What Does Your Credit-Card Company Know About You?

A 2002 study of how customers of Canadian Tire were using the company’s credit cards found that 2,220 of 100,000 cardholders who used their credit cards in drinking places missed four payments within the next 12 months. By contrast, only 530 of the cardholders who used their credit cards at the dentist missed four payments within the next 12 months.

Rudy Santana’s day began recently, as almost all his working days begin, with a name on a screen. The name that April morning belonged to a Massachusetts man in his mid-30s. He owed money on a credit card and a second mortgage, the screen told Santana, and was separated from his wife. He was behind in paying back $28,900.97 in debt. Which was why he was on Santana’s screen.

When Santana reached him by phone, the man quickly began talking about his ex-wife. “Listen,” the man said. “I called her about this debt, and a guy picked up — a guy I’ve never heard before — and when I asked for her, he hung up on me. Can you believe that? We used that money to renovate the kitchen! And now she won’t even talk to me! Who the hell was that guy who answered the phone?”
phone?"

“So you’ve spoken to your wife?” Santana asked, his voice soft and gentle. “Were you able to have a good talk with her? Even when you’re angry, it’s important to talk. Did you talk about the debt?”

“Yeah, we talked about it,” the man replied. He paused and released a small sob. “You know, she told me we would be together until we died. I know I have to pay this. But I’m not going to pay her half. I won’t damn pay it.”

“I know,” Santana said. “This is difficult, and I’ll be honest — I think you’re doing a great job. You’re really strong. But the thing is, to the bank, they don’t make a distinction between you and your wife. To them, it’s just debt. They just want to get paid.

“I think I can do something for you, though,” Santana continued, glancing at his screen. It was filled with information about the man, including the fact that he had recently sold his home at a loss. Some of this information had been sent by the man’s bank to Santana’s employer, Sunrise Credit Services, which collects delinquent debts for companies like Citigroup, Bank of America and HSBC. Santana’s company had added notes, too, including helpful tips — he is easier to reach in the mornings, for example — and new ways to contact him.

“Look,” Santana said. “I know you’re angry at your wife. One step to ending that anger is putting this debt behind you. It will really help you find peace. You owe about $29,000. How much do you think you can pay?”

“Well, how much are you gonna help me?” the man shot back. “These banks got all this taxpayer money from the government, and they’re the ones who ruined the market for my house! I helped bail them out. I think the banks should be paying me, instead of trying to suck all the life out of us they can!”

It was the first of numerous blowups that Santana would confront that day. Bill collectors don’t tend to encounter many pleasantries, even in the best of times. And these are nowhere near the best of times, for borrowers or for the banking and credit-card industries that lend to them. After two decades of almost constant expansion and profitability, card companies today are in deep trouble. Monstrous losses — estimated to top $395 billion over the next five years — are growing as cardholders, brought low by the recession, walk away from their debts. And Congress and President Obama are pushing for legislation that would make it much harder for companies to hike up interest rates and charge many of the sneaky fees that have been an easy source of revenue for years.

So credit-card firms are changing their business plans. Gone are the days of handing out
cards willy-nilly and hoping that the cardholders who dutifully pay up will offset the losses from those who default. Today companies are focusing on those customers most likely to honor their debts. And they are looking for ways to convince existing cardholders that if they only have enough money to pay one bill, it’s wiser to pay off their credit card than, say, the phone.

Put another way, credit-card companies are becoming much more interested in understanding their customers’ lives and psyches, because, the theory goes, knowing what makes cardholders tick will help firms determine who is a good bet and who should be shown the door as quickly as possible.

Luckily for the industry, small groups of executives at most of the large firms have spent the last decade studying cardholders from almost every angle, and collection agencies have developed more sophisticated dunning techniques. They have sought to draw psychological and behavioral lessons from the enormous amounts of data the credit-card companies collect every day. They’ve run thousands of tests and crunched the numbers on millions of accounts. One result of all that labor is the conversation between Santana — a former bouncer whose higher education consists solely of corporate-sponsored classes like “the Psychology of Collections” — and the man from Massachusetts. When Santana contacted the man last month, he was armed with detailed information about his life and trained in which psychological approaches were most likely to succeed.

