

A big lender's credit card trap

Capital One Financial keeps the limits low and offers its most vulnerable borrowers additional cards instead -- helping them dig ever-deeper holes with penalties of hundreds of dollars a month.

By [BusinessWeek](#)

When Brad Kehn received his first credit card from Capital One Financial in 2004, it took him only three months to exceed its \$300 credit limit and get socked with a \$35 over-limit fee. But what surprised the Plankinton, S.D., resident more was that Cap One then offered him another card, even though he was over the limit -- and then another and another.

By early 2006, he and his wife had six Cap One Visa cards and MasterCard. They were in over their heads.

The Kehns were late and over the limit on all six cards, despite occasionally borrowing from one to pay the other. Every month they chalked up \$70 in late and over-limit fees on each card, for a total of \$420, in addition to paying high interest rates as a penalty.

The couple fell further behind as their Cap One balances soared. Even so, they still received mail offers for more Cap One cards. "I didn't open them," says Kehn, 33, who manages a truck stop and runs a carpet-cleaning business on the side. "I owe these people that much damn money and they are willing to give me another credit card? This is nuts." The Kehns sought relief at a credit counseling agency last May.

Credit card experts and counselors who help overextended debtors contend that Cap One is simply aiming to maximize fee income from debtors who may be less sophisticated and who may not have many options because of their credit history.

By offering several cards with low limits, instead of one with a larger limit, the odds increase that cardholders will exceed their limits, garnering over-limit fees. Juggling several cards also increases the chance consumers will be late on a payment, incurring an additional fee. And if cardholders fall behind, they pile up over-limit and late fees on several cards instead of just one.

Practice not well-known

"How many more ways can I fool you? That is all this is about," says Elizabeth Warren, a Harvard Law School professor and author of "[Bankruptcy and Article 9](#)."

Consumers may not be the only ones who are unaware of Cap One's ways. Its practice of issuing multiple cards to some borrowers with low credit ratings doesn't appear well-known in the investment community. And just how much Cap One relies on fee income, versus interest, is a mystery. Like most lenders, it doesn't disclose that.

All credit card companies have become more reliant on fee income in recent years, but in a report issued in 2002, William Ryan, an investment analyst at investor-research firm [Portales Partners](#), warned that Cap One's earnings could be "devastated" if regulators cracked down on multiple cards or fees.

That hasn't happened. For now, Cap One's approach looks pretty savvy, however onerous it may be for some customers.

Ronald Mann, a card-industry expert, says that by generating so much revenue from late and over-limit fees, as well as interest, Cap One likely more than offsets for the risk of cardholders filing for bankruptcy. "The premise is to make money even if (Cap One) never gets fully repaid," says Mann, a law professor at the University of Texas in Austin. (Mann has been retained by a party suing Cap One in a business dispute.)

In a written response to questions, Cap One acknowledges that it offers multiple cards. "Our goal is to offer products that meet our customers' needs and appropriately reflect their ability to pay," it says. The company also stated: "Within our

current U.S. portfolio, the vast majority of Capital One customers have only one Capital One credit card with a very small percentage choosing to have three or more cards."

Spokeswoman Tatiana Stead declined to offer precise numbers or to say whether households with three or more cards were concentrated among "subprime" borrowers, people with low incomes and/or bad credit histories.

The nation's fifth-largest credit card issuer, with \$49 billion in U.S. credit card receivables as of the end of June, Cap One is a major lender to the subprime borrowers. According to Cap One's regulatory filings, 30% of its credit card loans are subprime.

Representatives of 32 credit counseling agencies contacted by BusinessWeek say that Cap One has long stood out for the number of cards it's willing to give to subprime borrowers. "In the higher-risk market, no lender is more aggressive in offering multiple cards," says Kathryn Crumpton, manager of [Consumer Credit Counseling Service](#) of Greater Milwaukee.

