True Credit Card Reform Will Take Time-At The Right Time

By Rep. Mike Pence

Just this week, Congress passed and the President signed what has been hailed as sweeping reforms to the credit card industry. Aimed at business practices of credit card issuers that some find too opaque, too confusing and at times, abusive and predatory-this legislation seeks to protect the American consumer, particularly the most vulnerable. As a father to three teenagers, I share the concerns of many that too often it is the young and uninformed who are deceived or misled about the requirements and potential of credit, and I am acutely aware that certain reforms are needed in our credit card industry.

However, while I am sympathetic to the intent of this legislation, introducing extensive federal mandates on the intricate details of private-market transactions is policy fraught with concerns. I believe the overall impact of this bill would hinder this economy's capacity to recover, hurting the very people it purports to help, and assisting those who were reckless to the detriment of those who were responsible.

This is no small matter. Approximately 145 million Americans, or half the population, own credit cards. Credit cards provide a quick and easy option for individual consumers to make purchases, pay bills, or get access to cash. But perhaps even more importantly in this troubled economy, credit cards provide vital access to short term credit to small businesses, which use credit for many vital functions: as start-up capital, to purchase inventory, cover payroll, and to make improvements.

The boundless potential of the American entrepreneurial spirit is its unique strength, but it is also inherently risky. Given the nature of small business, access to short term credit is imperative to small business owners. A recent study showed that an estimated 77 percent of small business owners and entrepreneurs use credit cards to manage their expenses and track purchases. The Small Business Administration estimates that at least half of new businesses fail within the first five years. The risk of failure is one that many Hoosiers have faced boldly in pursuit of the American Dream. But by restricting access to much-needed credit in an already weakened credit environment, the ability of small businesses to cope with economic turmoil will be severely if not completely crippled. Small businesses are the engine of our national economy-having provided the vast majority of new jobs in the last decade-it seems that this is precisely the wrong time to be impairing their ability to succeed.

This legislation contains provisions that were already scheduled to be implemented next year as a result of new Federal Reserve Board (Fed) regulations. It took the Fed three years to draft these regulations, incorporating input from over 60,000 concerned citizens and with substantive and thorough testing. The application of those regulations was scheduled in advance, allowing some time for companies to prepare for the new rules-in an effort to prevent undue costs to consumers or limiting access to credit as companies faced new expenses. This careful process stands in stark contrast to the way in which this costly legislation was rushed through Congress. The nonpartisan Congressional Budget Office has estimated that the mandates on private credit card companies will exceed $139 million per year as a result of this legislation. Part of my concern is that this cost to the credit card issuer will be passed on to consumers and that access to credit lines will be stifled.

By requiring companies to stop imposing certain fees, especially on higher risk cardholders, this law reduces credit card companies' ability to offer lines of credit based on risk. If companies are limited in their ability to impose higher rates on riskier consumers, the company has no incentive to provide access to credit for people without above-average credit ratings. This law could have the unintended consequence of further restricting access to credit during a global credit crunch that is both a symptom, and a cause of the worldwide financial downturn.

And ironically, the people that this legislation is ostensibly concerned with protecting-particularly those with imperfect credit histories, young people and new market entrants with little-to-no credit history-will find it much more difficult to actually obtain a line of credit. In fact, by precluding the use of credit cards and leaving fewer options, this policy could precipitate even riskier financial behavior.

But the impact of this legislation is not limited only to those who have less-than-sterling credit scores or to the companies that issue credit cards-it will also unfairly penalize those who have been responsible consumers. As risk-based pricing is restricted, credit card companies will be forced to spread the risk across all consumers; which would result in higher rates and fees for everyone, even those with above-average credit scores.

There are many ideas of how to cure this ailing economy and to restore America's fiscal footing. I believe that we need to return to the kind of fiscal restraint that was the hallmark of generations past. Our parents and their parents before them taught that the way to prosperity is responsible and frugal spending that is coupled with sensible saving. In these uncertain times, we should be encouraged to return to what has sustained our nation through similarly tough chapters of American history, not initiate unprecedented levels of government spending or limit the means by which individual Hoosiers can navigate this recession.