APRIL 2005

Households at Risk

The Bankruptcy "Reform" Bill and Its Impact on American Families

TABLE OF CONTENTS:

Dēmos
A NETWORK FOR IDEAS & ACTION

220 Fifth Avenue, 5th Floor, New York, NY 10001 • phone: 212.633.1405 • fax: 212.633.2015 • www.demos-usa.org

For Immediate Release
April 11, 2005

Contact: Timothy Rusch, Demos
trusch@demos-usa.org, 212-389-1407

BANKRUPTCY BILL ALERT:
"This Is the Last Chance for Congress to Protect Families— Bankruptcy Bill Must Be Amended," Urges Economic Policy Group

Key Research & Legislation Analysis Available Online: www.demos-usa.org/debt

NEW YORK, NY, AND WASHINGTON, DC — Today, Demos: A Network for Ideas & Action, a national economic policy research organization, urges Congress to recognize the fragility of our debt-driven consumer economy when considering the bankruptcy "reform" bill (S. 256/H.R. 685) that has been passed by the Senate and is now under consideration in the House of Representatives. Short of opposing this dangerous legislation, the House should at least include amendments that will protect our nation's families from the most deleterious provisions.

American families are not suffering from "irresponsible consumerism," as Senate sponsor Chuck Grassley claims, but from the effects of a stagnant economy and fraying social supports. Faced with declining real wages, job insecurity, long-term unemployment, and rising costs, American families have turned to increasingly available—and expensive—credit in order to make ends meet. The resulting rise in bankruptcies is an inevitable outcome for households struggling to keep up while the lending industry charges outrageous fees, high interest rates and capricious penalties. American families would be well-served if Congress addressed the widespread economic insecurity facing households, rather than close the door on this option of last resort.

"This is the last chance to help avert disaster for millions of families on the edge of bankruptcy," says Tamara Draut, Director of the Economic Opportunity Program at Demos. "To make this bill reflect the needs and concerns of families in severe economic distress, House members must demand that the household-protection amendments that were rejected by the Senate be included before the bill goes to a vote."

Key amendments the House must adopt:

- Protect servicemembers and veterans from means testing in bankruptcy, to disallow certain claims by lenders charging usurious interest rates to servicemembers, and to allow servicemembers to exempt property based on the law of the State of their premilitary residence.
- Provide a homestead floor for the elderly, the fastest-growing group in the bankruptcy courts.
- Exempt debtors whose financial problems were caused by serious medical problems from means testing.
- Limit the exemption for asset protection trusts, the "millionaire's loophole."
- Limit the amount of interest that can be charged on any extension of credit to 30 percent.
- Discourage predatory lending practices.

- Amend the Fair Labor Standards Act of 1938 to provide for an increase in the Federal minimum wage.
- Protect employees and retirees from corporate practices that deprive them of their earnings and retirement savings when a business files for bankruptcy.

"Our research tells a story that's no surprise to the millions of families struggling with credit card debt. Families are borrowing to make ends meet, and they're one missed paycheck away from collapse," says Draut. "The Congress members of both parties who are embracing these punitive measures for working families are dangerously out of touch with the grim economic realities faced by ordinary families."

The proposed changes in H.R. 685, as proposed, would allow lenders to pursue more debtors, even after bankruptcy has ruined their credit. Years of research show that people filing for bankruptcy due to credit card debt do so as a last resort, having already paid creditors thousands in penalty interest and fees, on top of the repaid principal. Bankruptcy protection provides these families—the majority of whom have suffered job loss, divorce, and, increasingly, a medical catastrophe—their only hope of regaining financial security.

"The tragedy is that this bill rewards a $30 billion industry for egregious behavior, and could have repercussions for every cardholder," says Draut. With interest rates rising and the threat of bankruptcy defused, credit card companies are likely to escalate the abusive tactics that have buoyed them to record profits in recent years. Real consumer bankruptcy reform would curb the practices that force people to file, which include $35 penalty fees, 29 percent interest rate hikes, and the odious new "universal default" clause that can multiply consumers' entire debt loads because of activity on a single account.

Demos' *Borrowing to Make Ends Meet* research series offers journalists and policymakers a well-rounded analysis of the real debt crisis facing Americans-information that is missing from the credit industry-fueled debate going on in Washington.

Key findings from the Borrowing to Make Ends Meet Series include:

- Credit card debt has risen across the board over the past decade—but the most for senior citizens, squeezed middle-income families, and minimum-wage earners. (*Borrowing to Make Ends Meet: The Growth of Credit Card Debt in the '90s*)
- Credit industry deregulation has played a major part in the rise of bankruptcies. (*Credit Card Industry Practices: In Brief*)
- Older Americans are the fastest-growing age group in the bankruptcy courts, having seen a 149 percent increase in average credit card debt between 1989 and 2001. (*Retiring in the Red: The Growth of Debt Among Older Americans*)
- Young families are starting out in the red. They are servicing five-digit student loan bills and mounting credit card debts when they should be starting businesses, families, nest eggs, and households. (*Generation Broke: The Growth of Debt Among Young Americans*)
- In order to pay credit card and other bills, families extracted $458 billion in equity during the 2001-2004 refinancing boom. As interest rates rise, and/or housing values drop, millions of families could find themselves in crisis. (*A House of Cards: Refinancing the American Dream*)

Members of Congress owe the American people a real inquiry into the factors driving the debt crisis in America. Any debate about bankruptcy "reform" that ignores the structural economic issues facing families is short-sighted, dangerous to family economic security, and does nothing to address the long-term health of our economy.

Resources are available at www.demos-usa.org/debt

Experts are available for interviews and background briefings. For more information, please contact Timothy Rusch at 212/389-1407.

Demos: A Network for Ideas and Action is a national, nonpartisan public policy organization based in New York. *www.demos-usa.org*

###

Bankruptcy Bill Met with Widespread Criticism…

"This bankruptcy bill places a thumb on the scales of justice against Americans who have done nothing wrong and who are simply the victims of a difficult economy or bad luck."

— Senator Hillary Clinton

"Reining in irresponsible consumers is a worthwhile goal — but only if it's coupled with responsible lending. In biblical times, those who made usurious loans were said to be banished from God's presence. These days, they are rewarded with record profits and new laws tilted in their favor. At a minimum, they deserve a plague of boils."

