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Statement of

John E. Bowman, Deputy Director, Chief Counsel  
Office of Thrift Supervision

concerning

**The Credit Cardholders' Bill of Rights Act of 2008**

before the

Subcommittee on Financial Institutions and Consumer Credit  
of the Committee on Financial Services  
United States House of Representatives

April 17, 2008

Office of Thrift Supervision  
Department of the Treasury

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**I. Introduction**

Good morning, Madame Chair, Ranking Member Biggert, and Members of the Subcommittee. Thank you for the opportunity to present the views of the Office of Thrift Supervision (OTS) on H.R. 5244, the Credit Cardholders' Bill of Rights Act of 2008 and issues related to credit card lending in the thrift industry. Thank you also for your interest and leadership on this important aspect of the financial services market. We share your commitment to protecting consumers from abusive credit card practices.

In my testimony today, I will discuss the thrift charter, authority for savings associations to issue credit cards, OTS authority to supervise the credit card activities of thrift institutions and credit card holdings of the industry. Next, I will explain how the OTS monitors and oversees the credit card activities of the industry. Then, I will address the adequacy of our authority to oversee credit card lending, regulatory alternatives to legislation and our comments on H.R. 5244.

I would also like to take this opportunity to update the Subcommittee on OTS efforts to curb abusive practices with regard to credit cards and other lending activities. On August 6, 2007 the OTS issued an Advance Notice of Proposed Rulemaking (ANPR) requesting comment on the issuance of additional OTS regulations implementing section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive acts or practices (UDAPs). The ANPR solicited comment on a wide range of potential UDAPs in addition to those already covered by the existing OTS Credit Practices Rule.

Based on our review of comments from consumer advocates, industry representatives, members of Congress, and the general public, we are working to issue a Notice of Proposed Rulemaking (NPR) in the immediate future. We expect the UDAP rule to address certain practices that have raised concern, including retroactive rate increases and double cycle billing. In response to commenters' requests for consistent interagency standards and a level playing field, we have invited the other federal agencies with FTC Act rulemaking authority – the Federal Reserve Board, Federal Trade



Commission, and National Credit Union Administration – to participate in the rulemaking. I will discuss our UDAP proposal in more detail later in this testimony.

In this regard, before proceeding it is important to note that we are providing comments on H.R. 5244 while our existing UDAP rulemaking is pending. As you are aware, there are clear standards and requirements under the Administrative Procedure Act (APA) that all federal agencies must follow in the context of any rulemaking. Therefore, we are providing comments on H.R. 5244 today mindful of preserving the integrity of our existing rulemaking under the APA. That is, our comments on H.R. 5244 are offered as observations only on that legislation. While policy observations have informed our rulemaking efforts, the public comment process will ultimately guide our rulemaking on our pending UDAP proposal.

## **II. Overview of the Thrift Charter and Thrift Credit Card Lending Authority**

By statute, thrift institutions must maintain 65 percent of their assets in mortgages and mortgage-related assets; however, this requirement makes accommodation for certain retail lending activities of thrifts, including credit card lending. The purpose of this statute and accommodation is to encourage a mortgage lending focus by thrifts, but also permit activities that are complementary to mortgage lending, such as consumer-based retail lending operations. This benefits consumers by increasing competition for these types of lending services. It also promotes asset diversification and balance in thrift operations by avoiding overexposure to a limited and narrowly focused lending strategy.

The authority for thrifts to engage in credit card lending depends on whether the institution is state or federally chartered. The authority for state-chartered thrifts comes from state law, and the extent and scope of this authority varies depending on the jurisdiction. Generally, state chartered thrifts may engage in credit card lending, although there may be differing limits and/or other restrictions depending on the state.

The authority for federal thrifts to engage in credit card lending derives from the Home Owners' Loan Act (HOLA). Pursuant to the HOLA,<sup>1</sup> a federal savings association may invest in, sell, or otherwise deal in loans made through “credit cards or credit card accounts” without limitation as a percentage of assets to the extent specified by OTS regulations. OTS regulations permit thrifts to issue credit cards and maintain credit card accounts,<sup>2</sup> but impose no general limitation on the extent of credit card lending by federal

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1. 12 USC § 1464(c)(1)(T).

