

HIGH & LOW FINANCE

Card Act Cleared Up Credit Cards' Hidden Costs



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The Card Act, which Congress passed in 2009, forced banks to be upfront about the fees they charged credit card consumers.

By FLOYD NORRIS
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Four years ago, Congress decided to force down the hidden fees that credit card companies collect from their customers. It passed a law called the 2009 Credit Card Accountability Responsibility and Disclosure Act — a name chosen so the law would be known as the Card Act.

High & Low Finance

Floyd Norris writes the High & Low Finance column for the Friday Business section.

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When Neale Mahoney, an economist at the University of Chicago's Booth School of Business, set out to evaluate the effect of that law, he was confident he knew what he and his colleagues would find: It didn't work.

"I went into the project with this sort of conventional wisdom that well-intentioned regulators would force down fees and that other fees and charges would increase in response," he told me this week, comparing hapless rule makers to the carnival visitors playing the game known as Whac-a-Mole, where a mole springs up somewhere else as soon as one is

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Dan Dry
Neale Mahoney, an economist at the University of Chicago, studied the Card Act's effects.

knocked down.

But his expectation was wrong. [The study](#) came to a conclusion that surprised Mr. Mahoney and his colleagues: The regulation worked. It cut down the costs of credit cards, particularly for borrowers with poor credit. And, the researchers concluded, “we find no evidence of an increase in interest charges or a reduction to access to credit.”

The study, whose other authors are Sumit Agarwal of the National University of Singapore, Souphala Chomsisengphet of the Office of the Comptroller of the Currency and Johannes Stroebel of New York University’s Stern School of Business, estimates that the law is saving American consumers \$20.8 billion a year.

“Looking at the data forced us to rethink our understanding of the effects of regulating consumer financial products,” Mr. Mahoney told me. “The data changed our view of the world. That is what’s so exciting about being an empirical economist.”

How can that be? One answer may be that financial services are peculiarly suited to deception, particularly of relatively unsophisticated consumers. Reduce or eliminate the possibility of deception and you may allow competition to work to the benefit of consumers.

Consider your own credit cards. Have you ever read the detailed terms the card company mailed to you? I know I haven’t.

Consumers do pay attention to three things: the annual fee, if any; the rewards, if any, like airline miles or cash rebates; and the stated interest rate. For many customers, that last one is the most important.

And in the past, that was often misleading, something the Card Act set out to fix.

It was misleading for two reasons. Banks could, and did, raise interest rates without warning, and for any reason they wished. But the fees — often unexpected by the consumer but an important source of profits for the bank — were much more important. The primary fees were for late payments and for borrowing more than the credit limit.

Some of the games banks played to maximize fee income were interesting. Banks would arrange the order in which they processed transactions by assuring that the biggest transaction was tallied first. Then, as each new transaction came in, a new fee could be charged for going further over the limit. (The bank could have simply not allowed such transactions, but permitting them and charging large fees was much more profitable.)

Banks would vary the due date from one month to the next and would sometimes set a deadline in the middle of a day. A consumer could pay the bill that afternoon and still face a penalty. Want to pay by phone or Internet? Fine, but there is a fee for that. Avoid that fee by paying by mail and you risked a slow delivery that would result in a late fee. Did you fall behind on one of your credit cards? Then a bank could charge you a fee on another credit card, even though you never missed a payment on it. There were even “inactivity fees” if a customer did not use the card. Failure to pay such a fee could lead to additional late fees.

The new rules, phased in during 2009 and 2010, required that banks send out bills at least 21 days before payment was due — up from the previous limit of 14. They required that the



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monthly due date remain constant and said that if a due date fell on a weekend, any payment received the next business day could not be assessed a late fee. They required that any increase in interest rates could take effect only with 45 days' notification and would not apply to purchases made before the increase took effect. They limited how many fees could be applied — like only one late fee each month — and they set limits on how large the fees could be. There would be no more fees for paying by phone or Internet.

Fortunately for those who would study the effect of the law, in 2008 the comptroller of the currency began requiring banks it regulated to submit detailed information on credit card accounts, including the [credit scores](#) of the account holders and payment histories. That data does not include personal identification, so people going through it cannot figure out what you've been up to, but they can trace your account without knowing who owned it.

That gave the authors of the new study access to information on more than 150 million credit card accounts. They found that on average, the new law saved customers an annualized 2.8 percent of the average daily balance on cards. That is what produced the \$20.8 billion estimate.

The study shows just how the fees added up before the Card Act took effect. Those with the worst credit — the subprime borrowers — were paying an effective interest rate of 20.6 percent, plus an additional 23.3 percent in fees. Most of those fees are now gone.

You might have expected — many economists certainly did — that banks facing reduced fee income would simply raise interest rates. But this study concludes that did not happen. Why? Banks were still competing on interest rates and could lose business if they appeared to be more expensive than their competitors. But now those rates were more indicative of the actual cost to consumers.

The banks do not dispute that the law has helped consumers. But Ken Clayton, the chief counsel of the American Banking Association, told me there was another cost.

“It's also contributed to a reduction in the availability of credit cards, particularly for people with imperfect credit histories or no credit history at all,” he said, citing a [study](#) his association did.

Even that, however, is not clear. Certainly banks have tightened credit standards, but the new paper concludes that tightening came in the aftermath of the financial crisis and was not related to the Card Act.

If that is true, it may reflect a surprising discovery made in the new paper. Subprime credit card holders do default more often than others, but the interest and fees they paid made them far more profitable for the banks than any other groups of credit card holders, even during the financial crisis.

“This was probably the worst period in modern history to be a lender,” Mr. Mahoney said. “At a time when banks were hemorrhaging money on subprime loans, subprime credit cards were a major source of profits.” With profits that high, banks could still do well even with lower fees.

Can this situation last? There is no guarantee it can. The data developed in the study shows a small increase in fee revenue in recent quarters, although the trend is far from clear.

“If your view is that the banks are slowly making up the loss in fee revenue, the data would not disprove it,” Mr. Mahoney said when I pointed that out to him. “The jury is still out.”

But for now, at least, this is a clear case of regulation that worked. Given all the hostility in Washington — to regulation in general and to the Consumer Financial Protection Bureau, whose rules enforce the Card Act, in particular — that is a very refreshing development.

Floyd Norris comments on finance and the economy at nytimes.com/economix.

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