this message. Thank you.

Finance Charges

Please see reverse side for important information

	Balance rate applied to	Periodic rate	Corresponding APR	FINANCE CHARGE
PURCHASES	\$4,053.69	.07189% P	26.24%	\$90.34
CASH	\$0.00	.07189% P	26.24%	\$0.00

<<< APR

ANNUAL PERCENTAGE RATE applied this period

26.24%

▼ PLEASE RETURN PORTION BELOW WITH PAYMENT ▼



New Balance	\$4,192.61
Minimum Amount Due	\$580.00
Payment Due Date	March 28, 2005

Total enclosed \$
Account Number: 5178-0521-4237-6181

Please print address changes below using blue or black ink.

Street _____ Apt # _____
City _____ State _____ ZIP _____
Home Phone _____ Alternate Phone _____

Capital One Bank
P.O. Box 650007
Dallas, TX 75266-0007



Please write your account number on your check or money order made payable to Capital One Bank and mail in the enclosed envelope.

9874T

4. Penalty Rates and Universal Default

A penalty rate is an increase in the card's initial annual interest rate (APR) triggered by the occurrence of a specific event, such as the consumer's making a late payment or exceeding the credit limit. Penalty interest rates can be as high as 30% to 40%.⁶⁴ The new terms apply to the old balance – leaving consumers stuck to pay often high balances at interest rates far higher than was originally agreed, with devastating consequences. In a 2005 survey by Consumer Action, the average penalty rate was 24.23%.⁶⁵

This practice is especially outrageous when applied retroactively. There is simply no legal or economic justification for assessing a penalty interest rate to an existing balance; the terms of a loan are being changed *after* the loan has already been secured.

“Universal default” policies are even more abusive. Under universal default, credit card issuers impose penalty rates on consumers not for late payments or any behavior with respect to the consumer's account with that particular issuer, but for late payments to any of the consumer's other creditors. In some cases, issuers will impose penalties simply if the card holder's credit score drops below a certain number, whether or not the drop was due to a late payment or another factor. A survey of credit card issuers found that just over 44% of banks surveyed had a universal default policy.⁶⁶ According to customer service representatives, the following circumstances could trigger a penalty rate hike: credit score drops (90%); late payment to any creditor (86%); going over limit (57%); bouncing a payment check (52%); too much debt (43%); too much available credit (33%); getting a new credit card (33%); inquiring about car loan or mortgage (24%).⁶⁷ Among other concerns, using credit reports to trigger penalty rates is connected to the enormous problem of inaccuracies in credit scoring and credit reporting.

5. Deceptive Marketing

Some card issuers engage in questionable marketing practices when soliciting consumers. “Bait and switch” tactics are common. For example, card issuers have marketed “no annual fee” credit cards, then imposed an annual fee six months later using a change-in-terms notice.⁶⁸ They heavily advertise low “fixed” rates, but subsequently raise rates through change-in-terms notices and use penalty fees with punitive late payment and over-limit policies to trip consumers up.

Another deceptive practice is that of “downselling” consumers by prominently marketing one package of credit terms, but then approving consumers only for accounts with less favorable terms, and touting the approved account in a fashion designed to mislead the customer about the fact that the received card is more expensive.⁶⁹

6. Payment Allocation Order

Many credit card companies heavily advertise low APRs in their solicitations that are only applicable to one category of transactions. They then allocate payments first to the balances with

⁶⁴ See Kathleen Day & Caroline Mayer, *Credit Card Fees Bury Debtors*, WASHINGTON POST, Mar. 7, 2005, at A1.

⁶⁵ LINDA SHERRY, CONSUMER ACTION, 2005 CREDIT CARD SURVEY 1 (Summer 2005), available at http://www.consumer-action.org/archives/English/CANews/2005_Credit_Card_Survey/CC_Issue_2005.pdf.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ See, e.g., *Rossman v. Fleet Bank (R.I.) Nat'l. Assn.*, 280 F.3d 384 (3d Cir. 2002).

