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March 24, 2005

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
 20th St. and Constitution Ave., N.W.
 Washington, DC 20551

Re: Docket No. R-1217
Advance Notice of Proposed Rulemaking
Truth in Lending (Regulation Z; 12 CFR Part 26)

Dear Ms. Johnson:

I am writing from Woodstock Institute in Chicago to comment on the advance notice of proposed rulemaking (ANPR) on the open-end credit rules of Regulation Z. Woodstock Institute is a Chicago-based nonprofit organization dedicated to promoting community reinvestment, credit access, and sound financial services to lower-income and minority neighborhoods both locally and nationally. For over 30 years, Woodstock has supported legislation and regulation in the best interest of low-income consumers.

We commend the Federal Reserve Board for their periodic reviews of regulations intended for consumer protection. However, we feel strongly that the current regulatory environment for the marketing, implementation, and disclosure of credit card lending is dangerous for consumers.

It is no longer a secret that Americans are hooked on credit cards. In January 2005, it was estimated that the average household has seven credit cards and carries a balance of \$14,000¹, the highest level of debt ever. Between 1989 and 2001, against the backdrop of an era of unmatched economic prosperity, credit card debt in America almost tripled, from \$238 billion to \$692 billion.² What's worse, Americans have begun to borrow against their fixed assets, such as their homes and vehicles, to pay off extensive credit card debt. Personal bankruptcies have nearly doubled from 1990 to 2002.³

While the high level of Americans' debt is likely due to a number of factors, one must examine the credit card industry itself as a central reason. Credit card providers have set up such an intricate trap of penalties and fees, all coded in complex cardholder agreements, which makes it difficult for Americans to pay off their balances. Some of the policies examined in the ANPR – such as increasing interest rates and credit limits on short notice to those in debt – are particularly destructive. The current regulatory environment allows banks

¹Karen Krebsbach, "Consumers are Overspending." U.S. Banker, January 2005.

²Tamara Draut and Javier Silva, "Borrowing to Make Ends Meet: The Growth of Credit Card Debt in the 90s." Demos USA, September 2003.

³Alex Baker, "Life and Debt: Why American Families are Borrowing to the Hilt." Century Foundation, 2004.

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to obscure important crucial information about their credit card products to incur penalties and fees. Banks' deceptive terms have led many Americans to undergo embarrassing bankruptcies, personal stress, and family problems.

This letter will address the questions in the ANPR which we find most important:

Abusive Fees, Q21-Q22, Q47-51
Payment Allocation and Late Payments, Q34-36, Q47-51
Change in Terms, Q26-Q27

Woodstock Institute has also joined with a coalition of consumer advocacy organizations to form a collective letter; in its entirety, the joint letter addresses all of the questions presented in the ANPR.

Abusive Fees

We feel it is necessary to discuss the fees presented in the ANPR within the context of the multitude of fees currently imposed by the country's largest credit card lenders. The evidence suggests that fees are increasing at a very rapid rate: in 1995, the industry generated \$8.3 billion in all fees, and by 2003 this number skyrocketed to \$20.7 billion.⁴ This is largely due to the 1996 Smiley v. Citibank Supreme Court decision that allows banks to export higher fee ceilings from the states in which they are located. It is no accident that banks have relocated their credit card processing centers to the states with the weakest consumer protection laws. This section will address four types of credit card fees: late fees (Q47-51), over-the-limit fees (Q21-Q22), cash advance fees, and balance transfer fees. In addition to these, credit cards may also charge annual fees, set-up fees, credit-limit-increase fees, return-item fees, currency conversion fees, and others.

In December of 2004, Woodstock Institute collected data on the characteristics of credit cards offered by three groups of providers. The survey considered only what appeared to be the most basic or most standard credit card offered by each financial institution.⁵ The first group is banks: that is, the primary depository institution of the largest U.S.-based bank and thrift holding companies, ranked by total amount of credit card loans.⁶ It is estimated that these ten institutions hold 90 percent of credit card accounts. Hereinafter, the term "bank" will be used to refer to institutions in this group. The cards surveyed are listed in table 1.

⁴Demos USA, "Credit Card Industry Practices: In Brief." Found online at http://www.demos-usa.org/files/IndustryPractices_WEB.pdf. Last accessed 6 January, 2005.

⁵Secured credit cards were not considered in the analysis. Many financial institutions have abandoned the traditional convention of offering three levels of cards based on creditworthiness, namely Standard/Classic, Gold, and Platinum cards. The cards were considered regardless of brand (e.g., Visa, MasterCard, Diners Club, etc.)

⁶As published in the American Banker, 18 August, 2004. Data are accurate as of 31 March, 2004. From this list, USAA Bancorp was eliminated due to restraints on information, and FleetBoston Financial Corp. was eliminated due to the merging of its credit card products with Bank of America Corp.

