Credit Cards

Ashley & Elizabeth

1914
METAL MONEY

- Western Union gave their privileged customers a metal card that allowed them to have interest free deferral payments.

WWI-WWII

- Because people couldn't purchase one of his vehicles outright, Henry Ford began offering car loans and personal financing.
- For a period during WWII credit use was restricted
- This caused people to want to 'charge it' even more.

1950

Would you believe I forgot my wallet?!?!

- Frank McNamara was out to dinner with friends and realized he had no money

To avoid this problem in the future, he and a partner created the "Diner's Club Card".

- In his mind, no longer would people be bound to only the cash they had in their pockets when they were out on the town.

Initially it was a business man's card, to be used for dinners and retail purchases while traveling

- Business men loved the idea that they could pay for some of their travel expenditures and worry about the cost later
- McNamara loved it because when people don't have cash in hand, they tend to spend more.

"'What is this with people wanting credit?'" Walter Wriston, a Citibank employee, recalled being asked by his boss. "And I said, 'Look, we just put five years of our life in a brown suit carrying an M1 rifle, and we want the refrigerator now.' "

1955

- Western Airline accepted Diner's Club to pay for flights.
- Within ten years, every other major airline followed suit.
- By securing the traveler's market, through restaurants, airlines, and retail stores, McNamara and his partner paved the way for the current system of credit cards.
- Diner's Club is still one of the top five credit card options all over the world.

1958

- Bank of America launched the nation's first general-purpose credit card in 1958, by mass mailing 60,000 credit cards to residents in Fresno, California.
- During World War II resources were tight. Bank of America hoped to use this to their advantage by providing a new type of revolving credit line, where people could make purchases anywhere, anytime, and pay it off over time.
- This produced little profit and a lot of default
- People were outraged and called the credit cards a "usurious temptation"

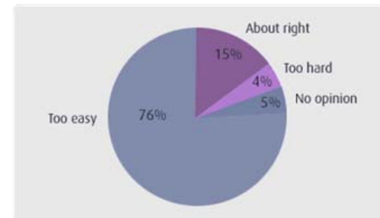
1966
"the Chicago debacle"

•Just before Christmas five million credit cards were mailed by a group of Midwestern banks in an effort to be the first to reach an untapped Chicago market of holiday shoppers.

•Cards were mailed to convicted felons, toddlers, and dogs. Nightly news reports ran stories about corrupt postal workers feeding stolen cards to organized crime rings. Suburban housewives who had never received cards were getting billed for thousands of dollars of charges.

•At the Congressional hearings that followed, some critics even demanded that credit cards be outlawed.

1967
Public Opinion Poll



1970's

•Technological innovations made credit card issuing more profitable.

- •1970 Introduction of the magnetic strip for credit cards
- •1979 Visa introduces the first electronic dial terminal at the point of sale, which allows for much speedier purchase transactions. This leads the way to electronic data capture (EDC) point-of-sale terminals, which virtually eliminate the time-consuming process of paper deposits.

1970's cont.

- Fraud was receding and banks were finally beginning to see profits after sending out more than 100 million credit cards.
- One is a 1978 Supreme Court ruling that held that the law of the state where a credit card is issued governs the interest rate charged to card holders, no matter where they reside.
- Two competing umbrella associations, known today as Visa and MasterCard, linked nationwide networks of merchants.

MasterCard

- It was originally created by United California Bank, Wells Fargo, Crocker Bank, and the Bank of California as a competitor to the BankAmericard issued by Bank of America. BankAmericard is now the VISA credit card, issued by Visa International.
- The name **Master Charge** was licensed by these California banks from the First National Bank of Louisville, Kentucky in 1967. With the help of New York's Marine Midland Bank (now HSBC Bank USA), these banks joined with the Interbank Card Association (ICA) to create "Master Charge: The Interbank Card".
- In 1979, "Master Charge: The Interbank Card" was renamed "**MasterCard**".

Visa

- **1958** Bank of America, based in San Francisco, California, issues BankAmericard. With the state of California as its market, the card is an early success, and it is the first "revolving-credit" card with universal merchant acceptance, allowing cardholders the option of paying their account balance in installments with a monthly finance charge applied to the remaining balance
- **1976** BankAmericard changes its name to Visa, a simple, memorable name with an international flavor that is pronounced the same way in almost every language. NBI is renamed Visa U.S.A. and IBANCO is changed to Visa International.