2. 12 CFR § 560.30. A credit card is “any card, plate, coupon book, or other single credit device that may be used from time to time to obtain credit.” 12 CFR § 560.30. A credit card account is defined as “a credit account established in conjunction with the issuance of, or the extension of credit through, a credit card.” 12 CFR § 560.30. A credit card account includes loans made to



thrifts. By regulation, however, the OTS may establish an individual limit on such loans if the agency determines that an institution's concentration in such loans presents a safety and soundness concern.<sup>3</sup>

### **III. OTS Authority to Supervise Thrift Credit Card Lending Activities**

Federal thrifts are subject to the authority of the OTS to supervise thrift credit card lending activities. OTS authority includes the ability to examine, regulate and, as noted above, limit for safety and soundness reasons the credit card operations of federal thrifts.<sup>4</sup> Pursuant to its authority to oversee the activities and operations of a federal thrift, the OTS is authorized to regulate, oversee and limit the credit card operations of a federal thrift that are in violation of consumer protection laws and/or that the agency determines pose a reputation risk – and thus a potential safety and soundness risk – to an institution.

### **IV. Thrift Industry Credit Card Holdings**

As of December 31, 2007, OTS-regulated thrifts had total credit card holdings of \$44.59 billion, or 2.9 percent of aggregate thrift industry assets. This amount represents approximately 10.6 percent of the aggregate \$422.5 billion of credit card holdings of all FDIC-insured depository institutions. Thrift holdings of credit card balances were highly concentrated in just a few thrifts. Eight OTS-regulated thrifts reported over \$1 billion in credit card balances as of December 31, 2007. These institutions reported \$43.54 billion outstanding, representing the vast majority (97.6 percent) of thrift industry holdings. By contrast, the remaining 116 thrift institutions that reported some level of credit card balances accounted for only \$1.05 billion, or 2.4 percent of thrift industry credit card holdings.

On an aggregate basis, unused consumer credit card lines at OTS institutions totaled \$686.5 billion in December 2007, up from \$597.1 billion one-year earlier. This

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consolidate credit card debt, including credit card debt held by other lenders, and participation certificates, securities and similar instruments secured by credit card receivables. 12 CFR § 560.3

3. 12 CFR § 560.30, Endnote 6.

4. Section 4(a) of the HOLA, 12 USC § 1463(a), provides that the OTS Director shall provide for the examination, safe and sound operation, and regulation of state- or federally-chartered savings associations. It further provides that the OTS may issue such regulations as the Director determines to be appropriate to carry out its responsibilities. In addition, HOLA section 5(a), 12 USC § 1464(a), provides that the OTS Director may prescribe the organization, incorporation, examination, operation, and regulation of federal savings associations. Finally, as previously noted, the OTS has specific authority to regulate the credit card activities of federal thrifts pursuant to HOLA section 5(c), 12 USC § 1464(c)(1)(T), which provides that a federal thrift may engage in credit card lending to the extent specified by OTS regulations.



represented 14.7 percent of the unused balance of \$4.68 trillion of consumer credit card lines reported by FDIC-insured institutions as of December 31, 2007.

Nineteen thrift institutions had credit card loan balances in excess of 10 percent of their risk-based capital. Nine of these institutions had credit card concentrations exceeding 100 percent of risk-based capital. Notwithstanding these levels, issuers continue to have strong capital positions supporting their credit card lending programs.

Credit card delinquencies have trended up in the past two years. Credit card balances with payments between 30 and 89 days delinquent were 1.88 percent at the end of 2007, up from 1.68 percent at the end of 2005. Similarly, credit card balances 90 days past due plus those in non-accrual status were 1.58 percent at the end of 2007, up from 1.08 percent two years ago. Net charge-offs by OTS-regulated credit card lenders have also been trending higher. On an aggregate basis, adjusted net charge-offs were 5.04 percent of the credit card portfolio during 2007, compared to 3.84 percent and 4.26 percent during 2006 and 2005, respectively. We continue to monitor these trends closely, especially given weakness in the labor markets and the strains on consumer budgets caused by higher energy and food costs.

