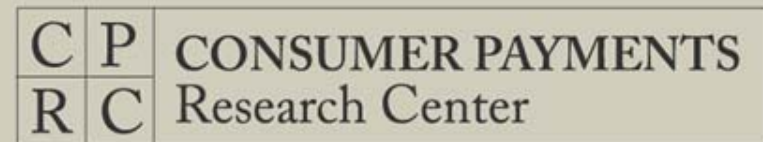


# Consumer Payment Cards: Lessons from the US Experience



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# Disclaimer

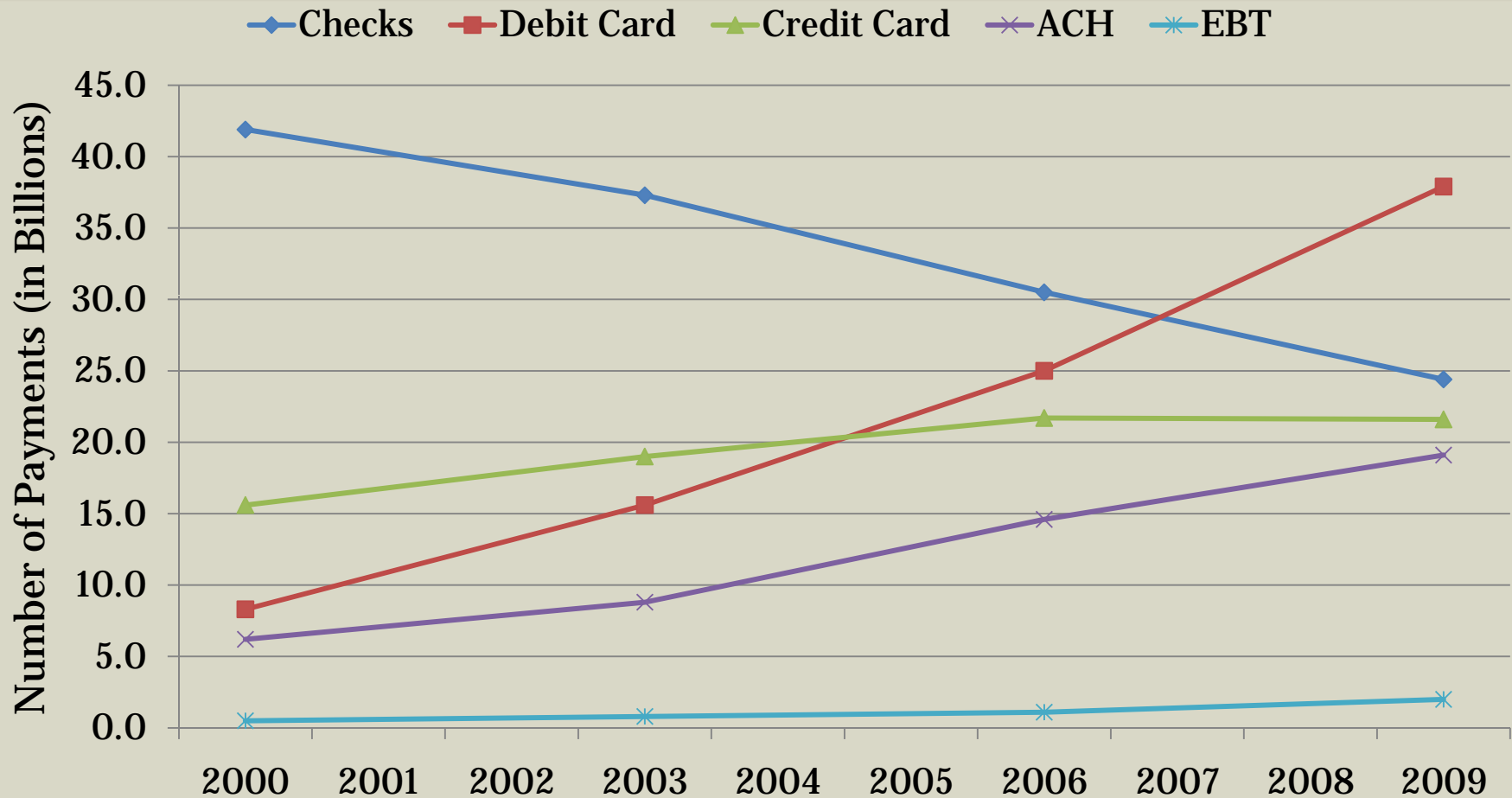
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# Outline