⁶⁹ See, e.g., Consent Order, *In re Direct Merchants Credit Card Bank*, No. 2001-24 (Dept. of Treasury, Office of the Comptroller of the Currency, May 3, 2001), available at <http://www.occ.treas.gov/ftp/eas/ea2001-24.pdf>.

lower APRs. According to published cases, the disclosure of payment allocation order has been very minimal,⁷⁰ or nonexistent.⁷¹ A review of several recent solicitations shows some banks disclosing their payment allocation order, but in smaller print and as a footnote to other disclosures in contrast to the prominence of the promotion for low APRs.

7. Posting Cut-offs

Card issuers have established cut-off times for posting payments and some of these hours have been set ridiculously early, leading unfair imposition of late-payment fees. In reported cases, creditors have used times as early 9 or 10 a.m. as the cutoff time for crediting payments received that day. Consequently, if a consumer's payment is received on the payment due date it will likely be considered late because, in all likelihood, the U.S. Postal Service will not have delivered the mail so early in the morning. Furthermore, when due dates fall on a weekend or holiday, card issuers will consider the payment late if not received on the prior business day. Non-business day due dates are inherently deceptive.

8. Changes to Credit Limits

Another recent abuse is sudden changes in credit limits by card issuers. The Minnesota Attorney General's Office has documented how Capital One engaged in this practice. In one case, two days after lowering the consumer's limit and before the consumer had received any notice of the change, Capital One charged this consumer an over-limit fee. To pour salt in the wound, Capital One then imposed a penalty rate.⁷²

9. Debt Collection Abuses

Credit card issuers, like many creditors, have been known to engage in plain old debt collection abuse – including harassment, deception and abuse -- which have been documented as rampant in America for many years now. There are however a few practices that are unique to credit card companies and their collectors.

Most important is the fact that card companies, or the debt buyers to whom they sell the debt, often initiate collection cases against consumers without any documentation of a credit card agreement signed by the consumer or even periodic statements to show transaction activity. This deprives the consumer of the ability to challenge erroneous transactions or demonstrate how much of the debt is due to purchases versus finance charges and junk fees.

One older consumer we interviewed told us that the collector's messages said things like: "I know you're there because you've been seen coming and going to work." She showed us a hand-written note addressed to one collection agency in which she wrote that when a collector called her son's workplace "the boss there told him not to call again but he called the next day." She wrote that another message on her answering machine said: "I know where you live and that you own property so you need to call me," while yet another said "I am verifying your coming and going on a daily basis."

Many of these calls are clear violations the Fair Debt Collection Practices Act. In fact, debt collectors have been the most complained-about industry on the Federal Trade Commission's

⁷⁰ *Broder v. MBNA Corp.*, 722 N.Y.S.2d 524 (N.Y. Sup. Ct. 2001) (promotional material ambiguously disclosed in small print footnote that card issuer "may" allocate payments to promotional balances first.)

⁷¹ *See Johnson v. Chase Manhattan Bank USA*, 784 N.Y.S.2d 921 (N.Y. Sup. Ct. 2004).

⁷² *Complaint, State of Minnesota v. Capital One Bank*, available at <http://www.ag.state.mn.us/consumer/PDF/PR/CapitalOneComplaint.pdf>.

consumer website for many years running. And abuses by out-of-control collectors appear to be getting worse: the FTC's latest report on collectors says the commission received 58,687 consumer complaints about them in 2004 alone, a big jump from the 34,565 a year earlier. Collectors have been the Federal Trade Commission's most complained-about industry for six years running.

Another practice peculiar to credit card debt is "zombie debt collection" where credit card lenders buy old credit card debts, and then offer the debtors new credit cards to revive the old debt. Often, the debts are time-barred by the statute of limitations and would constitute stale information on the consumer's credit report. A boom in the multibillion-dollar debt-buying industry has resulted in thousands of consumers getting dunned by collectors trying to cash in on debts so ancient that they are no longer enforceable in court or are beyond the seven-year period in which they can be reported to credit bureaus. Many were already charged off by original creditors, and then sold for pennies on the dollar to aggressive collectors.⁷³

A large number have long been charged off by original creditors and sold for pennies on the dollar to aggressive third-party collectors who get whatever they can from borrowers.