— USA Today *editorial, March 10, 2005*

"Greed, pure and simple. Campaign cash is worth more than family values."

— Robert Scheer, Los Angeles Times*, March 15, 2005*

"This 'reform,' which parades as an effort to stop folks from spending lavishly and then stiffing creditors by filing for bankruptcy protection, is a perfect illustration of how the political money system tilts the law against average Americans."

— David S. Broder, "A Bankrupt Reform," Washington Post*, March 13, 2005*

"Congress has done little to address spiraling medical costs for individuals or employers. Nor have lawmakers addressed the abusive lending practices inherent in the deluge of cheap credit offers flooding the consumer market. Instead, they opt for doing the bidding of the same companies that are aggravating the problem."

— Loren Steffy, "Politicians Offer Lecture on Debt," Houston Chronicle*, February 20, 2005*

"Any senator who votes for the bill should be ashamed."

— Paul Krugman, "The Debt Peonage Society," New York Times*, March 8, 2005*

"It's hard to imagine a more egregious example of class warfare than the Bush-pushed 'bankruptcy reform' bill that just cleared the U.S. Senate. It might seem to be the height of hypocrisy for an administration whose policies have been contributing to record budget deficits to make life so much tougher for American workers who are trying to dig out of debt."

— San Francisco Chronicle *editorial, March 13, 2005*

"This bill does a great job helping the credit card industry recover the profits they're losing, but what are we doing to help middle-class families recover the dreams they're losing?"

— Senator Barack Obama

"The one-sided provisions of this bankruptcy legislation are bad news for consumers, but they are also bad news for the financial service industry. Consumers are our customers. By creating a form of debt imprisonment, this bill will hobble the most important player in the world economy, the American consumer." *— Arkadi Kuhlmann, CEO, ING Direct*

"This legislation is not worthy of the Senate." *— Senator Edward Kennedy*

What's Wrong With H.R. 685, the Bankruptcy Bill?

H.R. 685 is identical to the bankruptcy bill passed by the U.S. Senate in March. It has been opposed by broad coalition of labor, women's groups, consumer groups, senior organizations, faith communities, civil rights organizations, law scholars, bankruptcy trustees, retired bankruptcy judges, economists and editorial boards of major national newspapers [Wash Post, NY Times, LA Times] and regional papers. The CEO of ING Direct has stated his opposition to the bill in recognition of Americans' low savings rates. This policy would aggravate household debt loads, directly affecting families' ability to save for retirement, education, and entrepreneurship.

The budgets of American families have been hit hard in recent years by massive layoffs, outsourcing of jobs, corporate scandals and ravaged pension and 401 (k) plans. Passage of the bankruptcy bill would make it harder for families struck by financial misfortune to get back on track. It would benefit the very profitable ($30 billion in 2004) credit card industry at the expense of the modest-income families who represent the great majority of those who declare bankruptcy.

Bankruptcies are driven by economic difficulties. The timing of this bill couldn't be worse. Ninety percent of all bankruptcies are triggered by the loss of a job, high medical bills or divorce. The economic recession has taken its toll on many families. Long-term unemployment continues to be a problem and the number of Americans without health insurance is at its highest level ever and growing. Seniors can't afford their prescriptions and more and more people are losing their pensions as companies continue to struggle to be profitable. The business bankruptcy provisions in the bill would also hurt business reorganization, causing further job loss.

Key problems with the bill include:

Imposes a rigid means test. The bill sets up an inflexible formula to determine if an individual debtor will be presumed ineligible for chapter 7 relief. A debtor whose Chapter 7 case is challenged due to these assumptions will have to litigate the issue— an expense many debtors cannot afford. The court is not allowed to waive the means test even if the debtor is seeking bankruptcy relief because of some terrible circumstance beyond his or her control.

Endangers child support. Despite extravagant claims to the contrary, the bill still threatens the welfare of children. If the parent who owes child support is the debtor, the bill will divert more money to other creditors (such as auto lenders) and allow more non-child support debts to survive bankruptcy. Thus after the bankruptcy is over the custodial parent will have to fight with creditors for the debtor's limited income.

Rewards an industry for tactics that turn manageable debt into bankruptcy cases. The rise in average credit card balances and bankruptcies has been brought on, in no small part, by new lending policies. The price of late and other penalty fees have doubled in less than a decade, and are more quickly levied (payments arriving after a certain *hour* on the due date are now considered late). Even more damaging have been the accompanying penalty interest rates. These rates average 29 percent, are retroactive to the entire balance, and thanks to "universal default" policies, now create a domino effect with a consumer's other loans. Real bankruptcy reform would curb these practices, allowing debtors to pay down debts over reasonable periods, without having to resort to bankruptcy.

Allows millionaires to continue to shelter their assets in bankruptcy. The bill will still allow some rich debtors (those who have not been found to have committed certain types of wrongdoing, or those who have owned their home in the state longer than 40 months) to protect an unlimited amount of value in their residences.

Expands opportunities for creditor motions. Creditors will be able to threaten debtors with new costly litigation and make it more likely that debtors who cannot afford to defend themselves in court will be coerced into giving up their legal rights.

Makes chapter 13 plans to save homes and cars far more difficult. Contrary to the supposed aim of encouraging more chapter 13 payment plans, numerous provisions in the bill will make chapter 13 much harder and less attractive. For many debtors, the bill will require five year plans (up from three years), assuring that the failure rate will be even higher than the current two-thirds who can't complete plans because of unexpected income or job loss.

Makes debtors more vulnerable to eviction. The bill makes it easier for residential landlords to evict a tenant who is in bankruptcy.

Provides misleading information to debtors in the name of "credit disclosure." Instead of providing a borrower with the information he or she needs to borrow responsibly and avoid getting into financial difficulty, this bill allows creditors to provide misleading information that may give a borrower a false sense of financial security.

Limits the ability for businesses to reorganize. The bill contains many restrictions on the ability of businesses to reorganize under chapter 11 and protect jobs. For this reason, labor and business bankruptcy lawyers have opposed these provisions.

Expert Bios

TAMARA DRAUT

DIRECTOR OF THE ECONOMIC OPPORTUNITY PROGRAM

Tamara Draut is co-author of the recent Demos reports, "Millions to the Middle: Three Strategies to Grow the Middle Class," "Generation Broke: The Growth of Debt Among Young Adults," "Retiring in the Red: The Growth of Debt Among Older Americans," and "Borrowing to Make Ends Meet: The Growth of Credit Card Debt in the 90s," among others. Tamara's op-eds have appeared in many newspapers across the country, and she has appeared as a commentator on CNN, MSNBC, Headline News and numerous radio shows. She is currently writing a book on the new economic challenges to becoming an adult, called Strapped, to be published by Doubleday Books in 2006.

