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Changing credit card terms squeeze consumers

By Kathy Chu, USA TODAY

Aggressive rate increases on credit cards are threatening to push struggling consumers into financial ruin, accelerating home foreclosures and the nation's descent into recession.

The growing problem is reflected in cases such as that of Dennis Spaulding, of Corona, Calif. He bought two last-minute plane tickets for his father's funeral in 2006, a purchase that increased the amount of credit he was using and made him appear riskier to banks. The result: Banks raised the interest rates on four of his credit cards — to 24% and higher — doubling his monthly payments to about $2,000.

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That led to a financial spiral that has put him on the verge of losing his home and filing for bankruptcy. "I see no light at the end of the tunnel," says Spaulding, a cabinet designer.

Valerie Walker, of Middletown, Del., tells a similar story: Increasingly high credit card rates mean she's scrambling to pay other debt obligations. She worries about falling behind on bills for her mortgage and business, Subway sandwich franchises.

Across the nation, a growing number of consumers and financial experts are complaining that sudden credit card limit reductions and sharp interest rate increases are triggering a domino effect that makes it harder for consumers to juggle bills, stay in homes and avoid going broke. No official data are available on how many people are being pushed into financial distress by credit cards rather than mortgages. But credit counselors, bankruptcy lawyers and legislators say banks increasingly are pummeling consumers for making the smallest payment error — or making no error at all.

The shift comes as regulators and legislators have spent the last year pointing to toxic mortgages and overextended home buyers as the culprits behind the financial crisis. Credit cards, by encouraging a society of spenders rather than savers, have played a significant role in loading up consumers with unaffordable debt whose rates and terms can change at any time.

"If people get charged 30% interest, that is going to push them over the edge," says Sen. Carl Levin, D-Mich., who has co-sponsored a bill to crack down on credit card fees and rates.

The Federal Reserve is expected to release a rule shortly aimed at cracking down on hair-trigger jumps in card rates and fees, but consumer advocates worry it won't go far enough in reforming credit card practices.

USA TODAY, in previous articles in its "Credit Trap" series, has reported that during the housing boom, banks sharply raised card limits in part because of a surge in home equity, then guided borrowers to use mortgages to pay off card balances. The series also found that banks' practice of packaging and selling credit card debt to Wall Street has given them a powerful incentive to raise card rates and fees.

Now, USA TODAY's interviews with credit counselors, bankruptcy lawyers and other financial experts show that as debt-saddled consumers struggle to stay afloat, banks are aggressively raising rates and fees — often stripping consumers of what little disposable income they have left and threatening to become another drag on the economy. Consumer spending makes up more than two-thirds of U.S. economic activity.

"This is the only credit people have available," says Robert Manning, author of *Credit Card Nation: The Consequences of America's Addiction to Credit.* "You raise their monthly payments … this is going to drive people straight into bankruptcy."

Walker, 52, says she missed a single credit card payment in 2007, causing Juniper Bank, the U.S. credit card arm of Barclays, to impose a late fee and more than triple her interest rate to 20%. She signed up for a credit-counseling program to get a handle on her bills.

Before she could do so, other banks also penalized her, possibly for the late payment to Juniper, a common practice in the industry. Bank of America cut off an overdraft line of credit on her bank account. American Express more than halved her credit line to $14,000, cutting off a key source of liquidity for her business. Then GE Money raised her interest rate to 23% from 16% on a store credit card and lowered her card limit to $100 from $4,000.

"We are still paying our mortgage and our business bills," says Walker, who owes about $35,000 on her credit cards. "But by the skin of our teeth."

Good mortgages, bad cards

Walker's situation is increasingly common, experts say.

"There's a misconception that everybody who comes in the door has a bad mortgage," says Doris Latorre, national director of quality assurance for Acorn Housing, which counsels troubled homeowners. "There are people who have good" mortgages but get into trouble with other loans when their banks change card terms, she says.

Rate increases and dramatic reductions in credit limits can push borrowers deeper into financial distress, rather than encourage them to pay their bills, says Robert McKinley, chief executive of CardTrak.com, a card research site.

American Express, in a statement, declined to comment on individual consumers but said that in general, it reviews credit limits "in an effort to prudently manage risk." GE Money, also in a statement, said it "respond(s) to economic challenges and make(s) adjustments to the portfolios as needed." Juniper Bank said it may adjust credit lines "to ensure the proper credit line assignment is in place." Bank of America, in a statement, declined to comment.

Although consumers typically carry far less credit card debt than mortgage debt, card debt often is more punitive because banks have significant leeway to change terms.

"The computer kicks in and considers this person a credit risk and raises their rate to 30%," which makes it hard for them to pay off that debt in their lifetime, says Marc S. Stern, a bankruptcy lawyer in Seattle.

Even so, 90% of card users will not see their interest rates go up this year, says Scott Talbott, senior vice president of government affairs at the Financial Services Roundtable, which represents the 100 largest lenders. Consumers who do, he says, "can attribute it to their credit history, the economy and the lack of (demand for credit-card-backed securities) in the market."

