



**Consumer Federation of America**

## ***FACTS ABOUT CONSUMER CREDIT CARD DEBT AND BANKRUPTCY***

### **Documented Connection Between Expansion of Consumer Credit and Increase in Bankruptcy Filings**

Studies by the Congressional Budget Office, the Federal Deposit Insurance Corporation, and independent economists link the rise in consumer bankruptcies directly to the rise in consumer debt.<sup>1</sup>

Deregulation of consumer credit interest rates have not produced a significant decrease in interest rates. Instead, deregulation has prompted aggressive marketing and a loosening of underwriting standards that have contributed to a rise in consumer bankruptcies.<sup>2</sup>

### **The Growth of Consumer Credit Card Debt**

Eighty percent of all households have at least one credit card. With well over one billion cards in circulation, the average household has about a dozen credit cards. About sixty percent of cardholders carry credit card debt from month to month.<sup>3</sup> The average credit card debt for households that carry a balance is more than \$10,000.<sup>4</sup> Americans owe more in credit card debt than for education.<sup>5</sup>

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<sup>1</sup> David Moss & Gibbs Johnson, *The Rise of Consumer Bankruptcy: Evolution, Revolution or Both* 73 Am. Bankr. L.J. 311 (Spring 1999); Diane Ellis, *The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-offs, and the Personal Bankruptcy Rate*, Bank Trends 98-05 (Division of Insurance, FDIC February 1998); Lawrence Ausubel, *Credit Card Defaults, Credit Card Profits, and Bankruptcy*, 71 Am. Bankr. L.J. 249 (1997); Statement of Kim Kowalewski, Chief, Financial and General Macroeconomic Analysis Unit, Congressional Budget Office, before the Subcommittee on Administrative Oversight and the Courts, Committee on the Judiciary, United States Senate, p. 4 (April 1997); Jagdeep S. Bhandari & Lawrence Weiss, *The Increasing Bankruptcy Filing Rate; A Historical Analysis*, National Conference of Bankruptcy Judges (Winter 1993).

<sup>2</sup> E.g., Ellis, *Consumer Interest Rate Deregulation*, *supra* ("Unfettered by any legal limitation on the income they could earn, lenders began to increase the depth of the market by looking for customers further down the spectrum of credit quality"). In 1978, the Supreme Court permitted banks to "export" the interest rate of its home state in its lending activities. *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299 (1978). When some states raised their interest rate caps, the entire consumer credit market was effectively free of all usury laws. The FDIC explains that after the *Marquette* decision, "Some states quickly seized the opportunity to deregulate interest and other banking functions to attract banks and other consumer lenders. . . . [M]ost leading banking states had relaxed or repealed their interest rate ceilings by 1982, and the bank credit market was functionally deregulated." FDIC, *Interest Rate Deregulation*, *supra*.

<sup>3</sup> Cardweb.com.

<sup>4</sup> Consumer Federation of America, September 2001.

<sup>5</sup> Federal Reserve Board. "Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances," *Federal Reserve Bulletin*, January 2000. Amounts are in inflation-adjusted 1998 dollars.

The growth of credit card loans has been faster than any other type of consumer loans.<sup>6</sup> Since 1997, credit card issuers have nearly doubled the amount of credit they offer to consumers, to more than \$3 trillion dollars--about \$30,000 per household.<sup>7</sup> Revolving debt, which is almost entirely card debt, increased from \$554 billion to \$730 billion between 1997 and 2002.<sup>8</sup> During the same period, credit card companies sharply increased the number of solicitations they mailed from three to five billion.<sup>9</sup> This means that in 2001 just about 50 mailings went out to every American household, not counting telephone solicitations.

