

PAYBACK: A STRUCTURAL ANALYSIS OF THE CREDIT CARD PROBLEM

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The market failure deemed “the credit card problem” is in fact a story of unprecedented market success. Advanced underwriting technology has facilitated identification of the most profitable credit card consumer as one who is on the verge of bankruptcy. The resulting market segmentation represents a massive upward redistribution of wealth from the poor to wealthy individuals and corporations. Neoclassical and behavioral economists seek to solve the credit card problem through increased disclosure and cognitive strategies, focusing exclusively on consumer rationality. These interventions are incomplete because the industry’s business model relies on the exploitation of “subsistence” credit card users who have little or no choice in their credit card use. This Article analyzes the credit card problem through the lens of structural inequality, and shifts the focus from the consumer to the industry. It proposes amendments to the CARD Act, including “subsistence amnesty,” the temporary elimination of interest rates and fees on subsistence purchases made by individuals living in poverty.

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INTRODUCTION

The mortgage and foreclosure crisis that triggered the larger financial crisis arose through the development of a subprime market, comprised of financial products designed to capture low-income users and primarily targeted at minority borrowers.¹ These predatory lending practices have led to a number of lawsuits against the loan companies and banks.² In December 2011, the Justice Department reached a \$335 million settlement with Bank of America subsidiary Countrywide Financial Corporation for the company's use of illegal, racially discriminatory

1. Raymond H. Brescia, *Subprime Communities: Reverse Redlining, the Fair Housing Act, and Emerging Issues in Litigation Regarding the Subprime Mortgage Crisis*, 2 ALB. GOV'T L. REV. 164, 166–75 (2009); Cecil J. Hunt, *In the Racial Crosshairs: Reconsidering Racially Targeted Predatory Lending Under a New Theory of Economic Hate Crime*, 35 U. TOL. L. REV. 211 (2003).

2. See Brescia, *supra* note 1, at 166–67. These include a suit brought by the American Civil Liberties Union (“ACLU”) against Morgan Stanley for discriminatory lending practices. Press Release, ACLU, *Morgan Stanley Sued for Racial Discrimination in Pushing Predatory Loans to Black Homeowners* (Oct. 15, 2012), available at <http://www.aclu.org/racial-justice/morgan-stanley-sued-racial-discrimination-pushing-predatory-loans-black-homeowners>.

mortgage lending practices.³ Wells Fargo settled a similar suit for over \$175 million in July 2012.⁴ These settlements came in the wake of numerous scholarly articles decrying mortgage lending discrimination.⁵ Legal scholars have also linked discrimination to subprime markets in the bankruptcy context. One study suggests that attorneys disproportionately steer African Americans into bankruptcy plans that are more expensive and carry less favorable terms than other plans.⁶

The credit card industry has also developed a subprime market for vulnerable consumers. In 2008, consumer credit card debt reached \$972 billion dollars.⁷ This came at the end of a decade in which consumer saving was at an all-time low.⁸ Although most economists and legal scholars view the “credit card problem”⁹ of excessive consumer debt as one of market failure,¹⁰ it is in fact a story of overwhelming market success. Through the use of sophisticated underwriting technology, the credit card companies learned that consumers who are on the verge of bankruptcy represent their greatest source of profits.¹¹ The industry responded to this information by completely altering its business model. Instead of seeking customers who would pay off their bills at the end of each month, known in the industry as convenience users or *deadbeats*, the companies began to target low-income consumers who would maintain balances from month to month, known as revolvers.¹²

Two seminal Supreme Court decisions paved the way for market segmentation by allowing banks to charge interest rates and fees based on the laws

3. Press Release, Dep’t of Justice, Justice Dep’t Reaches \$335 Million Settlement to Resolve Allegations of Lending Discrimination by Countrywide Financial Corporation (Dec. 21, 2011) [hereinafter DOJ Press Release], available at <http://www.justice.gov/opa/pr/2011/December/11-ag-1694.html>.

4. Charlie Savage, *Wells Fargo Will Settle Mortgage Bias Charges*, N.Y. TIMES, July 13, 2012, at B3.

5. See, e.g., Brescia, *supra* note 1; Cassandra Jones Havard, “On the Take”: *The Black Box of Credit Scoring and Mortgage Discrimination*, 20 B.U. PUB. INT. L.J. 241 (2011).

6. Jean Braucher et al., *Race, Attorney Influence, and Bankruptcy Chapter Choice*, 9 J. EMPIRICAL LEGAL STUD. 393 (2012); see also Tara Siegel Bernard, *Blacks Face Bias in Bankruptcy, Study Suggests*, N.Y. TIMES, Jan. 20, 2012, at A1.

7. Blake Ellis, *Credit Card Debt on the Rise, Again*, CNNMONEY (Sept. 22, 2011, 7:20 PM), http://money.cnn.com/2011/09/21/pf/credit_card_debt/index.htm.

8. *Personal Saving Rate (PSAVERT)*, FED. RES. BANK OF ST. LOUIS (Jan. 31, 2013, 8:32 AM), <http://research.stlouisfed.org/fred2/series/PSAVERT/>.

9. Oren Bar-Gill describes “the credit card problem” as the fact that “[c]redit card debt . . . is a notoriously prominent component of overall consumer debt and a leading culprit in consumer bankruptcy cases.” Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373, 1373–74 (2004).

10. *Id.* at 1379.

11. See Ronald J. Mann, *Bankruptcy Reform and the “Sweat Box” of Credit Card Debt*, 2007 U. ILL. L. REV. 375, 385–91.

12. Adam J. Levitin, *The Antitrust Super Bowl: America’s Payment Systems, No-Surcharge Rules, and the Hidden Costs of Credit*, 3 BERKELEY BUS. L.J. 265, 317–18 (2005).

of the states where they are headquartered, instead of their customers' home states' laws.¹³ These decisions led banks to move to the most permissive states, and states to race to deregulate lending to attract the banks' business.

Consequently, low-income consumers now receive credit cards with high fees and interest rates, while higher-income consumers reap the rewards of credit card use, such as travel miles and concierge services. Credit card companies target vulnerable consumers for inferior products through tactics such as teaser rates, mass mailings of preapproved cards, fee-harvesting cards, overly complex credit card agreements, and credit-card redlining. As a result of these practices, 80% of the industry's profits now come from interest payments and late and over-the-limit fees instead of annual and interchange fees.¹⁴ This shift represents a massive redistribution of wealth from the poor to wealthier consumers and corporations.

Excessive fees and interest rates can lead to debt spirals and poverty traps. A debt spiral occurs when a person borrows a small amount but all of her payments go towards interest and fees, never diminishing the principal. A poverty trap is when a household or individual lives below a threshold (known as the Micawber threshold) where it is possible to accumulate enough assets to escape poverty through saving.¹⁵ Industry practices that cause debt spirals appear to create, perpetuate, and exacerbate poverty traps.

Predatory lending practices also contribute to market failure. Neoclassical market economics assumes that a consumer, presented with a range of available products, will select the product that best suits her needs.¹⁶ In attempts to vie for the consumer's business, sellers cater to these needs. The result of this interplay between informed consumers and competing sellers is an efficient market reflecting rational consumer choice based on the availability of products that

13. *Smiley v. Citibank (S.D.), N.A.*, 517 U.S. 735 (1996); *Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978).

14. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-06-929, CREDIT CARDS: INCREASED COMPLEXITY IN RATES AND FEES HEIGHTENS NEED FOR MORE EFFECTIVE DISCLOSURES TO CONSUMERS 67 (2006) [hereinafter GAO], available at <http://gao.gov/new.items/d06929.pdf>.

15. The Micawber threshold was first identified in F.J. Zimmerman and M.R. Carter, *Asset Smoothing, Consumption Smoothing and the Reproduction of Inequality Under Risk and Subsistence Complaints*, 71 J. DEV. ECON. 233 (2003). The concept of the Micawber threshold, or poverty trap, has also been studied in the context of poverty experienced in the United States. See, e.g., Steven N. Durlauf, *Groups, Social Influences, and Inequality*, in POVERTY TRAPS 141 (Samuel Bowles et al. eds., 2006); Robert J. Sampson & Jeffrey D. Morenoff, *Durable Inequality: Spatial Dynamics, Social Processes, and the Persistence of Poverty in Chicago Neighborhoods*, in POVERTY TRAPS 176 (Samuel Bowles et al. eds., 2006); Michael E. Sobel, *Does the Clustering of Disadvantage "Beget" Bad Outcomes?*, in POVERTY TRAPS 204 (Samuel Bowles et al. eds., 2006) (discussing the impact of "neighborhood effects" on poverty traps in poor urban communities in the United States).

16. See Richard A. Epstein, *Behavioral Economics: Human Errors and Market Corrections*, 73 U. CHI. L. REV. 111, 130-31 (2006).

provide the consumer with the desired good or service at the acceptable or affordable price.¹⁷

In the credit card industry, behaviors on the part of the consumer and the seller do not conform to this model.¹⁸ Instead of seeking to create a product that matches the consumer's needs, credit card companies attempt to sell the consumer something undesirable: unmanageable debt.¹⁹ Consumers, for their part, often do not make choices based on a rational assessment of the desirability of the offered products. Instead, bounded rationality, cognitive mechanisms, and economic and social realities, all discussed below, inform consumers' actions.²⁰ In an efficient market, consumers generally express satisfaction with a product, and sellers' profits reflect a reasonable margin. In the credit card industry, profits generated from high interest rates and fees are completely disproportionate to costs and risks.²¹ Additionally, many consumers express intense dissatisfaction with their credit cards.²²

Excessive consumer debt carries high social costs that include illness, homelessness, and crime. Credit card use also correlates with increasing personal bankruptcies.²³ Even under bankruptcy, some consumers cannot escape the reach of the credit card companies. In response to extensive lobbying by the industry, the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act made discharge of credit card debt more difficult for consumers.²⁴

17. See *id.* at 129–31.

18. For more detailed explanations of the inefficiency of the credit card market, see, for example, Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 7–37 (2008); Ronald J. Mann, “Contracting” for Credit, 104 MICH. L. REV. 899, 899–918 (2006).

19. See John P. Watkins, *Corporate Power and the Evolution of Consumer Credit*, 34 J. ECON. ISSUES 909, 921 (2000).

20. See Epstein, *supra* note 16.

21. For example, Visa offers a credit card where the associated fees exceed the amount of credit offered. Lauren E. Willis, *Against Financial-Literacy Education*, 94 IOWA L. REV. 197, 266 (2008).

22. See Angela Littwin, *Beyond Usury: A Study of Credit-Card Use and Preference Among Low-Income Consumers*, 86 TEX. L. REV. 451 (2008). The Occupy Wall Street Movement and Bank Transfer Day are other good examples of consumer dissatisfaction with large banks and credit card practices.

23. See Mann, *supra* note 11, at 402–03.

24. Credit card companies contributed almost \$25 million to politicians and political parties between 1999 and 2005 in efforts to lobby for bankruptcy reform. Robert H. Scott III, *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: How the Credit Card Industry's Perseverance Paid Off*, 41 J. ECON. ISSUES 943, 945 (2007). They succeeded. Thanks to BAPCPA, they now recoup \$4 billion a year, representing a 7.5% increase in revenue. *Id.* This increase is due to more stringent requirements preventing people from filing bankruptcy sooner, allowing the credit card companies to collect fees and interest rates and garnish wages longer. *Id.* Statistics belie the propaganda supporting the credit card companies' lobbying campaign that accused consumers of abusing the existing bankruptcy laws. The most important predictor of personal bankruptcy is children, and 40% of personal bankruptcies result from medical emergencies. John P. Watkins, *Corporate*

Traditional and behavioral economists view the credit card problem as one of consumer rationality, constrained by either lack of information or cognitive mechanisms that lead to bounded rationality. Both of these approaches treat credit card consumers as an undifferentiated group,²⁵ which is problematic because consumers are not identically situated with respect to financial and social capital. Traditional economists see the problem as one of lack of information, with disclosure being the answer. Disclosure is the basis of U.S. financial policy and the 2009 CARD Act. Behavioral economists added to traditional economists' work the insight that cognitive mechanisms also affect consumer behavior. Their solution to these cognitive deficiencies is debiasing, which is changing consumers' cognitive awareness about their purchasing habits.