1980
"South Dakota saved Citibank."

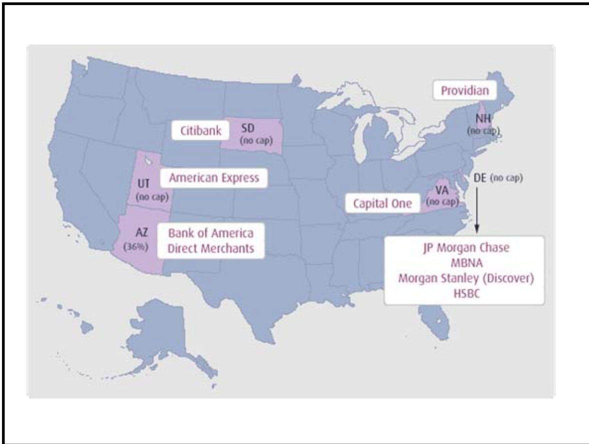
- South Dakota's economy was struggling
- Citibank was in trouble because the rate of inflation exceeded what usury laws said Citibank could charge its customers. They were charging 12% interest, but paying 20% interest.
- Citibank hoped New York lawmakers would make legislation in Citibank's favor because Citibank employed 3,000 people in its credit card unit in Long Island, but New York declined.
- A team of top executives went to South Dakota and proposed to Governor Bill Janklow that if South Dakota would quickly pass legislation enabling Citibank to charge higher interest rates they would move their credit card operations to the state, bringing hundreds of high-paying white collar jobs to South Dakota

1980's cont.

- Governor Janklow proposed a special "emergency" bill which passed in the South Dakota legislature in one day.
- Delaware passed similar legislation in 1981.
- Citibank made nearly $30 billion in net revenue in 2003

1981
New York Times Article

"… in nearby states, such as New York, New Jersey, Pennsylvania and Maryland…large banks are already planning to move and state officials are worried about the loss of tens of millions of dollars in potential revenue. While the Delaware bill was pending, Anthony B. Solomon, president of the Federal Reserve Bank of New York, voiced concern about the state's bankers moving too much of their business outside New York. The new Delaware law, which has yet to attract a bank into the state, has caused considerable controversy beyond its borders."



1980-1990

- Elimination of usury restrictions opened up the way for double-digit growth in the credit card industry.
- Even after inflation subsided and the Federal Reserve lowered the interest rates it charged banks, cardholders were still willing to pay 18% interest.
- In 1980 President Carter, in an effort to get a handle on inflation, imposed a freeze on soliciting for new credit card accounts.
- Credit card companies began introducing a $20 annual fee without running the risk of losing customers. This helped cover costs in unprofitable areas and increase revenue.
- Between 1980 and 1990, the number of credit cards more than doubled, credit card spending increased more than five-fold and the average household credit card balance rose from $518 to nearly $2,700. With the cost of money sinking and average balances climbing, profits soared.

1990's
…and "the big scare"

- 1990 AT&T offered a no annual fee credit card. On its first day, the offer generated 260,000 phone calls.
- Competitors quickly began offering no annual fee credit cards as well.
- November 12, 1991 President Bush's aide made last minute changes to a speech the president made, stating, "I'd frankly like to see credit cards rates down. I believe that would help stimulate the consumer and get consumer confidence moving again."
- Alfonse M. D'Amato, a senator from New York, was concerned about the 10-point gap between the prime rate and the interest rate typically charged to cardholders. The next day, Sen. D'Amato proposed national legislation to cap credit card interest rates at 14 percent.
- After about 30 minutes of debate, the Senate voted 74-19 to approve the measure

The Big Scare cont…

•This sent the banking industry into a panic and economists began speculating about huge bank failures, causing the stock market to plunge.
•Vice President Dan Quayle said if the proposed cap survived a House vote, it would likely be vetoed.
•The bill was dropped
•Because of the scare to the industry, it caused change in how credit card companies loaned money. Credit cards moved from a straightforward loan at 18% to more complex financial formulas including ever-shifting terms and prices

1996

•The U.S. Supreme Court made a ruling clearing the way for higher fees.
•Credit card companies took advantage of this and began more widely using penalty fees.

