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Credit Card Firms Won as Users Lost ;

They sought new laws but found ways to make money even on people who went bankrupt.

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In the eight years since they began pressing for the tough bankruptcy bill being debated in the Senate, America's big credit card companies have effectively inoculated themselves from many of the problems that sparked their call for the measure.

By charging customers different interest rates depending on how likely they are to repay their debts and by adding substantial fees for an array of items such as late payments and foreign currency transactions, the major card companies have managed to keep their profits rising steadily even as personal bankruptcies have soared, industry figures show.

As a result, while they continue to press for legislation that would make it harder for individuals to declare bankruptcy, the companies have found ways to make money even on cardholders who eventually go broke.

At the same time, under the companies' new systems, many cardholders -- especially low-income users -- have ended up on a financial treadmill, required to make ever-larger monthly payments to keep their credit card balances from rising and to avoid insolvency.

"Most of the credit cards that end up in bankruptcy proceedings have already made a profit for the companies that issued them," said Robert R. Weed, a Virginia bankruptcy lawyer and onetime aide to former Republican House Speaker Newt Gingrich.

"That's because people are paying so many fees that they've already paid more than was originally borrowed," he said.

In addition, some experts say, the changes proposed in the Senate bill would fundamentally alter long-standing American legal policy on debt. Under bankruptcy laws as they have existed for more than a century, creditors can seize almost all of a bankrupt debtor's assets, but they cannot lay claim to future earnings.

The proposed law, by preventing many debtors from seeking bankruptcy protection, would

compel financially insolvent borrowers to continue trying to pay off the old debts almost indefinitely.

"Until now, the principle in this country has been that people's future human capital is their own," said David A. Moss, an economic historian at Harvard University. "If a person gets on a financial treadmill, they can declare bankruptcy and have what can't be paid discharged. But that would change with this bill."

Debate about the bill continued Thursday, with the Republican-controlled Senate refusing to limit consumer interest rates to 30%. The vote was a bipartisan 74 to 24 to kill a proposed amendment by Sen. Mark Dayton (D-Minn.). Senate passage of the bill is expected next week.

The House has not taken up the issue this year, although it passed a version of the bill last year, as did the Senate. Attempts to reconcile the two bills failed.

Industry officials have sought to minimize the role of credit card companies in pushing for bankruptcy legislation since 1998. They have argued that the bill introduced last month by Republican Senate Finance Committee Chairman Charles E. Grassley of Iowa and supported by President Bush would affect about 5% of the roughly 1.6 million Americans who file for bankruptcy each year.

They have portrayed the measure's principal target as high-income individuals who are abusing the law to escape their debts.

"The bottom line is that there are people out there who are able to pay their bills who are not paying," said Tracey Mills, a spokeswoman for the American Bankers Assn., which represents most of the major credit card companies.

But consumer advocates, many academics and some judges and court officials argue that the bill would sharply reduce the number of Americans able to file for bankruptcy, even in instances where doing so would buy them time to repay their debts.

The critics argue that people unable to file would be at the mercy of increasingly aggressive efforts by lenders -- especially credit card companies -- to raise fees and boost collections.

People like Josephine McCarthy, for instance, a 71-year-old secretary at the Salem Baptist Church, less than a mile from where the Senate bill is being debating.

According to papers in her recent bankruptcy, McCarthy discovered at about the time of her husband's death in 2003 that the couple had a $4,888 balance on a Providian Financial Corp. Visa card and another $2,020 balance on a Providian Mastercard.

Over the two years from 2002 until early 2004, when she filed for bankruptcy, McCarthy charged an additional $218 on the first card and made more than $3,000 in payments, the court papers show. But instead of her balance going down, finance charges -- at what the bankruptcy judge termed a "whopping" 29.99% rate, together with late fees, over-limit fees and phone

payments fees -- pushed what she owed up to more than $5,350.

In the case of the second card, the papers show that McCarthy charged an extra $203 and made more than $2,000 in payments, but again fees and finance charges pushed the balance up.

McCarthy refused to comment on the case. A spokesman for Providian could not be reached last night.

But court papers show that McCarthy eventually paid all the bills in the case, including back taxes. The way she did it, using provisions of bankruptcy law, illustrates one of the problems with the proposed new law, critics say.

McCarthy had been making mortgage payments on two houses. She wanted to sell one of the houses to pay off her debts, but the house was entangled in legal difficulties. By declaring bankruptcy, she was able to stop the clock on her escalating credit card debts and give her lawyer time to clear up the legal problem, enabling her to sell the house and pay off the bills.

Under the proposed new law, McCarthy, who makes about $55,000 a year, would have had a much harder time qualifying for the bankruptcy protection that allowed her to pay creditors.

"The McCarthy case shows how hard-working people making good incomes can end up in situations that they can't dig themselves out of unless they file for bankruptcy," said Weed, her lawyer.

Credit card companies have come in for harsh criticism in recent years for their penalty fees and the "risk-based pricing" under which they charge customers different interest rates depending on their credit histories and their likelihood of paying.

Consumer advocates have accused firms of not adequately disclosing such controversial practices as universal default, when a company can jack up a cardholder's annual percentage rate, often to more than 30%, based on the cardholder's performance with another creditor, not the card company.

Regulators and law enforcement officials have accused companies of deceptive practices. In 2000, the U.S. Office of the Comptroller of the Currency and the San Francisco district attorney's office ordered Providian to pay $300 million in restitution after customers complained that the company didn't credit their payments on time and then imposed late fees.

A stream of court cases involving credit card companies has produced public outrage in various parts of the country.

In Cleveland, a municipal court judge tossed out a case that Discover Bank brought against one of its cardholders after examining the woman's credit card bill.

According to court papers, Ruth M. Owens, a 53-year-old disabled woman, paid the company $3,492 over six years on a $1,963 debt only to find that late fees and finance charges had more

than doubled the size of her remaining balance to $5,564.

When the firm took her to court to collect, she wrote the judge a note saying, "I would like to inform you that I have no money to make payments. I am on Social Security Disability.... If my situation was different I would pay. I just don't have it. I'm sorry."

Judge Robert Triozzi ruled that Owens didn't have to pay, saying she had "clearly been the victim of [Discover's] unreasonable, unconscionable and unjust business practices."

Efforts to reach Owens were unsuccessful. A spokeswoman for Discover said she could not comment on the case.

Analysts said that lost in the uproar over particular practices and cases is the fact that the credit card industry has almost completely remade itself in the years since it began pushing for passage of the bankruptcy bill -- a makeover that has left some analysts wondering why the industry needs the changes in bankruptcy law.

"The idea that companies are losing their shirts on bankruptcies is a lot of bull," said Robert B. McKinley, chief executive of CardWeb.com, a Frederick, Md., consulting group that tracks the credit card industry. "With these rates and fees, the card industry is a gravy train right now."

Mills, the bankers association spokeswoman, said bankruptcies affected all American households in the form of higher costs and lower returns on investments.

As recently as the late 1980s, credit card companies offered a one-size-fits-all card with a fixed interest rate and an annual fee. Virtually all cards went to middle-class borrowers with good credit histories; issuing cards to poor or high-risk borrowers was almost unheard of.

But in the early 1990s, companies such as AT&T and General Motors began issuing cards with variable rates and no fees, increasing competition. And by the middle of the decade, card companies were finding their traditional middle-class markets saturated.

Their response: lend to riskier customers and make up for the danger of more defaults by charging higher rates and then new fees.

McKinley, the industry analyst, said the firms were helped by a 1996 Supreme Court case that gave card companies new protections against state regulation of fees.

"That really opened the flood gates. It set off a fee frenzy," he said.