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(Statement of Associate Professor Adam J. Levitin,  
Geo. U. L. Center)

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**Written Testimony of**

**Adam J. Levitin**  
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**Georgetown University Law Center**

Before the  
United States House of Representatives  
Committee on the Judiciary  
Subcommittee on Commercial and Administrative Law

Hearing: Consumer Debt — Are Credit Cards Bankrupting Americans?

April 2, 2009

## **Witness Background Statement**

**Adam J. Levitin** is an Associate Professor of Law at the Georgetown University Law Center, in Washington, D.C., where he specializes in bankruptcy and commercial law and directs the Georgetown-Hebrew University in Jerusalem Executive LLM Program in Business and Commercial Law. Before joining the Georgetown faculty, Professor Levitin practiced in the Business Finance & Restructuring Department of Weil, Gotshal & Manges, LLP in New York. Professor Levitin has also served as Special Counsel for Mortgage Affairs for the Congressional Oversight Panel, as an expert witness for the FTC and FDIC on credit card litigation, and as law clerk to the Honorable Jane R. Roth on the United States Court of Appeals for the Third Circuit.

Professor Levitin's research focuses on financial institutions and their role in consumer and business finance, including credit card and mortgage lending, securitization, identity theft, DIP financing, and bankruptcy claims trading. His articles have appeared in numerous law reviews and finance journals and have won the 2007 Editors' Prize of the *American Bankruptcy Law Journal* and the 2009 Article Prize of the American College of Consumer Financial Services Lawyers. Professor Levitin is also a regular commentator on *Credit Slips*, a blog devoted to credit and bankruptcy issues.

Professor Levitin holds a J.D. from Harvard Law School, an M.Phil and an A.M. from Columbia University, and an A.B. from Harvard College, all with honors.

Professor Levitin has not received any Federal grants nor has he received any compensation in connection with his testimony and does not represent any party with regard to credit card regulatory issues.

Mr. Chairman, Members of the Subcommittee:

I am pleased to testify today about credit cards and bankruptcy. The credit card is one of the great innovations in the American consumer economy in the 20<sup>th</sup> century. Credit cards are, in many respects, an excellent product. Credit cards supply consumers with both an extremely convenient payment method and an easy source of financing. Credit cards are the dominant method of consumer financing for everyday purchases.

Credit cards, however, are also a product that can be misused by both consumers and card issuers. Consumers can use cards irresponsibly, and banks can issue cards and extend credit limits irresponsibly. Unfortunately, credit card business models and product design encourage unsustainable and irresponsible lending that leaves consumers mired in debt and which hurts responsible creditors like small businesses, landlords, tort victims, and the government. The 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) promotes these predatory business models and product designs, and I urge the Congress to consider repealing key parts of the BAPCPA. I also urge the Congress to consider more comprehensive credit card reform that includes standardization of cardholder agreements and simplification of credit card price structures.

I wish to make four main points in my testimony today:

(1) Credit card debt is a major factor in consumer financial distress and bankruptcy.

(2) Credit card product design and business models are an important factor in high levels of card debt.

(3) The BAPCPA encourages credit card product design that fosters unsustainable credit card lending at the expense of consumers and responsible creditors.

(4) A comprehensive approach should be taken to credit card reform legislation, and part of that approach should be the standardization of cardholder agreement terms and the simplification of credit card pricing. Simplified pricing and standardized terms will allow disclosure to function and make a safer, fairer, and more transparent card market.

#### **I. CREDIT CARD DEBT IS A MAJOR FACTOR IN CONSUMER FINANCIAL DISTRESS**

Credit card debt is a major factor in consumer financial distress. Data on credit card use and financial distress is limited, but an examination of credit card debt and bankruptcy filings shows that consumer bankruptcy filers are mired in credit card debt. 87% of consumer bankruptcy filers have credit card debt at their time of filing.<sup>1</sup> In 2007, the median consumer bankruptcy filer with credit card debt had \$16,576.00 in credit card

