Journal of Banking & Finance 46 (2014) 21–30

Contents lists available at ScienceDirect

Journal of Banking & Finance

journal homepage: www.elsevier.com/locate/jbf

Credit CARD Act of 2009: What did banks do?

Vikram Jambulapati [a,1], Joanna Stavins [b,*]

[a] MIT Sloan School of Management, United States
[b] Federal Reserve Bank of Boston, United States

ARTICLE INFO

Article history:
Received 12 November 2013
Accepted 27 April 2014
Available online 14 May 2014

JEL classification:
D14
D18
G28

Keywords:
CARD Act
Credit cards
Banking regulation

ABSTRACT

The Credit CARD Act of 2009 was intended to prevent practices in the credit card industry that lawmakers viewed as deceptive and abusive. Among other changes, the Act restricted issuers' account closure policies, eliminated certain fees, and made it more difficult for issuers to change terms on credit card plans. Critics of the Act argued that because of the long lag between approval and implementation of the law, issuing banks would be able to take preemptive actions that might disadvantage cardholders before the law could take effect. Using credit bureau data as well as individual data from a survey of U.S. consumers, we test whether banks closed consumers' credit card accounts or otherwise restricted access to credit just before the enactment of the CARD Act. Because the period prior to the enactment of the CARD Act coincided with the financial crisis and recession, causality in this case is particularly difficult to establish. We find evidence that a higher fraction of credit card accounts were closed following the Federal Reserve Board's adoption of its credit card rules, but not between May 2009, when the CARD Act was signed, and when most of its provisions became law in February 2010. However, we do find evidence that banks deteriorated terms of credit card plans at a higher rate during this period, especially lowered the credit limits. Among the survey respondents whose bank accounts were closed during that period, account holders were much more likely to close their own credit card accounts than to have them closed by their card issuers.

© 2014 Elsevier B.V. All rights reserved.

1. Introduction

The Credit CARD Act of 2009[2] introduced a series of reforms intended to prevent practices in the credit card industry that lawmakers viewed as deceptive and abusive. The Act was signed into law in May 2009, and the majority of its provisions became effective nine months after the passage of the law—in February 2010. However, the signing of the law was preceded by a long series of events that made the changes almost certain long before May 2009. In particular, at the end of 2008 the Federal Reserve Board adopted final rules pertaining to credit cards to protect consumers from unfair acts or practices with respect to consumer credit card accounts. The effective date for the Fed rules was several months after the CARD Act was to become effective. Therefore, the CARD Act superseded the Board's proposed rules, but by 2008—and possibly as early as 2007—issuing banks knew that the rules governing disclosure and rate increases were about to change.

Banks do not appear to have closed accounts at a higher rate between May 2009, when the CARD Act was signed, and when most of its provisions took effect in February 2010, based on our analysis of individual account credit bureau data and data from a monthly survey of U.S. consumers, the Consumer Finance Monthly (CFM). However, banks do appear to have changed terms on credit card plans during this period, especially the credit limits. Among the CFM survey respondents whose bank accounts were closed during that period, account holders were much more likely to close their own credit card accounts than to have them closed by their card issuers.

Yet banks may have taken action in anticipation of the passing of the CARD Act long before it was enacted into law. The evidence shows that a higher fraction of credit card accounts were closed immediately following adoption by the Federal Reserve Board of

* Corresponding author. Tel.: +1 6179734217.
E-mail addresses: vikjam@mit.edu (V. Jambulapati), joanna.stavins@bos.frb.org (J. Stavins).

[1] This paper was written when Vikram Jambulapati was a research assistant at the Federal Reserve Bank of Boston. He is now a Ph.D. candidate at MIT Sloan School of Management. Joanna Stavins is a senior economist and policy advisor at the Federal Reserve Bank of Boston. We are grateful to Pattie Allouise, John Driscoll, Chris Foote, Scott Fulford, Ashley Mahoney, Ali Ozdagli, Joe Peek, Scott Schuh, Oz Shy, Robert Triest and Christina Wang for helpful comments and to Sean Connolly for research assistance. The views expressed here do not necessarily represent the views of the Federal Reserve Bank of Boston or the Federal Reserve System.

[2] Officially known as the Credit Card Accountability, Responsibility and Disclosure Act of 2009 (Credit CARD Act of 2009, H.R. 627).

http://dx.doi.org/10.1016/j.jbankfin.2014.04.025
0378-4266/© 2014 Elsevier B.V. All rights reserved.

its rules concerning credit cards than in the period between the law's enactment and its taking effect. This earlier period coincides with the recession, making it difficult to identify clearly whether the main cause of these closures was the economic downturn or preemptive action in anticipation of the new legislation.

Significant restrictions placed on credit card issuers by the Act include advance notice of any interest rate increase, a limit on the fees charged for late payments, and improvements in the transparency and consistency of billing cycles. In particular, consumers must be notified in writing at least 45 days in advance before the issuer raises the interest rate on their credit card account (exceptions include promotional and variable rates). Advance notice also must precede other significant changes, and consumers must be offered the right to close their accounts in response to those changes.[3]

Because the Act made it more difficult for the issuers to change the terms on their credit card plans and the law did not come into effect until nine months after its passage, issuers may have made some changes in advance of implementation of the law, and even in advance of the Fed rules. Once issuers knew that the credit card policy changes were about to become law, they may have raised interest rates or lowered credit limits before the law took effect. Anecdotal evidence suggests that credit card companies raised rates and fees and closed unprofitable accounts in advance of the legislation (for example, Connelly, 2010).