- Background: Card payments in the U.S.
- Recent regulatory changes affecting payment cards
- Different policy approaches
- Income transfers associated with card payments

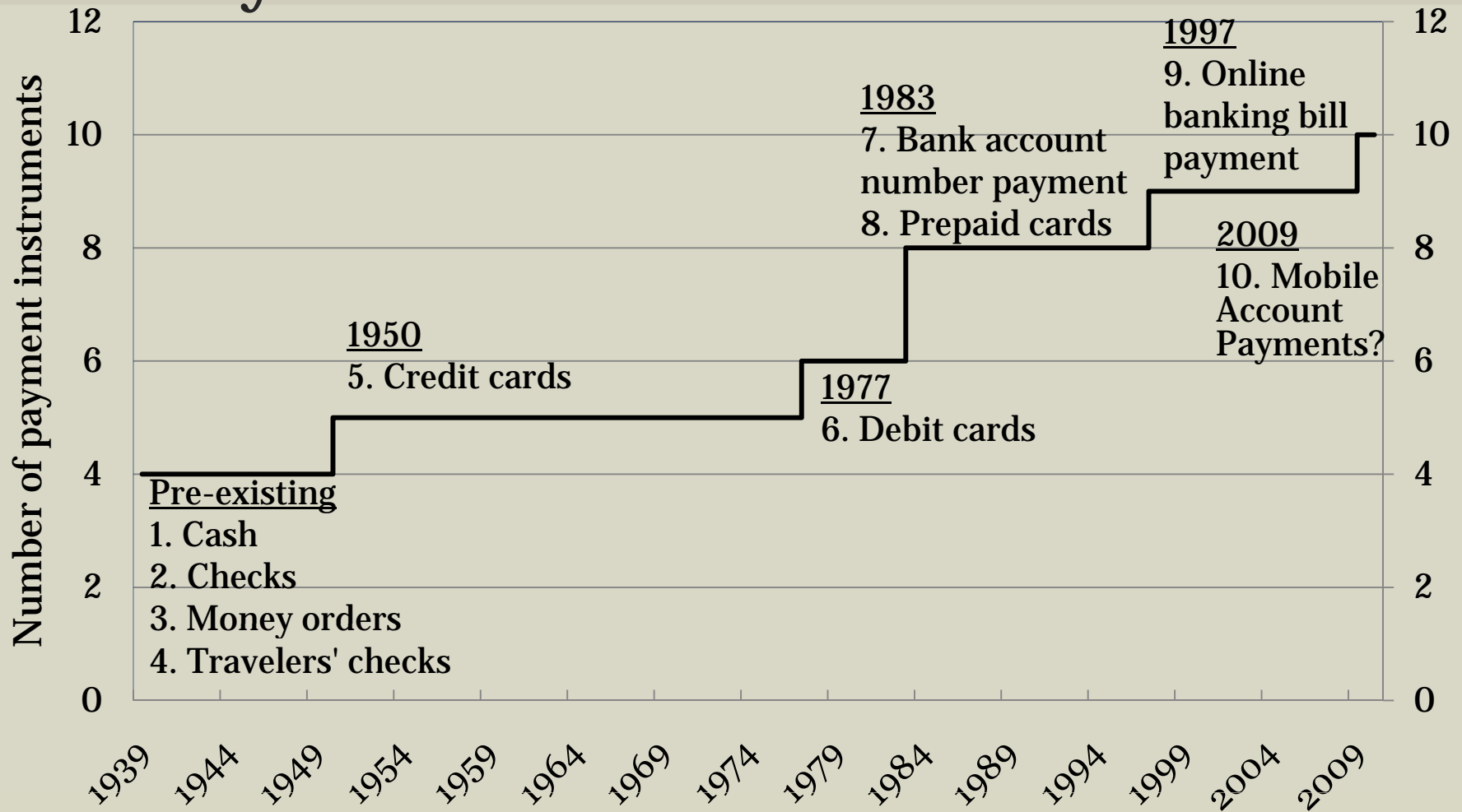
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# Payment Use in the U.S.