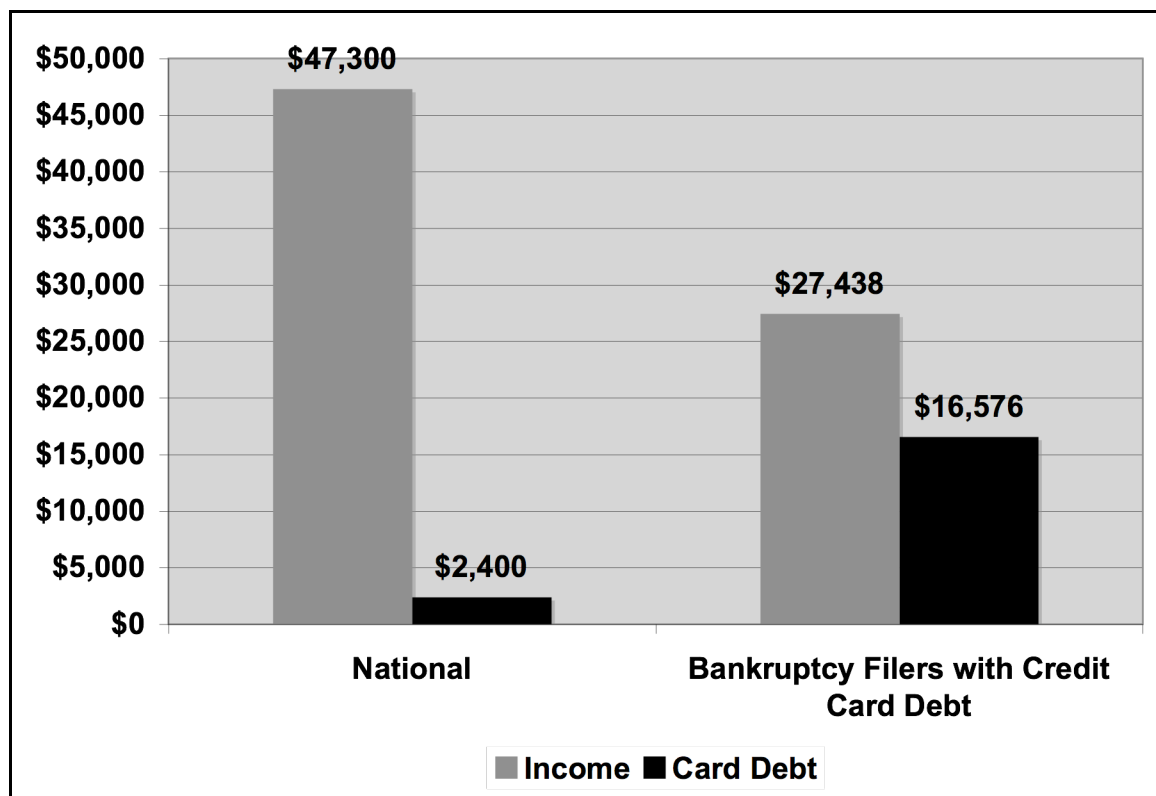
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<sup>1</sup> 2007 Consumer Bankruptcy Project. The numbers reported in this testimony are slightly lower than those reported (\$17,513.00) in testimony I presented to the Senate Judiciary Committee's Subcommittee on Administrative Oversight and the Courts on a March 24, 2009 hearing. The 2007 CBP oversamples elderly Americans. This testimony presents figures that have been corrected for that oversampling.

debt.<sup>2</sup> This accounted for 18% of the median consumer bankruptcy filer's total debt and 47% of the median consumer's unsecured debt (including taxes, rent, alimony, utilities, medical bills, and student loans).<sup>3</sup> Credit card debt is, after mortgage debt, the largest single obligation of most consumer bankruptcy filers.<sup>4</sup>

To provide some perspective on what \$16,576 in card debt means for the median bankruptcy filer, it is 60% of the gross, pre-tax household income of the median filer with card debt.<sup>5</sup> Consumer bankruptcy filers earn less than the median American household, but the \$16,576 is still over 35% of the median gross annual national income.<sup>6</sup> The relative severity of credit card debt burdens of bankruptcy filers is evident from Chart 1, which shows levels of credit card debt and gross annual income for the median American household and the median consumer bankruptcy filer in 2007.

**Chart 1. Gross Annual Income and Credit Card Debt**



It is not clear how much of consumer bankruptcy filers' credit card debt is purchase balances and how much is accrued interest and fees, but if a consumer with \$16,576 in credit card debt at an APR of 18%, made no more purchases, incurred no fees,

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* (median annualized gross monthly income of \$26,982.00).

