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Abstract

Credit card transactions might be at once the most perilous and least regulated consumer credit transaction. The relative lack of regulation is surprising considering the way consumers use cards in payment and borrowing markets. Card agreements have many of the traditional shortcomings associated with standardized financial contracts. They are lengthy and detailed. They conceal terms of economic import. They are complex. They use technical language requiring an advanced understanding of legal and financial concepts. Moreover, the agreements define a transactional structure that plays into several common behavioral biases, which unite to desensitize consumers to the risks of borrowing.

Card agreements also raise distinct issues. The trifurcated structure of credit card transactions (with separate points of agreement, purchase and borrowing) deemphasizes the significance of the contract itself; the important decisions are made when the consumer decides to spend and then to borrow. The small amounts involved in the individual spending and borrowing decisions render them trivial on an individual basis. Yet the triviality of the individual transactions obscures the significance of aggregate card borrowing. Time is also a factor. Because the transactions occur over an extended period, issuers generally retain the right to change the terms on which they extend credit. They do so with some regularity. Further, the changes typically apply to existing balances, which complicates the risk assessment that the consumer makes at the point of sale. A related issue is notice. Because issuers typically provide little or no advance notice when making changes, consumers often are not able to find other credit arrangements in time to avoid retroactive adjustment of the contract terms. A final point that distinguishes credit cards from other consumer credit transactions is that many consumers have not one, but several, different accounts with terms that differ in important respects.

Although credit cards are a global economic phenomenon, involving many market participants (large numbers of issuers and merchants and several leading networks) and a heterogeneous group of users, and raising a number of different policy issues in distinct payment and borrowing markets, this paper considers a narrow topic: the viability of direct regulation of the cardholder/issuer relationship. After discussing several forms of regulation suggested in the existing literature, I discuss the merits of prohibiting “unpriceable” terms and standardizing contract forms. At a minimum, I argue, we should prohibit the imposition of terms that purport to apply to existing debts – imposing risks on customers that they cannot plausibly account for when they use the card. More broadly, I think the best approach – paralleling the treatment of other major consumer financial transactions like home mortgages and insurance policies – would be to promulgate standardized terms. As I discuss, the standardized terms could come either from regulators or from industry intermediaries. In either case, those agreements could force competition to a limited number of product features that consumers reasonably can evaluate.