### **Credit Card Debt Problems Affect Low-income Consumers**

Credit use overall has grown fastest in recent years among debtors with the lowest incomes. In the early and mid-1990s, Americans with incomes below the poverty level nearly doubled their credit card usage, and those in the \$10,000-25,000 income bracket came in a close second in the rise in credit card debt.<sup>10</sup> By 2000, about one-third of lower income families spend more than 40% of their income on debt repayment, compared to 20% of moderate income households and 14% of middle income families.<sup>11</sup> Riskier borrowers typically carry a higher debt burden, pay more interest, and suffer more defaults.<sup>12</sup>

### **Credit Cards and College Students**

Direct solicitation of college students has intensified in the past decade. Cards are available at many colleges to almost any student -- no income, no credit history and no parental signature required.<sup>13</sup> An analysis of credit card debt by the student loan provider Nellie Mae found that in 2000, 78% of undergraduate students had at least one credit card. This is up from 67% of undergraduates in a similar study by Nellie Mae in 1998. In years past, these same students would not have been given credit cards, certainly not without a co-signer. Nellie Mae also found that undergraduates in 2000 carried an average credit card balance of \$2,748, up from \$1,879 in the 1998 study. Graduate students carried an average balance in 2000 of \$4,776.

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<sup>6</sup> OCC Advisory Letter 96-7, Sept. 26, 1996, (96-7.txt at [www.occ.treas.gov](http://www.occ.treas.gov)); FDIC Quarterly Banking Profile Graph Book, Fourth Quarter 1997.

<sup>7</sup> Veribanc, Inc.

<sup>8</sup> Federal Reserve Bulletin, July 2002.

<sup>9</sup> BAI Global, Inc.

<sup>10</sup> "Family Finances in the United States: Recent Evidence from the Survey of Consumer Finances" Federal Reserve Bulletin, p. 1, 21 at Table 14 (Jan. 1997).

<sup>11</sup> Federal Reserve Board. "Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances," *Federal Reserve Bulletin*, January 2000. Lower income households earn less than \$10,000 a year; moderate income- \$10,000 to \$25,000; middle income- \$25,000 to \$50,000.

<sup>12</sup> Sandra E. Black, Donald P. Morgan, "Meet the New Borrowers", 5 *Current Issues in Economics and Finance*, No. 3, p. 1 (Federal Reserve Bank of New York, February, 1999); Jennifer Babson, "Credit-card Debt Not a Liability in this Market" *Boston Globe*, p. F1 (April 4, 1999); Russ Baker, "Credit Quicksand Traps Consumers" *New York Daily News* (September 19, 1999).

<sup>13</sup> Report of the National Bankruptcy Review Commission 93 (Oct. 20, 1997); George M. Salem and Aaron C. Clark, *GKM Banking Industry Report, Bank Credit Cards: Loan Loss Risks are Growing*, p. 9 (June 11, 1996). The Bankruptcy Review Commission received an advertisement for a two-day workshop for creditors entitled "Competing in the Sub Prime Credit Card Market," including a presentation entitled "Targeting College Students: Real Life 101," with tips on how to "target the money makers of tomorrow."

In 1998, more than one quarter of all students reported paying late on a credit card at least once in the previous two years. More than one quarter also report using a cash advance to pay their debts.<sup>14</sup> Few students think through the consequences of failing to pay credit card debts on time, such as classification as a high risk/ high rate borrower.

### **Credit Card Lenders Target Low-income Borrowers and Students Because They Make Minimum Payments, Carry Big Balances, and Pay High Rates of Interest**

Industry analysts estimate that, using a typical minimum monthly payment rate on a credit card, it would take 34 years to pay off a \$2,500 loan, and total payments would exceed 300% of the original principal.<sup>15</sup> Credit card statements, unlike those for mortgage and car loans, do not disclose the amortization rates or the total interest payout at the minimum rate.<sup>16</sup>

Credit card issuers earn about 75% of their revenues from the interest paid by borrowers who do not pay in full each month. Several companies have instituted charges or even canceled credit cards for customers who pay in full each month, preferring customers with large credit balances who pay minimum monthly payments.<sup>17</sup>

### **Credit Card Profitability**

Credit card profits continue to be significantly higher than for other bank lending activities. Bankcard profits increased in 2001 to their second highest level in the last five years (3.24% of outstanding balances.) Growing profits were largely driven by the increasing “interest rate gap” between the benchmark rate set by the Federal Reserve, which dropped significantly, and interest rates charged by card issuers to consumers. In 2001, the Federal Reserve cut interest rates by 4.75%, but major bankcard issuers cut their rates by only 1.35% on average.<sup>18</sup>

### **Credit Card Debt and Bankruptcy Losses**

Industry consultants estimate that credit card companies could cut their bankruptcy losses by more than 50% if they would institute minimal credit screening.<sup>19</sup>

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<sup>14</sup> The Campus Credit Card Trap, (U.S. Pirg, Sept. 1998).

