Neighborhood Trust Financial Partners' Comment in Response to CFPB's Request for Information Regarding Consumer Credit Card Market

Docket No. CFPB-2023-0009
RE: Section 1c - Terms of, and practices related to, major supplementary credit card features (i.e. balance transfers)

Neighborhood Trust Overview: Neighborhood Trust is a national nonprofit social enterprise and marketplace innovator whose purpose is to transform workplaces and financial services to better meet the financial needs of low-wage workers. We create financial security for low-wage workers by delivering trusted financial coaching that enables them to reduce debt, improve cash flow and build savings as a buffer against financial shocks. We also leverage our core financial coaching operation to translate our data and trusted relationships with workers into actionable insights that fuel innovative new products, services and benefits, and drive market-level change.

To put together this comment, our team of expert Financial Coaches shared their perspectives on balance transfers and the current state of the market based on their combined 70 years of working with low-wage workers across the country and serving 3,000 clients every year.

Recommendations: For balance transfer cards to better support the financial security and protection of low-income consumers, there are a range of opportunities for improvement. In order of priority, here are our key takeaways and recommendations for better regulating the balance transfer market:

1. Ban retroactive interest on balance transfer cards.
2. Inform consumers how much they need to pay monthly in order to pay their balance off in full within the promotional period, up-front during the application process and once approved; and update the amount in every monthly statement.
3. Implement flexible repayment timelines based on history of consumer payments to make it easier for low-income consumers with strong credit to utilize balance transfers to reduce their debt and strengthen their financial security via affordable monthly payments.
4. Require lenders to send automated alerts letting consumers know when the promo period is about to expire.
5. Create a flat transfer fee that enables consumers to be clearly informed of the exact cost of the card and doesn't extract needless fees. 3-5% often makes these cards unaffordable for low-income consumers.
6. Require lenders to offer interest calculators to estimate how much a balance transfer could save a borrower given $X payment per month, relative to the APR on their current credit card
7. Change the structure of balance transfers so you can't make new purchases on the card until it's fully paid off. Or alternatively, don't provide a card in the mail or via ApplePay until it's paid off.

8. Create a self-sustaining cyclical balance transfer card that enables people to transfer their debt onto the same card once the initial transfer is paid off. Restart the promo period and charge another transfer fee, but save people the hard credit pull to avoid further hurting their access to affordable credit.
9. Require lenders to offer a live chat or call feature with a representative (including in non-English languages) as part of the application process to ensure the borrower has a sufficient opportunity to understand the product and has a plan for paying it off.

Current State of the Balance Transfer Card Market: Financial Coaches noted that there are several companies beginning to offer timelines of up to 21 months for their 0% APR promotional period. Coaches shared that while balance transfer cards remain imperfect for their low-income clients, the steadily increasing introductory APR timeline over the last few years makes them a much better product than in the past.

However, Financial Coaches explained that across the board balance transfers are marketed in potentially misleading ways. Balance transfers are not often marketed as a debt consolidation or refinancing tool, but rather as an “exciting low-interest option for gaining access to more credit.” As a result, consumers may be applying for balance transfers with a goal to free up a credit line by moving it onto a new 0% APR card, which will only increase their debt and further exacerbate their financial insecurity. As one Coach explained to her client during a session: “On the behavioral pattern side, [balance transfers] can be bad because some people get them, you know, do the balance transfer, but then they have more available credit, so you have to really be disciplined to then not use the other card that you have no balance on... and not just incur more debt."

Lenders also realize that consumers, especially those in desperate and/or stressful situations, often do not read the fine print in credit card agreements so lenders bury important details such as when a promotional period will expire. Coaches noted that other than stating the timeline up-front, balance transfer lenders typically do not send reminder emails or texts when the promo period is about to end, nor do they highlight it sufficiently in monthly statements. This practice sets consumers up to miss the deadline and incur a huge retroactive interest charge.

Compounding the impact of complicated and easy-to-miss fine print, Coaches highlighted an additional critical oversight regarding the terms and practices of balance transfers: lenders do not <u>at any point</u> provide the monthly payment necessary to pay off the full balance within the 0% APR promotional period. Because balance transfers are currently regulated the same way as other credit cards, they provide 2 monthly payment suggestions in their monthly statements: the minimum to avoid a late payment, and the minimum + an extra amount that will enable the borrower to pay the balance off faster. Both of these numbers typically fall below the monthly payment needed to avoid paying retroactive interest on a balance transfer. As a result, borrowers anchor on the minimum payment (as lenders know they will based on mountains of behavioral econ research around the power of anchoring) and then inadvertently put themselves in a position to scramble to pay off the full balance at the end of the promotional period or risk paying a huge interest charge.

