

August 19, 2002

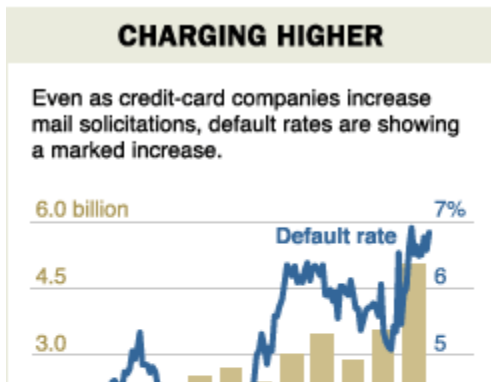
PAGE ONE

Credit-Card Scrutiny Hits Lenders And Threatens to Damp Spending

By CARRICK MOLLENKAMP
Staff Reporter of THE WALL STREET JOURNAL

A federal crackdown on credit-card lending is squeezing some lenders even before proposed guidelines take effect, and threatens to pinch consumer spending.

The new scrutiny is aimed at reducing a rapid rise in consumer debt and defaults. It tests the so-called subprime credit-card business that caters to customers with poor credit or low income, which grew quickly during the booming 1990s and is seeing its first economic downturn. Already, the government's attention has pushed some credit-card companies specializing in the subprime market -- estimated by one credit bureau at as much as 37% of credit-card loans -- to move toward increasing their reserve funds and change accounting and lending practices.



Credit-card giant **MBNA Corp.** said in a filing last week that it would have to set aside an extra \$200 million to \$300 million in reserve funds to meet the proposed requirements, a month after a top rival, **Capital One Corp.**, increased its reserves by \$247 million at the request of regulators. After the federal review, Capital One disclosed

SUBPRIME PROBLEMS

- [Subprime Lending Stays Strong Despite Fed Warnings, Poll Finds](#)¹
08/08/02
- [Regulators Issue Draft Rules to Monitor Subprime Loans](#)²
07/23/02
- [Capital One Shares Fall 40% on Warning From Regulators](#)³
07/18/02
- [African-Americans Call on Bush to Focus on Predatory Lenders](#)⁴
07/18/02
- [Efforts by Citigroup to Reform Subprime Unit Raise Questions](#)⁵
07/18/02
- [Fannie Mae's Attempts to Avoid Predatory-Loan Laws Irk Some](#)⁶
04/24/02
- [Spending Tempers Downturn, but Debts May Slow Recovery](#)⁷
01/02/02

COMPANIES

that nearly 40% of its loans were subprime, twice what some Wall Street analysts had estimated.

Such a breakdown also had been requested by the Securities and Exchange Commission last November, according to an SEC letter. The stepped-up federal scrutiny reflects growing concerns that some credit-card companies, eager to maintain revenue gains, have expanded their accounts too quickly without consistent accounting standards and enough safeguards to monitor risk. Consumers, deluged with the highest volume of mail solicitations in a decade, have scooped up credit-card offers only to fall deeper into debt.

Some analysts also expect the crackdown on subprime loans to spread to more parts of the lending industry, including banks issuing credit cards and financial companies offering auto and home-equity loans. "The issues they are talking about are no different in auto or home equity lending," said Charles Peabody, an independent financial institutions analyst at Portales Partners LLC in New York. Regulators have announced no such plans, however.

An effort to slow the growth of credit-card lending to high-risk consumers, while healthy for the economy in the long run, could damp consumer spending at a difficult time. Consumer spending has propped up the U.S. economy during its recent slowdown but has been accompanied by a rise in personal debt. In the last several weeks, makers and retailers of goods such as furniture and consumer electronics, along with consumer-entertainment venues such as amusement parks, have reported lower sales tied to worries about the economy and the stock market. A tightening of lending to subprime borrowers would impact a large part of the country, though estimates differ and regulators are still struggling to define the term. Equifax Inc., a credit bureau in Atlanta, arrived at its estimate of 37% of credit-card loans in a survey done for Capital One.

In July, the Federal Financial Institutions Examinations Council, an umbrella group representing five regulators of financial institutions, issued new credit-card guidelines. The new rules were aimed at cleaning up inconsistent accounting methods, slowing down the issuance of credit to consumers who can't pay it back and ensuring that credit-card companies are adequately reserved for bad loans and the fees tied to the loans. The move came after regulators at the federal agencies compared notes and discovered they were finding many of the same problems at companies specializing in subprime debt. The industry was given until Aug. 9 to respond, but that deadline was extended to Sept. 23 after credit-card companies asked for more time.

The new guidelines require companies to account immediately for portions of loans they forgive. They require the companies to better evaluate candidates for credit based on such things as repayment history rather than indiscriminately giving new credit lines to customers already in debt. For example, a customer behind in payments might be given a new credit limit, a practice which can increase the debt rather than capping credit lines until the debt is repaid.