Disclosure and debiasing, however, are unlikely to have a significant impact on the "subsistence user." A subsistence user is someone who uses credit cards to survive, to pay the electricity bill one month and the phone bill the next, or to purchase essential items such as gas, groceries, or diapers. This type of user contrasts with the "lifestyle user," who uses credit cards to enhance her lifestyle, either minimally or considerably. For subsistence users, credit cards offer an anonymous and dignified manner with which to meet their expenses and allow for creative financial juggling to avoid the consequences of insolvency, such as bankruptcy or homelessness. Other sources of credit can be burdensome, inconvenient, or insufficient. Bank loans usually require collateral.²⁶ Borrowing from friends or family members can create significant stress in interpersonal relationships, particularly as poor people tend to have poor friends and relatives.²⁷ Using pawnshops to obtain a loan requires that a person own valuable items. Moreover, pawnshops generally pay out only small amounts.²⁸ Payday lenders often charge 200 or 300% interest, and installment purchases increase the price of goods substantially.²⁹ Most low-income or subsistence users use a combination of

Profits and Personal Misery: Credit, Gender, and the Distribution of Income, 43 J. ECON. ISSUES 413, 418–19 (2009); see also Bar-Gill, *supra* note 9, at 1427 ("Credit issuers are willing to risk nonpayment because the profits on finance charges exceed their risks. Thus, the same industry that seeks customers who will spend more than their means requests that discharge be denied to these customers because of an implied promise (which courts must infer) not to spend more than their means." (quoting David F. Snow, *The Dischargeability of Credit Card Debt: New Developments and the Need for a New Direction*, 72 AM. BANKR. L.J. 63, 80–81 (1998))).

25. See, e.g., George Loewenstein & Ted O'Donoghue, "We Can Do This the Easy Way or the Hard Way": *Negative Emotions, Self-Regulation, and the Law*, 73 U. CHI. L. REV. 183 (2006); Cass R. Sunstein, *Boundedly Rational Borrowing*, 73 U. CHI. L. REV. 249 (2006).

26. See Willis, *supra* note 21, at 217.

27. Angela Littwin, *Testing the Substitution Hypothesis: Would Credit Card Regulations Force Low-Income Borrowers into Less Desirable Lending Alternatives?*, 2009 U. ILL. L. REV. 403, 460.

28. *Id.* at 437.

29. See *id.* at 436; Nathalie Martin, *1,000% Interest—Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 564 (2010).

all of these types of borrowing to get by, and many identify credit cards as the most pernicious.³⁰

Nonetheless, subsistence users need access to credit cards because they have evolved into an essential part of modern life. They are necessary to rent a car, stay in a hotel, or gain access to inexpensive entertainment, such as DVD rentals. Commercial airlines require credit cards to purchase tickets, check in at airports, buy food on planes, and use luggage carts. Most importantly, with a small or nonexistent social safety net in place for families in need, credit cards become indispensable in the event of medical emergencies, car accidents, and other unforeseen crises. Credit cards act as a form of insurance, social security, and status symbol. Without them, individuals may fall into an underclass, shut out from many mainstream activities.

A structural analysis of the credit card problem shifts the focus from the consumer to the industry, closely examining the range of tactics the credit card companies use to take advantage of the restricted choices of financially distressed consumers.³¹ Structural inequality—inequality embedded in and created by the social structures that dictate individuals' positions in relation to others—makes some individuals and communities more vulnerable to financial exploitation, particularly during periods of widespread economic depression or recession.³² Vulnerability arises from class position and race, in addition to gender, sexual orientation, physical ability, immigration status, and other dimensions of power and identity. Predatory practices and illegal discrimination create and perpetuate these vulnerabilities.³³ Credit card companies, like most public corporations, seek

30. See Littwin, *supra* note 27, at 433–44.

31. The work of other legal scholars on the credit card problem is incomplete because it does not apply the framework of a structural inequality analysis. Ronald J. Mann, Oren Bar-Gill, and Adam Levitin concentrate primarily on the effects of contractual and cognitive deficiencies on credit card use. See, e.g., Mann, *supra* note 18, at 899–919; Bar-Gill, *supra* note 9; Adam J. Levitin, *Priceless? The Social Costs of Credit Card Merchant Restraints*, 45 HARV. J. ON LEGIS. 1 (2008). Elizabeth Warren's work focuses almost exclusively on the middle class, even though low-income credit card users carry the greatest amounts of debt and pay the highest interest rates and fees. See, e.g., TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE FRAGILE MIDDLE CLASS* 115 (2000); Kimberly Palmer, *Elizabeth Warren: Middle Class Lacks Security*, US NEWS & WORLD REP. (Feb. 9, 2009), <http://money.usnews.com/money/blogs/alpha-consumer/2009/02/09/warren-middle-class-lacks-security>; Elizabeth Warren, *America Without a Middle Class*, HUFFINGTON POST (Dec. 3, 2009, 10:00 AM), http://www.huffingtonpost.com/elizabeth-warren/america-without-a-middle_b_377829.html.

32. See, e.g., IRIS MARION YOUNG, *JUSTICE AND THE POLITICS OF DIFFERENCE* (1990); MICHAEL OMI & HOWARD WINANT, *RACIAL FORMATION IN THE UNITED STATES: FROM THE 1960S TO THE 1990S* (2d ed. 1994); Daria Roithmayr, *Barriers to Entry: A Market Lock-in Model of Discrimination*, 86 VA. L. REV. 727 (2000).

33. Two studies document illegal, racially discriminatory practices in the credit card industry. Ethan Cohen-Cole, *Credit Card Redlining* (Fed. Reserve Bank of Bos., Working Paper No. QAU08-1, 2008), available at <http://www.bostonfed.org/bankinfo/qau/wp/2008/qau0801.pdf>; Chi-Jack Lin, *Racial Discrimination in the Consumer Credit Market*

above all to maximize their profits. This narrow focus is uniquely harmful in the context of credit cards because of the great need for credit by the most vulnerable members of society and the lack of both meaningful regulation of and competition in the industry.³⁴

This Article examines how systemic and institutionalized social conditions eliminate consumer choice in the use of credit, and the ways in which the credit card companies' targeting of socially and financially vulnerable consumers for subprime products serves to entrench those conditions. The Article proposes amendments to the Credit Card Accountability, Responsibility, and Disclosure Act ("CARD Act").³⁵ Although the CARD Act prohibited some of the credit card companies' most egregious practices, it also afforded them substantial opportunities to make up for any losses associated with these changes through other means, such as additional fees imposed on cards intended for low-income consumers.³⁶ These loopholes made possible the increase in consumer debt that occurred after the legislation's enactment.³⁷

The next iteration of the CARD Act should impose reporting requirements on the credit card industry. These disclosures could facilitate the reinstatement of federal usury laws, which cap the amount of interest a lender can charge. Increased transparency about the source of the industry's profits and market segmentation would also assist in crafting regulation of exploitative practices and products. Additionally, to strengthen the financial status of communities targeted by the industry's practices, the CARD Act should require credit card-issuing banks to assist low-income consumers by creating asset-based savings programs. These programs inure substantial benefits to consumers and corporations alike by increasing the number of banked consumers and facilitating saving that can lead to class mobility.

Finally, the CARD Act should implement a "subsistence amnesty," temporarily eliminating interest and fees on subsistence purchases made with credit cards by individuals living under the poverty line. This provision would compel the credit card companies to adjust their business model, refocusing their

ii (2010) (unpublished Ph.D. dissertation, The Ohio State University), available at <http://etd.ohiolink.edu/send-pdf.cgi/Lin%20ChiJack.pdf?osu1276708518>.

34. See Watkins, *supra* note 24, at 414 ("Consumer credit is the lever that transforms consumer assets into corporate profits.").

35. Credit Card Accountability Responsibility and Disclosure Act of 2009, sec. 101, § 127, 123 Stat. 1734, 1735–36 (codified at 15 U.S.C. § 1637 (2012)) [hereinafter CARD Act].

36. One example of such a card is First Premier's Platinum card, aimed at low-income consumers, which offers an interest rate of 36% and comes with a \$400 annual fee. Blake Ellis, *First Premier's \$400-a-Year Credit Card*, CNNMONEY (February 11, 2012, 9:37 AM), http://money.cnn.com/2012/02/09/pf/first_premier_credit_card/index.htm?source=cnn_bin; see also Andrew R. Johnson, *Credit-Card Issuers Circling Subprime Borrowers Again*, MARKETWATCH (Oct. 11, 2011, 3:11 PM), <http://www.marketwatch.com/story/card-issuers-circling-subprime-borrowers-again-2011-10-11>.

37. Press Release, Bd. of Governors of the Fed. Reserve Sys., Consumer Credit – G.19 (Dec. 2012), available at <http://www.federalreserve.gov/releases/g19/Current/>.

attention on wealthier consumers as sources of profit. It would also restore some of the exploitative profits derived from predatory practices to low-income consumers, allowing some of them to begin paying off the principal of their debts and eventually to emerge from debt spirals or poverty traps.

Part I provides an overview of the credit card industry and describes the companies' predatory practices. Part II sets out the neoclassical and behavioral economists' analyses of and remedies for the credit card problem. Part III analyzes this problem through the lens of structural inequality and proposes four amendments to the CARD Act. The Article concludes with a call for future work in this area by scholars in law and economics and behavioral economics to include an analysis of structural inequalities.

I. THE CREDIT CARD INDUSTRY

A. *History and Structure of the Industry*

The first plastic cards allowing consumers to buy now and pay later were charge cards associated with specific retail stores that appeared in the early twentieth century.³⁸ Diners Club introduced the first universal credit card in 1949.³⁹ The card allowed traveling businessmen to charge meals at a variety of restaurants and required payment in full each month.⁴⁰ Other cards soon entered the market, despite doubts that a credit card system could be profitable.⁴¹ From the 1960s to the 1980s, buoyed by congressional and judicial support of deregulation, Bank of America and a rival network, the Interbank Card Association, became the two major credit card players, offering cards that they would eventually brand as Visa and MasterCard, respectively.⁴²

The credit card game changed radically in 1978 when, in *Marquette National Bank of Minneapolis v. First Omaha Service Corp.*,⁴³ the Supreme Court ruled that national banks could charge interest rates according to the usury ceilings in the state where their headquarters were located, instead of their customers' home states.⁴⁴ This decision led most national banks to relocate to the states with the most permissive usury laws and led states to repeal restrictive laws to discourage the exodus of major financial institutions.⁴⁵ A second Supreme Court decision, *Smiley v. Citibank*,⁴⁶ extended this rule to fees in 1996, thereby

38. See Johnna Montgomerie, *The Financialization of the American Credit Card Industry*, 10 *COMPETITION & CHANGE* 301, 309–10 (2006).

39. *Id.* at 302.

40. RONALD J. MANN, *CHARGING AHEAD: THE GROWTH AND REGULATION OF PAYMENT CARD MARKETS* 81–82 (2006).

41. See ROBERT D. MANNING, *CREDIT CARD NATION: THE CONSEQUENCES OF AMERICA'S ADDICTION TO CREDIT* 85–86 (2000).

42. *Id.* The original cards were called Master Charge and BankAmericard.

43. 439 U.S. 299 (1978).

44. *Id.* at 308–12.

45. Bar-Gill, *supra* note 9, at 1381–82.

46. 517 U.S. 735 (1996).

completing the process of deregulation.⁴⁷ Later, securitization, the practice of selling parcels of credit card debt to investors, freed banks from reliance on their deposit pools to replenish capital available for lending to credit card consumers and led to global expansion of the industry.⁴⁸

Initially, the lifestyle user was the paradigmatic credit card holder.⁴⁹ Cultivating this type of consumer required a change in values surrounding credit. In the late nineteenth and early twentieth century, the use of credit was considered “an economic sin” that led “straight to serfdom” by setting “utterly false standards of living” and causing “hopelessly distorted” judgment.⁵⁰ Industrialization refocused the societal emphasis on production to consumption through urbanization, rising incomes, and the abundance of new goods.⁵¹ By the 1920s, it became “old-fashioned to limit . . . purchases to the amount of . . . cash balances,” with consumers using credit to finance up to 90% of their durable goods purchases.⁵²

Early credit cards attracted many lifestyle users, most of whom paid their balances in full, leading to the imposition of annual fees on cards in the 1970s.⁵³ Over the next few decades, technological advances altering social interactions created a new lifestyle user. As Juliet Schor explains in *The Overspent American*, most modern Americans no longer strive to emulate their neighbors.⁵⁴ Instead, they now seek to attain a quality of life manifested through materialist acquisition and overt consumption that matches that flaunted by celebrities, television and film characters, and co-workers.⁵⁵ The present-day leisure class transmits its taste and values to “the 99%” primarily through fictional families, and studies reveal that most people report dissatisfaction with their class status, regardless of what it is.⁵⁶

In the 1970s, the National Welfare Rights Organization led a successful grassroots campaign to democratize credit by extending it to women on welfare.⁵⁷

47. See *id.* at 744–47.

48. Montgomerie, *supra* note 38, at 302–03, 308.

49. A lifestyle user is a consumer who uses credit cards, not to survive, but to enhance her lifestyle, either to a small or great degree.

50. Watkins, *supra* note 19, at 913 (quoting CLYDE WILLIAM PHELPS, *THE ROLE OF THE SALES FINANCE COMPANIES IN THE AMERICAN ECONOMY* 39 (1952)).

51. *Id.* at 913–14.

