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Keep Government Out of the Card Industry

By Eric Grover

Government is surging across a broad swath of economic life historically dominated by the private sector, and the credit card industry, serving 160 million American consumers and 8 million merchants, is not exempt.

Senate Banking Chairman Christopher Dodd and House Financial Services Chairman Barney Frank have it in their cross hairs.

On Jan. 22, Frank and Rep. Carolyn Maloney reintroduced their Credit Cardholder Bill of Rights Act. Sens. Charles Schumer and Mark Udall introduced a companion bill. On Feb. 11, Dodd proposed the Credit Card Accountability Responsibility and Disclosure Act, though it is about dictating what products and pricing can be offered and to whom, not disclosure.

A combination of the Dodd and Frank measures will likely be enacted into law this year.

Washington is attacking the card industry's principal revenue sources — finance, interchange and penalty fees for creditworthy cardholders and administrative fees for subprime ones — and curbing consumers' freedom to choose products.

A range of issuer practices, including double-cycle billing, universal default and penalty and subprime administrative fees would be curtailed.

Many features to be banned strike Dodd, Frank, consumer activists and many consumers as undesirable. The important question, however, is not whether they are desirable, but whose determination of desirability is dispositive: Washington politicians and regulators or consumers in the market? If features are fully disclosed, Joe Sixpack should be free to make a choice different from what Barney Frank would make for him.

Pricing restrictions, particularly for riskier consumers, will have unintended but foreseeable consequences. Revolving credit will be diminished. Issuers, anticipating risk-based pricing restrictions, will raise fees preemptively.

Consumers' financial sovereignty is being encroached upon. Dodd's bill would prohibit those between 18 and 21 from obtaining a credit card without a parent or guardian signing and their taking a financial literacy course. Whoa! These Americans are adjudged competent to vote for Dodd, serve on a jury for capital crimes and join the Army, but now Congress would say they should not be free to choose and manage a credit card. Instead of encouraging responsibility, this would infantilize Americans.

Congress long pressured regulators to intervene under authority stemming from the Federal Trade Commission Act section on unfair or deceptive acts or practices. However, under Paul Volcker and Alan Greenspan, the Federal Reserve Board resolutely maintained its independence, holding that even though card disclosures might need to be revisited, additional restrictions were not necessary. After all, if a practice is fully disclosed, how can it be deceptive?

Demanding "fair" prices and practices, on the other hand, is a euphemism for rejecting what's freely chosen by mutually consenting parties in the market. The highly subjective fairness standard is an open invitation for regulators and politicians to meddle.

Mindful of the political winds, Fed Chairman Ben Bernanke changed tack. To "prohibit unfair or deceptive acts or practices," in December, the Fed, the Office of Thrift Supervision and the National Credit Union Administration implemented a battery of regulations in sync with the Frank-Maloney bill, but they will not take effect until July 2010.

Frank would ban fees higher than 25% of the credit limit; this would destroy the subprime card business model, curtailing credit for the 18% of American adults who are subprime and 27% who have thin or no credit.

A deep recession is an odd time to assault the credit card industry and Americans' access to revolving credit. If not for the ideological animus toward and distrust of credit card firms and private enterprise more broadly, it would not be happening.

Cardholders have $1 trillion in debt and almost $6 trillion in outstanding lines of revolving credit. Consumers and small businesses routinely draw down and repay these lines to support their personal and business needs.

During the campaign President Obama proposed rating credit card products with one to five stars, depending on the government's view of the relative attractiveness of their features. Dodd's bill calls for a study of such a system's viability. Of course, it is doable, but is it Uncle Sam's role?