Regulators also want credit-card companies to set aside capital reserves for uncollectable fees and finance charges tied to credit cards.

The number of credit-card solicitations multiplied in the last decade, from about one billion a year in 1991 to about five billion in 2001, according to BAIGlobal Inc., a Tarrytown, N.Y., market-research firm. During that same period, the credit-card default rate doubled to nearly 7%, according to an analysis of 37 credit-card portfolios by Standard & Poor's Corp. This year, the Consumer Credit Counseling Service of Greater Atlanta Inc., which helps people get out of debt, has received 293,055 calls from people needing help, many focused

Dow Jones, Reuters

MBNA Corp. (KRB)

PRICE 19.55
CHANGE -0.45
U.S. dollars 4:02 p.m.

Capital One Financial Corp. (COF)

PRICE 34.98
CHANGE 0.18
U.S. dollars 4:02 p.m.

Provident Financial Corp. (PVN)

PRICE 5.26
CHANGE -0.19
U.S. dollars 4:01 p.m.

Metris Cos. Inc. (MXT)

PRICE 3.51
CHANGE -0.12
U.S. dollars 4:01 p.m.

* At Market Close

on credit-card debt. That is 32% more calls than in all of 2001.

One example is Heather Bullock, a 25-year-old from Lake Worth, Fla., who had 13 credit cards and was \$15,000 in debt by August 2000. Ms. Bullock, who processes insurance claims for a dentist's office, sought the assistance of Consumer Credit Counseling to work out payments. In her effort to save enough to get out of debt by next year, "I can't even keep cash on me," she says. But she continues to receive mail solicitations offering her new credit cards.

Increased scrutiny by banking regulators has contributed to sharp declines in the stocks of many of the providers, which also include **Providian Financial Corp.** and **Metris Companies Inc.** "This business continues to grow and the risk associated with it continues to increase," said John Price, director of supervision policy at the Office of Thrift Supervision.

Many credit-card issuers say that they are already being prudent. "Capital One remains focused on providing clear and transparent disclosure on our loan portfolio," said company spokeswoman Tatiana Stead. "We will continue to evaluate our disclosure as the market, the industry and our business evolve, balancing our business needs with the interest of the market."

Credit analysts at Standard & Poor's on Friday issued a report looking at regulators' efforts to better scrutinize the credit-card industry. "The fear is these loans are being extended indiscriminately," said S&P analyst Daniel Martin. Regulators, trying to get a handle on how much subprime credit-card lending exists, next year will require for the first time that companies report their subprime levels.

Alarm bells in the industry were triggered after several credit-card companies ran into financial trouble in recent months. This year, the Comptroller of the Currency shut down NextBank, a bank unit of NextCard Inc. of San Francisco, that had gained attention by offering cards over the Internet. Regulators this year also ordered catalog retailer Spiegel Group of Downers Grove, Ill., to boost reserves after problems with increasing delinquencies. Spiegel Group is now trying to find a buyer for the credit unit, First Consumers National Bank.

The latest issues have surfaced at Capital One, a credit-card company in Falls Church, Va. Previously, investors had considered Capital One immune to problems because the company touted a technology that could figure out ways to provide credit while protecting the company from big losses. But earlier this month, regulators told the company to shore up its reserves.

Separately, securities regulators have urged Capital One to better disclose in securities filings how much of its portfolio is subprime, according to investor newsletter SEC Insight Inc. In a November letter, the SEC told Capital One to "consider providing a breakdown of your loan portfolio into prime and subprime loans."

A spokeswoman for Capital One said that it felt it provided the necessary disclosure as part of its agreement with banking regulators last month. She said no decision had been made whether Capital One will continue to break down its loan portfolio in future securities filings. In its regular quarterly securities filing last week after the agreement with the government, the company didn't break down its portfolio.

Write to Carrick Mollenkamp at carrick.mollenkamp@wsj.com⁸

URL for this article:

<http://online.wsj.com/article/0,,SB1029706103506414275.djm,00.html>

Hyperlinks in this Article:

(1) <http://online.wsj.com/article/0,,SB102874984813746560,00.html>

(2) <http://online.wsj.com/article/0,,SB1027373578695492560,00.html>

- (3) <http://online.wsj.com/article/0,,SB1026943366613877920,00.html>
- (4) <http://online.wsj.com/article/0,,SB1026955550976098240,00.html>
- (5) <http://online.wsj.com/article/0,,SB1026940736344091640,00.html>
- (6) <http://online.wsj.com/article/0,,SB1019594806998437560,00.html>
- (7) <http://online.wsj.com/article/0,,SB1009919429626001480,00.html>
- (8) <mailto:carrick.mollenkamp@wsj.com>

Updated August 19, 2002

Copyright 2002 Dow Jones & Company, Inc. All Rights Reserved

Printing, distribution, and use of this material is governed by your Subscription agreement and Copyright laws.

For information about subscribing go to <http://www.wsj.com>