## **V. OTS Monitoring and Oversight**

In addition to quarterly monitoring of the loan levels, performance and capital adequacy of thrifts engaged in credit card lending programs, the OTS monitors the marketing, pricing, fee and servicing practices of these programs. An important component of our oversight is examining for compliance with consumer protection laws, and particularly the account management and collection activities and practices of these institutions.

The OTS has a dedicated team of credit card specialists known as the Core Credit Card Specialty Group that works on continually improving our examination staff's knowledge base, effectiveness, and inter-regional training program with respect to credit card oversight. Our Core Group staff assists our regional examiners review institutions with the most complex credit card operations and they enhance cross-training efforts and the consistency of these examinations. Staff at the national office prepares specific quarterly monitoring reports and assigns core teams to assist in key selected institutions. For the thrifts that have significant credit card operations, we currently have examiners assigned to this core group. The group focuses on the major functional areas involved in credit card lending: marketing, underwriting, account management, and collections activity.

The OTS is required to ensure that thrifts conduct their credit card lending activities and programs in compliance with applicable consumer protection laws and subject to rigorous scrutiny of all aspects of an institution's program. In conducting its oversight of thrift credit card lenders, the OTS is particularly mindful of reputation risks



that could undermine the safety and soundness of an institution and/or the thrift charter under which an institution conducts its credit card operations.

We regularly examine thrifts for compliance with federal consumer protection statutes including the Truth in Lending Act (TILA) and fair lending laws such as the Equal Credit Opportunity Act (ECOA). We examine for compliance with our advertising regulation, which prohibits thrifts from making any representation that is inaccurate or that misrepresents its services, contracts, investments or financial condition.<sup>5</sup> We also examine thrifts for compliance with our nondiscrimination regulation, which prohibits thrifts from discriminating in lending and other services, appraisals, marketing practices and related areas.<sup>6</sup> Finally, long-standing OTS guidance provides that a thrift's collection activities must comply with the following:

- state laws that pertain to collection and foreclosure actions; and
- bankruptcy law – an institution's collection activity is affected by any bankruptcy plan into which a debtor has entered.

An area of particular scrutiny with respect to credit card management practices in recent years is the application of minimum amortization standards by credit card lenders. Pursuant to guidelines issued by the federal banking agencies, credit card lenders are expected “to require minimum payments that will amortize a current loan balance over a reasonable period of time, consistent with the unsecured, consumer-oriented nature of the underlying debt and the borrower's documented creditworthiness.”<sup>7</sup> The banking agencies understand that safety and soundness concerns are raised by prolonged negative amortization, inappropriate fees, and other practices that inordinately compound or protract consumer debt and disguise portfolio performance and quality.

OTS examiner guidance provides interpretation of the interagency amortization guidelines that are even stricter than those of the other agencies, stating that “monthly payments should cover at least a one percent principal balance reduction, as well as all assessed monthly interest and finance charges.”<sup>8</sup> While the interagency credit card guidance and OTS examiner guidance allow for exceptions within well-managed credit card programs, consistent with prudent underwriting, we significantly limit the issuance of exceptions.

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5. 12 C.F.R. § 563.27.

6. 12 C.F.R. Part 528.

7. Interagency Credit Card Lending, Account Management and Loss Allowance Guidance, January 8, 2003.

8. Section 218, *OTS Examination Handbook*.



## **A. Consumer Complaint Activity**

The OTS continually tracks, investigates and responds to consumer complaints involving thrift institutions with respect to product offerings and services, including credit cards. Consumer complaint staff and managers also prepare summaries of consumer complaints for OTS examiners to utilize in their reviews during on-site examinations.

Institution consumer complaint records are an integral part of the OTS individualized Pre-Examination Response Packages (PERK), which is our request to thrifts for data that will be used during the examination. This data plays a significant role in identifying areas for examiners to focus on during on-site examinations. These records also play a critical role in assessing the adequacy of an institution's overall compliance management program and in pursuing corrective action that may be appropriate to address programmatic weaknesses or deficiencies.