Eventually, the man from Massachusetts called Santana back with a proposal. He had spoken to his ex-wife, he said. They wanted to wipe out their debt by paying just $10,000 — only 35 percent of what they owed.

Santana had actually already sought permission from the bank to settle for as little as $10,000. It’s an open secret that if a debtor is willing to wait long enough, he can probably get away with paying almost nothing, as long as he doesn’t mind hurting his credit score. So Santana knew he should jump at the offer. But as an amateur psychologist, Santana was eager to make his own diagnosis — and presumably boost his own commission.

“I don’t think that’s going to work,” Santana told the man. Santana’s classes had focused on Abraham Maslow’s hierarchy of needs, a still-popular midcentury theory of human motivation. Santana had initially put this guy on the “love/belonging” level of Maslow’s hierarchy and built his pitch around his relationship with his ex-wife. But Santana was beginning to suspect that the debtor was actually in the “esteem” phase, where respect is a primary driver. So he switched tactics.

“You spent this money,” Santana said. “You made a promise. Now you have to decide what kind of a world you want to live in. Do you want to live around people who break their promises? How are you going to tell your friends or your kids that you can’t honor your word?”

The man mulled it over, and a few days later called back and said he’d pay $12,000.

“Boom, baby!” Santana shouted as he put down the phone. “It’s all about getting inside their heads and understanding what they need to hear,” he told me later. “It really feels great to know I’m helping people in pain.”

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To understand how the credit-card industry got interested in psychology, you have to go way back, to a time when many Americans didn’t have a credit card, when almost every
company charged the same interest rate regardless of a cardholder’s riskiness and when people often paid off their entire balance each month. All the way back, that is, to the 1980s.

Just a little more than two decades ago, the credit-card business was a quiet, slightly boring industry dominated by banks looking for easy revenue. Card issuers made money by collecting annual dues and interest payments from cardholders as well as fees from merchants each time a customer used a card. Then the math whizzes arrived. They emphasized that the biggest profits didn’t come from people who always paid off their bills but rather from less-responsible clients who never paid their entire balance, and thus could be milked through silently skyrocketing interest rates, late fees and other penalties. Since 1995, the percentage of the industry’s income from cardholder fees has more than doubled to 40 percent. In 2005, as the push to sign up cardholders peaked, the industry sent out more than 10.2 billion credit-card solicitations, which would cover more than the entire world’s population. Two years later, card companies collected $40.7 billion in profits before taxes, according to R. K. Hammer, a credit-card advisory firm. Today Americans carry an average of 5.3 all-purpose cards in their wallets, and the average household has $10,679 in credit-card debt, according to the industry publication The Nilson Report.

But giving credit cards to riskier customers posed a problem: How do you know which cardholders will pay something each month, providing fat profits, and which will simply run up a huge tab and then disappear?

The Ph.D.’s arrived at two solutions. The first was to create thousands of new kinds of cards with their own credit limits, terms and interest rates. Such a strategy theoretically protected companies by limiting how much a cardholder could buy and by charging sufficiently high interest rates to ensure that if a few cardholders walked away, the companies still made plenty of money.

The other solution was learning to predict how different types of customers would behave. Card companies began running tens of thousands of experiments each year, testing the emotions elicited by various card colors and the appeal of different envelope sizes, for instance, or whether new immigrants were more responsible than cardholders born in this country. By understanding customers’ psyches, the companies hoped, they could tell who was a bad risk and either deny their application or, for those who were already cardholders, start shrinking their available credit and increasing minimum payments to squeeze out as much cash as possible before they defaulted.

The exploration into cardholders’ minds hit a breakthrough in 2002, when J. P. Martin, a math-loving executive at Canadian Tire, decided to analyze almost every piece of information his company had collected from credit-card transactions the previous year. Canadian Tire’s stores sold electronics, sporting equipment, kitchen supplies and automotive goods and issued a credit card that could be used almost anywhere. Martin could often see precisely what cardholders were purchasing, and he discovered that the brands we buy are the windows into our souls — or at least into our willingness to make good on our debts. His data indicated, for instance, that people who bought cheap, generic automotive oil were much more likely to miss a credit-card payment than someone who got the expensive, name-brand stuff. People who bought carbon-monoxide monitors for their homes or those little felt pads that stop chair legs from scratching the floor almost never missed payments. Anyone who purchased a chrome-skull car accessory or a “Mega Thruster Exhaust System” was pretty likely to miss paying his bill eventually.
Martin’s measurements were so precise that he could tell you the “riskiest” drinking establishment in Canada — Sharx Pool Bar in Montreal, where 47 percent of the patrons who used their Canadian Tire card missed four payments over 12 months. He could also tell you the “safest” products — premium birdseed and a device called a “snow roof rake” that homeowners use to remove high-up snowdrifts so they don’t fall on pedestrians.