52. *Id.* at 915 (quoting FREDERICK ALLEN, *ONLY YESTERDAY: AN INFORMAL HISTORY OF THE 1920'S* (1931)).

53. *Id.* at 922.

54. JULIET B. SCHOR, *THE OVERSPENT AMERICAN: UPSCALING, DOWNSHIFTING, AND THE NEW CONSUMER* 3–4 (1998).

55. *Id.* at 5, 28–34.

56. *Id.* at 7–8, 11–19. Compounding the harmful effects of ubiquitous images of an idealized and unattainable lifestyle on non-wealthy lifestyle users are various psychological mechanisms that inhibit the rational use of credit.

57. Regina Austin, *Of Predatory Lending and the Democratization of Credit: Preserving the Social Safety Net of Informality in Small-Loan Transactions*, 53 AM. U. L. REV. 1217, 1253–54 (2004) (citing Felicia Kornbluh, *Black Buying Power: Welfare Rights, Consumerism, and Northern Protest*, in *FREEDOM NORTH: BLACK FREEDOM STRUGGLES*

Activists in the movement viewed the possession of a credit card as a status symbol, the absence of which relegated individuals to second-class citizenship.⁵⁸ Middle- and low-income convenience users (who do not pay interest or fees) were the primary beneficiaries of the credit democratization movement.⁵⁹ The expansion of credit card lending continued to the point where, in 2006, 80% of households possessed at least one credit card.⁶⁰

Underwriting technology, introduced in the 1990s, allows lenders to develop complex statistical models to predict spending and repayment behavior for increasingly smaller sections of the population.⁶¹ Based on these models, lenders can amass portfolios of cardholders previously considered too risky. This leads to new profits generated from low-income consumers' need to revolve balances.⁶² Many of these cardholders are subsistence users, who are initially attracted to credit cards' salient benefits but ultimately incur more harm than good from their use.⁶³

Presently, the credit card industry is the most profitable financial service in the United States.⁶⁴ The average credit card interest rate of 20% is "significantly higher than the prime lending rate and three times that of a home mortgage."⁶⁵ Credit card issuers earn roughly 80% of their profits from interest rates and penalty fees.⁶⁶ Initially, the credit card business model focused on attracting low-risk,

OUTSIDE THE SOUTH, 1940–1980, at 199, 199 (Jeanne Theoharis & Komozi Woodward eds., 2003)).

58. *Id.* at 1254. Middle- and upper-class women also viewed the lack of access to credit cards as a symbol of discrimination. Neither the mayor of Davenport, Iowa, Kathryn Kirshbaum, nor tennis star Billie Jean King could get credit cards without their husbands' signatures until Congress passed the Depository Institutions Amendments Act banning sex discrimination in lending in 1974. GAIL COLLINS, *WHEN EVERYTHING CHANGED* 250 (2009). The idea that possession of a credit card confers privilege that can overcome class or racial discrimination is still prevalent today. See Littwin, *supra* note 22, at 465–66. One example of this is the introduction of gold, platinum, and executive cards. Marketing and advertising campaigns appeal to this desire for upward class mobility although their practices make mobility far less likely. For a thorough and fascinating account of shifting marketing strategies and descriptions of the representative ads, see MANNING, *supra* note 41, at 1–30.

59. Steven Mercatante, *The Deregulation of Usury Ceilings, Rise of Easy Credit, and Increasing Consumer Debt*, 53 S.D. L. REV. 37, 43–44 (2008).

60. *Fast Facts About Credit Card Debt*, ABC NEWS (Jan. 2, 2006), <http://abcnews.go.com/WNT/Business/story?id=1457162#.UOsJCKX4ZUR>.

61. Ronald J. Mann, *Patterns of Credit Card Use Among Low and Moderate Income Households*, in *INSUFFICIENT FUNDS: SAVINGS, ASSETS, CREDIT, AND BANKING AMONG LOW-INCOME HOUSEHOLDS* 252, 257 (Rebecca M. Blank & Michael S. Barr eds., 2009), available at <http://www.columbia.edu/~mr2651/CreditCardsforthePoor.pdf>.

62. *Id.*

63. A subsistence user is a consumer who relies on credit cards to pay for the basics of her existence. While subsistence users are almost always low-income users, not all low-income users are subsistence users.

64. Montgomerie, *supra* note 38, at 301–02.

65. Mercatante, *supra* note 59, at 50.

66. GAO, *supra* note 14, at 67. These profits represent a significant shift in consumer attitudes toward debt from a financial mechanism of last resort to a necessary

convenience users whose transactions would generate merchant fees.⁶⁷ Now, the ideal credit card user maintains only enough financial stability to avoid bankruptcy proceedings.⁶⁸ The credit card companies' ability to induce this type of dependence is a testament in part to successful advertising and marketing.⁶⁹

The credit card industry divides consumers into four classifications: nonusers, convenience users (or deadbeats), revolvers, or late payers.⁷⁰ A nonuser is someone who does not use credit cards. A convenience user is a consumer who pays off monthly balances in a timely fashion. A revolver is a credit card holder who carries a balance over from month to month. A late payer is someone who pays off the monthly balance, but not before the due date.

The four major credit card brands in the United States are Visa, MasterCard, American Express, and Discover.⁷¹ Visa and MasterCard set interchange fees with merchants that intermediaries, called acquirers, collect for a small percentage of the interchange fee.⁷² Dominating the industry, these two

component of modern daily life. *See also* Watkins, *supra* note 24, at 414 (“Consumer credit is the lever that transforms consumer assets into corporate profits.” (citation omitted)).

67. MANN, *supra* note 40, at 81–83. In January 2013, merchants and the major credit card companies settled an ongoing suit. The settlement terms allow merchants to impose a surcharge on consumers for credit card use. This surcharge will likely decrease the potential for profits from transactions and focus the companies even more on fees and interest rates as their main profit sources.

68. *See* Mann, *supra* note 11, at 385–92. Merchant fees markedly decreased as a source of profit for credit card companies after the Federal Reserve implemented a cap on these fees, beginning in October 2011, of 21 to 24 cents, down from an average of 44 cents per transaction. Edward Wyatt, *Retailers Push Fed for Yet Lower Debit Fees*, N.Y. TIMES, Nov. 24, 2011, at B1.

69. “Selling consumer credit is, of course, selling debt—a commodity that would generally be an undesirable one as far as the buyer is concerned. The techniques of selling debt today, however, are such that the nature of the commodity for sale is concealed from the buyer.” Watkins, *supra* note 19, at 921 (quoting Arch W. Troelstrup, *The Influence of Moral and Social Responsibility on Selling Consumer Credit*, 51 AM. ECON. REV. 549, 550 (1961)).

70. JENNIFER WHEARY & TAMARA DRAUT, WHO PAYS? THE WINNERS AND LOSERS OF CREDIT CARD DEREGULATION 4–6 (2007), available at http://www.demos.org/sites/default/files/publications/whopays_Demos.pdf.

71. *See* Eva Norlyk Smith, *The Major Credit Card Companies*, CREDITCARDGUIDE (May 22, 2009), <http://www.creditcardguide.com/creditcards/credit-cards-general/major-credit-card-companies>. In 2006, Visa had 44% of the market, MasterCard had 31%, American Express had 20%, and Discover had 5%. *Q&A: More About Visa's Foray into the Stock Market*, USA TODAY (Feb. 25, 2008, 6:19 PM), http://usatoday30.usatoday.com/money/industries/retail/2008-02-25-visa-ipo-qa_N.htm.

72. *See* Zhu Wang, *Market Structure and Credit Card Pricing: What Drives the Interchange?* 3 n.6 (Fed. Reserve Bank of Kan. City, Payments Sys. Research, Working Paper No. PSR WP 06-04, 2007), available at http://www.frbatlanta.org/news/CONFEREN/08payments/08payments_Wang.pdf; *see also* Ann Kjos, *The Merchant-Acquiring Side of the Payment Card Industry: Structure, Operations, and Challenges* 2–3, 20 (Fed. Reserve Bank of Phila. Payment Cards Ctr., Discussion Paper No. 07-12, 2007), available at <http://ssrn.com/abstract=1031519>.

brands have a network of issuers that set card prices and terms.⁷³ Banks in the network also issue funds. Other issuers, such as Capital One, known as monolines, perform no functions other than issuing cards.⁷⁴ American Express traditionally did not operate through issuers. Instead, it relied on high annual fees paid by wealthy consumers for the privilege of the status, perks, and rewards enjoyed by members.⁷⁵ In 2004, however, American Express changed its business model, and MBNA became the first issuer to offer an American Express card, followed by Citigroup and a host of others.⁷⁶ Five credit card issuers (Chase, Bank of America, Citi, American Express, and Capital One) dominate the issuer industry,⁷⁷ and the top nine issuers hold approximately 90% of the existing credit card balances.⁷⁸

Despite the existence of hundreds of issuers and several hundreds of distinct credit card products, the credit card market is noncompetitive for low-income users, who uniformly receive offers of cards with disadvantageous terms.⁷⁹ Credit cards universally come with high interest rates and fees, which can be avoided through monthly payments in full by solvent consumers. The credit card companies profit from these users through transaction fees and fees associated with high-status cards that offer perks.⁸⁰

Credit cards perform two separate functions: transacting and lending. Although there are costs associated with transacting, merchants primarily bear these costs. Credit card companies pay merchants only 97 to 99% of the amount charged, depending on the type of card or the particular agreement between the individual merchant and company.⁸¹ In some states, merchants may attach a surcharge to credit card use to shift this cost to the consumer.⁸²

73. Wang, *supra* note 72, at 3 & nn.2, 6 (stating that Visa and MasterCard handle approximately 80% of all U.S. credit card transactions).

74. See Ronald J. Mann, *Credit Cards and Debit Cards in the United States and Japan*, 55 VAND. L. REV. 1055, 1068 (2002).

75. See Douglas Akers et al., *Overview of Recent Developments in the Credit Card Industry*, FDIC BANKING REV. (Nov. 17, 2005), <http://www.fdic.gov/bank/analytical/banking/2005nov/article2.html#33>.

76. See *id.*

77. In 2009, the top five issuers held \$450 billion in consumer debt. *U.S. General Purpose Cards—Midyear 2011*, NILSON REP., Aug. 2011, at 1, 7.

78. See CONSUMER FIN. PROT. BUREAU, BUILDING THE CFPB 12 (2011) [hereinafter CFPB Report], available at http://www.consumerfinance.gov/wp-content/uploads/2011/07/Report_BuildingTheCfpb1.pdf; NILSON REP., Aug. 2009, at 9.

79. Research assistants have searched tirelessly for a “good” card to recommend to concerned consumers, in vain.

80. These cards include the American Express Black and Centurion cards.

81. See Wang, *supra* note 72, at 1–3. Rewards cards cost merchants more than regular cards, but merchants do not pass these costs back to the individual consumer. In November 2011, the Federal Reserve capped the amount of interchange fees credit card companies could collect from merchants, leading the companies to pursue other profit avenues that will likely include vulnerable consumers. See Wyatt, *supra* note 68.

82. See Atossa Araxia Abrahamian, *Retailers May Add Surcharge in Credit Card Transactions*, REUTERS (Jan 28, 2013, 5:31 PM), <http://www.reuters.com/article/2013/01/28/us-creditcard-settlement-fees-idUSBRE90R14U20130128>; Reuters, *Retailers May*

Credit cards compete with other payment methods, including cash; checks; debit cards; consumer-to-consumer (“C2C”) payments, such as PayPal; and mobile payments.⁸³ Cash, which once represented the most honest and ethical form of payment, now carries a stigma of association with criminality and poverty.⁸⁴ The use of checks, though low in comparison to credit cards and debit cards, is considerable in light of the associated expenses and inconvenience.⁸⁵ Checks once offered consumers the opportunity to make purchases and delay payment until payday or other influxes of income in the near future, but new rules eliminated this advantage by requiring almost immediate payment by the bank upon which a check is drawn.⁸⁶ It is therefore likely that check use will decline dramatically in the United States, in line with international trends.⁸⁷

In many countries, debit cards are more popular than credit cards because of their low transaction costs (money transfers directly from the customer’s

Add Surcharges on Credit-Card Purchases, CHI. TRIB. (Jan. 28, 2013), http://articles.chicagotribune.com/2013-01-28/business/chi-retaiers-may-addl-surcharges-on-creditcard-purchases-20130128_1_debit-card-payments-credit-card-surcharges.

83. Visa has created a mobile payment system for use via cell phone in developing countries, beginning in Nigeria and Uganda, that allows consumers to conduct financial transactions without having to travel long distances to financial services institutions’ physical locations. Jenna Wortham, *Visa to Offer Mobile Payments in Developing Nations*, N.Y. TIMES BITS BLOG (Nov. 16, 2011, 10:00 PM), <http://bits.blogs.nytimes.com/2011/11/16/visa-to-offer-mobile-payments-in-developing-nations/>.