10. Use of Mandatory Arbitration Clauses

The use of arbitration provisions in credit card agreements has been a tremendous barrier for consumers seeking redress for credit card abuses. For example, consumers who have attempted to enforce their rights under the federal Truth in Lending Act for deceptive disclosures, late posting of payment, payment allocation abuses, and failure to follow fair billing procedures have lost their day in court due to arbitration provisions. In a 2005 Consumer Action survey, about 45% of the credit card lending banks confirmed that they required consumer to settle disputes using arbitration. Of these, just over 70% insisted on binding arbitration.⁷⁴

11. Tiny Minimum Monthly Payments.

With lowered monthly minimum payments, consumers who pay only the minimum will take much longer to pay off the debt and pay substantially more in finance charges. Worse, the combination of the minimum monthly payments and penalty interest rates often results in negatively amortizing debt. Even when the consumer is making the payments as requested and not incurring any new charges, the debt keeps climbing.

As a result of regulator guidance, credit card lenders began to raise their minimum payments during the past year. However, according to a Consumer Action survey, instead of raising minimum payment percentages, many lenders have responded by changing the way in which they calculate minimum payments.⁷⁵ For example, instead of figuring monthly minimum payments using a simple percentage of the balance after new finance charges have been added, Citibank and Chase are asking that 1% of the balance be paid each month, in addition to new finance charges and fees. Bank of America is requiring cardholders to pay \$10 plus new finance charges and fees. MBNA requires card-

⁷³ See Paul Wenske, *The Zombie Debt: Collection Companies Pursue Consumers for Amounts Considered Long-Past Dead*, KANSAS CITY STAR

⁷⁴ LINDA SHERRY, CONSUMER ACTION, 2005 CREDIT CARD SURVEY 2 (Summer 2005), available at http://www.consumer-action.org/archives/English/CANews/2005_Credit_Card_Survey/CC_Issue_2005.pdf.

⁷⁵ LINDA SHERRY, CONSUMER ACTION, 2005 CREDIT CARD SURVEY 4 (Summer 2005), available at http://www.consumer-action.org/archives/English/CANews/2005_Credit_Card_Survey/CC_Issue_2005.pdf.

holders to make a payment equal to 2.25% of the balance, or \$15, whichever is greater, plus finance charges and fees. Consumer Action's research also shows that most surveyed banks have not changed practices in response to the regulators' directive. Most continue to calculate the minimum payment using only a percentage of the balance and include:

- Nineteen (40.4%) require a 2% minimum payment, with 16 of them insisting that cardholders pay at least \$10-\$20.
- Nine (19.1%) ask for a 2.5% payment, with four requiring cardholders to pay at least \$10-\$50.
- Ten (21.3%) ask for a 3% payment, with six requiring at least \$10-\$20.

While positive in the long run, the trend toward higher minimum payments is likely to create short-term hardships for consumers.

The key problem, as we uncovered in our interviews with older consumers, is that many view the minimum payment as THE monthly payment. Cathy McConnell, Executive Director of West Virginia Senior Legal Aid described this phenomenon: "The minimum payment on their cards IS the bill to them," she says. "That's what they think they need to pay. They're not conscious of the balance until they get in trouble and call the [card] company, and the company says: 'You can't pay \$5 a month on a \$10,000 bill.'"

In reality, it would take a consumer nearly 20 years to pay off a \$1,000 balance with an 18% APR if the consumer makes only the minimum payment of 2% of the balance. It would take almost 45 years to pay off a balance of \$4,500 at this rate. Raising the minimum payment, even just to 4%, can make a tremendous difference. With the \$4,500 balance, paying a minimum payment of 4% allows the consumer to repay in about 12 years.

There is evidence that the recent increases in minimum payments are decreasing creditor's profits. This trend shows how precarious the credit card industry business model is, depending on making money from squeezing consumers as long as possible without breaking them. The increased minimum payments may accelerate the process as consumers figure out sooner that the fees and penalties and high rates make it impossible for them to keep making even minimum payments. For example, MBNA's profit declines in 2005 have been attributed to increases in minimum payments.⁷⁶

12. Change-in-terms

Credit cards are unique loans in that the borrower signs an agreement at one point in time. While circumstances may change, the expectation is that the borrower will continue to be able to use that card. Creditors likely need some flexibility to respond to changes in consumer circumstances. The problem is that they are allowed to change terms virtually at will with little lead time for consumers. Even if more lead time was given, consumers have few options to switch to other companies. To make matters worse, creditors often change terms and apply the new terms to previous charges.

