Bankruptcy Is the Cost of the Way the Credit Card Industry Does Business

One newspaper article in 1997 told me all I needed to know about the business model for the credit card industry. Beneficial National Bank, the credit card lender for BJ's Warehouse, notified 12,000 of its customers that it was revoking their credit card privileges. A logical guess would be that they were bad customers, paying late or not at all. In fact, their crime was paying the balance off in full every month, avoiding the assessment of interest and fees. Rather than find ways to encourage such behavior, credit card industry executives denigrate this type of customer, actually referring to them as 'deadbeats.'

Despite the risk of default, the industry prefers to target 'revolvers' -- or those who carry a balance forward from month to month -- because this is where the real profit is. Considering that a minimum payment only reduces the amount owed by 4%, targeting 'revolvers' is a lucrative proposition as it can take 11 years to pay off as little as $5,000 depending on the interest rate. The real bonanza, however, begins when a 'revolver' suffers a default, permitting the assessment of "vig" that would make Tony Soprano jealous. Credit card fees make companies like Citibank more profitable than Microsoft. Like the mob, once the credit card industry gets their hooks into you, the intricate system of fees and higher interest rates is designed to get them in so deep you'll never escape.

Just as the tobacco industry used to target teens to replace older smokers who died, the credit card industry now targets college students to replace older debtors who may file bankruptcy, following the same maxim -- 'you have to start 'em young.' A Sallie Mae study found that 82% of college students fit the preferred profile as being 'revolvers.' Since 2004, the percentage of freshman with at least one credit card has risen from 15% to 69%. College students have an average of 4.6 cards with eighty-four percent having at least one. An increasing number of college students now use credit cards to supplement student loans for tuition and books. Credit card companies became so aggressive in targeting college students that in 2009 Congress outlawed the practice of offering preapproved credit cards to students with no income absent a co-signer, and also banned credit card solicitors from campus. Undaunted, companies continue to circumvent the intent of the law by bombarding college students with credit card offers that are not preapproved. A study by Professor Jim Hawkins of the University of Houston Law Center found that 76% of undergraduates have received at least one credit card offer in the past year, and two-thirds of students report seeing credit card solicitors set up just off campus. Indiscriminate approval of credit card applications led Capital One recently to approve a $500 credit line for a five year old girl in Wallingford, Connecticut. This wasn't surprising as one of my clients told me his 5-year-old daughter had just received her first credit card offer in the mail.

There is a method to the industry's seeming madness in relentlessly targeting college students with little or no income. In my opinion, the credit card industry targets 'revolvers' not in spite of the risk of default, but -- at least in part -- because of it. Credit card companies know full well that a 'revolver' at some point...
will suffer a life catastrophe -- a job loss, a drastic reduction in income, a medical problem or family breakup. Shrewdly lying in wait, they are poised to reap a financial windfall when this occurs -- raising the interest rate and tacking on as many fees as possible, so the balance doesn't move -- the exact opposite of what a customer needs at that point. For proof, one need look no further than the recent announcement by Bank of America, the nation's largest bank, that it intends to increase interest rates to 29.99 percent for any customers missing even one payment. Prior to 1978, virtually all states had usury laws that made it illegal to charge exorbitant rates of interest. In Minneapolis v. First of Omaha, however, the US Supreme Court essentially deregulated bank lending rates, authorizing any interest rate as long as legal in the state where the bank was incorporated. Banks began flocking to incorporate in South Dakota, and later, Delaware, due to the bank friendly laws there which did away the limits on how much interest a bank could charge. In 1996, in Smiley v. Citibank, the US Supreme Court also prohibited states for regulating the fees of national banks, further unleashing this business model on American consumers.

