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Capital One sued over marketing practices

Minnesota AG says 'fixed rate' ads are misleading

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Updated: 4:40 p.m. ET Jan. 3, 2005

The Minnesota state attorney general's office has sued one of the nation's largest credit card issuers, claiming it is misleading consumers with promises of "fixed" interest rates, then hiking their rates as much as 400 percent.

Capital One and its subsidiaries are using bait-and-switch sales tactics, according to Attorney General Mike Hatch. While the firm markets credit cards as having the nation's lowest "fixed rates," rates can and often do change, the lawsuit alleges. In fact, 40 percent of Minnesota residents who've signed up with a Capital One card thinking their rate is fixed have hit a "tripwire," causing an overnight rate hike, Hatch said.

"(They are) changing the English language," he said. "Fixed rates don't mean fixed at all."

A Capital One spokesperson said the firm couldn't comment on the litigation, but offered a general statement.

"Capital One has cooperated fully with the investigation and believes it has acted properly and in full compliance with the law," said Tatiana Stead. "We regret the attorney general has chosen to proceed with the lawsuit, but we intend to continue to cooperate with (his) office."

Capital One's well-known "no-hassle card" television advertisements feature crowds of assaulting Vikings, representing high-interest rates chasing after consumers as they are about to make a credit card purchase. The lawsuit says the TV ads are "simply false."

It also claims other Capital One marketing tools, such as direct mail solicitations, break Minnesota's laws prohibiting false advertising, consumer fraud and deceptive trade practices. The lawsuit seeks an end to the marketing practices, and a return of any profits the firm has garnered as a result of misleading advertisements.

People surprised by 'penalty rates'

Consumers are often surprised by the tripwires that can trigger a "penalty rate," Hatch said. The lawsuit claims such tripwires are myriad, and are only mentioned in small print that appears for a few seconds on television advertisements, or at the bottom of direct mail solicitations. Late payments to Capital One — or other creditors — can trigger a chain of events that lead to rate increases, he said.

"Capital One aggressively markets its brand image as the credit card company with the nation's lowest fixed rates," Hatch said. "But that image is false. If you do something as simple as pay a day late, your rate with Capital One can skyrocket overnight."

The firms' credit card business is booming. According to its most recent SEC filings, Capital One's domestic credit card loans totaled $46.1 billion as of Sept. 30, 2004 — earning the firm a quarterly income of $414.4 million, a 50 percent increase from the same period in 2003. Capital One spent $827 million on marketing from January through September of this year, and claims it has 46 million customers.

According to the lawsuit, Zimmerman, Minn. resident Nicole Bourgeois signed up for a Capital One card in July 2003 after seeing a TV ad. She directly asked if her 4.9 percent rate would stay the same for the life of the card, and was told it would. In March 2004, she was notified that her rate had jumped to 14 percent. Bourgeois contends she always paid her bills on time. Another consumer, Robert Stein of Walker, Minn. said his rate went from 4.99 to 6.99 because he made one payment that was two days late.

Evasive telemarketers

The firms' marketing tactics are intentionally misleading, Hatch said. In one direct mail solicitation, Capital One describes its 4.99 percent interest rate as "low" 13 times and as "fixed" 17 times. Then, when consumers contact Capital One to apply for the card, Capital One telemarketers are prepared with scripts designed to evade a direct response to the question "What does fixed mean?"

In one script, phone operators are told to answer, "Unlike most credit card companies, Capital One's fixed rate is not variable and will not go up and down as interest rates change."

"Only if a consumer 'probes' another two times does Capital One concede that it cannot guarantee that its rates will stay the same forever," according to the attorney general's office.

In fact, consumers who qualify for a 4.99 percent interest rate can end up with a 20 percent "penalty rate," according to the lawsuit. Other consumers with higher initial rates can see penalty rates of up to 26 percent. Such increases apply to the consumer's entire balance, even if earlier purchases were made when the consumer believed a lower rate applied.

Other rate-hike practices irk consumer advocates

Another Minnesota resident, Patsy Trusty, complained to Hatch's office that her credit limit was lowered by Capital One without prior notification, and as a result, she was hit by late fees and ultimately a higher interest rate. The limit was lowered because her credit score had dropped, according to the lawsuit.

The controversial tactic is called "universal default" by credit card issuers. Credit card firms pull consumer credit reports as often as once a month to see if there's a late payment or other event that lowers a consumer's credit score. According to the industry, any late payment — even to an unrelated creditor, such as an auto loan issuer — makes a consumer a higher risk, and gives the credit card issuer the right to raise interest rates. Credit bureaus have specific products designed to catch consumers who are late with any bill.

The practice irks consumer advocates, who think late payment to one lender shouldn't impact interest rates charged by another — and believe the practice is simply designed to give credit card firms an excuse to raise rates.

"Consumers don't realize that there's no such thing as a truly fixed rate anymore," said Liz Putnam Weston, personal finance columnist for MSN.com and author of the recently-released *Your Credit Score.* "They discover the truth when they get a statement and find their rate has skyrocketed. Sometimes the rate hike resulted from something they did, like sending a payment in late, but other times it's because the credit card company simply changes its policy."

Capital One's Stead said that while universal default is a standard industry practice, Capital One doesn't engage in it. She said the firm does not raise interest rates based on consumer payments to other lenders. But Hatch said the firm does lower credit limits based on lower credit scores, which can result in effectively the same thing — and the practice isn't fair.

"It's a misrepresentation," he said. "People are not aware you can adversely effect your relationship with one lender because of a transaction with an unrelated party."

Robert Manning, author of "Credit Card Nation" and a frequent critic of the industry, said consumers are often at the mercy of lenders, which give themselves the right to change the terms of their member agreements at any time.

"The contracts are one-sided. The consumer has to honor whatever the industry offers, but industry doesn't have to offer anything in return," Manning said. Manning said consumers should be given a 60 to 90 day grace period before interest rates are raised so they have a change to either pay off the debt or shop for a better rate from another lender. Consumers should also be told what they have to do to get back to their original low rate. "I have yet to see a single credit card (issuer) do that," he said.

Not a level playing field

While Capital One couldn't comment on Stead's case, the firm maintains any interest rate increase is solely the result of consumer payment history with Capital One.

Either way, any rate increases to so-called "fixed rates" is unfair to both consumers and other lenders, Hatch said. Lenders must compete for business based on interest rates. Allowing firms to misrepresent low rates as fixed rates is unfair to firms that offer true fixed rates, Hatch said. Hatch's office is investigating other credit card issuer marketing practices, he said.

"It's not a level playing field," he said. "There's tremendous incentive for bankers to engage in this kind of practice."

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