The expansive change-in-terms provisions in many credit card agreements are the mechanism that permits card issuers to impose excessive junk fees and engage in abusive practices. Many issuers

⁷⁶ Martin H. Bosworth, *MBNA Profits Plunge*, CONSUMERAFFAIRS.COM, May 24, 2005, http://www.consumeraffairs.com/news04/2005/mbna_profits.html.

place extremely expansive language in their card agreements, allowing them to change any of the terms in the agreement at any time. A typical change-in-terms agreement provides:

We may amend or change any part of your Agreement, including the periodic rates and other charges, or add or remove requirements at any time. If we do so, we will give you notice if required by law of such amendment or change. Changes to the annual percentage rate(s) will apply to your account balance from the effective date of the change, whether or not the account balance included items billed to the account before the change date and whether or not you continue to use the account. Changes to fees and other charges will apply to your account from the effective date of the change.⁷⁷

Some states even permit changes in the terms of a credit agreement without such a clause in the credit agreement. This means that even when the credit card lender's advertising and disclosures tout a low, fixed APR, the reality is that the creditor may be able to change the APR in fifteen days with a change-in-terms notice. If a change in terms is not governed by the Truth in Lending Act (TILA), the creditor might be able to change a loan effective immediately, or theoretically even without notice. Consumers are considered to have accepted the change in terms if they use the card or do not send a notice of rejection.

These clauses make a mockery of the idea of consumers shopping for a card because the terms of the "bargain" are illusory. A savvy consumer could select a credit card after reviewing credit card disclosures, comparing terms, reading articles about picking a credit card, but then face a change-in-terms notice that totally changes the APR and other terms of the credit card in a matter of days. Furthermore, the vast majority of consumers probably do not read or understand change-in-terms notices. These notices often take the form of "bill stuffers" in tiny print that are slipped into an envelope with the consumer's monthly bill. Even when consumers do open and read change-in-terms notices, the notices are full of impenetrable legal jargon that even lawyers and seasoned consumer advocates have difficulty understanding. Regardless, consumers are treated as if they actually agreed to the change if they simply charge one more new item to the card or fail to send a notice of rejection.

13. Subprime and Secured Credit Cards

There are a number of credit card products targeted at the "subprime market", which generally means consumers with lower credit scores or impaired credit histories. The limited number of consumer protection actions taken by the federal banking regulators has primarily focused on subprime cards, targeting practices such as:

- "downselling" consumers by prominently marketing one package of credit card terms, but then approving consumers only for accounts with less favorable terms;
- issuing cards with low credit limits, then adding mandatory fees or "security deposits", resulting in little or no available credit when the consumer receives the card;
- Deceptive marketing credit "protection" products.⁷⁸

⁷⁷ Stone v. Golden Wexler & Sarnese, P.C., 341 F.Supp.2d. 189, 191 (E.D.N.Y. 2004).

⁷⁸ See OCC Advisory Letter AL 2004-10 (Sept. 14, 2004), *available at* www.occ.treas.gov/Advlst04.htm.

Another product targeted at consumers with poor credit histories is the secured credit card. These cards require the consumer to maintain a deposit with the lenders, which serves as collateral for the line of credit. Another OCC advisory letter addresses potentially unfair or deceptive practices in the marketing of these cards.⁷⁹

⁷⁹ OCC Advisory Letter AL 2—4-4 (April 28, 2004), *available at* www.occ.treas.gov/Advslt04.htm.

The Life and Debt Cycle: The Implications of Rising Credit Card Debt Among Older Consumers

POLICY RECOMMENDATIONS REGARDING CREDITOR PRACTICES

Because of the deregulation of bank credit, there is virtually no state regulation of credit card lender conduct. The federal Truth in Lending Act provides minimal regulation beyond requiring certain disclosures. While uniform and accurate disclosures are important, as discussed below, they are not substitutes for real regulation. Attempts by states and municipalities to regulate credit card lenders have been rendered ineffective by federal preemption. Even state deceptive practices statutes, which typically include general prohibitions against deceptive practices in the consumer marketplace, are inconsistent in their coverage of credit card lenders and in any event, because of federal preemption, cannot address critically important issues regarding credit card rates and terms.