<sup>6</sup> Brian K. Bucks, *et al.*, *Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances*, 95 FED. RES. BULL. A1, A5 (2009), at <http://www.federalreserve.gov/pubs/bulletin/2009/pdf/scf09.pdf> (reporting national median income of \$47,300.00).

and paid off the debt in five years, the Office of Comptroller of the Currency's recommended amortization period for credit card debt, the consumer would have to make monthly payments of \$420.92. These payments would be 18% of the median consumer debtor with credit card debt's gross (pre-tax) monthly income, and 11% of the national median gross (pre-tax) monthly income. For a middle- or lower- income consumer who also to pay taxes and provide basic necessities of food and shelter for her family, this sort of debt burden is near impossible. Few consumers can service high interest rates like credit card default rates from their disposable income, let alone make any headway in paying down the principal. Not surprisingly, 52% of consumer bankruptcy filers list credit card debt as a major factor in their bankruptcy.<sup>7</sup>

The precise dynamics of credit card debt and financial distress are not well understood. While Professor Ronald Mann has shown that dollar for dollar, a consumer with credit card debt is more likely to file for bankruptcy than a consumer with any other form of debt,<sup>8</sup> it is not clear whether card debt generate financial distress in the first instance or whether consumers in financial distress turn to cards as a source of short-term financing. In either case, however, credit card debt certainly contributes to financial distress as the interest and fees on card debt amounts faster than consumers can pay it off. Credit cards amplify existing debt burdens, and for many families this means credit cards are financial quicksand.

There are several factors underlying high levels of credit card debt: the macroeconomic strain of the American family; irresponsible spending; and credit card product design. High levels of credit card debt reflect the deeper economic problems of American families: the costs of health care, education, and housing.<sup>9</sup> These basic costs of living have increased dramatically in recent decades, while incomes have remained stagnant. Savings rates have plummeted to zero or even negative, and home equity, the largest single asset of many families, has been depleted. Household finances have been stretched thin by increased costs of living and stagnant incomes. This means there is no cushion left for middle class families faced with unpredictable shocks to their income like death, illness, divorce, or unemployment. Many American families are forced to finance basic expenses off of cards in order to maintain the same middle class standard of living. To be sure, there are some individuals who borrow lavishly and irresponsibly on their credit cards to support a lifestyle far beyond their means, but these are the exception, not the rule; macroeconomic pressures on the American family are the primary driver of card debt.

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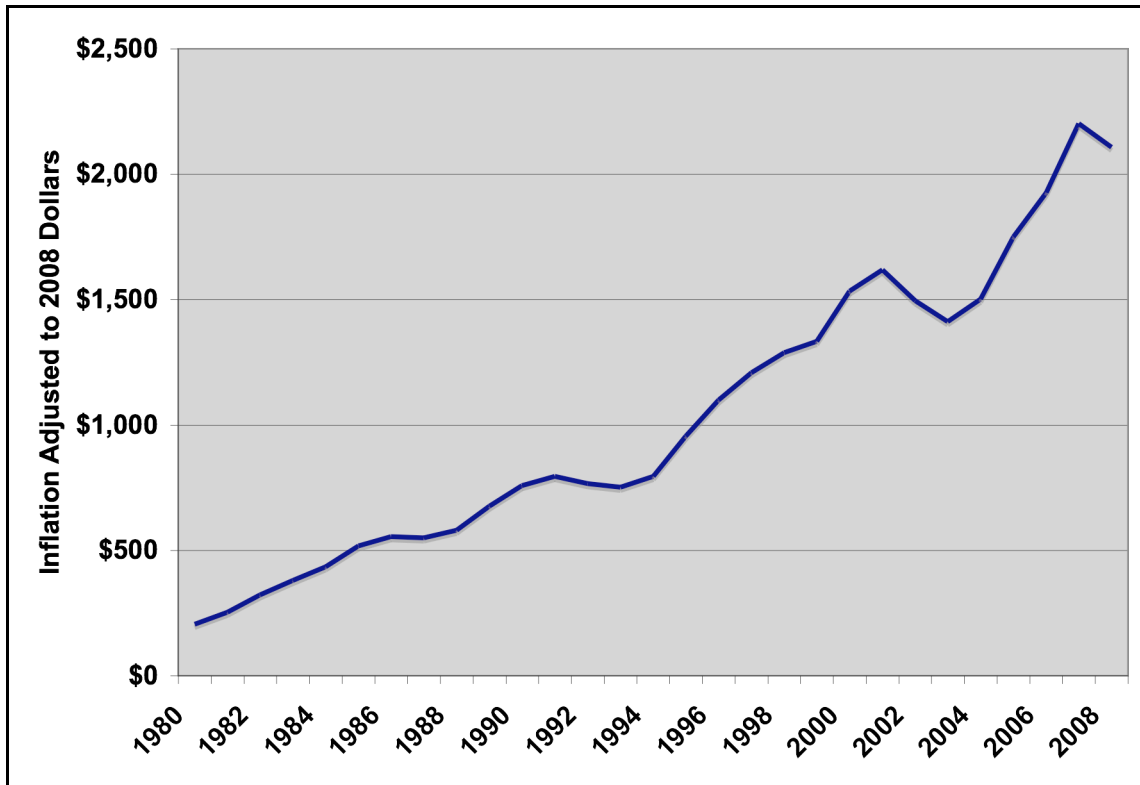
<sup>7</sup> 2007 Consumer Bankruptcy Project Database.