84. In terms of social value, cash is now often perceived as “the least sophisticated, least efficient, and least productive form of money.”

When we think of cash, we envision small amounts of money that will fit into a wallet, a cookie jar, the opening in a mattress, or a passbook savings account. When we think of cash in large amounts, we envision stacks of bills that have been illegally obtained or accumulated in the criminal or underground economies and that must be laundered or destigmatized. Cash is meant to be spent or saved; it is largely a tool of consumption, not an instrument of investment.

Austin, *supra* note 57, at 1245.

85. MANN, *supra* note 40, at 13. The federal government, however, has decided to go paperless. Since May 2011, social security and welfare recipients have received their benefits either through electronic deposit into a bank account or through a debit card. Christine Hauser, *As Benefits Go Paperless, Check-Day Rituals Vanish*, N.Y. TIMES, Jan. 29, 2011, at B1. The new policy is intended to reduce theft and will save the government \$120 million a year in costs associated with the use of checks. *Id.*

86. See Linda R. Crane, *Checking Out of the Exception to UCC 3-104: Why Parties Should Be Able to Negotiate Whether (or Not) Their Checks Are Payable on Demand*, 3 COLUM. J. RACE & L. 73 (2013).

87. Susan Herbst-Murphy, *Trends and Preferences in Consumer Payments: Lessons from the Visa Payment Panel Study*, FED. RES. BANK PHILADELPHIA, 9, 11 (May 2010), available at <https://www.philadelphiafed.org/consumer-credit-and-payments/payment-cards-center/publications/discussion-papers/2010/D-2010-Visa-Payment-Panel-Study.pdf>.

account to the merchant) and disciplinary effect.⁸⁸ Consumers cannot borrow money using a debit card. Therefore, although ease of use may lead a consumer to spend more using a debit card than she would making a cash or check purchase, debit cards are less likely to lead to financial distress.⁸⁹ In the United States, Visa and MasterCard dominate the debit, as well as the credit card, market and deliberately create consumer confusion between the two types of cards.⁹⁰ Most MasterCard and Visa cards function as either a debit or a credit card, but because of the higher profits associated with credit card use, companies encourage consumers to use credit cards through rewards programs and similar perks.⁹¹

Payment systems, such as PayPal⁹² and mobile payments through smartphones,⁹³ are emerging threats to credit cards because these new payment

88. See MANN, *supra* note 40, at 106. For example, the card markets of Australia, Canada, and the United Kingdom are dominated by the use of payment cards but with substantially lower use of credit cards and credit card borrowing than the United States, likely due to increased segmentation between debit and credit card products. *Id.*

89. *Id.* at 28–29, 119–20.

90. See *id.* at 32–33; MANNING, *supra* note 41, at 115 (explaining how the banking industry has attached automatic lines of credit to debit cards to erode “the traditional ‘cognitive connect’” between debit cards and bank accounts). Although American Express and Discover have traditionally not offered debit cards, American Express recently announced the introduction of a prepaid debit card. *American Express Unveils a ‘Simple’ Prepaid Debit Card*, CONSUMERREPORTS.ORG (June 15, 2011, 1:00 PM), <http://news.consumerreports.org/money/2011/06/american-express-unveils-first-no-fee-prepaid-debit-card.html>. Unfortunately, all prepaid debit cards are exempt from federal consumer protection laws that cover the consumer in cases involving fraudulent or erroneous charges. *Id.* Another burden for the consumer using an American Express prepaid debit card is the fact that putting cash on the card requires you to “purchase” a MoneyPack at a retailer like Wal-Mart, at costs of up to \$4.95 per transaction. *Frequently Asked Questions: All You Need to Know About the American Express Prepaid Card*, AM. EXPRESS, https://www212.americanexpress.com/dsmlive/dsm/dom/us/en/personal/cardmember/additionalproductsandservices/giftcardsandtravelerscheques/gpr_faqs.do?vgnextoid=0f6293eebf3ec210VgnVCM200000d0faad94RCRD&vgnnextchannel=95ddb81e8482a110VgnVCM100000defaad94RCRD&applInstanceName=default&name=gpr_faqs&type=intbenefitdetail#faqAddMoney (last visited July 24, 2011). So when the American Express prepaid card user wants to put \$40.00 cash on their card the cost of doing so results in an actual balance of \$35.05.

91. See Ann Carrns, *Cash-Back Credit Card Rewards Offers Going Strong*, N.Y. TIMES BUCKS BLOG (Feb. 15, 2012, 10:35 AM), <http://bucks.blogs.nytimes.com/2012/02/15/cash-back-credit-card-rewards-offers-going-strong/?scp=4&sq=credit%20cards&st=cse>.

92. For an explanation of how PayPal operates and some of the legal issues surrounding it, see Andrés Guadamuz González, *PayPal: The Legal Status of C2C Payment Systems*, 20 COMPUTER L. & SEC. REV. 293 (2004).

93. See, e.g., Maria Aspan & Sinead Carew, *Telco Payment Venture Targets Visa and MasterCard*, REUTERS (Nov. 16, 2010), <http://www.reuters.com/article/idUSTRE6AF3FA20101116>; Michael Finney, *Mobile Payments May Soon Make Debit Cards Obsolete*, ABC7 NEWS (Nov. 23, 2010), http://abclocal.go.com/kgostory?section=news/7_on_your_side&id=7806909; Andrew Munchbach, *Official: AT&T, T-Mobile, Verizon to Launch Mobile Commerce Network*, BGR (Nov. 16, 2010), <http://www.bgr.com/2010/11/16/official-att-t-mobile-verizon-launch-isis-mobile-commerce-network/>; Laurie

methods are easier and cheaper to use for consumers who have access to the required technology. In November 2010, three of the four top mobile phone providers (AT&T, Verizon, and T-Mobile) announced that they had established a joint venture for mobile payments that allows consumers to pay for items simply by waving a smartphone near a machine.⁹⁴ This joint venture, called Isis, partnered with all four of the major credit card companies.⁹⁵ Sprint created a mobile payment system in partnership with American Express,⁹⁶ and Google developed a similar technology in conjunction with MasterCard.⁹⁷ In Europe, iCarte partnered with Visa for contactless payments via the iPhone.⁹⁸ PayPal competes with the domestic ventures by offering in-store payments through mobile devices that do not rely on credit cards.⁹⁹

Eventually, for high-technology consumers, these innovations will lead to the elimination of wallets and credit cards, which will then become the province of the lower-income, less technologically advanced consumer. Under these circumstances, exploitation of the power imbalance between corporation and low-income consumer will likely increase.

B. Predatory Industry Practices

The credit card companies engage in a number of tactics designed to capture vulnerable consumers, and to extract the maximum amount of interest and fee payments from them. One practice that negatively affects a range of users is the offering of teaser rates, or very low introductory interest rates (often zero), that increase exponentially after a short period, usually six months.¹⁰⁰ The teaser strategy is a very successful marketing tool. Studies show that an appealing introductory interest rate is the most important factor in credit card selection for

Segall, *Your Mobile Phone is Becoming Your Wallet*, CNNMONEY.COM (Jan. 19, 2011, 9:14 AM), http://money.cnn.com/2011/01/19/technology/mobile_payments/index.htm?hpt=T2; Christine Speer, *Meet the People Who're Making Your Credit Card Obsolete*, PHILLYMAG.COM (Dec. 2010), http://www.phillymag.com/articles/pulse_chatter_meet_the_people_whore_making_your_credit_card_obsolete/.

94. Aspan & Carew, *supra* note 93.

95. Mark Hachman, *Isis Carrier Venture Signs Payment Deals with Visa, MasterCard, Others*, PCMAG.COM (July 19, 2011), <http://www.pcmag.com/article2/0,2817,2388712,00.asp>.

96. *Id.*

97. See *Google Wallet Goes Live, More Consumer-Friendly Version to Follow*, UNIBUL CREDIT CARD BLOG (Sept. 21, 2011, 10:52 AM), <http://blog.unibulmerchantservices.com/google-wallet-goes-live-more-consumer-friendly-version-to-follow>.

98. Charlie Sorrel, *Europeans Already Using iPhones for Payments*, WIRED (Feb. 2, 2011), <http://www.wired.com/gadgetlab/2011/02/europeans-already-using-iphones-for-payments/#>.

99. Matt Hamblen, *PayPal Unveils Mobile Payments for In-Store Shopping*, COMPUTERWORLD (Sept. 15, 2011), http://www.computerworld.com/s/article/9220048/PayPal_unveils_mobile_payments_for_in_store_shopping.

100. Bar-Gill, *supra* note 9, at 1392–93.

one-third of consumers.¹⁰¹ Most of these consumers borrow, however, at the higher post-promotion rates.¹⁰²

Teaser rates are a clear example of a marketing strategy called shrouding designed to exploit consumers' preference for short-term gains over long ones and their often misguided optimism about their financial management skills and opportunities.¹⁰³ These rates also appeal to customers who need credit quickly and cannot pay off their balances within six months due to financial instability. Exponential increases in interest rates after six months exemplify the lack of relationship between the rates and the issuers' true costs.

Another industry trick is the mass mailing of preapproved cards, frequently to people in low-income areas. These consumers often believe that they are not eligible for credit cards due to low credit scores or failed attempts to acquire cards through the regular application process.¹⁰⁴ Preapproved cards are hard to resist, particularly for people who live in areas without banks, lack easy access to transportation, are too consumed with work and childcare responsibilities to venture outside the home to obtain a card, do not believe they are eligible for a credit card, or simply have urgent financial needs. The cards usually come with very high interest rates and fees for default, late payments, and over-the-limit charges.¹⁰⁵ Mass mailings of preapproved cards generate two-thirds of all new credit card accounts.¹⁰⁶

The fee-harvesting card is another product that exploits consumers' urgent needs for credit and their short-term thinking. This type of card, available from many issuers, disguises its effective rates by attaching fees to its use that dwarf the credit it provides.¹⁰⁷ For example, one Visa card with a \$300 credit limit has a \$79 application fee, with an additional \$281 fee attaching to the card upon approval.¹⁰⁸

Consumers may not even realize that the card they have purchased is a fee-harvesting one. Credit card agreements are notoriously difficult to read and interpret.¹⁰⁹ They are voluminous, written in small print, and frequently consist of

101. *Id.* at 1392.

102. *Id.*

103. Shrouding is the process by which "merchants identify a myopic class of customers and exploit the[ir] lack of rationality by systematically backloading the less attractive terms into a less prominent time and place in the relationship." MANN, *supra* note 40, at 136 (citing Xavier Gabaix & David Laibson, *Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets*, 121 Q.J. ECON. 505 (2006)).

104. *See* Littwin, *supra* note 22, at 475.

105. *Id.* at 453.

106. *Id.* at 484.

107. Willis, *supra* note 21, at 265–66; *see* NATIONAL CONSUMER LAW CENTER, FEE-HARVESTERS: LOW-CREDIT, HIGH-COST CARDS BLEED CONSUMERS 5–6 (2007), available at <http://www.nclc.org/images/pdf/pr-reports/report-fee-harvester.pdf>.

108. Willis, *supra* note 21, at 266. For more specific examples of fee-harvesting cards, *see* Mann, *supra* note 61, at 257, 262.

109. Alan M. White & Cathy Lesser Mansfield, *Literacy and Contract*, 13 STAN. L. & POL'Y REV. 233, 234, 249–50 (2002).

different parts mailed to consumers at different times. Most agreements do not arrive until after a consumer acquires and begins to use the card.¹¹⁰ Consumers likely do not consider the agreement terms to be negotiable and, even if they wished to negotiate them, would not be able to identify the proper person with whom to do so.¹¹¹ Additionally, most agreements state that companies may change interest rates at any time for any reason without providing advance warnings or recourse to the consumer.¹¹²

Racial discrimination is another predatory practice in which credit card companies engage to increase their profits. Studies demonstrate that credit card companies discriminate based on race during face-to-face encounters with walk-in customers and through assumptions arising from an applicant's name, voice, or zip code. In 2008, the Boston Federal Reserve Bank published *Credit Card Redlining*, a study by Ethan Cohen-Cole comparing the terms and availability of credit card agreements entered into by credit card owners with identical risk profiles and payment histories living in different areas.¹¹³ The study reveals significant differences in access to credit and the amount of credit offered based on the racial makeup of the users' neighborhoods.¹¹⁴ For example, the difference in available credit in neighborhoods with a population that is at least 80% African American as compared to neighborhoods that are at least 80% white, all other factors being equal, is more than \$7,000.¹¹⁵

A 2010 study by Chi-Jack Lin also reports significant racial discrimination in the consumer credit card market.¹¹⁶ The study shows that, accounting for all alternative explanations, the fact that a consumer is African American negatively affects the probability of owning a credit card, the number of cards owned, and the average credit line per card. Using multiple regressions, the study demonstrates that companies deny some credit card applications from African Americans solely based on race.¹¹⁷ African-American credit card applicants benefit more from owning a house than white applicants, and from owning a car, having a job, earning a higher income, and possessing a greater net worth.¹¹⁸ These statistics indicate that while whiteness serves as a proxy for creditworthiness, African-American applicants must concretely demonstrate their

110. *Id.* at 249–50; *see also* Mann, *supra* note 18.