Credit Card Debt **EXPLOSION!**

- Some general figures to know…
- Credit Card debt within the USA:
  - Tripled since 1989
  - 31% increase just since 2000
  - $800 billion owed in credit card debt
  - Contributes to personal bankruptcy filings:
    - In 1989: 616,000 vs. In 2004: 1.8 million

- **The Plastic Safety Net:** The Reality Behind Credit Card Debt in America
  - Prior to this study, there have been few studies that analyze how households use credit cards & how they manage their debt
- New report released 10/12/2005 by Demos & the Center for Responsible Lending
- Existing data sources (tracking debt): Federal Reserve Board's triennial Survey of Consumer Finances
- Too little is known about the causes of America's household debt crisis
- Often data provides limited information & does not answer basic questions such as:
  - How long households have been in debt
  - The type of charges that lead to outstanding balances

Sources

- To view the full report:
  - http://www.demos-usa.org/
  - http://www.demos.org/
  - http://www.responsiblelending.org/
  - http://www.prnewswire.com

Credit Card Use **TODAY**

- $8,650 is average credit card debt of a low/middle income indebted household within America
- 59% of respondents in credit debt for longer than 1 year, with an average length of 3.5 years
- 7 of 10 low/middle income households reported using their credit cards as a so-called **"safety net"**
- In essence, relying on credit to pay for unforeseen expenses, such as:
  - Car repairs
  - House repairs
  - Medical expenses
  - Basic living expenses

Tamara Draut,

Director of the Economic Opportunity Program at Demos & co-author of report

- "American families are facing financial hardship not experienced for generations, and we commissioned this survey to tell us precisely why they are turning to credit cards so often."
- "The results are clear: wages have stagnated while medical and housing costs have skyrocketed, and if confronted with a layoff or health emergency there are few, if any, personal or public safety nets adequate enough to help in a crisis. Households are turning to high-cost credit cards to keep afloat."

Credit Card Use **TODAY**

- 20% of survey homeowners had paid off some credit card debt with a mortgage refinance in the last 3 years, reducing their home equity $12,000 on average
- Further, these households still had average credit card debt over $14,000
- As a result, they were carrying 18% more debt than homeowners who had refinanced a mortgage but not paid down credit card debt – even though their incomes were almost identical.
- **In other words, they were trading unsecured credit card debt for higher mortgage debt secured by their home**

Credit Card Use **TODAY**

- 47% of households have been called by a bill collector
- ½ missed or were late with a payment within the last year
- ¼ of households paying a late fee 1-2 times within the last year
- Late fees range from $30-$39
- In addition to late fees, most issuers also penalize cardholders for late payments by increasing the interest rate on the account two or three fold, *often after only one late payment!*
- A household with the average amount of credit card debt ($8,650 in their survey) would pay an additional $1,100 in costs *each year* if their credit card's interest rate was increased from typical 12% to the average 25% "default rate" for just *one late payment.*

College Students & Credit Cards

Ask yourself:
Does any of this apply to **YOU**?

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- OppenheimerFunds, Inc. is widely recognized as a leader in education & empowering investors
- Conducted by Smith College's Women & Financial Independence Program (WFI)

OppenheimerFunds,Inc.

- Study began in March 2004
- This is 1st of a three-part study
- Survey was administered to 2,763 undergraduate, graduate & professional students nationwide
- More than 700 (of 2,763) responded regarding credit card use

College Students **USAGE**

- Vast majority of college students are in credit card debt larges from use of credit cards to purchase personal items:
  - Toiletries
  - Clothing
  - Accessories
- 65% of college students carry credit card debt
- Over 50% charge their cards to the limit some or most of the time
- More than ½ (58%) said they never pay balances in full or pay less than half of the time
- Nearly 20% of students do NOT know what the APR is on the credit card they use MOST
- The average credit card debt among respondents is $2,400
- Yet 14% owe more than $5,000

College Students **USAGE**

- Female & Male students use credit card differently
- Female students are more likely to have credit card debt (67% female vs. 59% male) and a larger credit card debt burden.
- 11% of women surveyed report credit card debt of $3,001 - $5,000 compared to 7% of men
- These same percentages (%) hold true for debt of $5,001 - $10,000
- 68% of women use more than one credit card compared to 59% of men
- College women are 50% more likely to carry 5+ cards than men

College Students **USAGE**

- When do students use their cards?
- Most college students use their credit cards to pay for day-to-day living expenses ("nickel and diming it") instead of long-term needs
- Textbooks & school supplies (52%)
- Tuition & Fees (22%)
- Personal Items (58.5%)
- Car expenses (55%)
- Groceries (46.7%)

Side Effects of Increased Credit Card Use

- With the increase use of credit cards, also came increased identity theft
- As more households began using credit cards, more Americans began incurring excessive debt and the number of bankruptcies increased

Fair & Accurate Credit Transactions-The FACT Act

- To combat the increase in identity theft, congress put in place regulations to help consumers protect their identity and credit reports
- Part of the problem was that financial institutions, regulators, and law enforcement had different definitions of what identity theft was.