Specific complaint activity for particular institutions engaged in credit card lending varied considerably over the past year. Not unexpectedly, the largest issuers generally received larger numbers of consumer complaints. In contrast, the remaining institutions generated relatively few complaints in this area. The most frequent complaints related to billing errors and credit card underwriting. Other common complaint areas involved penalty charges, credit bureau reporting, fair debt collection practices, and customer service and consumer relations issues.

It is important to note that our consumer complaint policy provides that even when evidence does not reveal regulatory violations, OTS complaint analysts and management have the flexibility and authority to encourage thrifts to take voluntary action to satisfy a consumer, where circumstances warrant such action. This happens fairly frequently in the interest of preserving strong customer relationships and further enhancing the reputation of thrifts as essential providers of financial services.

## **B. OTS Enforcement Activities**

It is important to note that OTS jurisdiction and oversight of an institution's lending programs also extends to its holding companies and related entities, service providers, and other contractual relationships that an institution may utilize to conduct its credit card activities and related operations.

When an institution's lending programs are found to be potentially predatory or lacking adequate controls to support responsible lending, there are numerous options that the OTS can take. These include informal agreements, supervisory directives, board resolutions, and various other approaches.



For example, we previously addressed an issue with an institution that we believe was engaging in a potentially abusive subprime credit card lending program. The nature of the program was uncovered in the normal course of an examination. To resolve the matter, we directed the institution's board of directors to establish a systematic process to withdraw from the subprime credit card program and immediately cease new approvals under the program. Although this was an informal action pursued in the course of an examination, it resulted in termination of the program in a reasonably short timeframe following the examination. We have taken similar actions with other institutions in the past.

We have also used a combination of formal and informal enforcement actions to force the discontinuation of lending operations by federal thrifts that were attempting to exploit the charter to engage in lending programs lacking adequate consumer protections and management controls. Some cases referred to as "charter rental" strategies involve situations where an institution is attempting to avoid state oversight of out-of-state lending activities by the institution. In addition to raising significant consumer protection issues, these situations not only expose the institution to potential risks, but undermine the integrity of the federal thrift charter. The OTS is particularly vigilant in intervening and expeditiously shutting down these types of operations.

There are numerous other such examples of actions taken by the OTS in the course of examinations of the institutions we regulate. While we find informal actions to be an effective mechanism to address many supervisory concerns, we do not hesitate to use our formal enforcement authority when appropriate. Fundamental to our continuing oversight of the industry we regulate is ensuring that institutions conduct their activities in a manner consistent with sound consumer protection.

## **VI. Adequacy of Existing OTS Authority**

For the reasons described above, I believe that OTS's existing authority is adequate to address the types of issues and potential abuses that may arise with the credit card lending programs of OTS-regulated thrifts. While we believe many of the provisions of Chair Maloney's bill may be beneficial, OTS favors an alternative to new legislation prohibiting specific credit card practices. We support a more agile regulatory approach that allows OTS to respond to whatever unfair or deceptive acts or practices it finds exist in the industry or are on the horizon.

Accordingly, OTS believes the best approach at this time is to continue to work on regulations on an interagency basis addressing unfair or deceptive acts or practices under its existing statutory authority under the FTC Act. We do note, however, that using the FTC Act in a way that creates a level playing field among all financial institutions is complicated because of some restrictions on the Federal Trade Commission's rulemaking authority to prohibit unfair or deceptive acts or practices that appear to have outlived their usefulness.



Specifically, the FTC must use special rulemaking procedures applicable only to the FTC, while the other agencies with FTC Act rulemaking authority can use standard Administrative Procedure Act rulemaking procedures. The FTC has testified on a previous occasion before the House Subcommittee on Commerce, Trade, and Consumer Protection of the Committee on Energy and Commerce (October 23, 2007) that its rulemaking procedures “are much more cumbersome and time-consuming than the APA rulemaking procedures.”

This disparate rulemaking authority creates a potential regulatory gap because the FTC is responsible for issuing rules on unfair or deceptive acts or practices that apply to financial institutions that are independent of a depository institution as well as state chartered credit unions. Those entities would not be covered by a joint rule issued by OTS and the other agencies with FTC Act rulemaking authority.