111. Mann, *supra* note 18, at 905.

112. *Id.* at 908.

113. *See* Cohen-Cole, *supra* note 33.

114. *Id.* at 14–15.

115. *Id.*

116. Lin, *supra* note 33. This study appears to be the first of its kind, and highly accurate due to the use of multiple regressions. However, a 1980 attempt to establish a *prima facie* case of racial discrimination based on redlining against the issuer of a gasoline credit card company failed in part due to the complexity of the credit grading system and the lack of information about the common characteristics of the hypothesized applicant pool in the plaintiff's zip code. *Cherry v. Amoco Oil Co.*, 490 F. Supp. 1026, 1030–31 (N.D. Ga. 1980).

117. Lin, *supra* note 33, at 45.

118. *Id.* at 48.

ability to repay debt. The study also documents that Latinos receive cards with less favorable conditions than whites.¹¹⁹

II. NEOCLASSICAL AND BEHAVIORAL ECONOMISTS' ANALYSES AND SOLUTIONS

A. Neoclassical Economists

Neoclassical economic analysis, which forms the cornerstone of American credit card policy, attributes the inefficient functioning of the credit card market to consumers' lack of information.¹²⁰ Under this framework, the prescribed response to this dearth of information is increased disclosure by credit card companies.¹²¹ According to neoclassical economics theory, sellers compete to provide optimal goods to rational consumers. Because consumers are perfectly rational, markets only fail when buyers lack complete information.¹²² U.S. financial policy fully embraces this market theory, such that the cornerstone of credit card regulation is disclosure.¹²³ Accordingly, the aptly titled Truth in Lending Act, and its latest incarnation, the 2009 CARD Act, require increased disclosure of certain information to consumers, such as the length of time it will take to pay off a balance by making only minimum payments; the costs associated with exceeding a credit limit (accompanied by an opt-in procedure allowing the consumer to choose not to incur these costs); and the creation of an online database of the terms and conditions attached to more than 300 different cards.¹²⁴ Similarly, the Consumer Financial Protection Bureau ("CFPB") states that its primary goal is to provide transparency to consumers.¹²⁵

There are flaws in both the initial premise and the favored remedy of neoclassical economists' analysis of market failure. Herbert A. Simon describes the true behavior of the consumer as one informed by bounded rationality.¹²⁶ Bounded rationality contrasts with perfect rationality, which "requires a complete knowledge and anticipation of the consequences that will follow on each

119. *Id.* at 46.

120. See Richard A. Epstein & Oren Bar-Gill, *Consumer Contracts: Behavioral Economics vs. Neoclassical Economics* 4–5 (NELLCO Legal Scholarship Repository, Working Paper No. 91, 2007), available at http://lsr.nellco.org/cgi/viewcontent.cgi?article=1095&context=nyu_lewp.

121. See, e.g., DAVID S. EVANS & RICHARD SCHMALENSEE, *PAYING WITH PLASTIC: THE DIGITAL REVOLUTION IN BUYING AND BORROWING* 107–10 (2d ed. 2005); MANNING, *supra* note 41; MANN, *supra* note 40, at 159–65; Littwin, *supra* note 22, at 497–98; Elizabeth Warren, *The Over-Consumption Myth and Other Tales of Economics, Law and Morality*, 82 WASH. U. L.Q. 1485 (2004).

122. Epstein & Bar-Gill, *supra* note 120, at 1.

123. David Dante Troutt, *Ghettos Revisited: Antimarkets, Consumption, and Empowerment*, 66 BROOK. L. REV. 1, 29–30 (2000).

124. 15 U.S.C. § 1637 (2012); CARD Act, *supra* note 35.

125. See CFPB Report, *supra* note 78, at 9–10.

126. See HERBERT A. SIMON ET AL., *ECONOMICS, BOUNDED RATIONALITY AND THE COGNITIVE REVOLUTION* 3–6 (1992).

choice.”¹²⁷ In reality, neither consumers’ “knowledge nor their powers of calculation allow them to achieve the high level of optimal adaptation of means to ends that is posited in economics.”¹²⁸ Instead, consumers participate in the market based on limited information and often with considerable constraints on their choices and actions.¹²⁹

Bounded rationality entails shortcut reasoning that consumers use because they are unable to observe their environment in all of its complexity.¹³⁰ Alternatives may be unknown or accompanied by uncertain payoffs. When making credit decisions, it is logical to discount toward the present when it is unclear whether a future income stream will exist. Consumers also prioritize immediate expenses over potential future gains.¹³¹

Bounded rationality renders the ideal of a perfectly functioning market virtually unattainable. A narrow focus on disclosure similarly fails to reflect the realities of credit card use for most consumers.¹³² For subsistence users, credit cards are often the only viable means of paying bills and acquiring necessities, including medical attention and car repairs, or alleviating stress through comfort or status purchases. When consumers face severely limited options, disclosures about future consequences or minute and obscure differences in products are irrelevant. Not only is disclosure ineffective at the point of purchase, it also has a limited capacity to assist the consumer who has already entered a debt spiral. As highly indebted cardholders, these consumers are ineligible for new cards with more reasonable rates or transfer conditions.

1. *The CARD Act*

In 2009, the CARD Act amended the Truth in Lending Act by adding a number of provisions intended to reduce consumer confusion, eliminate some of the credit card companies’ most egregious practices, and identify areas of potential concern for future changes to the law.¹³³ According to the July 2011 CFPB progress report, after the CARD Act’s implementation, “the total amount consumers are paying for their credit cards is no higher, on average, than it was one, two, or three years ago.”¹³⁴ In other words, the CARD Act provided no

127. HERBERT A. SIMON, ADMINISTRATIVE BEHAVIOR 93 (4th ed. 1997).

128. SIMON ET AL., *supra* note 126, at 3.

129. *Id.*; see also KAARYN S. GUSTAFSON, CHEATING WELFARE: PUBLIC ASSISTANCE AND THE CRIMINALIZATION OF POVERTY 5 (2011) (discussing bounded rationality in the context of welfare recipients).

130. HERBERT A. SIMON, MODELS OF MAN: SOCIAL AND RATIONAL 261 (1957); see also Daniel Kahneman, *Maps of Bounded Rationality: Psychology for Behavioral Economics*, 93 AM. ECON. REV. 1449 (2003).

131. Sunstein, *supra* note 25, at 252.

132. *Id.* at 270.

133. CARD Act, *supra* note 35.

134. CFPB Report, *supra* note 78, at 12. Although some banks reported losses, overall profits did not drop. See Cyrus Sanati, *JP Morgan Feels Bigger Pinch From Rules on Fees*, N.Y. TIMES (July 15, 2010, 3:50 PM), <http://dealbook.nytimes.com/2010/07/15/>

financial benefit to consumers. This is due in part to the industry's creative response to the CARD Act of developing new ways to generate profits through high processing fees on new cards and other new fees.¹³⁵ The CARD Act does, however, have some positive effects on industry practices.

The CARD Act prohibits universal default, a practice that previously allowed any change in a person's credit score to lead to increased interest rates on all of that person's credit cards. The increases occurred even when the change resulted from an unrelated action, such as one late payment on one card or the addition of new mortgage or car payments.¹³⁶ Most consumers were unaware of this practice or learned about it subsequent to the precipitous act. The ban on universal default increases consumer protection for all credit card users.

To reduce fees resulting from consumers unwittingly exceeding their credit limits, the CARD Act establishes an opt-in procedure that requires consent to the extension of credit beyond pre-set limits with an accompanying charge for the privilege.¹³⁷ This provision does little to help the subsistence user, who must choose to exceed her limit when necessary. It does, however, increase lifestyle users' awareness of the consequences of their purchases and allow those users to make more informed choices regarding the value of their purchases based on their true costs.

The CARD Act also imposes new disclosure requirements. Credit card bills now state, in reasonably sized print, how long it will take to pay off the principal if the consumer chooses to make the minimum payment.¹³⁸ This change may influence lifestyle users to make fewer purchases and put more money toward increased payments. It is unlikely to alter the credit decisions of subsistence users.

The CARD Act identifies several groups that might require unique protections.¹³⁹ In compliance with this part of the Act, the Government Accountability Office ("GAO") produced a report describing the impact of lack of English proficiency on credit card use.¹⁴⁰ It describes significant barriers to financial literacy for non-English speakers due to the lack of availability of documents and educational materials in their native languages, the complexity of

jpmorgan-feels-bigger-pinch-from-rules-on-fees/?src=busln (estimating losses at between \$500 and \$700 million due to the CARD Act).

135. Sudeep Reddy, *Card Issuers' Novel Ways Outflank Law*, WALL ST. J., June 3, 2010, at C1.

136. See Eboni Nelson, *From the Schoolhouse to the Poorhouse: The Credit CARD Act's Failure to Adequately Protect Young Consumers*, 56 VILL. L. REV. 1, 4-5 (2011) (citing CARD Act § 101(a)).

137. See *id.*

138. CARD Act, *supra* note 35, § 201.

139. See *id.* §§ 301-05, 123 Stat. at 1748-51 (focusing on protection of underage consumers and college students); *id.* § 513 (mandating investigation of "the relationship between fluency in the English language and financial literacy").

140. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-518, CONSUMER FINANCE: FACTORS AFFECTING THE FINANCIAL LITERACY OF INDIVIDUALS WITH LIMITED ENGLISH PROFICIENCY 8-10 (2010) [hereinafter GAO REPORT], available at <http://www.gao.gov/assets/310/304561.pdf>.

translated documents, problems with interpretation provided by minor children, cultural differences in financial norms, and a negative view of carrying debt in some countries that prevents consumers from establishing a credit history in the United States.¹⁴¹ Responses to these obstacles, if implemented, might positively affect Spanish-speaking and immigrant consumers.

Another new disclosure provision compels the Federal Reserve to create an online database listing the terms and conditions of more than 300 credit card products, to help consumers find a card to meet their personal financial needs.¹⁴² The database in its current form is unlikely to increase or facilitate credit card shopping, however, because the language of the agreements is overly technical and complex.¹⁴³ Consumers can bypass the arduous task of sifting through the information in the database by going to www.lowcards.com to acquire similar information that is organized in a more consumer-friendly manner.¹⁴⁴ The ability of this site to help low-income consumers depends on access to the Internet, awareness of the site's existence, and the availability of choice in card selection.

The CARD Act served to frustrate credit card companies and consumers alike. While banning some harmful practices, it left the door open to others, such as increased fees. Initial resistance to the Act from the banks quelled once it became clear that it did not affect profit levels. Its overall effect was to make a gesture towards consumer protection without reducing, and perhaps increasing, consumer debt.

2. Increased Competition Through Antitrust Intervention

Antitrust law can reduce barriers to free competition that lead to market failure.¹⁴⁵ The credit card market is highly concentrated, dominated by only four major brands. These four brands all offer very similar products to low-income consumers. This parallel conduct raises the specter of anticompetitive behavior.¹⁴⁶

To establish whether anticompetitive conduct explains the lack of price differentiation, it is necessary first to identify the relevant market. This market could consist of the four major credit card brands, all credit card issuers, or some subset of issuers. Because issuers generally set interest rates, fees, and other conditions, the credit card issuer market is the most relevant.

141. *See id.*

142. *Credit Card Agreement Database*, CONSUMER FIN. PROTECTION BUREAU, <http://www.consumerfinance.gov/credit-cards/agreements/> (last updated Dec. 28, 2012).

143. *See* Sewell Chan & Andrew Martin, *Credit Card Database Is Heroic, and Mystifying*, N.Y. TIMES, May 24, 2010, at B8.

144. LOWCARDS.COM, <http://www.lowcards.com/> (last visited Feb. 6, 2011).

145. *See id.* at 2.

146. For some interesting earlier arguments about the competitiveness of the market, see Lawrence M. Ausubel, *The Failure of Competition in the Credit Card Market*, 81 AM. ECON. REV. 50 (1991). *But see* Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAP. L. REV. 79 (2000) (refuting Ausubel).