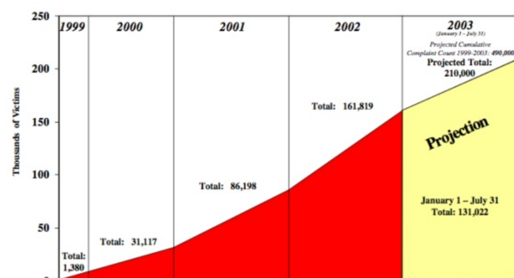


Figure 1

The FACT Act

- The definition for "identity theft" used by law enforcement agencies and federal regulators was: the range of illegal activities that leverage a piece of personal information – defined in the act as a "means of identification" – to perpetrate a crime.
- The financial services industry tends to classify the fraudulent use of stolen card numbers as payment card fraud rather than identity theft.

The FACT Act

The Federal Trade Commission's final rule defined identity theft as:

- (a) A fraud committed or attempted using the identifying information of another person without authority.
- (b) The term "identifying information" means any name or number that may be used, alone or in conjunction with any other information, to identify a specific person, including any
  - 1) name, Social Security number, date of birth, official State or government issued driver's license or identification number, alien registration number, government passport number, employer or taxpayer identification number;
  - 2) unique biometric data, such as fingerprint, voice print, retina or iris image, or other unique physical representation;
  - 3) unique electronic identification number, address, or routing code; or
  - 4) Telecommunications identifying information or access device (as defined in 18 U.S.C 1029(e))

The FACT Act

Now, besides using the definition of identity theft to trigger penalties in the criminal code, the FACT Act applies the definition to consumer rights and protections that assist in preventing identity theft and, in the case of victimization, in remedying its effects.

The FACT Act

1. Empowers consumers to guard against identity theft by increasing the effectiveness of consumer initiated fraud alerts and enabling consumers to block fraudulent information in their personal credit records after filing a police report;
   - Consumers now only have to make ONE call, to one of the credit agencies, to have an alert placed on all three bureaus. An initial fraud alert lasts 90 days and entitles the consumer to request a free credit report. After filing an identity theft report with any law enforcement agency, a consumer can place an extended alert for up to seven years, and may request two additional free credit reports over a 12 month period to help the consumer monitor his or her credit history.

The FACT Act

2. Increases consumer awareness of their rights if they believe they may be victims of fraud or identity theft;
   - ensures that victims know their rights regarding the identity theft provisions of the FCRA, and can collect proof of the identity theft from businesses that dealt with the thieves. *Sec. 151* also requires the Federal Trade Commission (FTC) to implement a campaign to teach the public how to prevent identity theft.

The FACT Act

3. Improves the accuracy of consumer credit information by discouraging the reintroduction of fraudulent information into the credit reporting system
   - Identify patterns, practices, and specific forms of activity that can compromise the accuracy and integrity of information furnished to consumer reporting agencies.
   - Review the methods (including technological means) used to furnish consumer information to consumer reporting agencies.
   - Determine whether furnishers maintain and enforce policies to assure the accuracy and integrity of information furnished to consumer reporting agencies.
   - Examine the policies and processes employed by furnishers to conduct investigations and to correct inaccurate consumer information that has been furnished to consumer reporting agencies.

The FACT Act

4. Expands consumer access to credit information to ensure accuracy by giving consumers the right to request a free credit report and credit score analysis annually;
   - permits a consumer to receive at least one free copy of the consumer's credit report annually from each of the three nationwide credit bureaus whether fraud is suspected or not. The FTC must prepare a model summary of the rights of consumers under FCRA, including their rights to obtain free copies of credit reports under all of the circumstances permitted and to dispute information contained in their credit reports.