Topics of Expertise: Credit Card Debt
Bankruptcy
Middle-class economic security
Young adults' finances
Credit industry
Student Loan Debt
Higher Education

JAVIER SILVA

SENIOR RESEARCH AND POLICY ASSOCIATE, ECONOMIC OPPORTUNITY PROGRAM

Javier Silva is the author of the recent Demos report, "A House of Cards: Refinancing the American Dream", and co-author of "Millions to the Middle: Three Strategies to Grow the Middle Class" and "Generation Broke: The Growth of Debt Among Young Adults". His work has been cited in numerous national and regional newspapers, and he has appeared on CNBC's Squawk Box, Telemundo, and WCBS-TV News in New York.

Topics of Expertise: Home refinancing
Appraisal Fraud
Housing Bubble
Credit card debt
Middle-class economic security
Credit industry
Debt and Assets among people of color

HEATHER McGHEE

PROGRAM ASSOCIATE, ECONOMIC OPPORTUNITY PROGRAM

Heather McGhee is the principal author of "Retiring in the Red: The Growth of Debt Among Older Americans". Her writing has appeared in the Detroit Free-Press and CampusProgress.org, and her research has been cited in numerous national and regional news outlets. She is also the Managing Editor of "Around the Kitchen Table", Demos' monthly e-journal on economic issues.

Topics of Expertise: Bankruptcy legislation
Retirement Security
Social Security
Credit industry
Credit card debt

Retiring in the Red

The Growth of Debt Among Older Americans

BY HEATHER C. MCGHEE AND TAMARA DRAUT

Key Findings From Borrowing to Make Ends Meet Briefing Paper #1
Second Edition

Seniors over 65 have become the fastest-growing age group in the bankruptcy courts. Rising costs for housing and health care, combined with low incomes and declining retirement wealth, have eroded the economic security of older households. "Transitioners" from the Baby Boom generation are approaching retirement with remaining family obligations, cashed-out home equity and low retirement savings. The following findings are from the Federal Reserve's Survey of Consumer Finances, tracking the dramatic rise in credit card debt among older Americans between 1992 and 2001.

Key Findings

SENIORS (OVER AGE 65)

- Average self-reported credit card debt among indebted seniors increased by 89 percent between 1992 and 2001, to $4,041.
- Seniors between 65 and 69 years old, presumably the newly-retired, saw the most staggering rise in credit card debt—217 percent—to an average of $5,844.
- Female-headed senior households experienced a 48 percent increase in credit card debt between 1992 and 2001, to an average of $2,319.
- Among seniors with incomes under $50,000 (70 percent of seniors), about *one in five* families with credit card debt is in debt hardship—spending over 40 percent of their income on debt payments, including mortgage debt.

TRANSITIONERS (AGES 55—64)

- Transitioners experienced a 47 percent increase in their credit card debt between 1992 and 2001, to an average of $4,088.
- The average credit card-indebted family in this age group now spends *31 percent* of its income on debt payments, a 10 percentage point increase over the decade.
- The credit card debt of middle- to low-income transitioner families without health insurance increased by 169 percent, as opposed to by only 37 percent for like-income families *with* health insurance.

220 Fifth Avenue, 5th Floor, New York, NY 10001 • phone: 212.633.1405 • fax: 212.633.2015 • www.demos-usa.org

Generation Broke

The Growth of Debt Among Young Americans

BY TAMARA DRAUT AND JAVIER SILVA

Key Findings From Borrowing to Make Ends Meet Briefing Paper #2,

Over the 1990s, credit card debt among young Americans rose dramatically—leaving many young adults over-extended and vulnerable to financial collapse. Driving factors include rising costs, slow real wage growth and skyrocketing college debt. This generation is also the first to come of age with deregulation of the lending industry, a change that has resulted in increasingly available and expensive credit. By 2001, 12 out of every 1,000 young adults were starting out their lives with the damaged credit caused by bankruptcy.

Key Findings

YOUNG ADULTS (25–34 YEARS OLD)

- Average credit card debt among indebted young adults increased by 55 percent between 1992 and 2001, to $4,088 (2001 dollars).
- The average credit card indebted young adult household now spends nearly 24 percent of its income on debt payments, four percentage points more, on average, than young adults did in 1992.
- Among young adult households with incomes below $50,000 (2/3 of young households), nearly one in five with credit card debt is in debt hardship—spending over 40 percent of their income servicing debt, including mortgages and student loans.
- Young Americans now have the second highest rate of bankruptcy, just after those aged 35 to 44. The rate among 25-34 year olds increased between 1991 and 2001, indicating that Gen Xers were more likely to file bankruptcy as young adults than were young Boomers at the same age.[1]

THE YOUNGEST ADULTS (18–24 YEARS OLD)

- The youngest adults saw a sharper rise in credit card debt—104 percent—to an average of $2,985 (2001 dollars).
- The average credit card indebted household in this age group spends nearly 30 percent of its income on debt payments, double the percentage spent on average in 1992.
- Among the youngest adult households with incomes below $50,000 (2/3 of younger households), nearly one in seven with credit card debt is in debt hardship.

Dēmos
A NETWORK FOR IDEAS & ACTION
220 Fifth Avenue, 5th Floor, New York, NY 10001 • phone: 212.633.1405 • fax: 212.633.2015 • www.demos-usa.org

A House of Cards

Refinancing the American Dream

BY JAVIER SILVA

Key Findings From Borrowing to Make Ends Meet Briefing Paper #3

In response to ever-increasing financial pressures, families have come to depend on high-cost credit as a way to bridge the gap between stagnant or decreasing incomes and rising costs. How are families coping with their new burden? To hang on to the American Dream, to be part of the ownership society, homeowners are depleting their homes' equity to pay off a growing mountain of unsecured debt —a financial strategy fraught with serious consequences.