If the market is only a few firms, an oligopoly, common practices or pricing amongst these firms may indicate tacit collusion.¹⁴⁷ Price fixing through tacit collusion is illegal under § 1 of the Sherman Act, as well as under § 5 of the Federal Trade Commission Act.¹⁴⁸ Some factors that make a market conducive to collusion are present in the credit card industry, including high concentration on the sellers' side, a large number of poorly informed buyers, economies of scale, barriers to entry, and a fungible or homogeneous product.¹⁴⁹

There are several barriers to establishing tacit collusion amongst credit card issuers, however. First, there are hundreds of issuers, not just the few firms that would make up an oligopoly. This makes tacit collusion between them unlikely due to logistical obstacles, such as lack of information about each others' pricing in an industry that is notoriously secretive.¹⁵⁰ Second, each issuer offers dozens of different cards with varying interest rates and conditions, making it difficult to establish tacit collusion based on products available to only one, or a few, segments of the population, such as low-income consumers. Third, it is possible that each issuer's decision not to offer competitive rates to certain consumers arises simply from a calculation that doing so would not increase its profits. This type of parallel behavior is usually insufficient to establish agreement in an oligopoly.¹⁵¹

Ronald J. Mann attributes the rapid concentration of the credit card lending market not to collusion but to the top issuers' investment in the sophisticated underwriting technology that makes market segmentation possible.¹⁵² Mann's explanation is reasonable, particularly in light of the high profit margin that low-income consumers provide to the lenders positioned to exploit them. The elimination of the majority of issuers, who do not possess the underwriting technology, from serious competition in the market frees the top issuers to earn substantial profits based on these models without having to compete with each other on price, because the models can identify enough low-income consumers to generate substantial profits for all of the companies.¹⁵³ The top issuers effectively act as a cartel and charge monopoly prices unfettered by antitrust law, which does not allow for intervention under these circumstances.

Courts have long grappled with the antitrust implications of activity by the four major brands, including the joint venture by MasterCard and Visa that imposed exclusionary rules on banks that prevented them from offering Discover

147. HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY* 159, 162 (3d ed. 2005).

148. 15 U.S.C. §§ 1, 45 (2012).

149. HOVENKAMP, *supra* note 147, at 170.

150. Information about how credit card issuers price their products is not publicly available.

151. *See Williamson Oil Co. v. Philip Morris U.S.A.*, 346 F.3d 1287, 1292–93, 1298–1300 (11th Cir. 2003).

152. Mann, *supra* note 61, at 6, 8.

153. *Id.*

or American Express cards alongside their brands,¹⁵⁴ and the setting of merchant fees.¹⁵⁵ Lack of competition at the brand level, however, does not directly impact the availability of reasonable rates and conditions for low-income consumers.

One potential solution to the lack of competition in the market would be the introduction of a public bank that issues credit cards. The 2008 financial crisis led to a call by some economists for the creation of state and federal public banks that would expand revolving lending without raising taxes, thereby generating essential employment and entrepreneurial opportunities.¹⁵⁶ To date, there is only one public bank in the United States, the Bank of North Dakota (“BND”).¹⁵⁷ Nineteen other states have introduced legislation for publicly owned banks or for studies or task forces to determine how a publicly-owned bank would operate in their jurisdiction.¹⁵⁸ BND, which is capitalized by the state and operates for the benefit of North Dakota’s citizens, weathered the financial crisis successfully.¹⁵⁹ North Dakota was the only state to emerge from the crisis with a budget surplus.¹⁶⁰ BND primarily provides services to other banks and small businesses, as opposed

154. See, e.g., *United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 234 (2d Cir. 2003).

155. LLOYD CONSTANTINE, PRICELESS: THE CASE THAT BROUGHT DOWN THE VISA/MASTERCARD BANK CARTEL 15–16 (2009).

156. See, e.g., ELLEN HODGSON BROWN, WEB OF DEBT: THE SHOCKING TRUTH ABOUT OUR MONEY SYSTEM AND HOW WE CAN BREAK FREE 421–30 (3d ed. 2008); TIMOTHY A. CANOVA & BETTY HUTTON WILLIAMS, THE PUBLIC OPTION: THE CASE FOR PARALLEL PUBLIC BANKING INSTITUTIONS 1–2 (2011), available at <http://growth.newamerica.net/sites/newamerica.net/files/policydocs/Canova%20Public%20Option%201%20July.pdf>; Michael Brei & Alfredo Schclarek, PUBLIC BANK LENDING IN CRISIS TIMES (2010), available at http://depot.gdnet.org/cms/conference/papers/Scharleks%20paper_6.3.pdf; Jason Judd & Heather McGhee, *Banking on America: How Main Street Partnership Banks Can Improve Local Economies*, DEMOS (April 21, 2011), available at http://www.demos.org/sites/default/files/publications/Demos_NationalBankPaper.pdf; *The Giant Banks are ALREADY State-Sponsored . . . So Why Not Create Public Banks to at Least Share the Gains, Help Out Main Street, and Grow our Local Economies?*, WASHINGTON’S BLOG (June 13, 2011), <http://www.washingtonsblog.com/2011/06/the-giant-banks-are-already-state-sponsored-so-why-not-create-public-banks-to-at-least-share-the-gains-help-out-main-street-and-grow-our-local-economies.html> (relying on work by economist Steve Keen, financial writer Yves Smith et al.).

157. See BANK N. D., <http://www.banknd.nd.gov> (last visited July 31, 2011).

158. *State Activity, Resource and Contact Info*, PUB. BANKING INST., <http://publicbankinginstitute.org/state-info.htm> (last visited Ja. 31, 2013). The 19 states are Arizona, California, Connecticut, Hawaii, Illinois, Idaho, Louisiana, Maine, Maryland, Massachusetts, Montana, Nevada, New Hampshire, New York, North Carolina, Oregon, Vermont, Virginia and Washington. In Massachusetts, the commission to investigate the logistics of a public bank is already in force. *Id.*

159. See Ellen Brown, *Washington State Joins the Movement for Public Banking, YES!* (Jan. 24, 2011), <http://www.yesmagazine.org/new-economy/washington-state-joins-movement-for-public-banking> (stating that North Dakota reported its largest budget surplus in history in 2009); Judd & McGhee, *supra* note 156, at 2–4.

160. See Brown, *supra* note 159.

to individuals.¹⁶¹ Although BND does not issue credit cards, it does make low-interest loans.¹⁶² If BND or another public bank were to issue credit cards on similarly reasonable terms, consumers at the lowest end of the wealth and income scales would take their business to the public bank, leaving private institutions dependent on annual and merchant fees for their profits.¹⁶³

Another possible role for public banking, espoused by economists such as Richard C. Cook and Peter Gowan, is the regulation of credit as a public utility through community-run investment banks.¹⁶⁴ Cook envisions a banking system under public control that would provide low-interest loans to individuals and businesses, similar to the Depression-era Reconstruction Finance and Home Owners Loan corporations.¹⁶⁵ Public control of credit could correct for the underrepresentation of low-income consumers' interests by ensuring that interest rates reflect calculated risk, not businesses' capacity to exploit lack of social and financial capital.

B. Behavioral Economists

Behavioral economists and psychologists challenge and build upon the neoclassical approach by identifying cognitive mechanisms that impede consumer rationality.¹⁶⁶ Behavioral solutions to market failure seek to debias or influence the cognitive strategies of a decision-maker.¹⁶⁷ Like the neoclassical approach, this conceptualization rarely takes into account the harsh realities faced by vulnerable consumers who, even if subject to successful debiasing strategies, must misuse credit.

The four major cognitive mechanisms affecting credit card use identified by behavioral economists are hyperbolic discounting, imperfect self-control, over-optimism, and miswanting.¹⁶⁸

161. Judd & McGhee, *supra* note 156, at 2–4. Judd and McGhee refer to these types of state banks as “partnership banks.” *Id.* at 6.

162. *Id.* at 2.

163. The limit on merchant fees imposed by the Federal Reserve in November 2011 makes this a particularly unappealing prospect for credit card companies.

164. RICHARD C. COOK, *WE HOLD THESE TRUTHS: THE HOPE OF MONETARY REFORM* (2009); Peter Gowan, *Crisis in the Heartland: Consequences of the New Wall Street System*, 55 *NEW LEFT REV.* 5, 22–24 (2009), available at <http://www.newleftreview.org/A2759>.

165. COOK, *supra* note 164.

166. See, e.g., Bar-Gill, *supra* note 9, at 1395–1401; Richard L. Wiener et al., *Consumer Credit Card Use: The Roles of Creditor Disclosure and Anticipated Emotion*, 13 *J. EXPERIMENTAL PSYCHOL.: APPLIED* 32 (2007).

167. See Wiener et al., *supra* note 166, at 33.

168. Some literature refers to hyperbolic discounting as “time inconsistency.” See, e.g., ABHIJIT V. BANERJEE & ESTHER DUFLO, *POOR ECONOMICS: A RADICAL RETHINKING OF THE WAY TO FIGHT GLOBAL POVERTY* 64–65, 194–95 (2011). Similarly, over-optimism is sometimes called underestimation. Despite the proliferation of nomenclature to represent similar ideas, these four theories represent the bulk of the work in this area.

A hyperbolic discounter prefers short-term payoffs to future gains.¹⁶⁹ For example, a hyperbolic discounter will choose to receive \$100 today instead of \$110 in 30 days, because she discounts the value of future rewards. This discounting will also prompt her to prefer to receive \$110 in 31 days over \$100 in 30 days, because both of those dates are sufficiently far in the future that she considers them to be equivalent. On day 30, however, she will revert to preferring to receive \$100 on that day over receiving \$110 the next.

Applying this theory to credit card use, a hyperbolic discounter will acquire a card in the present, because she believes that both future borrowing and repayment will be manageable. Similarly, on the date of purchase, she will discount the pain of paying off the debt. The immediate emotional gratification of acquiring goods consistently dominates the hyperbolic discounter's mind.¹⁷⁰ Compounding this shortsightedness is the use of a plastic card, which eliminates the pain of spending often associated with cash payments.¹⁷¹ Hyperbolic discounting accounts for the unique pricing patterns of credit cards: low up-front short-term prices, such as annual fees; and high long-term elements, such as interest rates and penalty fees.¹⁷²

Imperfect self-control can lead a consumer to make a series of minor borrowing decisions that lead to the accumulation of unmanageable debt. In other words, “[d]ebtors who never dream of seeking a \$5,000 bank loan might run up \$5,000 in charges of \$50 at a time.”¹⁷³ While succumbing to small temptations may seem relatively harmless at the point of purchase, piecemeal borrowing can eventually plunge the user into debt that she can only escape through bankruptcy.¹⁷⁴ Low-income users are particularly susceptible to this slippery slope of debt accumulation because they often need small-value items, such as cleaning supplies or diapers, not normally associated with the type of extravagant

169. Both Littwin and Bar-Gill offer good descriptions of this phenomenon. See Littwin, *supra* note 22, at 467–69; Bar-Gill, *supra* note 9, at 1396–97. This mental process can also be viewed as part of short-termism, a cultural phenomenon that values instant gratification over long-term rewards.

170. Interestingly, research reveals that this is a physical, not just an emotional phenomenon. In a study conducted by a team of economists, psychologists, and neuroscientists, they observed brain activity through fMRI scanners while participants chose between present versus future rewards, future versus more distant future, and more distant and even more distant future rewards. Parts of the brain associated with the limbic system, (responding to visceral, immediate rewards) were activated only in the first instance, whereas the lateral cortex responded equally intensely to all three choices. BANERJEE & DUFLO, *supra* note 168, at 195 (citing Samuel M. McClure, *Separate Neural Systems Value Immediate and Delayed Monetary Rewards*, 306 SCI. 503 (2004)), available at <http://www.uw.lax.edu/faculty/giddings/ECO474/Week6/SeparateNeuralSystems.pdf>.

171. For studies on the effects of negative emotions on purchasing decisions, see Loewenstein & O’Donoghue, *supra* note 25; Wiener et al., *supra* note 166.

172. See Bar-Gill, *supra* note 9, at 1376, 1396–97.

173. TERESA A. SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA 178 (1989).

174. See TERESA A. SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT 111 (2000) (labeling consumers who fall into this trap “sliders”).

purchasing that leads to financial distress.¹⁷⁵ The relative ease of making purchases with a credit card also exacerbates the temptations of incremental borrowing. Credit card companies are willing to extend small amounts of credit to low-income consumers because the resulting debt, even at low lending levels, is profitable.¹⁷⁶

Another popular theory of credit card use is the over-optimism bias.¹⁷⁷ Consumers consistently underestimate the likelihood of adverse events that would create a need to borrow, such as accidents, illnesses suffered by themselves or loved ones, or job loss.¹⁷⁸ These unfortunate circumstances ironically become more likely as debt amasses, because financial stress can lead to sickness, sleep deprivation, and increased responsibilities, such as childcare.¹⁷⁹ Over-optimism bias, like hyperbolic discounting, obscures the potential harm of unfair contract terms that arise only upon default or late payments.