It is time to reinstate substantive limits on the terms of credit and the cost of the credit, including the interest rate and all fees and charges. Suggested recommendations are provided below.

The overall goal of these policy recommendations is to stem credit card debt, not credit card use. The main problem is that the industry is set up to make the most profit from those consumers who get into trouble with credit cards. These industry practices have tremendous costs to society, including the growing numbers of older consumers trapped in credit card debt. Regulation is essential to force creditors to change their practices.

A consequence might be that convenience users are charged additional fees. This might be an acceptable trade-off as long as these fees are reasonable. Another consequence is that high risk consumers may be granted less credit. This too may be an acceptable trade-off, particularly if those consumers have access to debit cards as discussed below.

Regardless, the suggested policy changes with respect to credit cards are not enough to solve the basic problem. As long as older consumers are unable to meet increased expenses with fixed incomes, they will continue to turn to credit cards and other expensive short-term loans as their safety net. Therefore, it is essential that as a society we not only commit to addressing the most harmful practices of credit card companies, but also help to ensure that medical and other costs are affordable and that Social Security and other retirement income meets basic living standards. In addition, lenders and non-profit organizations should continue to develop and offer lower-cost, affordable loan products.

Specific Recommendations

1. Promote Debit Card Use and Level the Playing Field Between Credit and Debit Cards

Elders need the convenience of a non-cash payment method, but they need one that does not carry with it the borrowing trap that credit cards create. One suggested strategy is to encourage debit card use. Debit cards allow consumers to pay for purchases with existing funds rather than finance purchases. Although an imperfect substitute in some ways, they are extremely useful in keeping many consumers out of burdensome debt. They can be especially useful for consumers who do not have credit cards or those facing restrictive credit limits and trying to stay within those limits.

Promoting debit card use requires first that debit card users not be permitted to overdraw their accounts. In the past few years, many banks have implemented loan programs that permit overdrafts, including by debit card, at fees of \$20 to \$35 per overdraft. These fees translate to annual percentage rates of 300% or more. Since consumers may use their debit cards several times in a day, they can easily incur hundreds of dollars in overdraft fees a day once they first overdraw. Without protections against these overdraft loan programs, debit cards are just as dangerous for consumers as credit cards. In fact, they can be even more dangerous, especially if problems arise. It can often be easier to try to get a charge removed from a credit card rather than try to get funds improperly or erroneously debited back into an account.

Debit card users must be granted the same protections against unauthorized use and erroneous charges as credit card borrowers. Currently, debit card users have significantly fewer protections. There is no logical policy rationale for this discrepancy. Instead, it is to consumers' and society's benefit to help consumers stay within their budgets. Another benefit of imposing these protections for debit cards is that it will give creditors the incentive to create greater security features for debit cards. If creditors know that they rather than consumers will have to bear the cost of unauthorized use or erroneous charges, they will have more of an incentive to design security features that will prevent these events.

It is also important to limit the fees that banks charge for debit card use. About 14% of institutions that offer debit cards charge fees to at least some customers for using debit cards via a PIN system. The fees range from roughly ten cents to \$2 per transaction. A few also charge fees to consumers who use debit cards to make purchases without PIN numbers (with a signature instead).⁸⁰ If debit cards are to be a safe means for elders to make payments without incurring unaffordable debt, high PIN fees should be abolished.

Although debit card use is growing, debit cards have an unusually low share of all card transactions in this country compared to other countries. Although low compared to other countries, by 2003, consumers in the U.S. conducted more transactions with debit cards than with credit cards for the first time in history.⁸¹ Anecdotal evidence suggests that a desire to avoid the temptation of borrowing is behind a significant part of the increase in debit card use. Society should be rewarding this behavior, not punishing it by offering weaker protections for debit card users or allowing them to overdraw their accounts and incur hefty fees.⁸² In addition, debit cards have not caught on to a large extent because of the aggressive marketing and behavior of the existing credit card lenders. Thus, another strategy is to limit the types of benefit and affinity programs that credit card lenders are allowed to offer, or require that they be offered equally for credit and debit cards.

