What Bank Mergers Mean for Credit Cards

Calls for consolidation in financial services could mean higher prices and lower quality service for consumers.

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By David Balto, Tim Westrich | December 16, 2008

The continuing financial crisis has led to calls for greater financial services consolidation—under the premise that consolidation will enable at least some banks to survive—and for the ramping down of antitrust enforcement to permit it. In the case of credit card issuers, however, ramping down antitrust enforcement is a mistake—a merger is forever and the cost of increased concentration in terms of higher prices and lower quality service for consumers will last far longer than the economic downturn, however severe.

Consumers are increasingly dependent on credit cards for many everyday transactions and for essential borrowing, which is why antitrust enforcers should challenge those acquisitions that pose a threat to competition and thus promote higher prices and weaker service, a case we also made recently in the *American Banker*. This is more important now than ever as many large issuers still reeling from mortgage-related losses have already started boosting fees and rates to bring in more income.

In the past few weeks, several bank mergers have been announced and others considered. Many of the weakest institutions—including those at which you may have a credit card—have been arranged to be gobbled up by their rivals. JPMorgan Chase & Co. acquired Washington Mutual's credit card portfolio, Wells Fargo & Co. is acquiring Wachovia Corp.,

and PNC Financial Services Group has a deal to take over National City Corp. All of these deals require careful antitrust consideration, given the size and reach of the combined credit card business.

Credit cards have become essential to our modern economy. Almost all families have replaced checks and cash with plastic for transactions at the supermarket, gas station, and pharmacy. Moreover, credit cards will be a critical source of credit as other forms of credit have become more costly and less available.

But as numerous congressional hearings have documented at length, the costs of borrowing on a credit card are high relative to other types of credit, due to an overabundance of fees, high penalty rates, and fine print that obscures, rather than clarifies, the terms of borrowing on a credit card. On Thursday, in fact, the Federal Reserve Board will issue a reform rule to limit some of the worst credit card practices. It's currently unclear how strong its rule will be, but regardless of the outcome a smaller number of credit card issuers puts more pressure on worst practices—a trend that still deserves scrutiny.

In the end, families who use credit cards—already saddled with record-high credit card debt—could see increasing kinds and amounts of penalty fees by credit card issuers. This is happening already. As the economy sputters and banks' mortgage-related losses increase,banks are stepping up fees and rates to increase their income. Consumers are taking this on the nose—and with prices for every day necessities still high and wages for workers stagnant, they may be forced to take on more debt or default on their current debt.
A concentrated market only exacerbates these problems, and the antitrust enforcers have permitted all credit card mergers for years, including JPMorgan Chase-Bank One in 2004. In the two decades before the financial crisis of this year, there have been scores of mergers of credit card issuers without a single challenge by antitrust authorities. The share of total credit card loans held by the top 10 issuers rose to 87 percent in 2005, the last year for which complete data is available, from 70 percent in 1999 and 40 percent in 1988.[1] The level of concentration has increased to an Herfindahl-Hirschman Index, or HHI, a measure of concentration, of about 2,200 in 2008 from 1,100 in 1998. An HHI level of 2,200 is one that the courts and antitrust agencies define as highly concentrated or clearly susceptible to anticompetitive conduct.
We do not need a crystal ball to predict the effect of this consolidation. From 1988 to 2005, while the credit card industry was undergoing dramatic consolidation, consumers paid more: fees, rates and penalties all increased. A GAO study[2] found that typical cards today now include higher and more complex fees than they did in the past for making late payments, exceeding credit limits, and processing returned payments. At the same time, industry profits from penalties increased. Penalty fees assessed by credit card issuers rose to $17.1 billion in 2005, the last year for which complete data are available, from $12 billion in

2003 and $1.7 billion in 1996. This has been spurred in large part by the fee increase made possible when state caps were removed by the Supreme Court in the 1996 case *Smiley v. Citibank*.
Consumer Action found in an annual survey that late fees, a common penalty, rose to $25.90 in 2008, from an average of $12.53 in 1995. With no cap, history suggests these fees will increase even faster with greater consolidation.

Families' debt on credit cards also increased over this period, as a result of a number of factors. In the most recent release of data for October 2008, total credit card outstanding debt was at an all-time high of $937.7 billion. (all numbers in 2007 dollars). This is up from $730.6 billion in January 2000 and $482.3 billion in January 1995.

This is not good news amid an economic downturn given the already brisk accumulation of credit card debt by consumers over the past six years. The price of gasoline has fallen, but the cost of food, utilities, medical care, and college tuition have all skyrocketed since 2001, putting a squeeze on families' budgets. Credit cards may be the only relief for families dealing with these accelerating costs, or emergencies such as job loss or unexpected medical costs.

What is the solution? First, a competitive market is essential. The Justice Department and Federal Reserve Board must carefully scrutinize the impact of these mergers on credit card markets. Even though there is a tremendous demand for these mergers to occur, the Justice Department and Federal Reserve Board should require divestiture of the credit card portfolio of one of the merging firms.

Second, consumer sovereignty is essential for markets to function effectively. Consumers ought to have more control over the contracts that govern the fees and penalties that their issuer assesses them. Rep. Carolyn Maloney (D-NY) and Sen. Chris Dodd (D-CT) both introduced separate legislation this year containing a provision under which card issuers must provide 45 days' notice of a contract change, with the consumer retaining the right to opt out of the change, pay off any balance under the current terms, and close the account. In this way, consumers will have the ability to avoid increases in fees and penalties assessed by their issuers.

In the current economic environment it may be tempting to give credit card issuers and financial institutions a carte blanche to merge. This would be a Faustian bargain that would result in even higher prices and less competition in the future. That's a bargain no one should buy.

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Endnotes

[1] Arthur E. Wilmarth, Jr., Testimony before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services, U.S. House of Representatives (April 2007).
[2] U.S. Government Accountability Office*, Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effec tive Disclosures to Consumers*, GAO-06-929 (September 2006).

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