<sup>8</sup> RONALD J. MANN, CHARGING AHEAD: THE GROWTH AND REGULATION OF PAYMENT CARD MARKETS (2006).

<sup>9</sup> ELIZABETH WARREN & AMELIA WARREN-TYALGI, TWO-INCOME TRAP: WHY MIDDLE-CLASS MOTHERS AND FATHERS ARE GOING BROKE 180 (Basic 2003). It is also important to note that but for the mortgage bubble, Americans would like be mired far more deeply in credit card debt. During the mortgage bubble, many households did cash-out refinancings of their mortgages and used the cashed-out home equity to pay down credit card debt. At the time, with a rising housing market this seemed quite sensible. For example, a household might have paid off \$20,000 in credit card debt at 20% APR by refinancing it into a 9% APR mortgage. The mortgage bubble thus eased credit card debt burdens. Now that the bubble has popped and the home equity piggybank is empty, hard stretched American families are again turning to credit cards to finance daily expenses.

Card debt is the Scotch tape holding together the middle class. Unfortunately, for many families, it also exacerbates their financial distress. Simply servicing credit card debt is a major strain for American families. As Chart 2 shows, even in inflation adjusted dollars, the amount of interest US households pay on revolving debt (almost all of which is credit card debt), has grown significantly and is now at over \$2,000/year, or over 4% of gross annual median income. These high levels of credit card debt also discourage savings for future contingencies and retirement.

**Chart 2. Interest Paid on Revolving Debt Per Household**



*Source:* U.S. Department of Commerce, Bureau of Economic Analysis, National Income and Products Accounts, Table. 2.1.1, Line 29.

## **II. CREDIT CARD PRODUCT DESIGN AND BUSINESS MODEL FOSTER HIGH LEVELS OF CARD DEBT**

While credit card debt burdens are in part a function of the macroeconomic problems of the American family, they are also a function of credit card product design. Credit card product design makes it possible to lend profitably even to high risk consumers. A traditional creditor lends money with an eye to recovering its principal and making a profit from the interest. Such a lender cannot lend to overly risky customers, as loss of principal is devastating to its business model. As a result, a traditional lender will engage in robust underwriting of its loans.

Credit card issuers hardly engage in robust underwriting; credit cards are almost all stated income loans, which have come to be better known as “liar loans,” in the

mortgage context. While card issuers will look at credit scores and credit reporting information, this is extremely thin as underwriting goes—there is no validated information on income and assets or non-credit-reported debts.

#### *A. The Sweatbox Lending Model*

Card issuers are able to engage in unsecured stated-income lending because many employ a non-traditional lending strategy, one that Professor Ronald Mann of Columbia Law School has termed “the sweatbox.” Sweatbox lending does not require return of the principal. Instead, the sweatbox lender makes enough money off of interest and fees that even if it loses the principal, it will still make a handsome profit.<sup>10</sup> Thus, a sweatbox lender will be willing to make loans that are unsustainable in the long run, so long as it can extract sufficient profit before the consumer defaults. As explained by Julie L. Williams, then the Acting Comptroller of the Currency, “Today the focus for lenders is not so much on consumer loans being repaid, but on the loan as a perpetual earning asset...it’s not repayment of the amount of the debt that is the focus, but rather the income the credit relationship generates through periodic payments on the loan, associated fees, and cross-selling opportunities.”<sup>11</sup>