2. Prohibit the Most Dangerous Terms and Practices

Many of the elders we interviewed tried to pay their credit card debts, and in fact made years of payments, but because of punitive credit card terms their balances declined only imperceptibly or even grew. Allowing such terms creates a disincentive to payment and makes it impossible for elders to get

⁸⁰ See BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, REPORT TO CONGRESS ON THE DISCLOSURE OF POINT-OF-SALE DEBIT FEES 5 (November 2004), *available at* <http://www.federalreserve.gov/boarddocs/rptcongress/posdebit2004.pdf>.

⁸¹ *Id.* at 4.

⁸² See generally RONALD J. MANN, GLOBAL CREDIT CARD USE AND DEBT: POLICY ISSUES AND REGULATORY RESPONSES, U OF TEXAS LAW AND ECONOMICS RESEARCH PAPER NO. 49 32 (April 2005), *available at* <http://ssrn.com/abstract=705141>.

out of debt except through extreme measures such as bankruptcy or selling or refinancing their homes. We recommend the following regulatory changes to address this problem:

- Prohibit retroactive interest rate increases.
- Prohibit penalties for behavior not directly linked to the specific card at issue.
- Prohibit over limit fees if the issuer permitted the credit limit to be exceeded.
- Allow creditors to charge only one over limit fee once a consumer goes over the limit, not a fee for each month the consumer stays over the limit.
- Prohibit late charges as long as the payment is postmarked no later than the due date, regardless of the day or time of day it is received.
- Prohibit payment allocation policies that increase the cost of credit by keeping high-rate balances high.
- Cap periodic interest rates at prime plus a reasonable margin.
- Cap other charges, to an amount the card issuer can show is reasonably related to cost.

All of these changes would reduce the likelihood that elders will be caught in credit card debt that they cannot reduce despite making payments.

Many of the changes recommended above, such as a general cap on periodic interest rates, will not only help elders pay off credit card debt, but will also help prevent them from getting too deep in debt in the first place. In addition, we recommend at a minimum the following regulatory changes to reduce the likelihood that elders will get credit cards that lead to excessive debt:

- Prohibit unilateral changes in terms.
- When a creditor wants the consumer to agree to a change in terms, require it to give more than the currently-required 15 day notice, and make the new terms effective only if the consumer opts in and affirmatively accepts the changes in writing. Consumers must also be given the right to repay all existing balances under the terms in effect when the balances were incurred.
- Prohibit improvident extensions of credit.⁸³
- Prohibit mandatory arbitration clauses.
- Set meaningful penalties for violations of any substantive provisions or disclosure provisions so that creditors have real incentives to comply and disincentives for non-compliance.

⁸³ Julie Williams, who at the time was Acting Comptroller of the Currency, has specifically described concerns with creditors assigning initial credit lines and increasing credit lines without the proper underwriting analysis. See Testimony of Julie L. Williams, Acting Comptroller of the Currency, Before the Committee on Banking, Housing and Urban Affairs of the U.S. Senate, May 17, 2005, *available at* <http://www.occ.treas.gov/ftp/release/2005-49b.pdf#search=Julie%20Williams%20and%20testimony%20May%202017>.

3. Better Disclosures Are Not Enough....

Disclosures alone are not sufficient to protect consumers from overreaching creditors. This is because:

- Consumers lack equal access to information – most consumers will not have the knowledge to understand the legal consequences of the terms of credit.
- Consumers lack equal bargaining power – no consumer has the market power to call up a credit card company and negotiate either the basic terms or those in the adhesion contract.
- The credit card market does not provide real choices. With the increasing consolidation of credit card providers, the industry guarantees *less* meaningful competition. There is generally competition only on the surface, on a few prominently-advertised terms such as the periodic rate and annual fee. Consumers have little or no meaningful choices on the terms that create the bulk of the cost of open-end credit.
- Without some basic substantive regulation, there will continue to be competition between industry players only as to which can garner the most profit from the most consumers – regardless of the fairness, or the effects on consumers.
- Some harmful credit card terms are so subtle, so complex, or so multitudinous that consumers, whether young or old, cannot be expected to understand them and take them into account when selecting a credit card.