Spaulding, 40, says he's a conservative spender who got trapped under $70,000 of credit card debt and high finance charges after 15 years of relying on his credit card for emergencies, such as car repairs. In a letter to the Federal Reserve, a bank regulator, Spaulding complained that "credit card companies are the reason why hardworking Americans like myself struggle for years."

Banks started raising his card rates two years ago, after his utilization ratio — the credit he used compared with his available credit — rose above 50%, Spaulding says. He borrowed $16,000 from his 401(k) to cover the higher monthly payments. Even so, he eventually fell behind, leading to rate increases on three other cards.

The higher card payments made it difficult to keep up with his mortgage. And plunging housing prices provided another reason to stop paying his mortgage. Now, he's trying to sell his house for less than he owes on it.

"More likely, I'd still be managing today if the credit card companies didn't raise their rates," says Spaulding, who plans to file for bankruptcy because he doesn't want to be saddled with high-rate card debt when he and his fiancée, Michelle, have their baby in April.

For families living paycheck to paycheck, a jump in credit card rates could mean the difference between paying their bills and putting food on the table, says Stephen Lerner of the Service Employees International Union, whose more than 2 million members include janitors, bus drivers and doormen.

Talbott, of the Financial Services Roundtable, points out that when banks raise credit card rates because of market conditions, they usually give consumers the option to pay off their balance at the old rate — as long as they stop using their card.

But if banks change rates because they consider the borrowers riskier — because they've paid late or have gone over their credit limit, even once — that option won't be available, says Curtis Arnold, founder of CardRatings.com, a credit card site.

Consumer advocates say that while they understand that banks need to make money, steep credit card rates and fees have become more severe than missteps made by consumers.

"...e shouldn't be late fees," says Gail Hillebrand, a senior attorney at Consumers Union, which publishes *Consumer Reports*. But fees, she notes, should be tied to how much a late payment actually costs a bank.

The Federal Reserve is expected to release rules this week to crack down on the most egregious credit card policies, such as raising the rate on existing balances. But some say that the rules won't obviate the need for a law reforming such practices.

Reform is particularly needed, says Jim Campen, executive director of Americans for Fairness in Lending, at a time when consumers are staggering under a record load of high-rate credit card debt. The typical household now has about 11 credit cards and owes $11,211 in card debt, according to CardTrak.com.

Those figures don't include the billions of dollars of credit card debt consumers have rolled into mortgages.

Ken Clayton of the American Bankers Association says, "It's easy to look back and say that credit was too available, but consumers have complete control over how they used their cards."

Banks now are reducing their risk, he adds, by taking actions such as lowering credit card limits, because "that's the prudent thing to do."

A domino effect

As lenders do so, a growing number of borrowers will see higher credit card rates.

Here's why: When lenders lower credit limits, the amount of credit available to consumers is reduced. That increases the percentage of credit that borrowers are using compared with what's available — often hurting their FICO credit score. Lenders use FICO scores, which range from 300 (worst) to 850 (best), to determine how much credit to offer consumers and at what rates.

At a time when consumers already are struggling to stay afloat, lower scores and higher card rates could aggravate their financial problems, says John Ulzheimer, president of consumer education at Credit.com, a consumer information site.

"Now, other issuers think you're high risk, and they may start doing nasty things to you, and it starts snowballing," says Ulzheimer.

Borrowers who don't realize their credit limit has been lowered may also spend above their limit, triggering an over-limit fee and a higher rate, says Bill Hardekopf, chief executive of LowCards.com, a card-comparison site.

So far, overall credit scores have held up "shockingly well," says Mark Zandi, chief economist at Moody's Economy.com, because lenders are still expanding credit to the least-risky consumers, boosting the average credit card limit.

Yet Zandi believes it's probably not a matter of if — but when — credit scores will fall. He expects scores to decline most rapidly in areas where card debt is rising and housing prices are falling.

The potential for consumers' credit scores to fall and their rates to rise — through no action of their own — exposes a serious flaw in the credit-scoring model, some consumer advocates say.

Tom Quinn, vice president of global scoring at Fair Isaac, which developed the FICO score, defends its ability to predict which consumers are more likely to pay their bills. He says, though, that partly because of media inquiries, the company is reviewing how credit-line reductions affect consumers' credit scores.

As a growing number of banks pull back on credit lines, even healthy consumers could be pushed into distress.

Take Mary Craig, 26, of Ashburn, Va. Shortly after American Express lowered her credit card limit by 60%, to $7,200, Craig's credit score dropped from a decent 720 to a mediocre 683, she says. She applied for two loans in recent months, unsuccessfully, and worries that even if she got one, she wouldn't get the best rate because of her credit score.

It's a stinging setback considering that Mary and her husband, Sean, 32, have spent years improving their credit score so they could get a bank loan to consolidate $17,000 in card debt. When she called the bank, a rep told her she'd have to boost her score to 750 to get her limits raised.

It's a no-win situation, she says, because, "How can I increase my score to 750 when (the bank's actions) have no doubt damaged it?"

American Express spokeswoman Kimberly Forde says consumers' overall debt levels are the primary factor for any credit limit reduction, but the bank also looks at borrowers' payment history and credit score, among other information.

Craig worries that American Express and other banks will raise her rates because of her reduced credit score. "That," she says, "would put us in hot water."