Miswanting is the desire to purchase items that do not promote a person's welfare, or the opposite, a lack of desire for things that would increase an individual's well-being.¹⁸⁰ A desire to improve one's social position relative to friends and associates often drives miswanting, leading a person to use credit to fund a purchase that ultimately does not in fact provide any long-lasting psychic or material benefits.¹⁸¹ Miswanting extends beyond the point of purchase. Many consumers view the gratifying aspects of a once-desired acquisition negatively after the fact, leading to a shift in desire to another object.¹⁸² Credit card companies exploit a tendency to miswant through marketing and advertising that equate spending with "priceless" social and psychological gains.¹⁸³

175. See Littwin, *supra* note 22, at 469.

176. See SULLIVAN ET AL., *supra* note 173, at 23–24; Littwin, *supra* note 22, at 452–53 (noting “low-income families often pay such extraordinary rates of interest that they are among the industry's most profitable customers”).

177. Bar-Gill, *supra* note 9, at 1400; see also Sean Hannon Williams, *Sticky Expectations: Responses to Persistent Over-Optimism in Marriage, Employment Contracts, and Credit Card Use*, 84 NOTRE DAME L. REV. 733, 742–46 (2009).

178. Bar-Gill, *supra* note 9, at 1400.

179. *Id.*

180. See Sunstein, *supra* note 25, at 253. Sunstein attributes excessive borrowing to five problems: cumulative cost neglect (described as incremental borrowing and imperfect self-control above); procrastination and inertia, leading to late fees (this factor might also explain consumers' tendency not to transfer their balances after the expiration of low introductory or “teaser” rates); unrealistic optimism; myopia and self-control problems (similar to hyperbolic discounting in that it describes an emphasis on the short term at the expense of the future); and miswanting or relative position. See *id.* at 251–53.

181. See Howard Beales & Lacey L. Plache, *Rationality, Revolving, and Rewards: An Analysis of Revolving Behavior on New Credit Cards 2* (April 20, 2007) (unpublished conference paper), available at http://www.ftc.gov/be/consumerbehavior/docs/papers/Beales_Plache_Paper.pdf.

182. Daniel T. Gilbert & Timothy D. Wilson, *Miswanting: Some Problems in the Forecasting of Future Affective States*, in *FEELING AND THINKING: THE ROLE OF AFFECT IN SOCIAL COGNITION* 178 (Joseph P. Forgas ed., 2000).

183. See Wiener et al., *supra* note 166, at 33.

The primary strategy to disrupt these cognitive processes is debiasing, “a procedure for reducing or eliminating biases from the cognitive strategies of a decision-maker.”¹⁸⁴ Debiasing can occur through law, education, or changes to the credit card payment system.¹⁸⁵ For example, Netflix engaged in a successful educational debiasing campaign by convincing DVD-watchers that Blockbuster was profiting primarily from late fees and that consumers could save money by paying a higher upfront rental fee and no late fees.¹⁸⁶ For credit card consumers, psychologists have proposed the use of decomposition strategy, whereby credit card bills debundle purchases from a total to a series of subcategories to improve consumer recall, prompting the consumer to estimate more closely the correct amount of her future expenses.¹⁸⁷

Debiasing strategies are unlikely to be effective in reducing debt and spending among subsistence users, who primarily amass debt due to financial exigency. Although a subsistence user might exacerbate her debt due to the cognitive disabilities described above, “households with low incomes tend to use credit to help cope with budgeting troubles instead of increasing purchasing power.”¹⁸⁸ Any serious attempt to improve the subsistence user’s circumstances therefore should not focus on her complicity in her financial distress. The few studies that have examined the role that poverty-induced anxiety has on decision-making support the idea that concrete aid, not cognitive strategies, would have the greatest positive effect on low-income consumers’ credit card use.¹⁸⁹ Economic conditions, such as falling real wages, rising prices, and unemployment, play a

184. David Arnott, *Cognitive Biases and Decision Support Systems Development: A Design Science Approach*, 16 INFO. SYS. J., 55, 62 (2006).

185. See generally Christine Jolls & Cass R. Sunstein, *Debiasing Through Law*, 35 J. LEGAL STUD. 199 (2006).

186. MANN, *supra* note 40, at 136–37.

187. See Joydeep Srivastava & Priya Raghurir, *Debiasing Using Decomposition: The Case of Memory-Based Credit Card Expense Estimates*, 12 J. CONSUMER PSYCHOL. 253, 254 (2002).

188. Watkins, *supra* note 24, at 419–20 (citing Lillian Y. Zhu & C.B. Meeks, *Effects of Low-Income Families’ Ability and Willingness to Use Consumer Credit on Subsequent Outstanding Credit Balances*, 28 J. CONSUMER AFF. 403, 404 (1994); Christian E. Weller, *Need or Want: What Explains the Run-Up in Consumer Debt?*, 41 J. ECON. ISSUES 583, 584 (2007)).

189. Researchers documented a decrease in cortisol levels by individuals who received financial assistance. BANERJEE & DUFLO, *supra* note 168, at 140–41 (citing Brian P. Ramos & Amy F.T. Arnsten, *Adrenergic Pharmacology and Cognition: Focus on the Prefrontal Cortex*, 113 PHARMACOLOGY & THERAPEUTICS 523 (2007); Todd A. Hare et al., *Self-Control in Decision-Making Involves Modulation of the vmPFC Valuation System*, 324 SCIENCE 646 (2009); Daria Knoch et al., *Diminishing Reciprocal Fairness by Disrupting the Prefrontal Cortex*, 314 SCIENCE 829 (2006); Anthony J. Porcelli & Mauricio R. Delgado, *Acute Stress Modulates Risk Taking in Financial Decision Making*, 20 PSYCHOL. SCI. 278 (2009)).

large part in precipitating subsistence borrowing.¹⁹⁰ Regulation of the credit card industry could, however, reduce the harmful impact of economic recession.

III. STRUCTURAL INEQUALITY ANALYSIS AND PROPOSALS

Structural inequality arises from entrenched patterns that govern each individual's place in society, beginning from birth. Elaborate social rules and dynamics determine where a person lives, works, and plays; with whom she associates; and the social and financial status she achieves. Upward class mobility is rare, particularly for the bottom economic quintile of the population.¹⁹¹ Race plays a vital role in determining class position and social status.

A. Structural Inequality Analysis

Class and race have been inextricably linked since the founding of the United States. White Americans' early domination of high-level institutions, due to slavery and Jim Crow, allowed them to set rules to perpetuate their dominance of essential social resources. This dominance continued even after overt discrimination became subsumed by colorblind ideology.¹⁹² White privilege became entrenched in all aspects of American society through the acquisition of prime residential space, elite education, and profitable employment, accomplished primarily through social networking.¹⁹³ Daria Roithmayr describes the development of economically motivated white "racial cartels" that created a lasting monopoly of society's most valuable assets through positive feedback loops.¹⁹⁴ An example of a positive feedback loop is the informal network through which most people obtain employment.¹⁹⁵ People recommend their friends and acquaintances, usually members of the same racial and socioeconomic group, for positions,

190. See Lois R. Lupica, *The Consumer Debt Crisis and the Reinforcement of Class Position*, 40 LOY. U. CHI. L.J. 557, 588–89 (2009) (“When debt is used in an attempt to escape extreme financial exigency . . . consumers are not primarily concerned with emotional comfort, the satisfaction of material desires, or the creation of an identity . . .”).

191. See TOM HERTZ, CTR. FOR AM. PROGRESS, UNDERSTANDING MOBILITY IN AMERICA 8 (2006), available at http://www.americanprogress.org/kf/hertz_mobility_analysis.pdf; Gregory Mantsios, *Class in America—2003*, in RACE, CLASS AND GENDER IN THE UNITED STATES: AN INTEGRATED STUDY 193, 203 (Paula S. Rothenberg ed., 7th ed. 2006); JULIA B. ISAACS, BROOKINGS INST., INTERNATIONAL COMPARISONS OF ECONOMIC MOBILITY 2–4 (2008), available at http://www.brookings.edu/~media/Research/Files/Reports/2008/2/economic%20mobility%20sawhill/02_economic_mobility_sawhill_ch3.pdf; Deborah C. Malamud, *Class-Based Affirmative Action: Lessons and Caveats*, 74 TEX. L. REV. 1847, 1862 (1996).

192. See, e.g., EDUARDO BONILLA-SILVA, RACISM WITHOUT RACISTS: COLOR-BLIND RACISM AND THE PERSISTENCE OF RACIAL INEQUALITY IN THE UNITED STATES (2009); Ian Haney-Lopez, *A Nation of Minorities: Race, Ethnicity, and Reactionary Colorblindness*, 59 STAN. L. REV. 985 (2007).

193. DARIA ROITHMAYR, THEM THAT'S GOT SHALL GET: WHY RACIAL INEQUALITY PERSISTS (forthcoming).

194. *Id.*

195. Daria Roithmayr, *Racial Cartels*, 16 MICH. J. RACE & L. 45, 47–48 (2010).

thereby perpetually replicating insider group domination of an occupation.¹⁹⁶ Although this phenomenon occurs at all class levels, it has a harmful effect on lower-income individuals.

Immigration laws that gave preference to whites also laid the foundation for whites to represent the highest income and wealth levels.¹⁹⁷ Statistics released in 2011 revealed that African Americans have one-twentieth the amount of wealth that whites have,¹⁹⁸ even where levels of income and education are the same.¹⁹⁹ Similarly, Latino households have a median wealth of one-eighteenth that of white households.²⁰⁰ The median net worth of Latino households in 2009 was \$6,325, as compared to \$113,149 for white households.²⁰¹ African-American and Latino households have considerably more credit card debt than white households.²⁰² Eighty-nine percent of African-American households and 79% of Latino households, as compared to only 54% of white households, carry credit card debt.²⁰³ More than twice as many African Americans as whites pay interest rates higher than 20% on their balances—15% versus 7%—and 13% of Latino cardholders pay more than 20% interest.²⁰⁴ African Americans and Latinos also pay more late fees than whites.²⁰⁵ The households with the lowest incomes pay the highest interest rates, and almost twice as many single women pay higher interest rates than single men.²⁰⁶ These statistics do not appear to correlate with default risk or socioeconomic status.

Instead, these statistics reflect industry practices that exploit and exacerbate existing inequalities. Credit card companies confine low-income individuals to a subprime market and attempt to steer many middle-class African

196. *Id.* at 77.

197. IAN HANEY LOPEZ, *WHITE BY LAW* (2006).

198. RAKESH KOCHHAR ET AL., PEW RESEARCH CTR., *WEALTH GAPS RISE TO RECORD HIGHS BETWEEN WHITES, BLACKS AND HISPANICS* (2011), available at http://www.pewsocialtrends.org/files/2011/07/SDT-Wealth-Report_7-26-11_FINAL.pdf. The study revealed that the median wealth of black households fell by 53% between 2005 and 2009 due to the housing bubble and recession. In 2009, the “typical” African-American household had \$5677 in wealth, and 35% of African-American households had zero or negative net wealth. *Id.*

199. MELVIN L. OLIVER & THOMAS M. SHAPIRO, *BLACK WEALTH/WHITE WEALTH: A NEW PERSPECTIVE ON RACIAL INEQUALITY* 214 (tenth anniversary ed. 2006). See generally DALTON CONLEY, *BEING BLACK, LIVING IN THE RED: RACE, WEALTH, AND SOCIAL POLICY IN AMERICA* (2d ed. 2009).

200. KOCHHAR ET AL., *supra* note 198, at 1.

201. *Id.*

202. NAACP, *Usury: The Impact of Credit Card Debt and High Interest Rates on African American Wealth 1* (2009), available at http://naacp.3cdn.net/0dc056e220a879625b7_zgm6bxcpj.pdf.

203. *Id.*

204. Wheary & Draut, *supra* note 70, at 2, 6.

205. See *id.* at 8.

206. *Id.* at 6–7. An analysis of the disparities in debt by gender is beyond the scope of this paper, but is an important topic for future work in this area.

Americans and Latinos into subprime loans.²⁰⁷ Subprime lending refers to loans characterized by higher than normal interest rates and less favorable terms, ostensibly due to a greater risk of default.²⁰⁸ Once a consumer enters the subprime market, often as a result of manipulative and deceptive targeted marketing, exit becomes nearly impossible, as interest rates and fees quickly amass so that payments perpetually fail to erode the principal loan.²⁰⁹ Low-income households often cannot leave the subprime market because they are particularly susceptible to shocks, such as loss of employment, illnesses, and rising prices of consumer goods.²¹⁰

African Americans and Latinos bear the brunt of the credit card companies' predatory practices both because they are overrepresented in the lower-income levels,²¹¹ due to historical and present structural inequalities, and because of racial discrimination.²¹²

1. Structural Exploitation of African Americans and Latinos

Deeply entrenched structural inequality, originating in slavery and reinforced by policy, cultural stereotypes, and segregation, creates the circumstances that allow credit card companies to exploit vulnerabilities in African American households for profit. The 20-to-1 wealth gap between African Americans and whites increases African Americans' dependence on credit cards and deprives them of the safety net that often protects white households in times of crisis.²¹³ African Americans also have lower incomes²¹⁴ and employment rates than whites.²¹⁵ In 1995, Melvin Oliver and Thomas Shapiro estimated that most middle class African Americans could survive on their savings for only one month

207. See Brescia, *supra* note 1, at 166–67; see also Creola Johnson, *The Magic of Group Identity: How Predatory Lenders Use Minorities to Target Communities of Color*, 17 GEO. J. ON POVERTY L. & POL'Y 165, 167 (2010).