4. But They Could Help.

While improved disclosures will not balance the grossly unequal bargaining power between the credit card industry and the individual consumer, improved disclosures could inform consumers of the real costs and risks associated with open-end credit.⁸⁴ Improved disclosures might also bring some of the most abusive credit card terms into the daylight, creating market pressure to offer more consumer-friendly terms.

The federal Truth in Lending Act (TILA) requires different disclosures to be made at different times during the life of a credit card account. Disclosures are required when:

- The creditor is advertising a credit card or mailing a credit card offer (applications and solicitations disclosure)
- The account is opened (“account-opening” or initial disclosures)
- Monthly or periodic statements are sent
- The account is renewed (at this point the account-opening disclosures are repeated)

⁸⁴ COMMENTS OF NCLC, CENTER FOR CONSUMER AFFAIRS, CONSUMER FEDERATION OF AMERICA, CONSUMERS UNION, DEMOS, NATIONAL ASSOCIATION OF CONSUMER ADVOCATES, U.S. PUBLIC INTEREST RESEARCH GROUP, WOODSTOCK INSTITUTE REGARDING ADVANCE NOTICE OF PROPOSED RULEMAKING, REVIEW OF THE OPEN-END (REVOLVING) CREDIT RULES OF REGULATION Z, *available at* http://www.nclc.org/action_agenda/credit_cards/content/open_end_final.pdf.

- The creditor wants to change the terms of the agreement (change in terms notices).

Under the current version of TILA and Regulation Z, applications and solicitations for credit cards must display certain information in a table known as the Schumer box.⁸⁵ The Schumer box, although it needs significant improvement, is helpful to consumers because it makes it possible to compare various credit card offers at the application or solicitation stage. However, credit shopping is just as important after the application/solicitation stage. Yet TILA and Regulation Z require this relatively uniform, readable format only at the application stage.

TILA and Regulation Z currently require a different set of disclosures to be given when the account is opened. These need not be in a table or in any standardized format, and there is not even a type size requirement. These deficiencies make the disclosures extremely difficult to digest or even to see. The same is true at renewal and in change of terms notices. With no type size requirements, some change of terms notices are as small as 5-point type - a type face that is difficult even for younger people to read and impossible for many elders.

We propose expanding the Schumer box requirement so that it applies not just to applications and solicitations but also to the account-opening disclosures (provided when the issuer actually sends the consumer the card), periodic statements, and change of term notices. We also recommend changes to enhance the uniformity, readability, and usefulness of the disclosures. Disclosures at the point of purchase should also be considered.

Including a Schumer box disclosure as part of the account-opening disclosures is important because the creditor may have provided the consumer credit card terms different from those the consumer expected. Including a Schumer box in the account-opening disclosures, with the same items of information in the same order and format as the application or solicitation, would reveal these discrepancies. It would enable the consumer to compare the card that was provided with the card that was offered, and also with other available cards that the consumer might acquire and use. Making information about the actual terms of their own credit cards readily available to consumers would increase knowledgeable credit shopping and enhance competition.

The content of the Schumer box should also be improved in order to convey to consumers the true cost of a credit card. At present, TILA and Regulation Z require the creditor to take only the periodic rate, not other fees and charges, into account when calculating the annual percentage rate (APR) that is disclosed in the Schumer box. As a result, creditors are able to understate the cost of credit. For example, we recently saw a disclosure for a \$500 open-end line of credit in which the consumer was charged a periodic rate of 6% per year *plus* a monthly fee of almost \$150. As currently written, TILA allowed the creditor to disclose an APR of 6%, when the true cost of credit is over 300% APR. We recommend that the Schumer box provided with solicitations and applications and at the time the account is opened include a “typical” APR, similar to the EPA’s “energy label” on appliances. This APR would disclose the average monthly APR that consumers have paid on this type of credit card account and would include all the costs of the credit, not just the periodic rate. Periodic billing statements would show the actual effective APR, which would take into account the consumer’s actual use of the card, including cash advance fees, overlimit fees, and similar fees.

Some changes are also necessary to simplify the content of the Schumer box and make the terms and format more uniform. In addition, creditors must not be allowed to obscure the terms they are actually offering. Finally, even though there is currently a type size requirement for the Schumer box, many elders will need an alternative means of accessing the information. We recommend that

⁸⁵ 15 U.S.C. § 1632(c); Reg. Z § 226.5a(a)(2).

creditors be required to provide an 800 number that consumers could call to listen to the disclosures. A proposed revision to the Schumer box is attached as Appendix A.