We are interested in whether banks restricted credit supply to consumers beyond what was warranted by economic conditions.[4] The question we are investigating is as follows: Did banks move preemptively prior to the enactment of the CARD Act by closing credit card accounts or lowering credit card limits?[5] The Federal Reserve's October 2009 "Senior Loan Officer Opinion Survey on Bank Lending Practices" included a special question on banks' expectations with regard to the effects of the Credit CARD Act. As a result of the CARD Act, banks reported that they "expect to tighten or have already tightened" many terms on credit card loans for both prime and nonprime borrowers.[6] However, previous Senior Loan Officer Opinion Surveys conducted earlier in 2009 and in the second half of 2008 revealed that banks started tightening credit card lending standards and lowering credit limits on new and existing credit card accounts long before the CARD Act was signed into law.[7] We are interested in whether this tightening was due to something other than economic conditions.

Because the period just prior to the Act coincided with the recession, it is difficult to separate the effect of the recession from that of the CARD Act. As a result of the recession, aggregate consumption and therefore demand for credit dropped, while at the same time the legislation changed the supply of credit and the terms of credit card plans. We therefore use individual consumer data to take advantage of cross-sectional differences among cardholders to try to separate the supply and demand effects. There is evidence that a higher fraction of credit card accounts were closed and credit card lending was tightened right after the Federal Reserve Board adopted its rules pertaining to credit cards. We also find evidence that banks changed terms on credit card plans, especially the credit limits, just before the CARD Act became effective.

Several studies have examined the effects of the Credit CARD Act. Bar-Gill and Bubb (2012) compared terms of credit card plans just prior to the enactment of CARD Act rules in February 2010 to those after the final set of CARD Act rules became law in August 2010. Pew (2011) compared credit card application disclosures from July 2009 and March 2010 and found some evidence of a decline in practices that regulators intended to curb, but also some evidence of an increase in new fees, in penalty interest rates, and in cash advance fees.

A few studies examined the determinants of credit card limits independently of the Credit CARD Act. Dey and Mumy (2005) used a cross-section household survey to estimate approved credit limits. Gross and Souleles (2002a) used administrative data from credit card issuing banks and found that credit scores, debt levels, and account age affect credit card limits. Although credit card account closures have not been estimated directly, Campbell et al. (2012) estimated the determinants of bank account closures. They find that in addition to socioeconomic characteristics, social variables, such as crime and voter turnout, and prevalence of alternative financial institutions, such as payday lenders, predict involuntary bank account closures. Related to credit card account closures, a number of papers have analyzed default risks for credit cards. These include papers that adjust for selection bias (Greene, 2007), account for consumer relationships to issuing banks (Agarwal et al., 2010), and use duration models (Gross and Souleles, 2002b). To the best of our knowledge, this is the first paper analyzing the changes introduced by issuing banks between the time the Act was signed into law and the time when it became effective.

Section 2 describes the timing of the events leading up to the enactment of the CARD Act. Section 3 describes changes observed in aggregate U.S. data, while Section 4 considers evidence based on individual data from the Equifax credit bureau and separate data from the Consumer Finance Monthly, a monthly survey of U.S. consumers. Section 5 provides regression results from an analysis of the survey data, and Section 6 concludes.

2. Timing of the events

The CARD Act was a result of a long-standing sentiment in the Congress that credit card issuers' abusive and unfair practices, such as hidden fees and unannounced interest rate increases, were hurting cardholders and should be prevented. Both the Congress and the Federal Reserve were involved in the various stages leading to this legislation. Table 1 provides a timeline of the passage of the legislation. In May 2007, the Federal Reserve Board (the Board) published proposed revisions to the credit card disclosures required under the Truth in Lending Act regulations (titled Notice of Proposed Rule under the Truth in Lending Act). In February 2008, Chairman Bernanke testified before Congress that the Board was planning to use authority under the Federal Trade Commission Act (FTC Act) to propose rules prohibiting unfair or deceptive credit card practices. In May 2008, the Board issued for public comment proposed rules to prohibit unfair practices regarding credit cards and overdraft services. Among other provisions, the rules would protect consumers from unexpected increases in the rate charged on pre-existing credit card balances. The proposed rules would change Regulation AA (Unfair or Deceptive Acts or Practices), Regulation Z (Truth in Lending), and Regulation DD (Truth in Savings). On December 18, 2008, the Board adopted final rules pertaining to credit cards, published in January 2009, to protect consumers from unfair acts or practices with respect to consumer credit card

[3] Details of the bill are provided online at http://thomas.loc.gov/cgi-bin/bdquery/z?d111:HR00627:@@@R.

[4] There is a broad literature linking exogenous shocks with the price and supply of bank loans (for example, Bernanke and Blinder, 1988; Peek and Rosengren, 1997, 2000).

[5] Consumers who would otherwise have closed their accounts may have kept them open in anticipation of the future benefits of the CARD Act. However, it is more likely that banks acted preemptively to curtail credit supply.

[6] http://www.federalreserve.gov/boarddocs/snloansurvey/200911/.

[7] Although the CARD Act does not focus on credit limits, some of its provisions are related to credit limits: If a person has co-signed on a credit card account (typically for a minor), then the credit card issuer cannot change the limit without written consent from the co-signer; cardholders must now opt-in for the ability to exceed their credit limit; and annual fees and application fees are capped at 25 percent of the initial credit limit.

Download English Version:

https://daneshyari.com/en/article/5088810

Download Persian Version:

https://daneshyari.com/article/5088810

Daneshyari.com