Testing indicated that Martin’s predictions, when paired with other commonly used data like cardholders’ credit histories and incomes, were often much more precise than what the industry traditionally used to forecast cardholder riskiness. By the time he publicized his findings, a small industry of math fanatics — many of them former credit-card executives — had started consulting for the major banks that issued cards, and they began using Martin’s findings and other research to build psychological profiles. Why did birdseed and snow-rake buyers pay off their debts? The answer, research indicated, was that those consumers felt a sense of responsibility toward the world, manifested in their spending on birds they didn’t own and pedestrians they might not know. Why were felt-pad buyers so upstanding? Because they wanted to protect their belongings, be they hardwood floors or credit scores. Why did chrome-skull owners skip out on their debts? “The person who buys a skull for their car, they are like people who go to a bar named Sharx,” Martin told me. “Would you give them a loan?”

Some credit-card companies began using these and other discoveries to find new customers and to scrutinize existing cardholders. A few firms began sending offers to people who had registered for baby showers or weddings, for example, since data showed that getting married or having a child — in addition to making people buy lots of new stuff — often also makes them more responsible. Other companies started cutting cardholders’ credit lines when charges appeared for pawnshops or marriage therapy because data indicated those were signs of desperation or depression that might lead to job loss.

But on the whole, companies, including Canadian Tire, stuck to more traditional methods of managing risk, like raising interest rates when someone was late paying a bill, because they worried that customers would revolt if they found out they were being studied so closely.

“If you show us what you buy, we can tell you who you are, maybe even better than you know yourself,” said Martin, who now works for Wal-Mart Canada. “But everyone was scared that people will resent companies for knowing too much.”

Then last year, the economy blew up. Three things became obvious very quickly. First, all those extra charges that theoretically protected credit-card companies from losing money? Well, the worst-case models were way off, and some companies started hemorrhaging cash. Second, many of the predictions that card companies built around their understandings of people’s psyches were surprisingly accurate, even during an economic tsunami. And finally, when people start losing their jobs and feeling poor, it suddenly becomes very, very important to figure out how to persuade them to pay their credit-card bills.

Data-driven psychologists are now in high demand, and the industry is using them not only to screen out risky debtors but also to determine which cardholders need a phone call to persuade them to mail in a check. Most of the major credit-card companies have set up systems to comb through cardholders’ data for signs that someone is going to stop making payments. Are cardholders suddenly logging in at 1 in the morning? It might signal sleeplessness due to anxiety. Are they using their cards for groceries? It might mean they are trying to conserve their cash. Have they started using their cards for
therapy sessions? Do they call the card company in the middle of the day, when they should be at work? What do they say when a customer-service representative asks how they're feeling? Are their sighs long or short? Do they respond better to a comforting or bullying tone?

“It’s really hard to get clean insights of a cardholder's state of mind,” said Andy Jennings, the head of research and development at FICO, one of the biggest and oldest analytic firms. “The more subtle the insight, the more cleverness finding it requires. If someone pays for a big cable television package each month with their card, are they rich? Or does it signal they don’t have the sense to avoid products they can’t afford? If they check their balance three times a day, are they worried or uptight? We may look at 300 different characteristics just to predict their delinquency risk.”

If a credit-card company detects unsettling patterns, it might start cutting credit lines, raising interest rates or accelerating repayment schedules. (Companies are expected to withdraw $2.7 trillion of credit by the end of 2010, according to a March report from the Meredith Whitney Advisory Group, a banking-analyst firm.) But the most useful information the card companies are deriving from their data are the insights that help them deepen their relationships with customers, particularly when a cardholder is going through a rough time. One of the strongest conclusions of the psychological studies is that cardholders are most likely to pay the bills of those companies with which they have an emotional connection.