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Table 1
Largest U.S.-Based Bank and Thrift Companies, Ranked by
Total Amount of Credit Card Loans

	Institution	Card Surveyed
1	CitiGroup Inc.	Citi Platinum Select MasterCard
2	Bank Of America Corp.	Visa Gold
3	MBNA Corp.	NFL Extra Points
4	JP Morgan Chase & Co.	Chase Platinum MasterCard
5	Bank One Corp.	Platinum Visa Card
6	Wells Fargo & Co.	Visa Platinum Card
7	US Bancorp	Visa Classic
8	Capital One Financial Corp.	Platinum MasterCard
9	National City Corp.	Elite Visa
10	BB&T Corp.	Platinum MasterCard

To provide contrast to the abusive practices instituted by banks, the survey also measured the fees of the credit cards of two groups of credit unions. Credit unions illustrate the reality that credit card lending can be done sustainably, but without instituting the exorbitant fees and unclear procedures that banks use. This is done in keeping with the credit unions movement's mission to provide sound and principled products to consumers of small means. The second group of credit card providers, listed in table 2, is made up of the ten largest credit unions nationwide, ranked by total amount of credit card loans.⁷ The third group, listed in table 3, is made up of the ten largest credit unions based in the Chicago MSA, ranked by total asset size.⁸

Over-the-Limit Fees (Q21-22)

The survey shows that, through the use of over-the-limit fees, banks are willing to take advantage of their accountholders' math errors. Many banks reserve the right to charge these fees when the consumer exceeds the limit by as little as \$1. On this issue, banks' policies are more egregious than credit unions. In fact, the lowest over-the-limit fee charged by a bank in the sample (\$29) was higher than the highest fee charged by a national credit union (\$27). As shown in table 4, the banks' average of \$33.60 far exceeds the national credit unions' average of \$17.90 and Chicago credit unions' average of \$23.33. Only one institution, a Chicago credit union, does not have an over-the-limit fee.

⁷As published in the American Banker, 16 November, 2004. Data are accurate as of 30 June, 2004.

⁸As determined through the 2004 Directory of Federally Insured Credit Unions, published by the National Credit Union Administration. Data for total amount of credit card loans for this group were not available.

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Table 2
Largest Credit Unions Nationwide, Ranked by Total Amount of Credit Card Loans

	Institution	Card Surveyed
1	Navy FCU	Visa Classic
2	Pentagon FCU	Visa Classic
3	Suncoast Schools FCU	Visa Classic
4	Boeing Employees CU	Visa
5	Pennsylvania State Employees CU	Visa Capitol Card
6	Digital FCU	Visa Classic
7	Orange Co. Teachers FCU	Visa Classic
8	Vystar FCU	Visa Classic
9	Golden 1 CU	Visa Classic
10	America First CU	Visa Classic (Option B)

Table 3
Largest Credit Unions Based in the Chicago MSA, Ranked by Total Asset Size

	Institution	Card Surveyed
1	Alliant CU	Regular MasterCard
2	Selfreliance Ukrainian American FCU	Visa Credit Card
3	Baxter CU	Classic Visa
4	Corporate America Family CU	Advantage Visa
5	Motorola Employees CU	Visa Classic
6	Great Lakes CU	Visa Classic
7	First Northern CU	Visa Classic
8	DuPage CU	Visa Plus
9	Chicago Patrolmen's FCU	Visa Classic
10	Illiana Financial CU	MasterCard Regular

Table 4
Over-the-Limit Fees

	No. With O/L Fees	Lowest	Highest	Average	Standard Deviation
Banks	10 of 10	\$29	\$39	\$33.60	3.41
National CUs	10 of 10	\$10	\$27	\$17.90	5.66
Chicago CUs	9 of 10	\$10	\$35	\$23.33	6.61

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Cash-Advance fees

While cash advance fees were not explicitly mentioned in the ANPR, we find it is necessary to include them to provide a context of all fees instituted on credit cards. This section only addresses the fees associated with cash advances; banks also typically assign a higher APR to cash advances than to purchases (this will be addressed later in this letter under Payment Allocation and Late Payments). The data show that banks charge excessive fees for cash advances, whereas credit unions institute a much more modest fee. As table 5 shows, a majority of the credit unions don't charge cash advance fees whatsoever.⁹ On average, banks charge a fee of 3.2 percent of each cash advance, but not to be lower than an average "floor" of \$6.50. While it may seem inappropriate that banks mandate a floor for cash advances, it is even more alarming that all ten have no upper bound for cash advances. Thus, for a cash advance of \$1,000, the average bank would charge a fee of \$32. Of the three national credit unions that do have fees, the average fee is 1.93 percent of the advance; at the four Chicago credit unions, this number is 2 percent. As shown in table 6, their fee floors are much lower.

