Published in *National Review Online* April 28, 2009

Credit Cards in the Crosshairs

Chris Dodd and Barney Frank want to make Americans' financial decisions for them.

By Eric Grover

The reigning sentiment in Washington is barely bridled hostility to and distrust of the private sector — and abiding faith in the efficacy and righteousness of government. Congress, President Obama, and regulators are bent on moving economic decision-making power from the private sector into the public realm. They have the credit-card industry in their sights.

Used by 160 million American consumers and 8 million merchants, credit cards have been a mainstay of retail-bank profitability. Consumers and small businesses have a safe and convenient payment instrument, about $1 trillion in credit-card debt, and about $5 trillion in additional available credit. The option to tap credit at any time has enormous value.

Democrats are exercised about what they regard as rapacious credit-card companies such as Bank of America, Capital One, and Citi taking advantage of witless consumers. During the campaign, Obama railed that most Americans are "falling into debt because credit-card companies are pushing them over the edge," and that "for too long, credit-card companies have been using unfair and deceptive practices to trick Americans into signing agreements they can't afford." On *Meet the Press*, White House economic adviser Larry Summers piled on, accusing credit-card companies of getting Americans addicted to credit.

Until early 2008, the Fed held that more effective disclosures were all that was needed. After all, if features and fees are fully disclosed, how can they be deceptive? However, bowing to political pressure, Fed chairman Ben Bernanke changed tack. On December 18 the Fed, the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA) implemented a battery of restrictions on credit-card practices that will take effect July 1, 2010. Finance, penalty, and administrative fees will be curbed. Double-cycle billing, increasing interest rates on existing accounts in good standing, and annual administrative fees greater than 50 percent of credit limits will be prohibited. Rules favorable to consumers on payment application and late-fee assessment will be implemented.

Bernanke characterized the regulations as "the most comprehensive and sweeping reforms ever adopted by the Board for credit card accounts." At first blush, none of this seems unreasonable. However, card issuers' willingness to supply revolving credit to riskier consumers will be reduced. And, worryingly, the regulations are an extension of government power where it isn't necessary.

Congress is impatient. Two credit-card bills are on the front burner: House Financial Services Committee chairman Barney Frank and Rep. Carolyn Maloney's "Credit Cardholder Bill of Rights Act," and Senate Banking Committee chairman Chris Dodd's "Credit Card Accountability, Responsibility and Disclosure Act."

On April 22, the House Financial Services Committee, on a vote of 48 to 19, approved Frank and Maloney's bill, sending it to the full House for consideration. Besides requiring a 45-day notice of rate increases and implementing more severe restrictions on administrative fees, it simply legislates what the Fed, OTS, and NCUA are already doing by regulatory diktat. Senators Levin and Udall sponsored the Senate companion bill.

On March 31, Dodd's Senate bill, which addresses many of the same issues as Frank and Maloney's House bill, won committee approval 12 to 11, with all Republicans and South Dakota Democrat Tim Johnson voting against it. Its name notwithstanding, Dodd's legislation wouldn't improve accountability, responsibility, or disclosure. Big Brother would treat credit-card companies more like public utilities and consumers as too feeble and incompetent to manage their own affairs.

Dodd would prohibit anyone between the ages of 18 and 21 from obtaining a credit card without both getting parental approval and passing a financial-literacy course. This infantilizes Americans who can vote, serve on juries, have abortions, and join the military.

Washington mandarins are also entertaining getting in the business of endorsing some credit cards over others: Dodd proposes that the government rate cards from one to five stars. Is this the state's role? There are already a host of web sites through which shoppers can evaluate thousands of credit cards based on feature-set combinations and prices.

Democrats decry high-fee credit cards as "predatory"; these cards are often provided to the same risky consumers whose mortgages the government encouraged (policies exhorted banks to make the loans and Fannie Mae and Freddie Mac to buy them). Frank would ban annual fees greater than 25 percent of the credit limit, destroying the subprime-credit-card business model — and curtailing revolving credit for the 18 percent of American adults who have subprime credit and the 27 percent who have thin or no credit. True, sometimes people make bad financial decisions. Nonetheless, in a free society it should be them making the decisions, not Barney Frank, Chris Dodd, or Ben Bernanke.

Another front in the government's war on credit-card companies: Re-reforming bankruptcy law so that charge-offs get a boost.

Unlike the mortgage industry, the credit-card industry did not radically weaken credit standards. Nevertheless, in a deep recession, losses are mounting — up 52 percent in the fourth quarter, year-over-year. Yet Obama proposes weakening the 2005 bankruptcy reform. Bankruptcy costs would be reduced, filing made easier, more assets shielded as part of a national “homestead,” and a 120-day moratorium imposed on bad-credit reporting. All of this would increase bankruptcies and consequently credit-card write-offs.

Bankruptcy permits those burdened beyond their means a fresh start — a critical function. But it shouldn’t be easy, and stigma should attach. The president seems to view it as yet another vehicle to “spread the wealth around.”

Washington also wants to mandate cuts in the fees merchants pay to the credit-card industry — the industry’s number-two revenue source. Dodd proposes the GAO study “interchange,” the largest component of these fees. This would set up a revival of Rep. John Conyers and Sen. Dick Durbin’s “Credit Card Fair Fee Act,” a bill to impose price controls on fees.

There is no reason for the government to step into this area. Every stage in the card-payments value chain — issuance, the networks, acquiring, and processing — is vigorously competitive. Imposing price controls, which Conyers and Durbin tried to do in 2008, would increase cardholder fees, reduce benefits, and suppress innovation. It would also diminish card acceptance for small, nontraditional, and otherwise high-risk merchants, because at the lower fees the credit-card companies would be less willing to take chances.

The Democrats’ “Employee Free Choice Act” could also affect the credit-card industry. As is the case in most industries, labor is a significant cost for credit-card companies. The bill would virtually eliminate secret ballots in union elections, and in some cases enable the government to write labor contracts. More credit-card businesses would be unionized — meaning their compensation and work policies would become politicized, work-rule flexibility diminished, and costs increased.

Greater government control and the politicization of credit cards will put a damper on innovation and delivery of revolving credit — particularly to those in greatest need. It will ill serve consumers and hamper economic revival.

— *Eric Grover is a principal at Intrepid Ventures, a corporate-development strategy consultancy. An expert on credit cards, Grover was the first to publicly call for banks to spin off MasterCard and Visa.*