“Today the goal is for customers to get a warm-and-fuzzy feeling from their credit-card company,” said Carl Pascarella, a former chief executive of Visa USA. “If we have a deep relationship with you over a range of products and experiences, if we trust each other, you’ll listen when we give you advice.”

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It was the first day of training for Bank of America’s newest credit-card customer-assistance employees, and some of the 12 new hires sitting around the classroom were a little confused.

At another company, these employees — who earn about $35,000 a year — might be called “collection agents” or “at-risk account reps.” But at Bank of America, “our whole program is built around assisting the customer,” explained Ric Struthers, president of the credit-card division. “We call it assistance, because we’re here to find a solution.”

To see how one company transforms thousands of low-paid employees into telephone psychiatrists, I attended a day of Bank of America’s four-week training program at the company’s Delaware offices. (I was allowed to attend on the condition that I neither identify nor interview the trainees during the course.) At the front of the classroom, a poster explained the company’s “Customer Delight Model.” The trainees were supposed to “provide a delightful opening,” “employ delightful words,” “acknowledge and empathize” and “personalize with a POWER close.” They spent the morning discussing hypothetical cases, like a cardholder with twins whose husband announced he had fallen in love with another woman. He handed over divorce papers, had a moving truck outside and in short order took over the house and left the cardholder with two kids, only $400 a week and a ton of credit-card debt.

“I would tell her to castrate the man,” one trainee said to the others in her assigned group. “You know, Mel Gibson is getting a divorce, and what he’s doing to that poor woman, he should get his gut hacked up with a rusty knife. I would tell her to cut the husband where it matters, and then ask the new girlfriend what she thinks of what’s
down there now!"

These were not, apparently, the “delightful words” that Bank of America had in mind. A much younger male trainee opined that there might be more delicate ways of handling the conversation.

“What do you know?” the woman retorted. “You’ve never been married! You spent your whole life on vacation! Why don’t you learn something instead of moving your mouth all the time?”

Score one for the power close.

As the class discussed how to talk to someone who has recently lost her husband or her job, a young man raised his hand.

“Uh, when we hear a story like this, how are we going to ask them for money?”

“We’ll get to that later,” the instructor, Sheri Roberts, replied.

Then the trainees listened to a recording of an actual call with a cardholder who was about $10,000 in debt, divorced and couldn’t pay her bills. The Bank of America representative was chipper and positive and after 10 minutes offered to cut the woman’s minimum monthly payments in half and drop her interest rate to 5 percent.

“Oh, my God,” the cardholder sobbed on the tape. “Oh, that would help so much. I’m not a bad person.”

“No, of course you aren’t,” the representative replied. “We’re going to figure this out together.”

Such conversations, credit-card companies say, happen all the time. Indeed, just days earlier I spoke to Donna Tiff, a 49-year-old Missouri woman. We were introduced through the Center for Responsible Lending, an advocacy organization that Tiff contacted after companies began hounding her about the $40,000 she owed on multiple cards.

“The phone would ring nonstop,” she told me. “I would get on, crying, and tell them I don’t believe in suicide, but I’m close. That I’m going to file for bankruptcy, and then you’ll get nothing.”

And then Tracey came along. She worked for a company that today is a subsidiary of Bank of America. Tracey had talked to Tiff several times and noticed that there was a mistake on her account — an automatic payment was going to be deducted twice from her checking account. If that happened, Tiff's other checks would bounce.

“I told her, thank you so much for catching that,” Tiff recalled. “And then we talked for over an hour about my problems and raising kids. She was amazing. She was so similar to me. She gave me her direct number and said that I should call her directly anytime I had any questions or just needed to talk about what was going on.”

Over the next three years, Tiff paid off the entire $28,000 she owed Bank of America and spoke regularly with Tracey, she said. And the $12,000 she owed on other cards? Well, those companies didn’t have a Tracey. They never got fully repaid.

It’s a heartwarming story. Unless you’ve seen how people like Tracey are schooled in the art of bonding. What are the odds that the random customer assistant who dealt with Tiff would have so much in common with her and manage to strike such a close bond? I
tried to call Tracey myself, using the information Tiff provided. But I was told she didn’t work there anymore.