5. Improve Help for Elders Who Are In Over Their Heads.

Even with the recommendations listed above, some elders will not be able to avoid unmanageable credit card debt burdens. For example, even with fair credit card terms, illness, medical expenses, or loss of employment will lead some elders unable to make the required payments on their credit card debt. A second report, to be released in August 2006, will examine what help is available, and what help should be available, to elders who are overwhelmed by credit card debt.

The second report, “The Life and Debt Cycle Part Two: Finding Help for Older Consumers With Credit Card Problems”, includes results of a national survey of the types of services available for older consumers with credit card problems. This second report also explores financial literacy programs and other ways to help older consumers better understand their finances and hopefully avoid problems.

CONCLUSION

Achieving a minimal level of economic comfort over the life cycle is important on many levels. It is essential on a purely human level so that elders can grow old with some peace of mind and some ability to pay for necessary services. It is also essential to our society and economy to try to help elders help themselves by building assets and income security prior to retirement. These efforts must be complemented by a strong, expansive safety net, including Social Security and health insurance coverage.

Increased debt has contributed to a collective blinding to the growing lack of security after retirement. At least for a while, easy credit allows many elders to buy services and products that they need—including food and prescription drugs. They can use credit cards to buy these items even when their monthly income is insufficient to cover the charges.

But there is a cost. Creditors have been given more freedom than ever to charge what they want and change terms as they want. As a result, the charges mount and the fees for late payments and high balances accumulate. At the same time, unexpected events such as illness, death in the family or other emergencies put many people over the edge. At this point, the underlying problem of income insecurity and unaffordable expenses can no longer be hidden by plastic. When this happens, elder consumers have few places to turn and little margin for error in terms of healthy working years to rebuild assets.

The solutions are complex in many cases. They require a combination of substantive change that will ban the most dangerous products, behavioral changes that will help increase savings, foster asset development, lessen reliance on credit, and lead to the development of alternative credit products that are more affordable. Targeted programs to assist consumers, as discussed in the second report in this series, are also critical. The recommendations in these reports are wide-ranging and ambitious, but the problems require this sort of multi-faceted effort. There is too much at stake not to try.

Appendix A: Proposed Schumer Box

ACCOUNT TERMS⁸⁶

PERIODIC RATE for purchases	0.0% for the first six billing cycles. After that, 12% . (The periodic rates disclosed here and in the next box do not include fees and charges other than interest.)
Other periodic rates	Cash advance: 12% Balance transfer: same as for purchases Default periodic rate (see conditions below*): 21%
Typical ANNUAL PERCENTAGE RATE (APR)⁸⁷ including fees [on periodic statements this would read “Your APR including fees”]	18.4% (This APR includes fees and charges.)
Variable rate information	Your APRs may vary. The rate for purchases (after the first six billing cycles), cash advances, and balance transfers is determined quarterly by adding 15% to the Prime rate. The rate for the Default APR is determined quarterly by adding 16.4% to the Prime rate.
Annual fee	None
Minimum finance charge	For each billing period that your account is subject to a finance charge, a minimum total FINANCE CHARGE OF \$1.00 WILL BE IMPOSED.
Late charge	\$29 if your payment is more than ten days late
Over-the-credit-limit fee	\$29
Cash advance fee	3% of the amount of the advance, but not less than \$10.00
Balance transfer fee	3% of balance transferred (minimum \$10, maximum \$75)

⁸⁶ Our inclusion of an improved manner of disclosing a particular fee should not be construed as supporting the imposition of or the amount of the fee.

⁸⁷ The APR and finance charge disclosures must be disclosed more conspicuously than all of the other information. 15 U.S.C. § 1632(a).

Miscellaneous fees	Set-up charge: \$10 Credit limit increase charge: \$10 Expedited payment fee: \$10
Credit limit	\$10,000
Security interest required	None
Grace period	20 days, but none for balance transfers or convenience checks

*Your APR will increase to the default APR if your payment is late twice in any six-month period.

°The “Prime Rate” is [explain].