Credit card price structures are a key part of the sweatbox model. Credit cards not only have high interest rates, but they have extremely high back-end fees that are unrelated to costs, such as late fees and overlimit fees, plus a host of billing tricks and traps that function as hidden price points. Tricks and traps directly generated over \$12 billion in revenue for the card industry in 2007,<sup>12</sup> which was over 30% of the industry’s pre-tax profits.<sup>13</sup> By shifting the cost of credit away from prominent, up-front price points like purchase APR to back-end fees and penalty APRs and billing tricks and traps, card issuers encourage greater use of cards, thereby increasing the number of consumers who enter the sweatbox.

#### *B. Interchange Fees*

Several other features of credit card product design also encourage riskier lending. Increasingly, the card industry’s business model is fee-based, not interest based. Unfortunately, just as with subprime mortgages, the fee-based business model creates a perverse incentive to lend indiscriminately and ignore delinquencies.

Card issuers make money on every credit card transaction, regardless of whether the consumer ultimately pays a finance charge. The issuer receives around two percent of every transaction in a fee paid by the merchant (and passed on to all consumers in the

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<sup>10</sup> See Ronald J. Mann, *Bankruptcy Reform and the "Sweat Box" of Credit Card Debt*, 2007 U. ILL. L. REV. 375, 392-97 (2007).

<sup>11</sup> Remarks by Julie L. Williams, Acting Comptroller of the Currency, Before the BAI National Loan Review Conference, New Orleans, LA, March 21, 2005, at <http://www.occ.treas.gov/ftp/release/2005-34a.pdf>.

<sup>12</sup> Comment Letter 177, Unfair or Deceptive Acts or Practices (2008-0004), from Oliver Ireland, Partner, Morrison & Foerster LLP, dated August 7, 2008, available at <http://files.ots.treas.gov/comments/bdc5cc5c-1e0b-8562-eb23-ff7159e49505.pdf>. The letter does not address on whose behalf Mr. Ireland is writing, but Mr. Ireland is a prominent credit card industry lobbyist.

<sup>13</sup> CardData.com (subscription data source).



form of higher prices), called the interchange fee.<sup>14</sup> Card issuers will collect about \$48 billion in interchange fees this year.<sup>15</sup>

Because interchange is based on transaction volume, it creates an incentive for banks to issue as many cards as possible, with little regard to the creditworthiness of the borrower. By creating a huge revenue stream unrelated to credit risk, interchange encourages card issuers to engage in less careful underwriting.

### *C. Securitization*

Banks have compounded this problem by shifting much of the loan risk to investors through securitization. When card issuers securitize credit card debt, they transform the credit card debt into a pool of assets used to pay off bonds. If the pool turns out not to be large enough, the bond investors take the loss. But if there's a surplus, it goes to the card issuer.

To illustrate, credit card securitization deals typically require that the card issuer retain an untranch 7% stake in the securitized pool. Many issuers will keep a higher stake. Suppose an issue has a 15% stake in a pool and the pool needs to pay \$100 million in bonds. If the pool generates revenue of \$110 million, the card issuer gets \$25 million (\$10 million in excess spread + 15% of \$100 million). If the pool only generates \$90 million in revenue, however, the card issuer loses only \$1.5 million (15% of \$10 million in losses).

Because the card issuer retains control of the terms of securitized accounts, it can easily increase their volatility by applying and increasing penalty interest rates and fees. Some consumers will default as a result of higher rates and fees, but others will simply pay more. Because the card issuer has all of the upside and only a fraction of the downside, there is an incentive for the card issuer to crank up the interest rates and fees. For example, if a card issuer normally has a 5% default rate for an average balance of \$100, it can expect revenue of \$95. If the card issuer raises interest and fees so that average balances go up to \$110, even if default rates go up two and a half times to 12.5%.

While card issuers sell off most of the default risk, they keep any upside that comes from inflating their fees and rates. If the higher fees and rates cause more defaults, it is investors who bear the loss. If the higher fees result in more income, however, it is the card issuer, not the investors, who benefit. Credit card securitization creates a heads I win, tails you lose situation and leads the banks to increase fees and interest rates on securitized debt. Interchange and securitization thus make it possible for card issuers to engage in less careful underwriting, which allows them to apply the sweatbox to even more consumers, including ones who are less economically stable.