As mortgage interest rates fell to record levels during the refinance boom, it became more appealing to cash out home equity during the refinancing process to pay down credit card debt and finance current living expenses—a short-term solution that fails to address the long-term economic realities faced by the average family. The added burden of missing a mortgage payment results in putting at risk your home—your family's most important asset. All of these factors lead to a crisis in personal finance: a blurred line between good debt—debt that results in appreciable asset—and bad debt, which does not.

Key Findings

- Households cashed out $333 billion worth of equity from homes between 2001 and 2003, the beginning of the refinancing boom—levels three times higher than any other three-year period since Freddie Mac started tracking the data in 1993.
- A majority of households that refinanced between 2001 and 2003 used cash equity from their homes to cover living expenses and pay down credit card debt, further eroding their homes' cash value, which many families rely on for economic security.
- Between 1973 and 2004, homeowner's equity actually fell—from 68.3 percent to 55 percent. In other words, Americans own less of their homes today than they did in the 1970s and early 1980s.
- In 2002, the financial obligations ratio— the percentage of monthly income to the amount needed to manage monthly debt payments —reached 18.56 percent, a single year record since data started being collected in 1980.
- The rise of appraisal fraud has fueled inflated home prices over the last several years. Even though it is underreported, appraisal fraud was the fastest type of mortgage fraud reported by major lenders in 2000, and could leave many homeowners owing much more than the true market value of their home.
- Homeowners who reduced their homes' equity during the refinance boom could suffer devastating effects if home prices begin to fall. As a result, a homeowner could owe more on their mortgage than the house is worth—known in the industry as being "upside down" in a house.
- As the Federal Reserve continues to raise interest rates, a mortgaged family with an adjustable rate mortgage will experience a significant increase in their monthly mortgage payments. The combination of higher mortgage payments coupled with rising costs of basic living expenses represents a growing financial threat.

Dēmos

A NETWORK FOR IDEAS & ACTION

220 Fifth Avenue, 5th Floor, New York, NY 10001 • phone: 212.633.1405 • fax: 212.633.2015 • www.demos-usa.org

Borrowing to Make Ends Meet

A NETWORK FOR IDEAS & ACTION

The Growth of Credit Card Debt in the ’90s

EXECUTIVE SUMMARY

Tamara Draut, Director, Economic Opportunity Program
Javier Silva, Senior Policy and Research Associate

$4,126
Average credit card debt for an American family in 2001

Overview

The mid and late 1990s will always be remembered as an era of unprecedented prosperity. But for most American families, the roaring ’90s had a dark underbelly—it was also the Decade of Debt.

Between 1989 and 2001, credit card debt in America almost tripled, from $238 billion to $692 billion. The savings rate steadily declined, and the number of people filing for bankruptcy jumped 125 percent.

How did the average family fare? During the 1990s, the average American family experienced a **53 percent increase** in credit card debt, from $2,697 to $4,126 (all figures measured in 2001 dollars). Low-income families saw the largest increase—a 184 percent rise in their debt—but even very high-income families had 28 percent more credit card debt in 2001 than they did in 1989.

$2,697
Average credit card debt for an American family in 1989

Credit card debt is often dismissed as the consequence of frivolous consumption. But an examination of broad structural and economic trends during the 1990s—including stagnant or declining real wages, job displacement, and rising health care and housing costs—suggests that many Americans are using credit cards as a way to fill a growing gap between household earnings and the costs of essential goods and services. Usurious practices in the credit card industry, in the form of high rates and fees, have taken advantage of the increased need for credit. As a result, a growing number of American families find themselves perpetually indebted to the credit card industry, which—despite claims of losses and chargeoffs—remains one of the most profitable sectors of the banking industry.

During the 1990s, the average American family’s credit card debt rose by 53 percent.

Key Findings

Average Credit Card Debt Increased by 53 Percent. American families in all income groups rapidly accumulated credit card debt in the 1990s. According to 2001 data from the Survey of Consumer Finances, 76 percent of American families hold credit cards, 55 percent of those with cards carry debt, and the average amount of debt is $4,126.

Average Debt of American Families, by Income Range

Family income group	*Families holding credit cards in 2001*	*Cardholding families reporting debt in 2001*	*Average household credit card debt in 2001*	*Percent increase 1989–2001*
All families	76%	55%	$4,126	53%
< $10,000	35	67	1,837	184
$10,000–$24,999	59	59	2,245	42
$25,000–$49,999	80	62	3,565	46
$50,000–$99,999	90	56	5,031	75
$100,000 or more	98	37	7,136	28

Dēmos's calculations from the Survey of Consumer Finances, 1989, 1992, 1995, 1998 and 2001.

As the previous table shows, between 1989 and 2001:

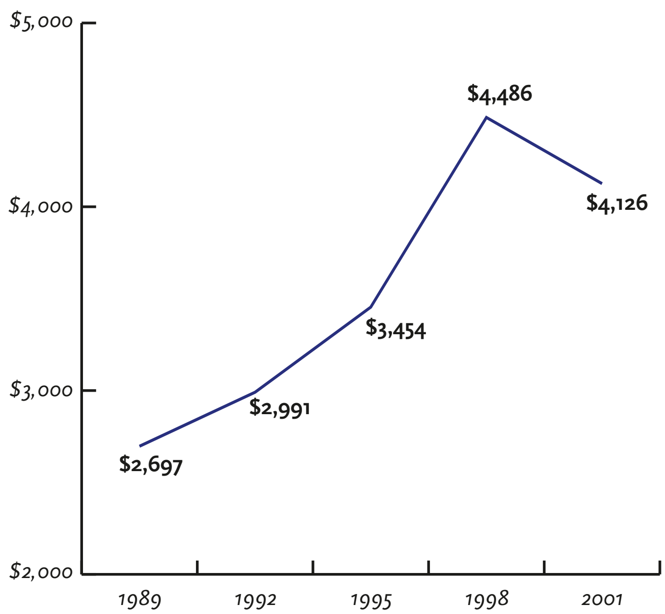
- Credit card debt among **very low-income families** grew by an astonishing **184 percent**. But **middle-class families** were also hit hard—their credit card debt rose by **75 percent**.
- **Very low-income families** are most likely to be in credit card debt: 67 percent of cardholding families with incomes below $10,000 are affected. Moderate-income families are not far behind: 62 percent of families earning between $25,000 and $50,000 suffer from credit card debt.