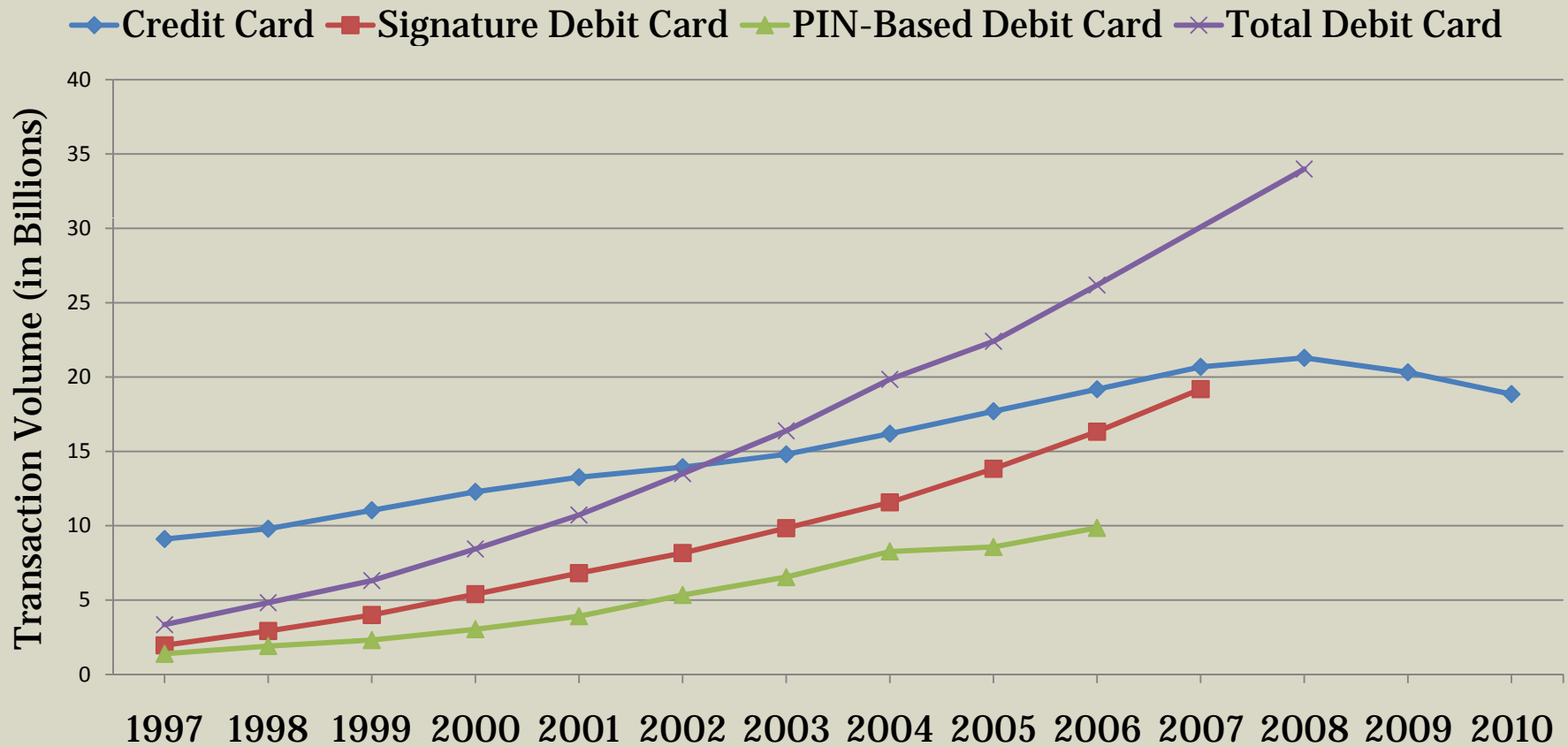
Source: Federal Reserve Payment Study

# A Brief History of Payment Instruments in the U.S.



# Credit Cards in the U.S.

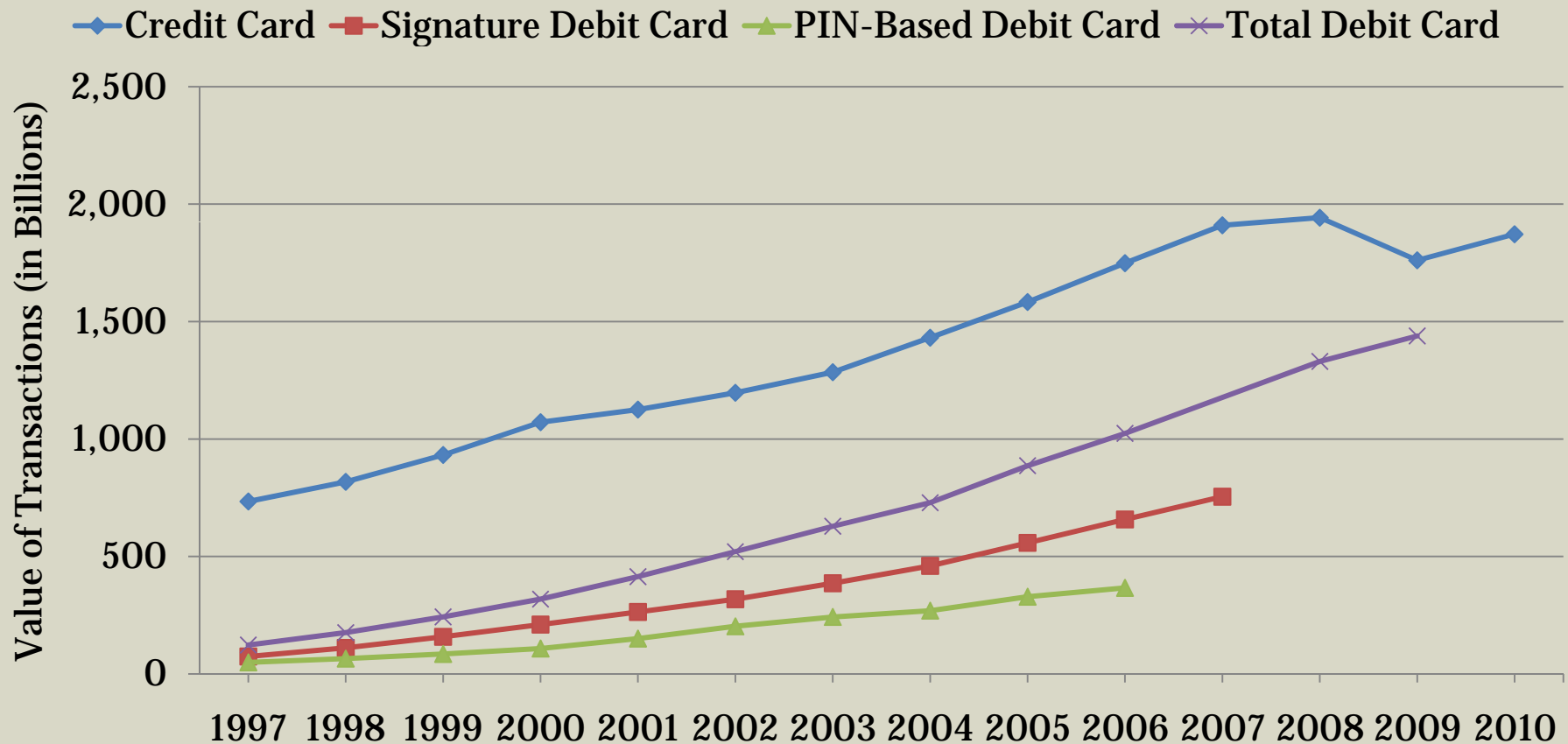
## Volume and Value of Credit Card Transactions



Source: Nilson Report

# Credit Cards in the US

## Value of Card Transactions



Source: Nilson Report



# Credit Cards in the US

	2007
% of Households with Credit Cards	73.0%
Average Number of Credit Cards in Household	3.24
Average Value of New Charges on Bill	\$1,200
% of Credit Card Households Carrying a Balance	60.3%
Average Balanced Carried by Households Carrying a Balance	\$7,300