### *D. Sweatbox Lending and Bankruptcy "Reform"*

All lenders lend for profit, of course, but a lender who lends with an eye to getting its principal repaid and making a profit from the interest is a very different type of lender than one who lends with an eye to turning the consumer into a "perpetual earning asset."

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<sup>14</sup> Technically, the interchange fee is the fee paid by the merchant's bank to the issuer, but this fee is simply passed along to the merchant as is the bulk of the "merchant discount fee." See Levitin, *supra* note **Error! Bookmark not defined.**

<sup>15</sup> Merchants Payments Coalition.

No matter how greedy a lender is, a lender that is looking to get back its principal, cannot squeeze a consumer too hard lest it push the consumer into default. A lender that doesn't care about getting principal repaid, as much as about extracting maximum payments from the consumer will squeeze much harder. This business model resulted in things like the "interest only" and "pay option ARM" mortgages that are currently wreaking havoc on the economic. It is an inherently reckless business model because even if lenders do not want consumers to default, they lack sufficient information to make sure that they do not end up pushing the consumer into default. The sweatbox lending model is predatory and unsuited for sustainable lending.

There are two keys to making the sweatbox lending model work. First, the "heat" must be high enough—interest rates and fees must be lathered on. Card issuers have shown that they are expert at this. And second, the consumer must be kept in the sweatbox as long as possible. As Professor Mann has observed, the longer the consumer can be kept in the sweatbox of making minimum payments that exceed the cost of funds before eventually defaulting, the more profitable the loan. Bankruptcy is an escape hatch from the sweatbox. Thus, anything the lender can do to delay the default, such as making it more difficult to file for bankruptcy, allows the lender to extract greater revenue from the consumer.

The aim of keeping consumers in a lending sweatbox for as long as possible explains key parts of the BAPCPA, in particular the means test and credit counseling requirements.

### **III. THE BAPCPA BENEFITS CREDIT CARD ISSUERS AT THE EXPENSE OF DEBTORS AND OTHER CREDITORS**

The centerpiece of the BAPCPA was the "means test" that determines which consumers are eligible for filing for Chapter 7 bankruptcy. The means test is a rubric for a complex statutory provision regarding whether a rebuttable presumption of abuse exists for a consumer debtor to file for Chapter 7 and who can raise the presumption. If a consumer bankruptcy filer's adjusted income is too high, then a presumption of abuse exists against the consumer. If the debtor's filing is found to be an abuse of Chapter 7's provisions, then the case must be dismissed or converted to Chapter 13 or 11.

Whatever one thinks about means testing as a general policy matter, there is broad consensus that the current means test is poorly drafted and ineffective. There has been no noticeable impact on the income of consumers filing for bankruptcy before or after the 2005 amendments; the median income and the distribution of income of bankruptcy filers in 2001 was virtually identical to filers in 2007.<sup>16</sup> As the most recent empirical study of the impact of BAPCPA on bankruptcy filings notes, "instead of functioning like a sieve, carefully sorting the high-income abusers from those in true need, the amendments' means test functioned more like a barricade, blocking out hundreds of thousands of struggling families indiscriminately, regardless of their individual income

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<sup>16</sup> Robert M. Lawless, *et al.*, *Did Bankruptcy Reform Fail? An Empirical Study of Consumer Debtors*, 82 AM. BANKR. L.J. 349, 358-63 (2008).

circumstances.”<sup>17</sup> This is not what the bill was marketed as doing. It “was not the Bankruptcy Numbers Reduction Act; it was the Bankruptcy Abuse Prevention Act.”<sup>18</sup>

The credit card industry’s goal with the 2005 amendments, however, was not to sort out can-pay debtors or to extract greater payouts in bankruptcy. Instead, the card industry sought to delay bankruptcy filings. Delayed bankruptcy filings boost credit card industry profits. The 2005 amendments, in particular the documentation required for means testing and the requirement of pre-bankruptcy credit counseling, add delay directly to the filing process. They also encourage delay for debtors who wish to avoid the abuse presumption of the means test; it is relatively easy for a debtor to game the means test, but to do so requires delaying a filing by some months. And the 2005 amendments add cost to the filing process, and cost adds further delay, as many consumers file for bankruptcy not because of an exigent need, like to prevent a mortgage foreclosure, but when they have saved up enough money to file.