Table 5
Cash Advance Fees*

	No. of Institutions With Cash Advance Fees*	Of those with CA Fees, Average Percent of Balance Charged as Fee	Of those with CA Fees, Average Fee not to Be Lower Than (Fee Floor)
Banks	10 of 10	3.20%	\$6.50
National CUs	3 of 10	1.83%	\$0.66
Chicago CUs	4 of 10	2.00%	\$3.5

*At one national credit union, there is a flat fee of fifty cents for a cash advance, regardless of the amount of the advance. Similarly at one Chicago credit union there is a flat \$2 fee for cash advances. These two cases are not included in the above table.

⁹At one national credit union, there is a fee of 50 cents for a cash advance, regardless of the amount of the advance. Similarly at one Chicago credit union, there is a \$2 fee for cash advances.

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Table 6
Balance Transfer Fees*

	No. of Institutions With Balance Transfer Fees	Of those with BT Fees, Average Percent of Advance Charged as Fee	Of those with BT Fees, Average Fee not to Be Lower Than (fee floor)	Of those with BT Fees, Average Fee not to be Higher Than (fee ceiling)
Banks	7 of 10	3.00%	\$6.43	\$63*
National CUs	2 of 10	2.00%	\$2.00	\$30
Chicago CUs	0 of 10	"	"	"

*At two of the seven banks with balance transfer fees, there is no limit to the maximum amount of fee possible. These two were not included in this average.

Balance-Transfer Fees

Similar to the above section on cash advances, this section only addresses the fees associated with balance transfers; balance transfer rates will be discussed in the next section. As shown in table 7, banks charge much more for balance transfer fees, which are often poorly disclosed. All seven banks that implement balance transfer fees charge a rate of 3 percent of each transfer. All seven set a fee floor, which averages \$6.43. What's worse, two of these banks have no maximum cap for a balance transfer fee (the other five cap at an average of \$63). This means that, for example, a balance transfer of \$3,000 will incur a fee of \$90 at one of these banks. On the other hand, eight of ten national credit unions and zero of ten Chicago credit unions have balance transfer fees. At the two national credit unions that do charge for balance transfers, the fee is 2 percent of the advance, with an average cap at \$30.

Table 7
Late Fees

	No. Using Tiered Systems Rather than a Specific Fee	Lowest Late Fee in Group*	Highest Late Fee in Group*
Banks	8 of 10	\$15	\$39
National CUs	0 of 10	\$10	\$25
Chicago CUs	0 of 10	\$10	\$25

* "Lowest" or "Highest" late fee refers to the lowest or highest value advertised, regardless of whether this value was part of a tiered system.

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Late fees (Q47-51)

Providers have made late fees increasingly higher, and have introduced a number of schemes in order to make more payments late (these schemes will be discussed later under "Payment Allocation and Late Payments"). Late fees are the golden goose of credit card providers. In 1996, the industry generated \$1.7 billion in late fees; in 2002, it collected a whopping \$7.3 billion.¹⁰ This increase was due in large part to the aforementioned *Smiley v. Citibank* decision, which effectively eliminated state-instituted caps on late fees. According to a survey published by the Federal Reserve, nearly 30 percent of credit card users had been charged a late fee in 2001.¹¹ The chief issue with late fees has become the clarity with which they are presented. The survey found that eight of ten banks used a tiered system in assessing late fees. For example, a bank may charge a \$15 late fee on a balance up to \$100; \$29 on balances of \$100-\$1,000; and \$39 on balances of \$1,000 and over. On the other hand, no national credit union and no Chicago credit union used tiered systems, thus eliminating confusion. One national credit union, however, charges 5 percent of the past due payment, but no more than \$10. Due to the use of tiered systems, dollar-to-dollar comparisons across the three groups were not made.

Payment Allocation and Late Payments

As in the above section on abusive fees, we feel it is necessary to discuss payment allocation and late payments by describing them in the context of credit card payments.

Payment Allocation

In today's credit card market, a single credit card may have several APRs. For example, most have one rate for purchases, a higher rate for cash advances, a lower rate for balance transfers, and a fourth "default" or "penalty" rate. To add to this lack of clarity, a credit card provider may offer a lower introductory or promotional rate, but it may apply to only one of the rates. The promotional rate may skyrocket to the default rate upon the first late payment or other penalty. Given this confusion, we feel the central issue at hand is clarity, not payment allocation. Use of multiple rates and teaser rates only baffles the consumer, and makes cost-shopping among credit cards increasingly difficult.

In addition, that banks would allocate a consumer's payment to the lowest-rate balance first is additional evidence that banks aggressively mine for profit on every aspect of credit card lending. Amending Regulation Z to address payment allocation would be appropriate: a pro-consumer method of allocation would make it much easier for Americans to pay off their debt. The survey was unable to track data on payment allocation, as it typically was not included in solicitation disclosures.