5. Simplifies consumers' ability to limit unsolicited offers of credit;
   - requires the FTC to simplify existing notices of how consumers can remove their names from lists that are compiled for financial institutions to make unsolicited credit card and insurance offers. This section expands a two-year opt out period to five years. The FTC is required to actively publicize and conspicuously post on its website the address and toll-free telephone number that consumers can use to opt out from receiving unsolicited credit card and insurance offers.

The FACT Act

6. Enlists financial institutions' support in fighting identity theft by requiring them to develop procedures to "red flag" identity theft, investigate certain changes in customer addresses, and truncate credit and debit card information;
   - Requires federal regulators to establish red flag guidelines for financial institutions to use to detect identity theft in customer accounts.

The FACT Act

7. Directs regulators to determine how to increase the prompt investigation and correction of disputed information in a consumer's credit file;
   - Weigh such a regulation's benefits to consumers against the costs on furnishers and the credit reporting system.
   - Determine the impact of such a regulation on the overall accuracy and integrity of consumer reports.
   - Determine if direct contact by the consumer with the furnisher would likely result in the most expeditious resolution of any dispute.
   - Weight the potential impact on the credit reporting process if credit repair organizations are able to circumvent provisions which state that the direct dispute rules shall not apply when credit repair organizations provide notices of dispute on behalf of consumers

The FACT Act

8. Removes the sunset from the expiring uniform national consumer protection standards to make them permanent.

9. Allows consumers to block fraudulent information from the credit report
   - requires credit bureaus to stop reporting any information that a consumer has satisfactorily identified as resulting from identity theft, and to notify the furnisher of the information about the block.

The FACT Act

- These tools enable identity theft victims to limit true name fraud's effect on their credit scores and on their ability to qualify for future loans.

- The article suggests that definitions do matter and that a more refined set of generally accepted definitions would lead to improvements in at least three critical areas in the search for solutions to identity theft crime. These include:
  - measuring the success (or failure) of efforts to fight this crime
  - educating consumers about the risks and responses to this crime
  - coordinating mitigation strategies across stakeholders and geographies.

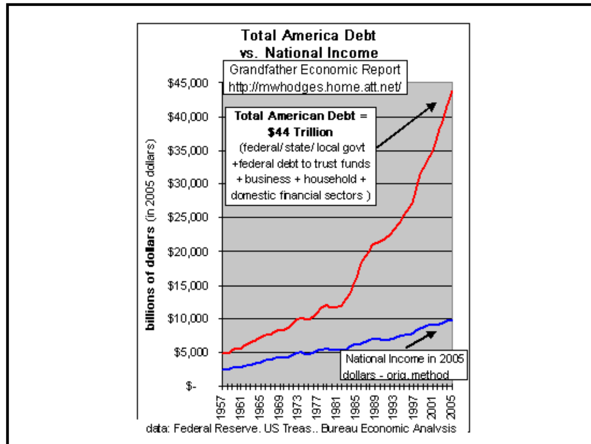
The FACT Act

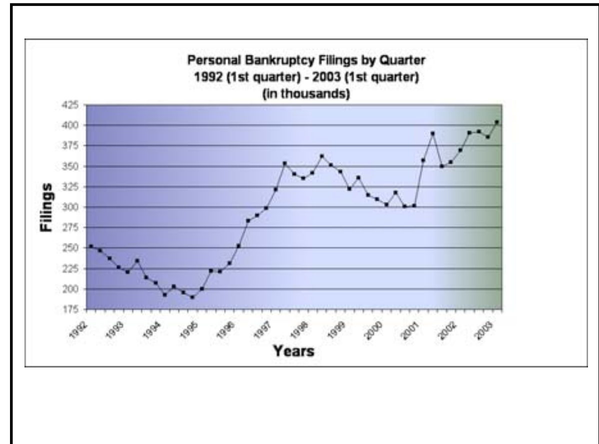
How might the FACT Act benefit households?

How might it be a detriment?

The American Household Debt Crisis

With increased credit card usage comes increase debt...