Source: Federal Reserve Board Survey of Consumer Finances, 2007

Ratings Scale 1 to 5	Acceptance for payment	Security	Cost	Convenience
Credit cards	4.5	2.9	2.7	4.4
Average for all payments	3.8	2.8	3.7	3.8

Source: Federal Reserve Bank of Boston's Survey of Consumer Payment Choice, 2009

# Credit Cards in the U.S.

## Credit card adoption and use by household income

Annual household income	Adoption	Incidence of Use
Less than \$25K	41.6%	31.0%
\$25K to \$49K	68.4%	53.9%
\$50K to \$74K	77.9%	67.9%
\$75K to \$99K	93.9%	81.5%
\$100K to \$124K	99.1%	94.6%
\$125K to \$199K	94.0%	88.6%
Over than \$200K	91.6%	85.1%

Source: Federal Reserve Bank of Boston's Survey of Consumer Payment Choice, 2009.

# U.S. versus Other Countries

U.S. payment card system differs from the rest of the world:

- Competitive issuer market
- Issuers compete for cardholders by offering rewards
- Merchants bear the cost of consumer reward programs, consumers benefit
- Results in high interchange fees

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# The Credit CARD Act of 2009

- Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act), effective February 22, 2010
- Protect consumers from “unfair, deceptive, or abusive practices” by lenders and provide more transparency and disclosure to consumers
- Limited rate increases, advance notice required
- Highest rate balance must be paid off first
- Provide reasonable amount of time to make payments, fixed due date
- Statement warnings, universal definitions, minimum font size
- Promotional rate must be valid for at least 6 months
- Limited card issuance to minors
- Subprime fees cannot exceed 25% of credit line

# The Dodd-Frank Act

- The Dodd-Frank Wall Street Reform and Consumer Protection Act passed in July 2010
- Sweeping financial reform
- Durbin Amendment
  - Federal Reserve Board of Governors responsible for setting “reasonable and proportional” interchange fees on debit cards
  - Federal Reserve Board of Governors released proposal of debit card interchange fee rule for public comment in December 2010
- Dodd-Frank Act created Bureau of Consumer Financial Protection (CFPB); mortgages, credit cards, and other consumer financial products and services.

# Overdraft Protection

- In 2009, banks received an estimated \$20 billion from overdraft fees for debit card and ATM transactions, typically \$35-\$39 per overdraft
- As of July 2010, consumers cannot be automatically enrolled in debit overdraft program, but must “**opt in**”
- Bank of America eliminated overdraft fees beginning in August 2009

# DOJ Settlement

- The U.S. Department of Justice filed a lawsuit against Visa, MasterCard and American Express for antitrust violations
- DOJ proposed a settlement with Visa and MasterCard to allow merchants:
  - more flexible discounts and price differentiation by payment method
  - inform customers about their costs of accepting payment methods
  - **but:** no surcharge rule (NSR), surcharges not allowed  
merchants lack full information about fees



