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Banks Get Picky In Doling Out Credit Cards

BY JANE J. KIM

When Edward Miller recently applied for a **Charles Schwab** Corp. credit card, a company representative asked him to fax in copies of his bank-account statements to verify his net worth.

It was "a bit of a hassle," says the 64-year-old retired economics and finance professor from Bethesda, Md. He complied and was eventually approved for the card—with a $5,000 limit.

After years of mailing cards out to just about anybody, banks are suddenly freezing out all but the most creditworthy customers. Those who do get cards have to jump through more hoops, such as sending in copies of their pay stubs. And they're being hit with higher rates and fees.

Banks always tighten credit standards in an economic slowdown. But the recently passed Credit Card Act of 2009 is forcing the industry to rewrite the play book it has used for years. The new legislation aims to limit fluctuating interest rates, ban some controversial practices and arm consumers with more information on their debts.

Tighter Limits

Banks' responses to legislative and economic changes include:

- Tightening standards for credit-card applicants, rejecting more people and offering smaller credit lines.
- Raising interest rates and fees and switching customers with fixed rates to variable ones.
- Enhancing rewards programs for a few customers but adding more fees.

Banks have until February 2010 to comply with the act's key provisions, although some parts of the law have earlier deadlines. Beginning in August, for example, issuers have to mail bills at least 21 days before the due date and provide at least 45 days' notice before changing any significant terms on a card.

The result: Many banks are tightening things up now before many of the restrictions go into effect.

For consumers, the tougher underwriting standards by banks may seem like a pendulum shift back to an earlier era when credit cards sported annual fees and double-digit interest rates.

In recent years, issuers cast as wide a net as possible by offering credit to millions of customers, knowing they could always raise rates on those who turned out to be bad bets. That pricing flexibility helped firms rapidly expand their operations, as those with less-than-stellar credit—many of whom carried a balance or paid late fees and penalty rates—generated millions of dollars in revenue.

Now, the industry is scrambling to figure out who its new profitable customer is. "Without the ability to reprice customers, raise fees or rates, the old profitability calculation won't apply," says Alan Mattei, managing director at Novantas LLC, a bank consulting firm.

In recent months, banks including **Bank of America** Corp., **Citigroup** Inc. and **J.P. Morgan Chase** & Co., have raised interest rates and fees,

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switched customers with fixed rates to variable ones, and dropped credit lines and closed accounts. Credit Suisse Group's Moshe Orenbuch expects credit-card balances could shrink by 10% to 15% through 2012 as banks drop their teaser-rate offers and cut back on offering credit to riskier customers.

Charles Crawford of Grand Prairie, Texas, says that Bank of America raised the interest rate on his $19,000 balance to 23.2% from 12.2% starting with his June statement, citing his high balances. Mr. Crawford says the move nearly doubled his monthly finance charges to about $420 from about $220. "I feel so upset with them that I was thinking about not paying them," says the 58-year-old engineer.

Repricing Accounts

Although Betty Riess, a spokeswoman for Bank of America, declined to comment on an individual account, she noted that the bank periodically reviews individual accounts and may reprice an account for risk, based on the individual's performance and external credit-risk factors.

In April, Bank of America also notified some customers who had interest rates below 10% that their rates would increase starting with their June statements, reflecting current economic conditions and the cost of providing credit, says Ms. Riess. In both cases, individuals could call and opt out of the new rate, and pay off any outstanding balances under the old rate, as long as they stopped using the cards.

"Prior to the Card Act, we were able to charge people for the risk they posed and, as a result, also allowed others to pay lower rates," says Kenneth Clayton, senior vice president of card policy at the American Bankers Association, a trade group in Washington.

Banks are also facing higher losses due to the economy and higher funding costs, all of which make it harder for them to lend, he says.

For consumers, this means that not only will it be harder and more expensive to get credit, but the average credit line that gets assigned up front will be less generous, says Rich Tambor of Novantas. That would have been true in any economic slowdown, but the legislative changes are exacerbating those trends. For example, the percentage of credit applications that are getting a "human look" is increasing, he says. **Discover Financial Services**, for one, says it has been doing more manual underwriting of new applications due to the economic environment.

In the short term, banks will focus on making up for lost revenue by getting existing customers to spend more—mainly by offering targeted reward programs, says Gene Truono, managing director at BDO Seidman LLP's BDO Consulting.

He expects that annual fees, including fees to redeem rewards points, will go up. In the meantime, loyalty offers—such as bonus cash-back incentives—to existing customers are up through the second quarter, in contrast to overall offer mailings, which are down sharply, according to Mintel Comperemedia, a market-research firm.

Two Flavors

Eventually, issuers' products could boil down to two main flavors: no-fee, no-frills cards that can be offered to a broader group of customers, and "premium" rewards cards with annual fees, says Megan Bramlette of Auriemma Consulting Group.

Chase's new rewards program, for example, features two cards: the Chase Freedom card, a no-fee card that earns 1% cash back on all purchases (with quarterly bonus opportunities), and a Sapphire Preferred card with enhanced rewards benefits for a $95 annual fee.

The Chase Freedom card also comes with an upgraded feature that lets customers earn a fixed 3% bonus for spending in grocery, gas and fast-food categories for a $30 annual fee.