Because bankruptcy distributions on unsecured debt are made pro rata, delayed filings benefits creditors, like credit card issuers, with higher interest rates. Their claims grow relatively faster than unsecured creditors who charge no or low rates of interest, such as tort claimants, medical bills, landlords, local merchants and small businesses, and federal, state, and local government. Because distributions on unsecured debt are made pro rata, it is a zero sum game; to the extent that card issuers’ claims are larger because of delay it comes at the expense of other creditors.

This can be seen when one compares pre-BAPCPA debt burdens of bankruptcy filers to post-BAPCPA debt burdens. From 2001 to 2007, median secured debt rose 20.8% and median unsecured debt (primarily credit cards) rose 43.6%.<sup>19</sup> Delayed filings only leave debtors more deeply mired in debt (not all of which is dischargeable, thus limiting the potency of the bankruptcy “fresh start”), and may delay filings past the prudent point. The delay comes at the expense of creditors who charge more manageable rates of interest. And means testing adds a significant burden to the court system. Whatever one thinks of the policy of means testing and related measures supposedly designed to prevent bankruptcy “abuse,” they have been unsuccessful on their own terms; BAPCPA has delayed and kept down bankruptcy filings in general, rather than screened out abusers.<sup>20</sup> The abuse prevention measures in BAPCPA were also unnecessary; the Bankruptcy Code already gave creditors the ability to challenge debtors’ discharges,<sup>21</sup> but credit card issuers rarely litigated under these provisions.

Eliminating the means test and credit counseling requirements for bankruptcy filers would make it cheaper and simpler to file for bankruptcy and would discourage card issuers from sweatbox lending that pushes many consumers into bankruptcy and exacerbates the economic problems of the already-stretched American family.

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<sup>17</sup> *Id.* at 353.

<sup>18</sup> *Id.* at 352.

<sup>19</sup> *Id.* at 368.

<sup>20</sup> *Id.* at 352.

<sup>21</sup> 11 U.S.C. § 523(a)(2).

#### **IV. SUGGESTIONS FOR CREDIT CARD REFORM LEGISLATION**

##### *A. The Need for Comprehensive Card Reform Legislation*

Credit cards play an important role in the American economy, but they also cause significant problems and exacerbate others. The current financial crisis underscores the importance of consumer protection for the health of the entire economy, and the Congress has rightly taken a keen interest in credit card reform legislation. The credit card reform legislation that has been proposed, however, takes a piecemeal approach. There are bills that deal with billing practices, with bankruptcy, with interchange, with usury, and with establishing a federal financial product safety commission. These are all important issues, but they are also intertwined. Therefore, I urge Congress to consider taking a comprehensive approach to credit card reform legislation. Issues like bankruptcy, billing practices, interchange, securitization, and usury are all intimately linked, and would be best addressed comprehensively, rather than piecemeal.

##### *B. Limitations with Current Approaches to Credit Card Regulation*

I would also urge the Congress to recognize that there are significant drawbacks to the two primary methods of card regulation used to date: disclosure regulations and substantive regulations.

#### **1. Disclosure Regulation**

Disclosure has been the primary paradigm for card regulation since the 1968 Truth-in-Lending Act. Unfortunately, there is no evidence that it works for complex financial products like credit cards. While disclosure is effective for simple financial products where consumers can compare one or a few price terms, it cannot work for credit cards. Credit cards are different from virtually every other consumer financial product in their complexity. Most consumer credit products, such as auto loans, mortgages, and student loans have only one or two price points. These price points do not vary except in relation to an objective index, such as the Federal Funds Rate or LIBOR. Unlike other common consumer credit products, however, credit cards have an astounding array of price points: annual fees, merchant fees, teaser interest rates, base interest rates, balance transfer interest rates, cash advance interest rates, overdraft advance interest rates, default interest rates, late fees, overlimit fees, balance transfer fees, cash advance fees, international transaction fees, telephone payment fees, etc. These are all explicit price points, disclosed in Truth-in-Lending schedules.