In terms of the application process for balance transfer cards, Coaches reported that lenders weigh credit score the most, followed by an applicant's income. This process is biased against low-income consumers because an applicant may have a collection account from a medical bill, for example, but otherwise have on-time payments on all consumer debts. Their credit score will disqualify them, despite having a demonstrated ability to repay and a clear need for debt refinancing. Coaches also expressed frustration that it requires a hard credit pull just to find out what amount in credit limit a client will be approved for, because this information is a critical part of determining whether a balance transfer is the right option for a client in the first place.

The Reality of Balance Transfer Usage Among Low-Income Individuals: Financial Coaches surfaced a few main ways that they see balance transfer cards being used among their low-income clients that fall into a few user personas with different financial needs:

1. <u>One-time user:</u> This persona understands how the balance transfer works, establishes a plan to pay off the full balance within the promotional period and sticks to the plan. They have strong enough credit to apply, and enough of a cash flow buffer to stick to their payment plan. This persona is least common among Neighborhood Trust clients.

2. <u>"Life Happens" User</u>: This persona understands balance transfers, has strong enough credit to qualify, and makes a plan to pay it off, but has trouble sticking to their payment plan because their budget is unpredictable given low- or volatile-income and the reality of unexpected expenses and/or the rising cost of living. After a few months of planned payments, other expenses take priority and they switch to only paying the minimum on their balance transfer card. As the end of the promotional period ends, they may be able to re-prioritize and pay it off in time, otherwise they may try to transfer it again to another card or let the promo expire and pay it off as quickly as possible from there.

   Coaches highlighted that most clients that are turning to balance transfer cards to refinance their credit card debt do not have emergency savings, because overwhelming debt that warrants a balance transfer typically means there's not sufficient cash flow to save. As a result, any unexpected expense is likely to derail a payment plan due to repurposing the money that would've gone towards the payment for the emergency expense. And there is no recourse for re-negotiating the 0% promotional period timeline if an emergency arises, which nearly guarantees that a low-wage balance transfer user will struggle to pay off their balance within the promo period.

3. <u>Cyclical User</u>: This persona has a long relationship with balance transfers and is trapped in a habit of continuing to transfer whatever is left on their balance onto a new balance transfer card. It feels sustainable for a while because they can afford the 3-5% transfer fee and then have 0% interest, but still remain trapped in a debt cycle and unable to pay it off. The cycle also always breaks eventually when this client is approved for their next balance transfer at a much lower credit limit than they need to transfer their full remaining balance, or are just denied outright.

The cyclical user might also use a balance transfer so they can focus on their high-interest card while only paying the minimum on the balance transfer. Then they plan to transfer their balance again to hold onto 0% APR, ideally until all their other debts are paid off, before refocusing on paying the balance transfer off. Most often, this client has trouble transferring more than a few times until the credit limit is too low to end up saving them any money on interest.

A few Coaches agreed that in some circumstances balance transfer hopping can be part of a good plan if the client can commit to consistently paying it down. But this becomes a challenge if the client falls off track, or they stop becoming approved for new balance transfers. If a client stops coming to sessions then Coaches usually begin to worry that the client lost momentum and feels shame about meeting with their Coach again.

4. Basic Needs User: This persona is generally not a good fit for a balance transfer so our Coaches don't typically make this referral, though this group is certainly still accessing balance transfers with some frequency outside of our client base. These are people who unfortunately are forced to rely on credit cards to meet their basic needs because their income is insufficient to meet cost of living. These individuals will typically use balance transfers to gain access to more credit by transferring the balance of their current card so they can run up that balance again, and then make only the minimum payment on both that existing card and the new balance transfer card. This is a really unsustainable practice and requires greater intervention than just improving balance transfers. These individuals need wage increases, a stronger social safety net, and better access to affordable credit.

5. Confused User: This persona is also uncommon, but can end up in real trouble without a Financial Coach for support. These clients misunderstand balance transfers, for example, by thinking that 0% APR means $0 monthly payments for the period of the promotional period, which resulted in interest accruing after the first late payment and a charged off account for principal + interest. Another client explained their confusion to their Coach when faced with an ad for a balance transfer: "I saw it on my Capital One. So I just didn't understand. Like, I was thinking that it was something that was you make the transfer, you know, you transfer that balance over to the following month, but I was like, that just doesn't make any sense."

Please feel free to reach out to rsilbermarker@neighborhoodtrust.org with any follow up questions or for further discussion.