Consumers are taken aback when they learn that years of faithful payments count for nothing when they need help. The vast majority of my clients report that lower monthly payments are not an option as the phone calls become relentless. To stop the harassment, many consumers 'tread water' for as long as they can, paying the minimums. My clients often liquidate 401ks, saving accounts and kids' college funds, trying to infuse cash into a situation that is spiraling out of control. I regularly meet with clients who have done this for a year or two, slowly dissipating retirement monies that may never be replenished, but regarding this as preferable to filing bankruptcy. I feel bad when I meet with clients that have done this because I know they could have kept their pension in its entirety in a bankruptcy. Bankruptcy, however, is not on anyone's list of fun things to do. As a last resort, people consider a bankruptcy only when the alternative is worse. With ordinary Americans making less and paying more for things like gas, many become tapped out, and enter the next stage of the crisis -- having to juggle payments, often having to choose between paying a mortgage or paying the credit cards. To prevent 'revolvers' from escaping through a bankruptcy, the industry spent more than $100,000,000 lobbying Congress to toughen the bankruptcy laws in 2005 through things like mandatory credit counseling. A study by the US General Accounting Office in 2010 criticized this requirement, finding that consumers are usually too far gone by the time they consider a bankruptcy to make credit counseling an effective alternative. The industry couldn't outlaw bankruptcy, so they made the process more expensive.

It isn't surprising that the targeting of 'revolvers' doesn't stop with the filing of a bankruptcy. In my own practice, clients are incredulous to receive credit card offers within months of discharge in a bankruptcy. One client told me that Capital One had offered him a new card even though Capital One had been included in his bankruptcy. Having learned his lesson, he declined, as do virtually all of my clients, refusing to let the credit card industry entice them back onto that treadmill of revolving debt again. They understand that there will never be a bailout for the little guy, and that a bankruptcy is the closest they'll ever get to one. Unlike the credit card industry though, bankruptcy clients have no desire to ever repeat the process that got them there in the first place.
Suggestions:

(1) If you are a 'revolver,' don't assume that credit card defaults can never happen to you. Even in the most well-intentioned life, things have a way of spiraling out of control at some point. I have represented doctors, lawyers, judges, bank vice presidents, and debt collectors. No one is immune. Unless you exercise caution by refusing to spend as much as you're making in the good times, the credit card trap will likely spring shut on you in the bad times. Pay more than the minimums if possible, and avoid cards that have high penalty interest rates.

(2) If the worst has already happened, look for a global solution for all of your debt. People in crisis often lose perspective, putting out 'brush fires' with individual creditors, rather than looking for a solution to their debt as a whole. Placating one nagging creditor may lessen your aggravation, but makes no sense if you're still left with overwhelming debt. It is understandable to hope your situation is only temporary. One sign you're gone beyond that into the danger zone is if you're using cash advances to stay up to date on all your payments or putting food or gas onto the cards. This constructs a 'house of cards' that will eventually topple over of its own weight. The sooner you come to grips with your situation, the more likely it is you can make a controlled rather than a crash landing. If your 'take home' pay is insufficient to pay all your debt, prioritize payments towards that which is most important to you -- your house, your car to get to work, etc. It's surprising when clients tell me they've gotten behind on their mortgage trying to keep their credit card companies happy.

(3) Draining a 401k or pension. Make a hard decision before you liquidate pensions -- not only for the obvious reason that you will need that money to retire, but also because if this doesn't solve the problem, and you still have to file bankruptcy, you could have kept your pension in its entirety.

(4) Avoid home equity loans. If you're one of the lucky few who actually has home equity, taking out an equity loan to pay credit cards is rarely a good idea as it places your home in jeopardy if you default. In New Hampshire, the first $200,000 of home equity for a married couple is exempt from creditors even in a bankruptcy unless you choose to share it with them. Bankruptcy is not on anyone's top ten list of fun things to do, but people consider it when the alternative has become worse.

The above is not intended as legal advice for your particular situation. Questions should be addressed to attorneys admitted to practice within your state. Richard Gaudreau is a consumer bankruptcy attorney admitted to practice in New Hampshire (NH) and Massachusetts (Ma) and may be reached through his website at attorneygaudreau.com, by email at Richard@attorneygaudreau.com, or by calling 603-893-4300.