

How Credit Cards will Change

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With the new regulations on credit cards from the Federal Reserve and the changes Congress has now passed, the credit card business model is now significantly changed. Federal Reserve Board Chairman Bernanke has publicly recognized that this change will occur, as the basic card loan is now more risky. The card industry understands completely that card terms had become too complex and that clearer consumer disclosures and improvements in terms were needed, but it is important that everyone understand the trade-off the Congress has made and the impact of these changes on the availability and the pricing of credit.

Basically, the credit card began about fifty years ago, and for many years most cards had an annual fee and charged roughly the same interest to everyone. Over the years, card companies developed the capability to distinguish between credit risks, and, as a result of strong competition, many different types of cards began to be offered, most without an annual fee. Other features were added, such as reward programs and cash-back cards.

The new rules will limit the ability of card companies to price according to risk. The rules will also change the card loan, as a practical matter, from a short-term line of credit to a medium-term line of credit, which is more risky. The result – more risk and less ability to distinguish according to risk – will have the following results: 1.) Less credit will be available generally, which means some consumers and small businesses will not be able to obtain credit cards at all (particularly younger people and start-up small businesses); others will have smaller credit lines. 2.) In some cases, higher interest rates will need to be charged to cover the increased risk. 3.) Those who have managed their credit well and currently have very good credit card deals will find that card companies are limited in their ability to distinguish between them and those that have credit problems; the result will be some subsidy from those that manage their credit well to those that have problems, affecting negatively the terms the former will receive.