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**Expect credit card offers even after bankruptcy**



By Jeremy Simon

Consumers once were hard pressed to get credit in the wake of a bankruptcy. Times have changed: After bankruptcy, credit card offers now flood mailboxes.

The risk-to-reward ratio has shifted in favor of credit issuers, resulting in new credit offerings for the recent bankruptcy filers. Experts say there are several reasons.

- Due to a 2005 change in bankruptcy laws, it has become tougher for borrowers to refile quickly. That removes some of the risk for lenders that decide to extend credit to consumers with troubled credit histories.
- A lack of usury laws in states where major credit card issuers are headquartered means the sky is the limit for interest rates. Under the industry's risk-based pricing model, issuers are free to charge very high rates to the riskiest consumers.
- Card issuers send out so many card offers that some just slip through to recently bankrupt consumers.
- Complex risk-based pricing enables issuers to extend credit profitably to certain consumers who are emerging from bankruptcy.



**Law change shifts risk**

Credit card issuers pushed for the 2005 change in bankruptcy laws to ostensibly eliminate what they saw as abuse of the bankruptcy system as a means of relief from consumers' debts. But the law changes also means that consumers have less opportunity to use bankruptcy as an escape hatch for credit card or other debt.

"The most important changes are they expanded by two years the amount of time you have to wait in between filing for Chapter 7 bankruptcy and that will have a huge impact on creditor's willingness to extend credit," says Stephen Elias, bankruptcy attorney and author of "How To File for Chapter 7 Bankruptcy."

The table below shows how the new law has lengthened the time between refilings. The extra time varies, depending on which chapter in the bankruptcy code was used for the old filing and the new one: Chapter 7 bankruptcies dismiss (discharge) debt, while Chapter 13 bankruptcies create a three- to five-year court-supervised repayment plan for debt.

Prior bankruptcy	New bankruptcy	Prior wait before refiling	New wait before refiling
Chapter 7	Chapter 7	6 years	8 years
Chapter 13	Chapter 7	4 years	6 years
Chapter 7	Chapter 13	No wait	4 years
Chapter 13	Chapter 13	No wait	2 years

The change also made it harder to file for bankruptcy, especially for Chapter 7 bankruptcy, which dismisses debt. Before the law changed, "for the most part, everyone was eligible to file a Chapter 7 liquidation bankruptcy," says Los Angeles-based bankruptcy lawyer Byron Moldo. Now, the law imposes a "means test" for Chapter 7 filings, limiting its availability.

**Lending after bankruptcy**

With consumers more frequently stuck with their debt, it might seem that issuers would be less likely to offer them credit. But this is not the case.

The frequency of this situation was highlighted in a recent study by Katherine Porter, an associate professor of law at the University of Iowa. In a paper titled "Bankrupt Profits: The Credit Industry's Business Model for Postbankruptcy Lending," professor Porter found that 96 percent of consumers polled were offered new credit in their first year after declaring bankruptcy.

Porter's study looked at individuals who filed for bankruptcy in 2001, before the change in bankruptcy law. "If anything the new bankruptcy law will worsen the phenomenon because it lengthens the period between when consumers can receive a bankruptcy discharge from six years to eight years," she says.

#### **Unlimited interest rates**

Meanwhile, the lack of usury laws in the states where banks are often headquartered, such as Nevada, means they are free to charge unlimited credit card interest rates. So for consumers with bad credit histories or who have just emerged from bankruptcy, credit cards issuers can offer plastic with steep rates to their riskiest consumers.

"Rate equals risk. That's the No. 1 tenet of banking. And banks are experts at risk management and they price their products accordingly," says American Bankers Association spokesman John Hall. While rates can be high, it makes credit available to those who would otherwise not have access to it, he says. "There are a lot of people who would not have cards today if there was an unreasonable cap on credit card interest rates."

#### **Credit card mailings cast wide net**

If you've declared bankruptcy and suddenly get a great offer, don't be overjoyed. It may be a simple goof. Consumers may receive post-bankruptcy credit card offers because card issuers simply don't know they filed.

It's a data issue. Banks typically refresh their prequalified mailing lists once per quarter, so an issuer's information may be out of date by more than two months. And those who cast the net aren't the ones who reel in and sort the fish. Card issuers' marketing departments throw wide nets for potential applicants; the bookkeepers who screen for creditworthiness step in later.

