

DCC DOLLARS & \$ENSE

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The Secret History of the Credit Card

A review of the PBS Frontline program

Special points of interest:

- The banking industry's definitions of consumers.
- Reforms to Improve Consumer Protection.
- Credit Agreement Terms Revealed.
- How Interest Rates Became so High
- More Complaints Than any Other Industry

A PBS Frontline program created in association with *The New York Times*, investigated an industry, "few Americans fully understand". Documented by Lowell Bergman, the credit card industry was investigated as to the techniques used to entice consumers further into debt, and thereby earn record profits.

Bergman stated "The almost magical convenience of plastic money is critical to our famously compulsive consumer economy, with more than 641

million credit cards in circulation and accounting for an estimated \$1.5 trillion of consumer spending, the U.S. economy has clearly gone plastic."

The hour-long program highlights several aspects of the credit card industry, broken down into five main chapters. Here is a brief overview of what was covered, but we encourage you to view the whole program.

<http://www.pbs.org/wgbh/pages/frontline/shows/credit/view>

Chapter 1 "Over a Thousand Miles from Wall Street"

Sioux Falls South Dakota, is the credit card capital of the world. In 1979, South Dakota began making changes to their historical laws on interest rates, called "Usury Laws". The original laws limited the interest rates that banks could charge a consumer. Previously a bank was limited to charging 12% interest to a consumer while they themselves were charged 20%. Therefore, there was very little lending in South Dakota for mortgages or any

other loans.

The new Usury Laws eliminated the cap on interest rates, and allowed banks to charge higher rates. These changes encouraged consumer lending. However, now there was no regulation as to how much consumers could be charged.

Another legal change in Usury Laws was the Marquette Bank decision, by the Supreme Court. This allowed banks to charge interest to all consumers under the Usury Laws of the state where the lending institution was located, regardless of where the consumer is located. Therefore if South Dakota had no cap on interest, a bank operating out of South Dakota, could effectively charge you 20% interest, even if you were located in another state with a cap of 9%.

Chapter 2 "A Closer Look at The Industry's Best Consumers"

In the banking industry, there are two types of debtors, "revolvers" and "deadbeats". Contrary to the name, deadbeats are not consumers that don't pay their bills, but rather those who pay their bills *in full* each month. Avoiding interest and penalty fees and reducing the bank income.

Revolvers, or the "Sweet Spot" as Ed Yingling, incoming president of the American Bankers Association calls them, are the 35 million Americans who carry a balance on their card each month, paying the minimum or slightly more.

Chapter 3 "Credit Reporting Agencies/Traps in the Fine Print"

The three major credit-reporting agencies are Experian, Transunion and Equifax. These agencies are gathering information daily on consumers and building up consumer records, the information is used by

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banks to determine a consumers credit risk.

Fair Isaac and Co. has worked to compile a mathematical formula to work with this data to determine a consumer's credit score. "The median FICO score is 720 out of a possible 850. The riskiest customers have scores below 600. The score is an indication of how likely you are to pay your bills," States Tom Quinn, a representative for Fair Isaac and Co. "Lenders use that score almost like a thermometer to determine if they're going to grant credit or not. So the algorithm is an indication of that consumer's future risk, in terms of credit behavior."

The Fine Print

Though the information contained in a credit contract is difficult to understand, it shouldn't be overlooked. Several "traps" are included in the agreement. The most common trap identified is "Universal Default" which states that if you default the agreement of any card, your rates can be increased. Or, if you take on additional credit, a lender can determine that you've become over-extended, and raise your rate because you are now a "riskier" client. How do they determine that you've defaulted or taken on more debt? Through the network of credit reporting agencies.

Consumers should be aware of and understand that the terms of their revolving credit agreement can be changed at any time with only a 15-day notice. Even without a universal default clause in the initial agreement, it can always be added by the lender.

In 1996, another important Supreme Court decision opened the door to bigger profits for the credit card industry and a raft of new complaints from their customers. That decision; *Smiley vs. Citibank*, much like the *Marquette* decision, lifted state restrictions, this time on the fees that credit card banks could charge. The change instigated increases in fees for "riskier" clients.

Chapter 4 "More Complaints Than any Other Industry"

The Office of the Comptroller of the Currency (OCC), part of the Treasury Department, regulates national banks. Julie Williams, the acting Comptroller, states the OCC has three goals, "to make sure that the banks don't fail, to ensure the integrity of how the banks operate, their corporate governance, and to make sure that they deal fairly and honestly with their customers."

According to Frontline, "In Washington, the OCC has been increasingly asserting its authority and attempting to curb consumer enforcement actions by local prosecutors. This

has sparked a nationwide battle, led by the attorneys general in all 50 states." Leaving the impression that there is a "turf" war between the states and the OCC regarding consumer protection.

Pat Wallace of the Bay Area Better Business Bureau stated "It's not an accident that the banking/credit card business, generates more complaints, nationally, across the country, than any other industry. Now, what does that say to you? Out of 1,000 industries that we track, they're number one. I'd say there's a problem here. These things aren't an anomaly." Julie Williams, the acting Comptroller of the OCC was not aware that the largest number of consumer complaints, was the banking/credit card business..

Chapter 5 "The Efforts to get Reform"

Senn. Christopher Dodd (D), Connecticut, believes "Virtually everyone who holds a credit card, one way or the other, under existing laws today and provisions, can be completely taken advantage of by the credit card industry." He is working to do something about it. According to Frontline, "In the summer of 2004, Sen. Dodd introduced a credit card reform bill that would, among other things, require credit card companies to disclose how long it would take consumers to pay off their balance."

Senn. Dodd is not however, optimistic. His attempts at previous reforms were not passed. Despite the lack of optimism and previous failures, he continues to work to "inject some responsibility on the part of this credit card industry."

This program presented by Frontline, is valuable consumer information which we have only highlighted. We encourage all consumers to set some time aside and watch the full program to gain a better understanding of how the industry came to be what it is today, and to learn about the effects that it may have on you.

Please use the following URL address to watch the complete program:

<http://www.pbs.org/wgbh/pages/frontline/shows/credit/view/>