Other big card-industry players that do subprime lending include [Bank of America](#), [Chase](#) and [Citigroup](#). Representatives for Chase and Citigroup say they do not offer multiple cards to subprime customers; Bank of America did not respond to inquiries.

No objections from the Fed

Last year, West Virginia Attorney General Darrell V. McGraw Jr. filed an action in state court seeking documents from Cap One related to its issuance of multiple cards, as well as other credit practices. Other than that, however, Cap One's practices do not appear to have drawn regulatory scrutiny. A spokesman for the Federal Reserve, Cap One's primary federal overseer, declined to comment about Cap One, but said that in general the regulator doesn't object to multiple cards. Still, Fed guidelines warn multiple-card lenders to analyze the credit risk tied to all the cards before offering additional ones.

If consumers were using one Cap One card to make payments on another, it could artificially hold down the company's delinquency and charge-off rates, metrics that investors closely watch because they affect earnings, says Allen Puwalski, senior financial analyst at the [Center for Financial Research & Analysis](#) in Rockville, Md.

In filings with the Securities and Exchange Commission, Cap One says its delinquency and charge-off rates as of Sept. 30 were 3.6% and 2.5%, respectively, about middle of the pack for major card lenders.

In an e-mail, Cap One's Stead says: "It is not our practice -- nor our intention -- to offer an additional card to customers who are currently delinquent or over limit on a Capital One card."

But Daniel Carvajal believes that's just what Cap One tried to get him to do. Carvajal, 38, who is in a wheelchair with cerebral palsy and lives with his mother in Miami, says he exceeded his \$1,500 Cap One credit limit last Christmas by several hundred dollars and was late on payments in January and February. In March, he says, a Cap One representative offered him a second card, which he refused. Using the new card to catch up with his first, he suspects, "is what they wanted me to do."

Some overextended Cap One customers [admit using one card to pay another](#). In mid-2005, Kehn, the South Dakota truck stop manager, already over the limit on three Cap One cards with \$300 to \$500 limits, received an offer from Cap One for another card with a \$500 limit. He transferred part of the balances from the first three cards to get them under the credit limit. When his wife got a second card in early 2006 with a \$1,500 cap, the couple took expensive cash advances on it to try to help make payments on the five other Cap One cards. "I robbed Peter to pay Paul," Kehn says.

Christine Garcia, 41, of Orange, Calif., said she and her husband did the same when stretched with five Cap One cards between them. So did Bernice Thompson, 46, of Fort Smith, Ark., who, along with her husband, had seven Cap One cards.

"[We got caught in a circle](#), and couldn't get out," says Thompson.

Ron Nesbitt, 37, a Macon, Ga., truck driver, and his wife sought credit counseling last year. By the second half of 2004, Nesbitt says, the couple had become consistently late and over limit on six Cap One cards, generating \$348 in fees alone each month. "It was out of control," he says.

These examples bring into question Cap One's public stance on its subprime lending. Analysts, including Carl Neff, ratings director on card securitizations for [Standard & Poor's](#), say Cap One tells investors that it carefully controls risk by giving such borrowers only small lines of credit. Indeed, the largest percentage of Cap One's 28 million credit-card accounts, 43%, have balances of \$1,500 or less, according to its SEC filings. But if many borrowers had larger aggregate balances because they have multiple accounts, that percentage would be lower, and Cap One's "underwriting wouldn't appear as conservative as it looks," says the Financial Research Center's Puwalski.

Like other big card companies, Cap One secures most of its card receivables as bonds, which are rated by credit agencies such as Standard & Poor's (S&P is a unit of The McGraw-Hill Cos., publisher of BusinessWeek). Cap One's ratings are strong, allowing it to command a higher price for the bonds.

But Neff of S&P says he is surprised Cap One would offer riskier borrowers multiple low-limit accounts given what it has told the market. "If it was a very prevalent practice, that would lower (Cap One's credit) quality in our eyes," Neff says. A sampling of credit counseling agencies across the country indicates that about a third of the troubled debtors they see with Cap One cards have two or more Cap One accounts.