Zero balance? Credit card companies may zero in on "deadbeats"

June 15, 2009

Payment industry experts suggest that credit card companies will make up for lost income from congressionally-mandated curtailment of fees and penalties by going after credit card "deadbeats," which may not mean what you think. To credit card companies, "deadbeats" are customers who pay off their balances regularly and provide little or no revenue to the card issuers. Because banks are expected to lose substantial revenues as a result of the new legislation, they are looking to replace those revenues, more than likely through a revival of annual fees and the elimination of reward programs that the credit card deadbeats currently enjoy.

Congress passed credit card reform legislation in early June to limit some of the unscrupulous pricing schemes that have evolved in recent years—sudden, unexpected hikes in interest rates and double-cycle billing, for example. The law goes beyond codifying the Federal Reserve's regulatory rules already scheduled to go into effect in July 2010 by adding tougher restrictions and extending consumer protections.

Reform may have been necessary, but will the current legislation result in unintended consequences for consumer retail payment behavior?

Pricing for risk
In the early days of the credit card product, banks charged a flat interest rate and an annual fee, which made sense since they only gave cards to their most creditworthy customers. The development of credit scoring models in the late 1980s enabled banks to expand their market by allowing them to measure their potential credit risk for an individual cardholder and price for that risk accordingly.

As the competition for credit card business heightened in the 1990s, competitive pricing schemes evolved with teaser periods permitting low- or no-interest payments on new accounts and transferred balances. This practice permitted consumers to transfer balances frequently for introductory period financing. At some point, the transfer game would inevitably get out of hand and the consumers would become overextended financially. As those overextended cardholders began to experience debt service problems, the credit card issuers responded by repricing their card products to compensate themselves for the additional risk. In fact, some issuers targeted the subprime customer segment exclusively.

Since the reform effectively reduces revenue potential at a time when charge-offs are rising, card issuers will likely rethink their pricing models. If they shift these lost revenues as additional costs or reduced benefits for creditworthy customers, will these customers opt for other payment mechanisms?

Credit or debit?
Will increased costs for credit card products drive credit card deadbeats to use their debit cards instead? While they are different products governed by different sets of laws, many issuers now provide the same consumer protections for debit cards that

they do for credit cards. Yet credit cards still have their advantages in terms of the "pay now" or "pay later" decision option. And if you have a dispute over a credit transaction, you still don't have to make the payment until the problem is resolved. With a debit card dispute, the money has already left your account, and your arguments are focused on how to get it back. So a few distinctions favoring credit cards remain. Whether or not deadbeats will pay for them remains to be seen.

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