<sup>15</sup> George M. Salem and Aaron C. Clark, GKM Banking Industry Report, Bank Credit Cards: Loan Loss Risks are Growing, p. 25 (June 11, 1996).

<sup>16</sup> See 11 U.S.C. § 1637. A provision which would require new Truth in Lending disclosures on these issues was included in the bill passed by the Senate (§ 209), but deleted from the Conference Report.

<sup>17</sup> David S. Evans & Richard L. Schmalensee, The Economics of the Payment Card Industry Fig. 3 (1993). Beneficial National Bank of Delaware canceled the Mastercards for 12,000 customers who pay their bills in full; they are expected to cancel another 30,000 customers soon. Other lenders, such as NationsBank and GE Rewards MasterCard have imposed fees or canceled cards for customers who pay their bills in full. Bruce Mohl, The careful debtor loses credit at BJ's, The Boston Globe A1, col.1 (Sept. 25, 1997).

<sup>18</sup> Federal Reserve Board, “The Profitability of Credit Card Operations of Depository Institutions,” June 2002.

<sup>19</sup> Fair, Isaac & Co. released a new bankruptcy predictor that it says can eliminate 54% of bankruptcy losses by screening potential non-payers from the bottom 10% of credit card holders. Fair, Isaac & Co. @ [www.fairisaac.com](http://www.fairisaac.com); Credit Cards: Fight for Bankruptcy Law Reform Masks Truth, 162 Am. Banker 30 (September 8, 1997).

Some institutions now invest in bad credit card debt. For example, Commercial Financial Services acquires credit card debt that has been charged off as uncollectible from 25 of the largest credit card issuers, packages the debt into securities which it sells to investors, then pursues new collection activities against the customers. CFS securitized \$1 billion in charged-off credit cards in 1997, and plans to securitize \$1.5 billion this year.<sup>20</sup>

The FDIC observes that by marketing high-risk debt to customers who are at substantial risk for non-payment, credit card issuers have contributed to the rise in consumer bankruptcies.<sup>21</sup>

Banks actively solicit debtors for new credit after they file for bankruptcy. Industry analysts explain that these debtors are attractive because they have shown they will take on credit and, by law, they cannot seek a bankruptcy discharge for another six years.<sup>22</sup>

In response to reckless lending practices, federal regulators have begun to require lenders to be more responsible. In January of 2003, the Federal Reserve Board, FDIC, and other bank regulators issued new regulations requiring credit card companies to tighten up “account management and loss allowance practices”—such as the use of very small required minimum payments that keep consumers’ liable for their debts for many years—that may endanger the financial stability of the lending institutions.<sup>23</sup>

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<sup>20</sup> See OCC Comptroller's Handbook on Credit Card Lending, at 44-48 (Sept. 1996); CFS Stays Private While Getting Bigger, Private Placement Report, 1, 1998 WL 5034591 (Jan. 12, 1998).

<sup>21</sup> E.g., Ellis, Consumer Interest Rate Deregulation, *supra* at 5-6 (“The dismantling of usury laws opened wide the doors to new markets for credit card lenders. . . . [W]hen interest rates were deregulated, less credit rationing occurred and higher-risk borrowers were allowed into the market. . . . [I]nterest rate deregulation altered the credit markets and led to a substantial expansion in credit availability, which has led to an increase in the level of borrower credit problems, including personal bankruptcy.”).

<sup>22</sup> Dr. Michael Staten, Director, Credit Research Center, Krannert School of Management, Purdue University, Working Paper No. 58 The Impact of Post-Bankruptcy Credit on the Number of Personal Bankruptcies (Jan. 1993). See Like Marines, Credit Card Solicitors are Always Ready, Consumer Bankruptcy News, p. 18 (Aug. 27, 1998) (letter from Judge John C. Akard enumerating 53 post-petition credit card offers to chapter 13 debtors Keith and Debra Lazenby).

<sup>23</sup> Federal Financial Institutions Examination Council, the Office of the Comptroller of the Currency, The Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision, January 8, 2003, NR 2003-01.