It is important to note that these figures may be substantially underreported. The absolute figures (for example, $4,126 of average debt) are based on data that consumers reported about themselves in surveys. Aggregate data on outstanding revolving credit reported by the Federal Reserve puts the average credit card debt per household at about $12,000—nearly three times more than the self-reported amount. Although the survey figures may underestimate the severity of credit card debt, they can be compared accurately from year to year, showing us a clear trend: debt skyrocketed for all income groups in the last decade.

It should be noted that while debt substantially increased between 1989 and 2001, average credit card debt fell between 1998 and 2001 for all income groups. Preliminary research and data suggests a portion of credit card debt was transferred using cash-out refinancing, home equity loans, and credit lines—taking advantage of 40-year lows on interest rates during this period. Other factors contributing to the decrease in credit card debt, which is mostly observed in families with incomes less than $50,000, are low unemployment rates and increases in wages during the 1998 to 2001 time period.

However, the declining trend in credit card debt between 1998 and 2001 should be observed with caution, due to the lingering recession that began in March 2001 and the continued rise in unemployment rates.

Average Credit Card Debt in the 1990s



Source: Demos

Average Debt by Race/Ethnicity. Though they may be less likely to have credit cards, the black and Hispanic families who do use them are more likely to have credit card debt than white families. The higher reliance on credit cards among black and Hispanic families may reflect the lower than average incomes, savings, and wealth among these groups.

Race/Ethnicity	*Percent holding credit cards in 2001*	*Cardholding percent reporting debt in 2001*	*Average credit card debt in 2001*
All families	76%	55%	$4,126
White families	82	51	4,381
Black families	59	84	2,950
Hispanic families	53	75	3,691

Dēmos's calculations using 2001 Survey of Consumer Finances.

What's Driving the Rise in Debt?

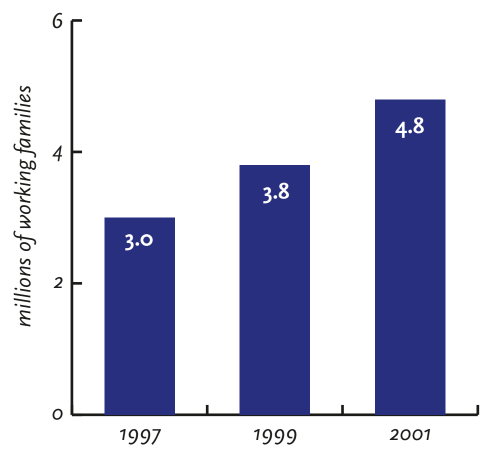
Families with credit card debt are often thought to be shortsighted or ill disciplined, guilty of "living beyond their means." While materialistic pressures or desires are part of the story, major trends in wages, housing costs and health care costs strongly suggest that structural economic factors helped fuel the Decade of Debt.

As the data below indicate, the 1990s saw health care and housing costs rise for many segments of the population, while real wages stayed flat or decreased.

Housing Costs. The number of working families with severe housing burdens—those spending more than 50 percent of their income on housing—grew dramatically in the late '90s. From 1997 to 2001, that number increased by nearly 60 percent, jumping from 3 million to nearly 5 million working families (see graph at right).

Health Care. Health care premiums consistently increased over the decade. Between 1989 and 1990 alone, they jumped 18 percent; between 2000 and 2001, they jumped another 11 percent. In addition, the proportion of individuals whose employers paid the full costs of health coverage fell significantly.

Housing Crisis Increased

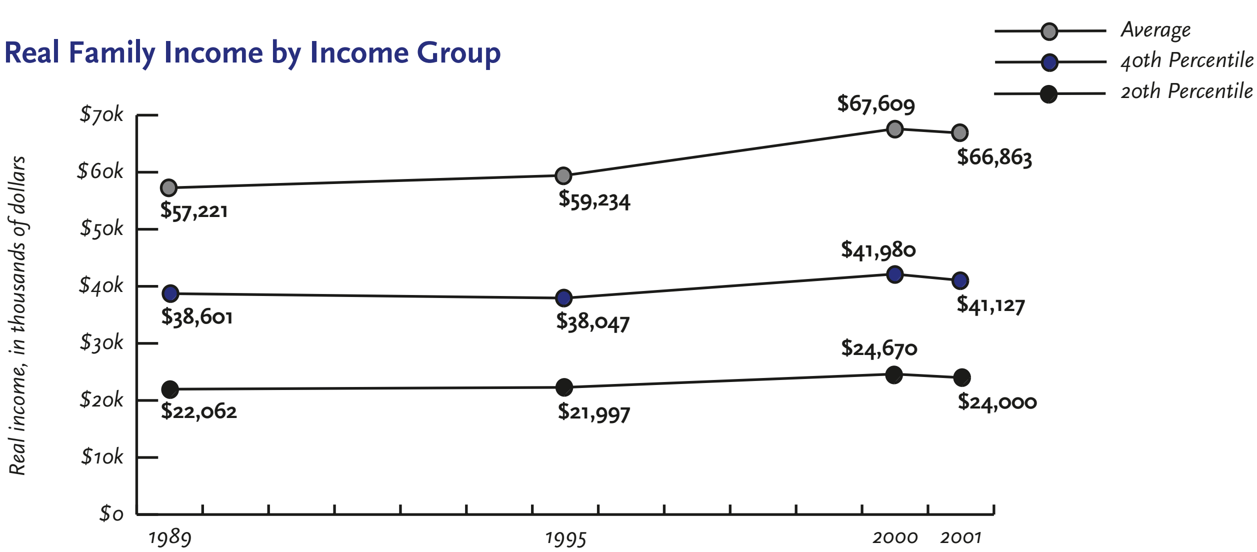


Source: America's Working Families and the Housing Landscape

Real Income. Real incomes for low- and moderate-income families were stagnant or declining. Family incomes for the bottom 40 percent of the income distribution finally rose in the last half of the 1990s, but quickly declined between 2000 and 2001 with the onset of the recession.

Although more research would be needed to establish a causal relationship between these trends and the concurrent rise in credit card debt, the preliminary data suggest a meaningful association.

Real Family Income by Income Group



Source: State of Working America, 2002

Industry Practices in an Unregulated Market

Since the late 1970s, America's credit card industry has enjoyed a period of steady deregulation. Two Supreme Court rulings, the first in 1978 and the second in 1996, effectively hobbled state usury laws that protected consumers from excessively high interest rates and fees. The rulings allowed national banks to charge the highest interest rate permitted in the bank's home state—as opposed to the rate in the state where the customer resides.

