

WHY NOT?



asleep-at-the-wheel cardholders who miss notices in the midst of their junk mail.

Can the law provide the right kind of flexibility—allowing the risk-driven changes to take effect while disallowing or at least discouraging the bad, revenue-driven changes? NYU law professors Oren Bar-Gill and Kevin Davis say, “Yes, we can!” Their proposed Change Approval Board would have to sign off on any proposed modification of the credit card agreement. They would pay attention on our behalf.

We have an alternative solution, employing a market test of a proposed change. At the time when the lender proposes a unilateral change, it would be required to put the existing account balance up for auction

on a LendingTree-like service that would allow other credit card issuers to bid for a chance to issue a new card and take over the existing balance.

Borrowers wouldn't be forced to switch to the auction winner. They'd just be given the option. When an existing

credit card issuer proposes a rate increase, it would be required to pass on the terms of the winning bid and a comparison with its own terms, and the borrower would decide whether he wanted to make the switch.

A market test would distinguish between good and bad interest hikes. Issuers would not be deterred from making interest increases that were driven by increased risk because they would not be concerned that competitors would undercut their offers. But unfavorable changes in interest rates or late fees that were just trying to squeeze out higher profit might be deterred. The issuer would have to worry that a competitor would steal the business.

With market-testing, it would no longer be necessary to impose a 45-day waiting period before any proposed interest rate increase

takes effect, which gives cardholders time to get another card with a more favorable interest rate or to pay off the balance on their old card. Also, issuers would have the right to hike rates on borrowers who had stopped making payments on other cards.

Many account holders will still be asleep at the wheel, and others will want to stick with their existing card because they like the reward program or don't want the hassle of updating credit card numbers on all the automated bill payments they've set up online. But the risk that others would read the fine print and defect would have a strong disciplining effect on gougers.

A market is a great way to separate good deals from bad ones. As they say over at LendingTree—when banks compete, you win. **F**

A MARKET TEST FOR CREDIT CARDS

THE NEW CREDIT CARD HOLDERS' BILL OF RIGHTS WILL protect borrowers from a variety of traps in credit card contracts—no more over-limit fees (without your permission) and no more double-cycle billing (the insidious practice of charging interest on last month's balance even when you paid the bill in full). But the new law goes too far in limiting lenders' ability to raise interest rates.

The law, signed by President Obama on May 22, prohibits rate hikes on existing balances even if the risk of default has increased—say, because the borrower stops paying on other loans or runs up balances on other credit cards. The new law prohibits interest hikes on existing balances unless the cardholder falls 60 days behind on the minimum payments.

Isn't that fair? After all, with a mortgage, the interest rate doesn't vary with every subsequent change in your credit score. But with a mortgage the lender has seniority. If you take out a subsequent home equity line, that loan is junior to your mortgage. With credit cards all the lenders are treated as equals.

A bank that offers a customer a \$5,000 credit line can find its position jeopardized by another issuer with poor controls that lets the borrower get in over his or her head. The second bank might even be justified in expanding the line to \$10,000 at a higher interest rate, but then the first bank finds itself locked into a rate that is no longer commensurate with its risk.

One option is to give credit cards loans seniority. The first bank to give the person a credit line would have seniority over the others. Or the first bank could make its line conditional on not taking on more credit. In that case a new credit card would have to offer to take over all your previous debt. Absent that, the first lender gets stuck with more risk and thus should be allowed to increase its rates.

Unfortunately, banks have a history of raising rates just because they can. It isn't reasonable to change the terms to take advantage of

The risk of losing a customer to a competitor would have a strong disciplining effect on gougers.



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