Minimum Payment Regulations

To help combat the increase in debt and bankruptcies caused or affected by credit card debt, new regulation has been made to increase the minimum payment to help consumers pay off credit card balances

Regulation changing the minimum payment requirement

- The Office of the Comptroller of the Currency (OCC) charters, regulates, and supervises all national banks.
- Under rules instituted by the Office of the Comptroller of the Currency (OCC) in 2003 and phased in through the end of 2005, the minimum amount required for paying a credit card balance each month increased from 2% to 4% or more, depending on the bank that issued the card.
- If your debt is $15,000, for instance, and you pay $300 a month with an interest rate of 13 percent, it would take you nearly twenty years to pay off the debt, with nearly $9,000 in interest, according to the Cardweb.com credit card information site.
- Doubling the payment to $600 would enable you to pay off the debt in 29 months, with interest of $2,3667.56.

The Bad News

- The average American carries roughly $10,000 in credit card debt, and though raising the monthly minimum may help them get out of debt faster, those already struggling to make their payments may see this as more burden than blessing.
- Many Americans do not have the financial means to pay off their debts any faster. Retirees on fixed incomes, young adults just getting out of college, and low-income families may have a tough time adjusting their debt load to meet the new payoff rate, especially with rising gas prices and the high cost of housing.

But…

- Monthly payment requirements had been set so low that borrowers who paid the minimum payment might see their balances increase, even if they made no new charges. Under this new plan balances would be more likely to go down, even if the account has a high interest rate.
- In a statement made by the OCC, they said, "We recognize that the change in required minimum payments will make it more difficult for some existing credit card borrowers to pay the full amount of the increased minimum payments due. We have encouraged lenders to work with these borrowers to the maximum extent possible to avoid writing down the loan and cutting off the customer's credit."
- The OCC also said, "In addition, lenders always have the option of reducing high interest rates charged to delinquent borrowers – sometimes exceeding 30 percent of the outstanding loan balance – and/or waiving fees in order to reduce a minimum payment while still amortizing a modest amount of the outstanding principal."

And…

- A recent survey by the American Bankers Association showed that 42 percent of card owners paid their balances off in full each month, up from 39 percent in 2004.
- Others applaud the higher minimum payments, even if they cause short-term pain for some consumers. Most economists agree that American consumers are saving way too little and carrying way too much debt.

Minimum Payment Increase

Who benefits from this new regulation?

Who does this new regulation hurt?

Another Twist

to the new minimum payment requirements

"Universal Default"

- This clause has been around since at least 2003, before 10/17/2005 bankruptcy reform
- Recent bankruptcy reform laws say nothing about the legality of universal default
- Universal default is usually a hidden clause in the fine print of your credit card agreement,
- States that if you are more than 30 days late on "any payment to anyone," the interest rate on your credit card could automatically increase to as much as 29.9% and your FICO (credit) score could be damaged as a result.
- The universal default provision is becoming more common while customers are adjusting to the new regulation designed to encourage them to pay off credit card debt quicker.

"Universal Default"

- U.S. Comptroller of the Currency has yet to rule on whether universal default is illegal.
- Office has warned banks & other credit card issuers that they must "properly notify consumers in writing and with a larger type size on their offers and agreements when discussing default and universal default."

"Universal Default"

- The American Bankruptcy Institute said: "Higher minimum credit card payments (now required by 2003 guidelines from the Federal Reserve, Federal Deposit Insurance Corp., Office of the Comptroller of the Currency & Office of Thrift Supervision) will put a squeeze on many households, causing more consumers to go into default status. The American Bankruptcy Institute expects more filings from low-income consumers who can't handle higher credit card payments. Yet it may not be feasible for some to declare bankruptcy because of the stricter bankruptcy rules that have taken effect."

"Universal Default"

- Did **YOU** know about this clause prior to this class?

Policy Recommendations

- Debt is not a safety net: reforms to promote economic security are as follows:
  - Promote increased savings, not increased debt, to help families meet unexpected financial emergencies
  - Improve wages for working families
  - Improve access to affordable health insurance for all Americans
  - Strengthen unemployment insurance coverage and benefit levels

Suggested Reforms for Fair Credit & Lending

- Reform "penalty pricing" that saddles financially-vulnerable consumers with thousands of dollars in extra fees and interest costs
- Require changes in credit card rates and fees to be related to the original contract and limited to future activity on the consumer's account
- Clearly disclose to consumers the long-term costs of making only minimum payments
- Ban binding mandatory arbitration clauses that prevent consumers from pursing complaints in a court of law
- Require meaningful underwriting standards to ensure credit limits do not exceed a consumer's ability to repay their credit card debt

What do YOU think?

(regarding suggested policy reforms)

This is much easier said than done!

Reforming this policy leads to many other policy issues…