To close that gap, the House of Representatives passed H.R. 3526 on December 5, 2007. One provision in that bill would allow the FTC to use the same APA rulemaking procedures that the other agencies use when promulgating an FTC Act rulemaking jointly with the other agencies to address unfair or deceptive acts or practices. We note that H.R. 3526 also would provide the OCC and FDIC with the same rulemaking authority under the FTC Act as is currently provided to the OTS. We believe these provisions are a good idea and would be helpful.

## **VII. Consumer Protection Issues**

Now I would like to describe two regulatory agencies’ proposals to provide proper disclosure and to curb abusive practices with regard to credit cards, as well as to address Chair Maloney’s bill.

### **A. Proposed Amendments to Truth in Lending Act (TILA) Regulations**

I believe that clear, comprehensible disclosure of all significant loan terms is essential to every consumer credit transaction. One of the primary purposes of TILA is to provide meaningful disclosure of credit terms so that consumers are able to compare financial products and avoid the uninformed use of credit.

While the Federal Reserve Board (FRB) has sole authority to promulgate substantive rules to implement TILA,<sup>9</sup> a number of regulatory agencies have authority to enforce them. Known collectively as Regulation Z, these rules are enforceable against

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<sup>9</sup> 15 U.S.C. 1604.



thrifts, thrift holding companies, and thrift subsidiaries by the OTS under TILA, HOLA, and the Federal Deposit Insurance Act.<sup>10</sup>

In September 2006, the Government Accountability Office issued a report which concluded that the credit card disclosures used by the largest issuers had weaknesses which reduced consumers' ability to understand them.<sup>11</sup> In June 2007, the FRB proposed changes to the provisions of Regulation Z that apply to open-end credit.<sup>12</sup> According to the FRB, the goal of the proposed amendments is to improve the effectiveness of the disclosures that creditors provide to consumers at application and throughout the life of an open-end account that is not secured by a home.<sup>13</sup> Consistent with this narrow goal, the amendments do not attempt to directly address practices that may cause harm to consumers.

## **B. Proposed Rulemaking to Address Unfair or Deceptive Practices**

As noted above, TILA and Regulation Z are primarily intended to provide consumers with information to help them comparison shop among competing products. While improving the quality of this information is a positive step, there are a number of harmful practices that cannot be addressed through improved disclosure alone.

Recognizing this, the OTS has initiated a rulemaking intended to address unfair or deceptive practices (UDAPs) prohibited by the Federal Trade Commission (FTC) Act. On August 6, 2007, we issued an advance notice of proposed rulemaking (ANPR) requesting comment on the adequacy of our current UDAP rules.<sup>14</sup> Based on our review of comments from consumer advocates, industry representatives, members of Congress, and the general public, we are working to issue a Notice of Proposed Rulemaking (NPR) in the very near future.

In response to commenter requests for consistent interagency standards and a level playing field, we invited the other federal agencies with FTC Act rulemaking authority – the Federal Reserve Board, Federal Trade Commission, and National Credit Union Administration – to participate in the rulemaking. The Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency currently do not have

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<sup>10</sup> 15 U.S.C. 1607(a)(2), 12 U.S.C. 1464(d), 1467a, 1813(q)(4), and 1818.

<sup>11</sup> See, “Credit Cards: Increased Complexity in Rates and Fees Heightens Need For More Effective Disclosures to Consumers”, GAO-06-929, issued September 2006.

<sup>12</sup> 72 FR 32948 (June 14, 2007).

<sup>13</sup> *Id.*

<sup>14</sup> Unfair or Deceptive Acts or Practices: Advance Notice of Proposed Rulemaking, 72 FR 43570 (August 6, 2007).



rulemaking authority under the FTC Act; however, we have consulted with them regarding our UDAP proposal. We envision promulgating a rule that adopts principles-based standards for unfairness and deception. Under these standards, a practice is viewed as unfair if: it is likely to cause harm; consumers cannot avoid the injury; and the injury is not outweighed by countervailing benefits to consumers or competition.<sup>15</sup> A practice is viewed as deceptive if it involves a material representation or omission that is likely to mislead a consumer acting reasonably.<sup>16</sup>

Our ANPR examined a broad array of issues and practices, including practices relating to the marketing, origination and servicing of credit cards.

