

## New Credit Card Rules Could Harm Some

BY DAVID VAN DEN BERG

The Federal Reserve and Congress have announced plans to bar credit card issuers from some controversial practices and require card issuers to disclose more information to card holders. Some of these changes have already taken effect, while others are scheduled for 2010. While these tougher rules are designed to protect consumers from some questionable practices, the policy change could bring unintended consequences.

The Federal Reserve approved a set of changes to credit card regulations in December 2008 after a lengthy review process. In May 2009, Congress approved and President Obama signed the Credit Card Accountability, Responsibility, and Disclosure Act, which built on the Fed's rules. The Federal Reserve will implement the law, and expects to complete that process by August 2010.

The Fed's new rules bar credit card companies from using "double-cycle billing." This is a method used to calculate interest for a given billing period. It takes into account not only the average daily balance of the current billing cycle but also the average daily balance of the previous period.

Consider a card holder who makes a credit card purchase on January 10 for \$1,000. When the bill arrives in February, the customer pays \$700, leaving a \$300 balance. When the March bill arrives, under double-cycle billing, the customer would face interest charges dating back to the January purchase of \$1,000 as well as on the remaining \$300 balance.

The Fed also substantially restricted fees on subprime, low-limit credit cards. These cards are known as "fee harvester" cards because they have low credit limits yet require relatively sizable fees from the consumer. In addition, the Fed initiated rule changes that: 1) require a "reasonable amount of time" for consumers to make a payment 2) mandate that payments beyond the minimum due be allocated to the balances with the highest interest rate, and 3) ban annual percentage rate increases in the first year except in certain instances such as when a customer is more than 30 days delinquent.

The Fed created new disclosure requirements, too, mandating that key terms be stated clearly when an account is opened. Credit card companies will be required to show not just the amount of time it would take for the borrower to repay the debt if he makes only the minimum payment each month but also an itemization of interest charges for different types of transactions. Fees and interest charges will now have to be grouped separately on statements, as will a tally of the total fees and interest paid for the given month and for the year to date.

Congress added more rules to those the Fed approved. Among them is a mandate that promotional interest rates

must last at least six months. They also require college students under the age of 21 to prove their ability to repay or get an adult co-signer in order to receive a credit card.

Although many credit card practices are addressed in the new regulations, notes Adam Levitin, a law professor at Georgetown University, the new rules address only problems that are apparent today without solving the problems of tomorrow. Levitin says this approach can start "to look like a regulatory game of Whac-a-Mole. No sooner do regulators put the kibosh on one problematic practice, then another one pops up."

There could be other unintended consequences of the regulation. The new rules limit some of the tools lenders currently use to manage the risk they take on, argues Kenneth Clayton, senior vice president and general counsel of the American Bankers Association's Card Policy Council. Card issuers can either price risk for all consumers upfront, or price for individual consumers as their circumstances change.

The latter option, while leading to the evolution of certain practices that have been outlawed by the new regulations, has arguably also allowed credit card companies to offer lower rates and more credit to some borrowers.

Yet if credit card companies are sufficiently restricted from charging credit card holders for the risk the bank is taking, the lenders might operate under the assumption that all borrowers are about equally likely to default. This could manifest itself in lower credit limits for existing qualified borrowers or a decrease in the number of credit opportunities for new borrowers.

What's more, traditional fees often provide informational value to the consumer as well as the provider, notes a 2008 study by the Federal Reserve Bank of Chicago's Sumit Agarwal, the Federal Reserve Board's John Driscoll, Harvard University's David Laibson, and New York University's Xavier Gabaix. The researchers studied fees assessed on cash advances, over-limit purchases, and late payments. Paying such a fee is a form of "negative feedback." Paying a fee in the previous month reduced the likelihood they paid a fee in the current month by about 40 percent. The more time that passes after a consumer pays a fee, the more likely the consumer will be to forget about it. "However," the study concludes, "on net, knowledge accumulation dominates knowledge depreciation. Over time, fee payments drastically fall."

Once the rules take effect, policymakers should pay close attention to monitor the behavior of credit card issuers and consider the long-term aggregate effects of the new rules on both pricing strategies and the availability of credit. **RF**