Taking advantage of this deregulatory climate, the credit card companies ushered in a wave of unscrupulous and excessive practices in the 1990s—all aimed at keeping consumers in debt. Some of these practices include:

Aggressive Marketing. Direct mail solicitations jumped from 1.52 billion in 1993 to over 5 billion in 2001.

Relentless Credit Extension. Between 1993 and 2000, the industry more than tripled the amount of credit it offered to customers, from $777 billion to almost $3 trillion. The average cardholding household now has six credit cards with an average credit line of $3,500 on each—for a total of $21,000 in available credit.

Amount of Time and Money It Takes to Pay Off Debt at New "Monthly Minimum" Rates

Credit card balance	*Interest rate*	*Years to pay off debt*	*Interest cost*
$5,000	15%	32	$ 7,665
$5,000	18	45	13,531
$8,000	15	37	12,581
$8,000	18	52	22,260
$10,000	15	39	15,857
$10,000	18	56	28,079

Most credit cards assume a minimum payment of 2 percent of the balance or $10, whichever is higher. Source: Dēmos's calculations.

Lowering of Minimum Payment Requirements. Minimum payment requirements—the amount of their balance customers can pay without incurring a penalty—dropped from 5 percent to only 2 or 3 percent, making it easier for consumers to carry more debt. Assuming an interest rate of 15 percent, it would now take more than 30 years to pay off a credit card balance of $5,000 by making the minimum payment.

Skyrocketing Late Fees and Penalties. Late fees have become the fastest growing source of revenue for the industry, jumping from $1.7 billion in 1996 to $7.3 billion in 2001. Late fees now average $29, and most cards have reduced the late payment grace period from 14 days to 0 days. In addition to charging late fees, the major card companies use the first late payment as an excuse to cancel low, introductory rates—often making a zero percent card jump to between 22 and 29 percent.

The credit card industry's punitive practices have paid off. Despite the industry's complaints about sharp increases in delinquencies and charge-offs, credit cards are continually one of the most profitable sectors in the banking industry. Pretax return on assets, a key measure of profitability, averaged 4.2 percent in 2002, the highest level since 1988.

Policy Recommendations

New legislation is needed to protect consumers from abusive industry practices, including excessive interest rates and fees. Additionally, it is important that policymakers acknowledge the growing economic insecurity facing low- and moderate-income families by addressing the lack of savings and assets, low or stagnant wage growth, rising unemployment and soaring housing and health care costs. The following policy recommendations are aimed at jumpstarting a conversation with policymakers, economic security advocates and asset building organizations.

Addressing Industry Practices

- Enacting a National Usury Law
- Regulating Late Payment Policies
- Increasing the Minimum Payment Requirement
- Improving Disclosure of Cardmember Terms

Expanding Asset Building and Access to Credit

- Scaling up Individual Development Accounts
- Increasing Access to Alternative Forms of Short-term Credit
- Expanding Financial Literacy Education

Addressing Economic Insecurity

- Maintaining Bankruptcy Laws for Families in Severe Economic Distress
- Closing the Gap between Earnings and Costs:
    - Increasing the Minimum Wage
    - Bolstering Unemployment Insurance
    - Expanding Health Insurance Coverage and Access to Quality Early Childhood Education and Care

Credit Card Industry Practices

IN BRIEF

Dēmos
A NETWORK FOR IDEAS & ACTION

REGULATORY BACKGROUND

- Before 1978, 37 states had usury laws that capped interest rates and fees on credit cards for customers in their state, most at less than 18 percent APR.[1]
- Two court cases effectively invalidated state usury laws, *Marquette vs. First Omaha Service Corp* in 1978 and *Smiley vs. Citibank* in 1996.
- *Marquette* held that national banks could charge credit card customers the highest interest rate allowed in the bank's home state, as opposed to the customer's. As a result, major banks moved to states like South Dakota and Delaware, where there were no usury ceilings on rates.[2] Because the credit card market is dominated by national issuers, what few state usury laws remain are irrelevant.
- In 1996, *Smiley* effected the same outcome for fees which, like interest rates, used to be regulated at the state level. Late fees averaged $16 before *Smiley*. Now, it's $32.[3]

INDUSTRY PRACTICES

1. Rate hikes and fees for late payments

- All the major issuers now raise a cardholder's interest rate when their payment is late—often to 29% or even 34%. Late payment penalties affect millions of cardholders of all credit risk levels, as there is no longer a late payment **grace period**. A payment is "late" if it arrives after 1:00 or 2:00 on the specified due date. Issuers have also begun systematically mailing statements closer to the due date, giving customers less turn-around time.
- In addition to raising the interest rate on the card, issuers also charge the consumer a late fee, now typically between $29 and $39.[4] According to one survey nearly 60% of consumers had been charged a late fee in the past year.[5]
- Revenue Generated by Late Fees:[6]
  1996: $1.7 billion 2002: $7.3 billion

2. Penalty and Other Fees Skyrocketed in the late 1990s

- While annual fees have largely disappeared, credit card issuers now levy several different fees, other than the late fee: the balance transfer fee; the over-the-limit fee; the cash advance fee and the foreign exchange fee.
- Revenue Generated by All Fees:[7]
  1995: $8.3 billion 2004: $24 billion

3. "Bait and Switch" / Universal Default Policies

- Card issuers now routinely check their cardholders' credit reports and will raise the interest rate on the card if there has been a change in the consumer's score. For example, if a Bank One Visa cardholder is late on their MBNA MasterCard, Bank One will now raise the cardholder's interest rate—even if that cardholder has never missed a payment with them. Interest rate increases can also be triggered when a cardholder's profile has changed due to the addition of new loans, such as a mortgage, car loan or other type of credit.[8]

4. New Low Minimum Payment Requirements

- Credit card companies have also lowered their minimum payment requirement from a standard 5 percent to only 2 or 3 percent of the outstanding balance.[9] This makes it easier for consumers to carry more debt each month. It also ensures more interest income for the card companies, as consumers who pay only the minimum will revolve their balances over a longer period of time.