One Bank of America executive acknowledged that Tiff — and the caller on the recording in the training course — probably could have cut her debt in half just by asking. Much of what they’re paying, after all, is fees and interest that Bank of America itself tacked on.

“Some cardholders are not as savvy as others,” said Tony Allen, a company spokesman, who added that the company tries to educate cardholders about their options. “I’m sure some people feel like we have conflicted interests and that we’ll only educate as much as it helps us get paid. But we take our responsibility seriously.”

I asked Tiff if she ever asked Tracey to write off the late fees and the interest charges.

“Oh, no,” she told me. “She was so kind to me. How could I ask her for something like that?”

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If you ask credit-card executives about the current financial crisis, they’ll admit things aren’t good right now. But what really has them worried is what’s going on in Washington.

Just last month, President Obama invited 14 credit-card executives to the Roosevelt Room and told them he planned to ask Congress to outlaw “anytime, any-reason rate boosts and late-fee traps” and to increase scrutiny of the industry. A week later, the House passed the “Credit Cardholders’ Bill of Rights” by a margin of 287 votes. The legislation would force companies to give advance notice of interest-rate hikes, ban most retroactive rate increases and stop companies from issuing cards to people under 18 years old. And if that fails to become law, in 2010 new Federal Reserve Board rules will bar issuers from changing interest rates on existing balances in most cases. In other words, once you get a credit card, it will be much harder for the company to suddenly start charging you more.

The industry has responded by warning that interest rates will rise for everyone. Already, some issuers, including American Express, Bank of America and Citigroup, have started rejecting more card applications. You’re almost sure to get fewer offers in the mail, and the days of interest-free cards for six months (followed by soaring interest rates) are probably gone.

Despite their woes, it’s hard to feel sorry for the card companies. A survey conducted last year by Consumer Action, an advocacy group, revealed that the average penalty interest rate for cardholders who had missed a payment was 26.87 percent. And for years companies have also denied consumers the right to go to court by requiring arbitration, have aggressively marketed to college students and have adopted policies like “universal default,” which allows them to hike your interest rate if you miss a payment on a card issued by a completely different company. Some of their innovations, like cash-back rewards for unpaid balances, were designed to get cardholders to stop paying the full amount they owe.

Meanwhile, as they prepare for an uncertain future, the card companies are scurrying to find the next breakthroughs in credit-card psychology. Take, for instance, Capital One’s Card Lab, a festive Internet site that lets customers design their own cards. I ordered one with my son’s photo on it.

The site is interactive. If I indicate I don’t want to pay an annual fee, for instance, the
Web site tells me I must pay a higher interest rate. If I want a low rate, the site tells me I can’t get any rewards points. In essence, the Web site offers a series of choices that determine the relative values I place on different options. Capital One can watch as I navigate the site, learning more and more about me. The industry doesn’t have to drop rats in a maze anymore. We’ve started going there on our own.

“Card Lab is at some level an enormous real-time, ongoing experiment,” says Jack Forestell, senior vice president of marketing and analytics at Capital One. By observing people’s choices and then tracking how they use their cards, the company has learned who is more willing to pay annual fees and who wants airline miles badly enough to pay higher interest rates. “We’ve learned interesting things, like people are more loyal to cards that have their kids’ photos on them,” Forestell says.

What the card companies realize — and what legislation most likely won’t change — is that no matter how much we say we dislike credit cards, they’ve become an essential part of our lives. It’s really hard to rent a car without a card. Or shop online. Or buy plane tickets. Often, executives say, we are just looking for an excuse to use our cards, and so companies are becoming experts in figuring out which excuses we each most want to hear. They’ve let me transform my card into an expression of love for my son. They’ll let you tell yourself that charging a meal gets you closer to a free flight to Tahiti.

Before I left the Bank of America training session in Delaware, the instructor gave the class a little pep talk.

“You’re going to have some days when you help customers, and you’re going to walk out and feel really, really good,” she told them. “It’s O.K. to help people know that we are all working to make the world a better place. It’s O.K. to help them believe.”

Then she turned to the young man who had previously inquired about bringing up the indelicate topic of money with someone who had just lost her job, her house or her husband.

“We are the ones who let them know that there’s always a brighter tomorrow,” she told him. “That’s how we get paid back.”

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