The sheer number of explicit price points that make it difficult for consumers to accurately and easily gauge the total cost of using credit cards.<sup>22</sup> Consumers are not capable of doing the on-the-spot calculations necessary to figure out whether or not to use any particular credit card for any particular transaction. There is too much information that the consumer must process. Even if the consumer could process all this information, it simply would not be worthwhile to do for every transaction. The burden this would impose would negate all of the convenience benefits credit cards have for consumers.

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<sup>22</sup> Mark Furletti, *Credit Card Pricing Developments and Their Disclosure*, Discussion Paper, Payment Cards Center, Fed. Res. Bank of Phila., Jan. 2003, at 19.

Consumers' difficulty in determining the cost of credit cards is compounded by credit cards' hidden price points in the form of billing practices, such as universal cross-default, unilateral term changes, residual interest, two-cycle billing, unlimited overlimit fees, application of payments to the lowest interest rate balance, non-standard use of terms like "fixed rate" and "Prime rate," and unclear policies as to precisely when a payment is due. These billing practices make credit card pricing to vary based not only on objective indices, but also on the card issuers' subjective whim. Credit card billing practices alter the application of the explicit price points and make the effective cost of using credit cards higher than disclosed. These billing practices further obfuscate the true cost of using credit and make it virtually impossible for a consumer to make a fully informed decision about whether to use credit and, if so, which credit card product to use.

## **2. Substantive Regulation**

Substantive regulations, like usury laws and unfair and deceptive acts and practices (UDAP) statutes are able to address specific egregious card industry practices. Strong substantive regulations can have the unintended consequences of product substitute and credit rationing. But even more limited substantive regulation can result in term substitution: card issuers will simply substitute new terms for the regulated ones. Thus, legislating against specific practices inevitably devolve into a game of regulatory Whac-A-Mole: every time regulators put the kibosh on one practice, the card industry invents another to take its place. The card industry has shown itself to be remarkably resourceful in engineering its products around regulation. Congress will always be playing catch-up in this game of regulation and innovation. A dedicated federal regulatory agency, like a consumer financial product safety commission would be able to move faster than Congress, but even then it might not move fast enough.

### *C. A New Approach to Card Regulation: Standardization and Simplification*

The only sure way to stop negative innovation in the card industry is to flip the regulatory model on its head. Currently card issuers are allowed to do anything, except specific prohibited practices. The better regulatory structure would be to prohibit anything, except for specific permitted practices. Such a regulatory model could be combined with a mandatory simplification of credit card price structures. All of credit cards' myriad price points can be boiled down into three price terms: an availability fee, a transaction fee, and an interest rate. Congress would do well to mandate that these and only these three fees may be charged by card issuers, and to require standardization of key cardholder agreement terms, just as is currently done with insurance policies. Card issuers would be free to compete and price as they wish within this focused structure.

The benefits of mandating standardization and simplification of credit card price structures are that consumers would be able to easily and simply compare cards on an "apples-to-apples" basis that would give them the entire picture of the costs involved with a card. There would be no worries about the fine print and no hidden fees or price points designed to take advantage of consumers' tendency to overestimate their future ability to repay and underestimate the costs of delayed fees and interest.

While standardization would come at the price of some product differentiation, the variation among credit cards currently is insignificant—consider Capital One's present advertising campaign, which touts the special feature of Capital One's cards: that

a cardholder can choose the picture that goes on the card. Instead, what one would expect to emerge would be a (much-needed) bifurcation to occur in the card market. There should emerge a market for cards aimed at transactors and another aimed at revolvers. Those aimed at transactors, would feature high interest rates, but low per transaction fees, while those cards aimed at revolvers would have higher transaction fees, but lower interest rates.

None of this would solve the problem of consumers' inability to accurately predict whether they would revolve or merely transact, and many consumers alternate between the two. But by simplifying card pricing structure, consumers would be able to at least pick the lowest cost card in either category, and this would push down interest rates (and eliminate back-end fees). Without inefficiently high interest rates and back-end fees, the sweatbox lending model cannot work, and the card industry would have to go back to safer, more sustainable, and non-predatory traditional lending models.

I urge the Congress to take up a comprehensive program of credit card reform legislation. While repealing parts of the BAPCPA is a key element to creating a fair and sustainable card lending industry, that alone will not eliminate predatory lending models. Instead, I strongly urge the Congress to consider mandating term standardization and price structure simplification for credit cards.