¹⁰Demos USA, "Credit Card Industry Practices: In Brief." Found online at http://www.demos-usa.org/pubs/IndustryPractices_WEB.pdf. Last accessed 6 January 2005.

¹¹Thomas A. Durkin, "Consumers and Credit Disclosures: Credit Cards and Credit Insurance." Federal Reserve Bulletin, April 2002.

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Late Payments

Evidence shows that banks have instituted many schemes to maximize the number of payments that are considered "late" (late fees were addressed earlier under "Abusive Fees"). First, many providers have squeezed the grace period for repayment from an industry-standard of 30 days down to 20 days to increase the likelihood of a late payment, as the survey exhibits in table 8. In contrast, credit unions' grace periods are longer. Second, anecdotal evidence shows that some providers periodically switch their payment address among multiple P.O. boxes, so that payments are bounced around the card processing center to cause a further delay.¹²

Table 8
 Grace Periods*

	Lowest	Highest	Average	Standard Deviation
Banks	20 days	25 days	21.5 days	2.41
National CUs	25 days	25 days	25 days	0.00
Chicago CUs	25 days	25 days	25 days	0.00

*Grace period is defined as the number of days between the close of the billing cycle and the date the payment is due.

Many banks have also instituted a payment cut-off time at 1 p.m. on the due date; thus, if the letter carrier is late that day, so is the payment. A 2004 survey by Consumer Action showed that 58 percent of surveyed banks now have a cut-off time.¹³ Furthermore, anecdotal evidence shows that banks whose processing centers are located in the central time zone will establish their payment at 1 p.m. eastern time, effectively making payment due at noon. Then, if mail is delivered until after the cut-off time on that day, the grace period is cut short by one day. Given these circumstances, the Board ought to amend Regulation Z requiring creditors to credit payment as of the date they are received, regardless of time.

Change in Terms

The ANPR's inquiry regarding change in terms (Q26-Q27) exhibits how the Board could amend Regulation Z to prohibit the controversial practice of "universal default." Under current practice, a credit card provider reserves the right to increase a consumer's interest rate when (s)he is late or delinquent with

¹²Amy C. Fleitas, "20 Snaky Credit Card Tricks." Found online at <http://www.bankrate.com/bnm/news/cc/20021106.asp>. Last accessed 4 January, 2004.

¹³Linda Sherry et.al, "Credit Card Survey 2004," Consumer Action News, Spring 2004.

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an entirely different creditor or utility provider,¹⁴ which is done through an arrangement with one of the three credit bureaus. Thus, if a consumer is late with Bank X, Bank Y could raise its rate, even if the consumer has never missed a payment with Bank Y. Usually, the rate skyrockets to the default rate; among the ten banks in the survey, this rate averaged 25.4 percent. It becomes very difficult for consumers to pay off their balances at rates this high. Data show that universal default is catching on: a 2004 survey by Consumer Action of California showed that 39 percent of its sample of bank credit cards implemented universal default.¹⁵

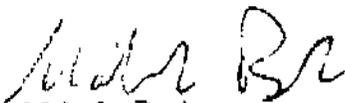
The Board is poised to stop universal default: the practice could be ended by amending Regulation Z to by requiring 30 days' advance notice or longer when a consumer is in default or delinquency with another creditor. Universal default is premised on the consumer's ignorance of the procedures for changing the rate: an extended advance notice period will allow consumer to realize their mistakes, and perhaps transfer his/her balance from the high rate card to another card. We feel strongly that this is a particular deceptive practice and ought to be eliminated.

Summary

In sum, this ANPR gives the Board the occasion to act in the best interest of the consumer by ending a number of credit card providers' most deceptive practices. Among these, the Board has the opportunity to end unreasonable fees, deceptive payment allocation, cut-off times, and universal default. Given that the purpose of the Truth in Lending Act is to encourage competition through the informed use of credit, we feel that it is critical to end these detrimental practices.

Furthermore, as our colleagues will argue in our joint letter, the Board also has the opportunity to make information about credit card products presented in a clearer and more uniform way. This will facilitate better cost-shopping among credit cards and other forms of credit, and so that consumers can be fully knowledgeable of the products they use. While we understand that the cost structures are different in the credit union sector, as this comparison shows, credit union credit card products are much more consumer-friendly than bank products and should be viewed as better practices.

Sincerely,


Malcolm Bush
President

MB/bab

¹⁴Lucy Lazarony, "Credit card companies look to raise your rates by spying on your credit." Bankrate.com, found online at: <http://www.bankrate.com/btm/news/cc/19990524.asp>. Last accessed 4 January, 2004.

¹⁵Linda Sherry et al., "Credit Card Survey 2004." Consumer Action News, Spring 2004.