### **C. Comments on H.R. 5244**

We have reviewed your bill, the Credit Cardholders Bill of Rights (H.R. 5244), which seeks to end certain credit card industry practices and provide important consumer protections to credit cardholders.

We share many of your concerns. For example, some issuers have engaged in pricing practices that are potentially harmful to consumers. These include increasing the annual percentage rate on an outstanding balance for reasons other than cardholder behavior that is directly related to the account. In our UDAP proposal we expect to place restrictions on some of these types of practices.

Also troubling is “double cycle billing,” the practice of computing finance charges based on account balances in billing cycles preceding the most recent billing cycle. It is very difficult for consumers to avoid the increased costs associated with double cycle billing because most consumers simply can’t understand it. This is another area that we address in our proposal.

Like you, we believe that payment allocation practices also require attention. Where an account has balances with different rates (e.g., for balance transfers, cash advances, and charged purchases), most issuers now allocate payments in ascending order from the balance with the lowest interest rate to the highest. This maximizes issuer returns, but is costly for consumers. Moreover, because cardholders have difficulty understanding how issuers allocate payments, it is hard for them to use their cards in a manner that minimizes the cost attributable to these strategies. Your bill would respond to these issues by requiring that issuers allocate payments on a pro-rata basis. We agree

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<sup>15</sup> See 15 U.S.C. 45(n) (unfairness standard codified for FTC use).

<sup>16</sup> See FTC Policy Statement on Deception, Letter from the FTC to the Hon. John H. Dingell, H. Comm. on Energy & Commerce (Oct. 14, 1983) (“FTC Policy Statement on Deception”) (available at <http://www.ftc.gov/bcp/policystmt/ad-decept.htm>)



that payment allocation needs to be addressed, but would offer additional options that could reduce cost for consumers. These might include allocating payments from the highest interest rate balance to the lowest or allocating payments equal dollar amounts to each balance.

Overlimit fees have also generated negative public attention. It can seem counterintuitive that an issuer would permit a cardholder to exceed his or her credit limit - which ostensibly represents the amount of credit for which the cardholder is qualified - and then charge a fee for the transaction that the issuer permitted. The possibility that an issuer would take this approach multiple times during a billing cycle is disturbing. Your bill would respond to these concerns by restricting overlimit fees to one per cycle if the cardholder's credit limit was exceeded on the last day of the cycle. Our research indicates that most issuers are already handling overlimit fees in this manner. We are continuing to gather information in this area.

Finally, your bill responds to serious concerns that have been raised about cards typically offered in the subprime market. All too often, fees imposed when such cards are issued erode most of the credit promised. Your bill would prohibit issuers from imposing fees during the first year an account is open from exceeding 25% of the credit financed. We certainly support efforts to ensure that consumers who are promised credit actually get it.

We appreciate your intentions in introducing H.R. 5244 and would be pleased to work with you and your staff to address these important issues. In crafting our UDAP rule, one of our primary objectives has been to deal with practices that have raised concern about the fairness and transparency of the credit card market.

## **X. Conclusion**

While credit card lending programs are not prevalent throughout the OTS-regulated thrift industry, there are a number of institutions that engage in significant amounts of credit card lending. For our part, we will continue to work with our institutions to ensure safe and sound underwriting standards and strong consumer protections that benefit both the institutions that we regulate and their customers. We will continue to support efforts to strengthen the ability of consumers to make informed decisions with respect to their credit card accounts.

As I said earlier in my testimony, I favor a regulatory solution to protect consumers from any abuses in the credit card lending activities and practices of the thrift industry. I do not believe that additional statutory authority is necessary at this time, with the exception of enhancing the FTC's rulemaking authority and providing the OCC and FDIC the authority to issue joint rules on unfair or deceptive acts or practices as previously indicated. However, at such time as a need should arise, I assure you that we will advise the Chair and Members of the Subcommittee of the need for legislative



assistance to address any deficiency in our ability to supervise and/or respond to thrift credit card lending practices that pose consumer protection, safety and soundness, or other risks to the federal thrift charter.

Thank you, Madame Chairman and Ranking Member Biggert, for holding this important hearing. We appreciate the opportunity to present the OTS's views on these issues.

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