Amount of time and interest payments for selected credit card balances and interest rates

Credit Card Balance	*Annual Interest Rate*	*Years to Pay Off Credit Card Debt*	*Interest Cost*
$5,000	15%	32	$7,789
$5,000	18%	46	$13,931
$8,000	15%	37	$12,790
$8,000	18%	50	$22,805
$10,000	15%	39	$16,122
$10,000	18%	50	$28,524

Most credit cards assume a minimum payment of 2 percent of the balance or $10, whichever is higher.
Source: Demos' calculations.

5. Aggressive Marketing and Credit Line Extension

- In 1993, credit card companies sent 1.52 billion solicitations to American homes; in 2001, they sent over 5 billion.[10]
- Between 1993 and 2000, the amount of credit extended to the American public grew from $777 billion to almost $3 trillion.[11]

Notes

1. Lewis Mandell. *The Credit Card Industry: A History*. (Twayne Publishers: Boston), 1990. See also, Diane Ellis, "The Effect of Consumer Interest Rate Deregulation on Credit Card Vlumes, Charge-Offs, and the Persaonl Bankruptcy Rate", FDIC, Number 98-05, March 1998, www.fdic.gov/bank/anlystical/bank/bt_9805.html.
2. Vincent D. Rougeau, "Rediscovering Usury: An Argument for Legal Controls on Credit Card Interest Rates," *University of Colorado Law Review*, Winter 1996.
3. Card Web. "Late Fee Bug," *CardTrak*, May 17, 2002; CardWeb. "Fee Revenues," *CardTrak*, July 9, 1999; Card Web. "Fee Escalation," June 18, 2003. www.cardweb.com.
4. Ibid.
5. Ibid.
6. Ibid.
7. Robert D. Manning, *Credit Card Nation: The Consequences of America's Addiction to Credit,* (Basic Books: New York), 2000 and Cardweb.Com, "Fee Income 2003" http://www.cardweb.com/cardflash/2004/january/12a.xcml Figures cited are in nominal dollars.
8. Amy C. Fleitas, "20 Sneaky Credit Card Tricks." Bankrate.com. www.bankrate.com/brm/news/cc/20021106a.asp.
9. Ibid. See also Consumer Federation of America, Press Release, "Credit Card Issuers Aggressively Expand Marketing And Lines Of Credit On Eve Of New Bankruptcy Restrictions, February 27, 2001.
10. Mail Monitor, a service of BAIGlobal, Inc. See also Consumer Federation of America, Press Release, "Credit Card Issuers Aggressively Expand Marketing and Lines Of Credit On Eve Of New Bankruptcy Restrictions, February 27, 2001.
11. Ibid.

PERSONAL STORY

Michelle Gardner, Military Mom

September of 2001 was a hard month for Michelle. First, 9/11 pulled the country to the brink of war, threatening to drag her newlywed husband—a U.S. Army staff sergeant—into active combat. Second, the mail was late.

While the first problem eventually subsided (her husband wasn't shipped out), the second problem set off a chain of events that reads like a Kafka novel about credit card debt.

Michelle's credit card problems started in the summer of 2000, around the time of her wedding. Her husband's military salary brought in about $1,500 a month—hardly enough to support a young family. Expenses from the wedding and from starting a new life together left the couple nearly $8,000 in debt. Michelle quickly realized that her family's financial future was in danger, so she enrolled with Consumer Credit Counseling services to consolidate her debt.

"My credit card payments should reflect my real balance. I'll definitely pay what I owe, but I can't pay these crazy penalty fees!"

Joining CCC gave her a clear plan for working her way out of debt. Every month, she made a $262 payment to CCC, which distributed the money to her creditors. The plan worked smoothly—until September of 2001.

"One of my credit card companies, Cross Country bank, slapped me with some extra charges in October," Michelle says. "When I asked why, they said that [a payment was late], and that gave them the right to stick me with late fees and raise my rates to 27 percent. Well, I told them, 'Of course the payment was late! Didn't you notice 9/11? Didn't you notice the whole anthrax scare shutting down the mail system? Where have you been living?'"

Cross Country had no response to that, Michelle says, and quickly changed their tune. They called her back and blamed the late fees and rate hikes on a "3 percent" rule—if she wasn't paying off 3 percent of her balance each month, the payment plan became invalid and the fees started accruing. Again, Michelle questioned that explanation.

"I wanted to know, when did that rule go into effect? How come you would take my money for almost a year and then all of a sudden change the rules?"

Cross Country backpedaled a second time. They finally sent her a letter saying that she had missed her November billing cycle by two days, thus incurring the extra fees and the rate hikes. But Michelle says she has the documents to prove that the fees started accruing in October—a month before she supposedly missed her payment.

"Look, all I want is for my payments to reflect my real balance," Michelle says. "I'll definitely pay what I owe, but I won't pay these crazy penalty fees. We're a military family living paycheck to paycheck. I'm busy worrying about whether my husband will get sent to Iraq, and trying to take care of my son, and looking for steady work, and now this? It's just too much."

PERSONAL STORY

Roberto Towler, Bankrupt by Credit Card Debt

As a professional accountant, Roberto always used his credit cards with the utmost care. His civil servant salary, around $30,000 a year, did not give him much margin for error. But when life, in his words, "threw me a bunch of curveballs," he had no choice but to rely on his cards—a situation that eventually led him to bankruptcy.

In early 2000, Roberto suffered a significant back injury and had to take unpaid leave from work for two months. Though his health insurance covered most of the medical expenses, the months of lost salary sharply drained his savings. He found himself nervously relying on his credit card.

"I started using my cards for things I'd never charged before," Roberto says. "Toiletries, clothes for my son, groceries ... I was very uncomfortable doing it, but I didn't have much of a choice. I had to feed my son."

After recovering from his injury and going back to work, Roberto slowed down his credit card use as much as possible, but was unable pay off the debt he had accumulated. "I found myself only paying the monthly minimums, which I never did before. But all my paycheck was going to pay my bills. I just didn't have money to pay the credit cards."

Roberto's largest monthly bill was his rent, which has gone up significantly in the past few years. "When I moved into my apartment in 1985, I was paying $363 a month," he explains. "Now, I pay $770. That's a bigger and bigger chunk of my budget all the time. And the landlord doesn't take no for an answer." In fact, Roberto's housing costs became such a burden that at one point, he had to take a cash advance from a credit card to pay his rent.

After another debilitating medical problem and a few months of struggling with increasingly unsympathetic debt collectors, Roberto made the difficult decision to file for bankruptcy. At the time of his declaration, he was $29,000 in debt—$22,000 of credit card debt and $7,000 of medical bills.