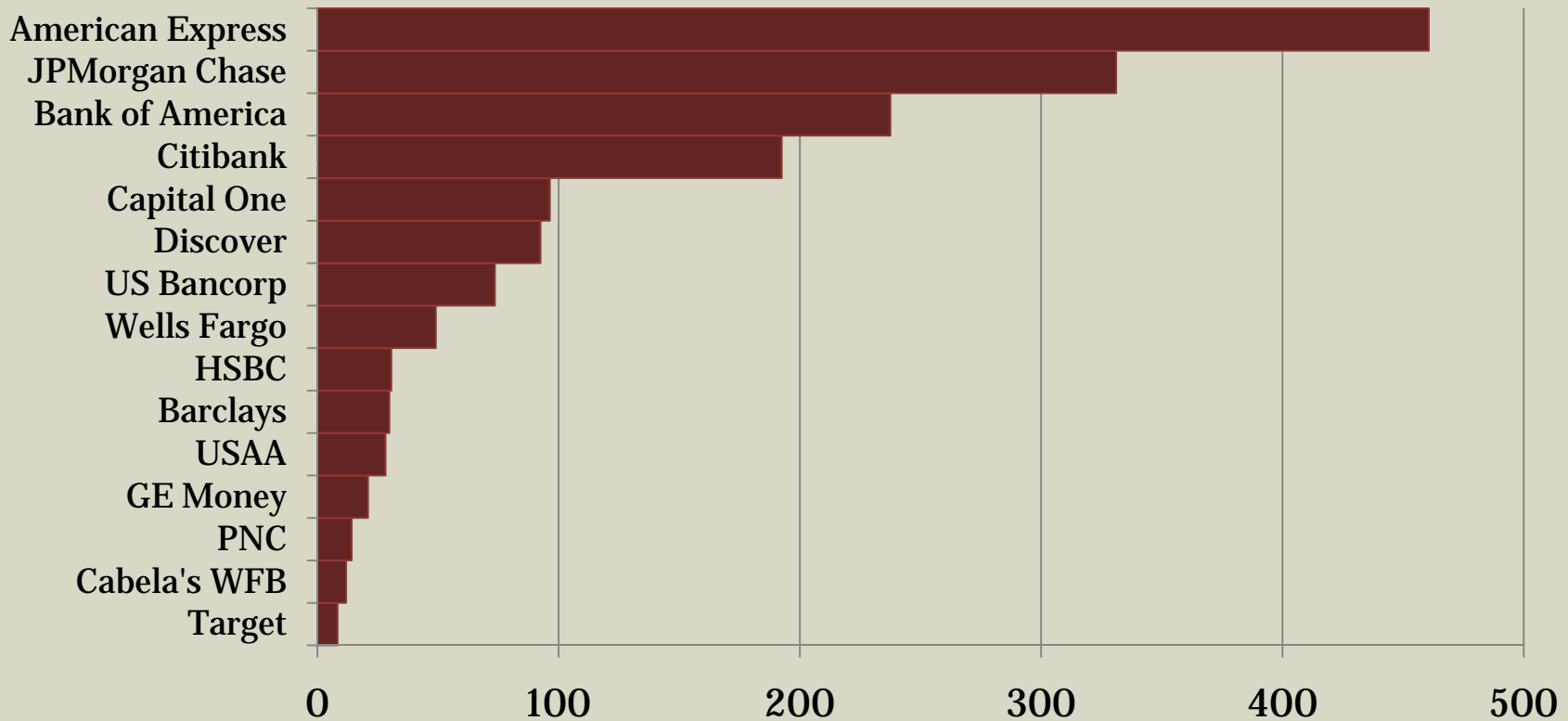
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# Different Policy Approaches

- Regulating fees versus using market forces
- CARD Act: more transparency and some restrictions, but no price regulation
- Durbin Amendment: regulate interchange fee level
- DOJ Settlement: use market forces (allow merchants)
- Overdraft protection: consumers can still choose overdraft, but default option changes
- Perfect information + proper incentives → market forces
- Market failure → regulation (*but*: how to find optimal fee level? unintended consequences possible)
- Disclosure of information and correct incentives are key **in any market**

# Market Concentration

## Top 15 Credit Card Issuers by Total Transaction Value



Source: Nilson Report, 2011

Billions of Dollars (2010)

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# Credit Cards Cause Income Transfers

- Credit cards costly to merchants  
(high interchange fees → high merchant fees)
- No surcharge rule → costs passed onto all consumers (cash and card users)
- Result: cash/debit users subsidize credit card users, especially reward card users

# Credit Cards Cause Income Transfers

- Schuh, Shy, and Stavins (2010): “Who Gains and Who Loses from Credit Card Payments? Theory and Calibrations”
- On average, each cash-using household pays \$149 to card-using households and card-using households receive \$1,133 from cash users each year
- Credit card spending and rewards correlated with income: regressive transfer from low-income to high-income
- On average, the lowest-income household (\$20K and lower) pays \$21 and the highest-income household (\$150K and more) receives \$750 every year
- Reducing merchant fees and card rewards could increase consumer welfare

# Consumer Payments Research Center (CPRC)

Find papers, articles, and data on the latest  
issues in consumer payments at

<http://www.bos.frb.org/economic/cprc>

## **Federal Reserve Bank of Boston**

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