"A mass mailing wouldn't look at a credit report. They'd get a huge mailing list and send out an offer to apply rather than a preapproved offer. So they wouldn't have even looked at a credit report in that instance," says Rod Griffin, manager of public education with the credit reporting agency Experian.

#### **How credit card application works**

When a bank offers you a credit card, it doesn't mean you will get one, at least, not on the terms in the original offer. Banks can deny consumers' applications or charge them a much higher interest rate. That's because when someone responds to an offer, a new copy of the consumer's credit report is pulled. If the consumer has a history of late payments -- or a bankruptcy -- the issuer will discover it then.

A bankruptcy filing will not automatically trigger dismissal, but it will ratchet up rates. Complex risk-based pricing models allow issuers to tailor their interest rates to consumers based on their individual credit risk. With these models, many issuers can profitably lend to certain consumers who are emerging from bankruptcy, as long as they exhibit the desired behavior. John G. Finneran Jr., president of corporate reputation and governance for CapitalOne Financial, testified before the United States Senate Committee on Banking, Housing and Urban Affairs on Jan. 25, 2007. "Pricing for risk has become more targeted," he said. "Those consumers who exhibit riskier behavior typically pay higher rates than those who do not, or may be charged fees for paying late or going over their credit limits."

#### **'Pay up!' 'Want a card?'**

This approach explains why a consumer might get an offer from the same bank whose collection department was aggressively calling just prior to the person filing for bankruptcy protection. It's simply an example of competing business objectives within an organization -- the collection department seeks to meet debt recovery goals while the marketing department tries to meet new-account targets.

"The same day in the same mailbox the consumer would open a letter from the credit card issuer with a past due notice, and the next envelope they open contains an offer for an additional credit card or to raise the credit limit on his existing card," says Gail Cunningham, vice president of business relations for Consumer Credit Counseling Service of Greater Dallas.

**Dealing with post-bankruptcy credit offers**

Nevertheless, for consumers who do file, those post-bankruptcy credit card offers may prove confusing. After all, why would companies that once avoided them suddenly want their business again?

For one group that advocated for the change in bankruptcy law, the credit card offers are in consumers' interest. That's because a credit card can help them re-establish credit, the ABA says. "It's part of the whole fresh start you get after declaring bankruptcy," says ABA spokesman John Hall. Still, he says, consumers "do need to take special precautions -- that's why we advocated for consumer credit counseling before declaring bankruptcy."

But critics charge that the reason for keeping consumers from declaring bankruptcy is purely financial. Instead, banks continue to earn money in the form of various fees and penalties levied against consumer who find themselves in financial straits but who do not file for bankruptcy.

One of these precautions may be evaluating credit card offer that arrive in the mail following a bankruptcy discharge with a critical eye. "You will get solicited for credit, but the credit will have some very punitive terms that consumers need to watch out for," Porter says.

Porter calls the sudden offers from credit card who wouldn't work with consumers leading up to bankruptcy "disingenuous." She says that the change in laws keeps people in the worst financial shape paying for longer. Others agree.

Following a bankruptcy, "You're either not going to get into debt again, or you are going to get into debt again -- but before you do they [card issuers] are going to make money off you in fees," says Sandy Shore, a senior counselor with financial management agency Novadebt in Freehold, N.J.

Edward Jamison, a Los Angeles consumer credit attorney, takes a harsher view, likening card issuers to parasites that want to continue to live off even weakened hosts. He says that for the banks, drawing from a consumer in a weakened state post-bankruptcy is like "getting taken from a major artery to a smaller artery."

But while it has been easy to get credit after bankruptcy in recent years, the pendulum could be swinging back in the other direction. In the wake of the subprime mortgage meltdown, credit card issuers may also begin to reconsider the way they target consumers with bad credit. "Will housing subprime carry over to credit card subprime?" asks Elias. "Until a few weeks ago debtors were offered credit cards the day after their discharge. Now it's anybody's guess."

See related story: [4 ways to re-establish credit after bankruptcy](#).

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- ▶ [Gas-buyers fume at credit card limits, 'blocks'](#) – High gas prices, industry practices leave consumers sputtering at the pump when they pay with plastic.
- ▶ [Surprise rate cut aids markets, but no credit card rate relief](#) – Surprise Fed cut in the discount rate soothes markets, but has no immediate impact on consumers' credit card rates.
- ▶ [FTC blocks card issuer from reaching into consumers' accounts](#) – A court has granted the Federal Trade Commission's request to temporarily block

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