"Credit cards are the worst thing I can think of for hardworking people living paycheck to paycheck."

"Credit cards are the worst thing I can think of for hardworking people living paycheck to paycheck," he says. "They [credit card companies] are all about making money, no matter who they are making money from."

Within his community, Roberto is not alone. The Harlem Bethel Gospel Church, where he regularly attends service, recently offered a counseling session on credit card debt. Roberto was surprised to see how many of his fellow congregants attended the event. "There were so many people there, everyone asking different questions, telling their stories," he recalls. "This credit card problem seems to strike everyone."

"For me, life threw a curveball—no, a bunch of curveballs—and I had no choice but to use credit cards," Roberto says. "A lot of things added up in the same time. The cards helped me in the short term, but in the long run, they pushed me into Chapter 7."

PERSONAL STORY

Marika Kovach, Laid Off After 9/11

In May of 2003, Marika, age 61, lost her health insurance. She couldn't afford the $300 monthly premiums after her unemployment benefits ran out in April. She feels healthy enough, she says, and has more pressing expenses to worry about—she has to pay $600 a month to credit card companies, on an income of $0.

Born in Hungary, Marika immigrated to the U.S. in 1962 to escape the repression of the Eastern Bloc. "I consider 1962 my birthday," she laughs, revealing her youthful optimism. In 1992, Marika moved to New York to find a steady job. During her job search, she covered her most basic costs—food, rent, and transportation—with the only source of credit she could find: high interest cash advance loans from her credit cards. After a few months, she landed a full-time secretarial job at music giant BMG. By this time, however, the compound interest had driven her debt up to about $16,000.

"I spent no more than five dollars a day on food.... What money I made went to pay back my credit cards."

"The worst part was in the beginning, with the 20 percent interest rates," Marika recalls. "By the time I started working at BMG, I was paying the credit cards five or six hundred dollars a month, and only covering my interest charges."

Determined to pay off her debts, Marika lived the life of a pauper. "I spent no more than five dollars a day on food," she says. "I never went out, never bought new clothes. I wasn't making that much money, but what money I made went to pay back my credit cards." Her frugal lifestyle helped her slowly chip away at her balance until, after a decade of work, it was down in the low thousands.

Then came 9/11 and New York City's subsequent economic crash. Marika was unexpectedly downsized from her job in November of 2001. At age 59, her prospects for finding employment were slim. But she had no choice—she was still in debt, had no savings, had no family to fall back on, and needed to pay her bills. Besides, Marika has an exuberant work ethic. She constantly talks about her desire to be a productive member of society, in whatever way she can. Not looking for work was unthinkable.

Two years and scores of resumes later, Marika is still unemployed. To meet her basic needs, she has relied on meager unemployment benefits and, once again, credit cards.

At this point, Marika's credit card debt is so high that she is ashamed to reveal an exact figure. "No, I just can't say how much it is," she demures. "That is too personal. But trust me, it is a very large number."

She will, however, reveal some of the details of her life. "I have to be very thrifty," Marika says. "I eat next to nothing. But I must spend some money to feed myself. I cannot eat grass, can I?"

PERSONAL STORY

John Miller, Semi-Retired Business Reporter, Age 64

John, the son of a banker, grew up in an era when credit cards were first introduced to the public. He remembers the first gas cards, the Sears cards, and eventually the Visa and MasterCards of today. As a television business reporter and then small-business owner, John used his credit cards responsibly, building good credit and never falling behind on his payments. After all, he understood better than most how compound interest worked. In his words, "I knew as much about finances as just about anyone."

It was ironic, then, that at age 55 a set of unfortunate circumstances over a two-year period forced John to go into deep credit card debt, and eventually into bankruptcy.

"After a lifetime of financial conservatism and caution, it only took two years of bad luck ... to get myself almost $50,000 in debt."

First, his wife began to have medical problems. Though not terribly expensive, her problems kept her from working, so John was supporting both of them on one income. Second, his video production business, which ebbs and flows with the economic cycles, took a turn for the worse. Third, through selling his home in Park City, Utah, he incurred a significant amount of IRS tax debt, which he owed at the end of the year.

The triple whammy of circumstances forced John to quickly burn through his savings. After that, John began to rely heavily on credit cards. In the space of two years, he amassed about $10,000 in credit card debt, $30,000 of IRS debt, and $7,000 in debt for the condo he moved into. He floated his credit card debt for three years by paying the monthly minimums, but it became clear he wasn't making a dent in his principal. "The minimum payments are intentionally scheduled so that you only pay off the interest, or part of the interest, and never make a dent in the principal. It's a nefarious scheme," says John.

John tried to negotiate with his credit card companies. With his training as a business reporter and his solid credit history, he thought he had a good chance of persuading the companies to lower his rates. But they would not negotiate. They insisted that he pay around 20 percent interest on all his credit card debt.

So John found himself in a strange position. Essentially, he had a choice—pay off his debts, or start saving for retirement. From a financial planning perspective, it made little sense to spend his pre-retirement years paying off high-interest credit card debt, leaving him no money to save for the future. He finally accepted the disappointment of having to tarnish a lifetime of financial responsibility, and filed for Chapter 13—at the rates he was being charged, it was the only viable option.

John has now paid off his debts, and is back to using a credit card sparingly and paying it off normally. In John's words, "I have re-established control over my financial life." In fact, he became so well-educated during his Chapter 13 proceedings—and got so angry about the system—that he is working with Jumpstart, a financial literacy group, to teach young people how to avoid getting caught in the debt trap. He's also considering writing a book. And he's been in conversation with Sen. Orrin Hatch's office about a "debtors bill of rights," because Hatch is the chair of the Judiciary Committee.

This turnaround was not without its emotional toll. "My credit card debt put a tremendous amount of emotional pressure on me," John recalls. "In some ways, their tactics are like legalized extortion."

"When you think about it simply, all of us who get into credit card debt, our stories are the same—we spent above our income, period, and that put us into debt," John says. "People do need better financial literacy. But circumstances happen that no one can control. My credit card companies were unreasonable, and charged outrageous rates."

"I always thought I would be able to catch up, and tried to enjoy the same standard of living even though my expenses were up and my income was down. After a lifetime of financial conservatism and caution, it only took two years of bad luck, tough circumstances, and poor planning to get myself almost $50,000 in debt."