208. See Bar-Gill & Warren, *supra* note 18, at 38.

209. *Id.* at 57–58.

210. See *id.* at 64.

211. NAACP, *supra* note 202, at 3.

212. “African Americans and Latinos are disproportionately victimized, not through happenstance, but because predatory lenders intentionally target them.” Johnson, *supra* note 207, at 167. “Even when credit scores and other variables were similar to whites, minorities were still much more likely to receive subprime loans.” *Id.* at 179.

213. A 2011 study revealed that the median wealth of white households is 20 times that of black households and 18 times that of Hispanic households. KOCHHAR ET AL., *supra* note 198, at 1. “[T]he typical African-American household had just \$5,677 in wealth (assets minus debts) in 2009; the typical Hispanic household had \$6,325 in wealth; and the typical white household had \$113,149. Moreover, about a third of black (35%) and Hispanic (31%) households had zero or negative net worth in 2009, compared with 15% of white households.” *Id.* at 1–2.

214. “On average, African Americans and Latinos earn 62 and 69 cents, respectively, for every dollar earned by their white counterparts.” NAACP, *supra* note 202, at 3.

215. In April 2009, the overall unemployment rate for African Americans was 15%, whereas the national average was 8.9%. *Id.*

after a loss of income.²¹⁶ In the wake of the unprecedented loss of property and jobs precipitated by the 2008 financial crisis, some race pundits now predict the complete demise of the African American middle class.²¹⁷

The wealth gap originated in government policies enacted following World War II, such as the Social Security and Federal Housing Acts.²¹⁸ The Social Security Act did not cover agricultural and service workers, which excluded most African Americans from benefit eligibility.²¹⁹ The Federal Housing Act channeled home loans away from urban neighborhoods where African Americans lived and into white suburbs.²²⁰ The government also openly used and encouraged use of racially restrictive covenants to maintain property values in white neighborhoods.²²¹

Historical restrictions on the types of businesses in which African Americans could participate steered them into specific industries, the majority of which did not offer the potential for substantial profits.²²² Moreover, African-American businesses were traditionally confined to African-American neighborhoods and catered to a mostly African-American clientele, many of whom did not have high levels of disposable income.²²³ Although some of these niche industries flourished, such as hair and beauty products (which depend for the most part on the negative societal images of their clientele),²²⁴ many African-American businesses struggled to survive, particularly as successful African Americans

216. OLIVER & SHAPIRO, *supra* note 199, at 99. The authors report that “[at] poverty living standards, 35 percent of the black middle class might last for one month, and 27 percent might hold out for three.” *Id.*

217. See, e.g., Devona Walker, *How Ruthless Banks Guttled the Black Middle Class and Got Away With It*, ALTERNET (Sept. 3, 2010), http://www.alternet.org/economy/148068/how_ruthless_banks_guttled_the_black_middle_class_and_got_away_with_it/ (reporting that black and Latino families owned more than half of California’s foreclosed homes).

218. See OLIVER & SHAPIRO, *supra* note 199, at 40–42.

219. *Id.* Due to minimum amount requirements, even blacks in eligible occupations often did not qualify for benefits. For example, in 1935, 42% of blacks in eligible occupations failed to meet the minimum income requirements, while only 22% of whites did. *Id.* at 40. Southern legislators deliberately structured benefits policies to leave out domestic and agricultural workers, but the Social Security Act itself was colorblind. See *id.* at 40–41.

220. *Id.* at 41–43. To facilitate racial segregation, the Federal Housing Act handbook provided a model restrictive covenant to white homebuyers. *Id.* at 41–42.

221. Brian Gilmore, *Chances Are: Lessons from the 1962 United States Civil Rights Commission Housing Discrimination Hearings in Washington D.C. for the Current Foreclosure Crisis*, 3 COLUM. J. RACE & L. 1 (2013).

222. Martha L. Olney, *When Your Word is Not Enough: Race, Collateral, and Household Credit*, 58 J. ECON. HIST. 408, 425–31 (1998) (citing a study reporting that, in 1920, over half of all black businessmen were in the grocery industry).

223. See OLIVER & SHAPIRO, *supra* note 199, at 48–51 (describing the “economic detour” that compelled a black businessman to “seek his customers or clients ‘from within his own race,’ no matter the business” (citation omitted)).

224. GOOD HAIR (Chris Rock Productions & HBO Films 2009).

emigrated away from all-African-American neighborhoods. Ghettoized economies prevent financial growth for small African-American businesses and individual consumers, forcing them to rely on debt to meet monthly expenses.

Many low-income African Americans have a higher cost of living than whites at the same income levels. African Americans living in poor neighborhoods pay more for goods and services than people in other neighborhoods pay for identical products, including basic food items.²²⁵ Many inner-city residents lack the means of transportation to shop for cheaper goods in other places or cannot travel due to child care, time, or health issues.²²⁶ Transportation costs may be prohibitive, and mass transit often underserves or does not service poor neighborhoods.²²⁷

Credit discrimination against African Americans has a long history. Martha Olney's study of store credit in the 1910s reveals that, even though most whites relied on merchant credit to make purchases, stores offered African Americans only installment credit.²²⁸ Under the informal store credit system offered to whites, merchants did not require the customer to pay either a down payment or interest.²²⁹ Consumers could pay off goods over time without threat of repossession and build a good credit history in the process.²³⁰ Installment credit, in contrast, involved hefty down payments, gave the merchant the legal right to repossess the good upon default, and did not allow consumers to build a positive credit history.²³¹ Additionally, merchants officially retained title of goods purchased through installment credit until the consumer rendered full payment.²³²

As a result of poor treatment by or exclusion from the formal credit market, African Americans often turn to alternative sources of credit, such as pawn shops, cash checking services, and payday loans.²³³ Scholars have written extensively on these sources of credit, which typically charge exorbitant fees in

225. See Andrea Freeman, *Fast Food: Oppression Through Poor Nutrition*, 95 CALIF. L. REV. 2221, 2240 (2007); Nareissa Smith, *Eatin' Good? Not in this Neighborhood: A Legal Analysis of Disparities in Food Availability and Quality at Chain Supermarkets in Poverty-Stricken Areas*, 14 MICH. J. RACE & L. 197, 224–25 (2009).

226. People working at more than one job to support a family are extremely unlikely to have time to travel to other neighborhoods to save money on a purchase, particularly one that is relatively urgent.

227. The BART system linking San Francisco to the greater metropolitan area is an example of an expensive system that has expanded to service wealthy neighborhoods while bypassing areas where many residents do not own cars. See, e.g., Randal O'Toole, *BART Connection to San Jose Will Solve Nothing*, SAN JOSE BUS. J., Oct. 5, 2007, available at <http://www.bizjournals.com/sanjose/stories/2007/10/08/editorial4.html?page=all> (“Thanks to BART, wealthy white commuters have gotten heavily subsidized train rides while low-income inner-city residents have lost less-costly bus service.”).

228. Olney, *supra* note 222, at 410–12 & tbl.1.

229. *Id.* at 409, 415.

230. *Id.* at 426.

231. *Id.* at 429.

232. *Id.* at 427.

233. See Mann, *supra* note 61, at 262.

exchange for convenience and access to cash when no other options are available.²³⁴ In comparison, even the most exploitative credit card interest rates can appear reasonable.

Cultural stereotypes figure prominently in the relationship between African Americans and credit card companies. In a study of African-American financial habits, Sheila Ards and Samuel Myers debunk the myths that African Americans overspend, fail to save, and are not creditworthy.²³⁵ Contrary to popular mythology, the study demonstrates that African Americans have high saving rates, a factor ordinarily correlated with good credit, and that they spend primarily on rent.²³⁶ Generally, the necessity of funneling a significant percentage of income toward rent prevents individuals from amassing wealth. Homeownership has therefore historically represented one of the primary reasons for the wealth gap between African-American and white families.²³⁷ The study also reveals no statistically significant difference in bad credit rates between African-American and white households at both the lowest and highest wealth levels.²³⁸ Ards and Myers attribute observed differences in credit rates in the middle wealth range to differential treatment of African Americans and whites in credit markets.²³⁹

The myths associating African Americans with bad credit lead many African Americans to internalize stereotypes that cause them to assume that they have bad credit even when they do not.²⁴⁰ These mistaken beliefs can make African American consumers agree to bad terms and conditions in credit card agreements without investigating the possibility of finding a more desirable card. Credit card companies, equipped with extensive information about applicants' creditworthiness that often contradicts popular stereotypes, exploit these beliefs by offering subprime cards to individuals eligible for the regular market.²⁴¹

One of the most damaging stereotypes degrading African Americans' financial habits is that of the conspicuous consumer. This stereotype originated in the post Civil War era, when "the central debate in American social life was about

234. See, e.g., Johnson, *supra* note 207, at 176–87; Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1 (2002); Nelson, *supra* note 136; Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 MINN. L. REV. 1110, 1123–28 (2008).

235. Sheila D. Ards & Samuel L. Myers, Jr., *The Color of Money: Bad Credit, Wealth, and Race*, 45 AM. BEHAV. SCIENTIST 223–39 (2001).

236. *Id.* at 224, 230–31. Olney offers as explanation for high savings rates in low-income African American households the necessity of saving to pay off goods purchased on installment credit. Olney, *supra* note 222, at 428–29.

237. OLIVER & SHAPIRO, *supra* note 199, at 111–12 & tbl.5.4. Homeownership resulting from subprime mortgage loans does not ameliorate this situation, and likely worsens it.

238. Ards & Myers, *supra* note 235, at 237 & tbl.8.

239. See *id.* at 236 & tbl.6.

240. *Id.* at 225.

241. See MANN, *supra* note 40, at 113–14 (discussing the credit card companies' reliance on extensive personal data to identify ideal customers and maintain profitability).

how the newly freed slaves would participate in labor and consumer markets as well as in the polity.²⁴² During this period, a white supremacist narrative describing African-American consumption as “indulgent, impulsive and wasteful” sought to stem the tide of integration of freed slaves into society.²⁴³ Whites deeply resented African Americans’ attempts to best them in displays of status, as well as their participation in middle class activities, such as attending the theater.²⁴⁴ This type of resentment continues to the present day, expressed in the common critique of hip-hop culture as a reflection of African-American consumerism and materialism, prioritizing the acquisition of “bling” over the consequences of overspending.²⁴⁵

Some African Americans have internalized the conspicuous consumer stereotype.²⁴⁶ Bill Cosby popularized the trope with his comment at the NAACP fiftieth anniversary celebration of *Brown v. Board of Education*.²⁴⁷ Cosby commented that African-American parents are willing to spend \$500 on a pair of

242. David Crockett, *Credit, Conspicuous Consumption and Crisis*, COMMONDREAMS.ORG (Apr. 2, 2005), <http://www.commondreams.org/views05/0402-22.htm>.

243. See *id.* (discussing the black consumer myth as understood by historian Ted Ownby in *American Dreams in Mississippi*, stated as “the proverbial fool to be soon parted from his money”); see also Jason Chambers, *Equal in Every Way: African Americans, Consumption and Materialism from Reconstruction to the Civil Rights Movement*, 7 ADVERT. & SOC’Y REV. (2006) (surveying African Americans’ encounter with material goods from the end of the Civil War through the end of the Second World War), available at <http://muse.jhu.edu/journals/asr/v007/7.1chambers.html>. Chambers describes consumption as a tool of anti-oppression:

[B]lacks have long understood the difference between materialism and a materially-intensive life and have used goods as a way to demonstrate their desire to be equal in every way with their fellow [white] citizens. Hence, consumption becomes a means of political and social activism on par with other better-known efforts such as the battle for voting rights or an end to racial discrimination.

Id.

244. See, e.g., Hannah Rosen, “Not That Sort of Women”: Race, Gender and Sexual Violence During the Memphis Riot of 1866, in *SEX, LOVE, RACE: CROSSING THE BOUNDARIES IN NORTH AMERICAN HISTORY* 267, 269–71 (Martha Hodes ed., 1999) (describing how white peoples’ resentment of African-American women and men entering leisure spaces and consuming luxury goods contributed to the tensions that sparked the Memphis Riot of 1866).

245. See, e.g., PAUL BUTLER, LET’S GET FREE: A HIP-HOP THEORY OF JUSTICE 127–28, 191 (2009); Akilah N. Folami, *From Habermas to “Get Rich or Die Tryin”*: Hip Hop, the Telecommunications Act of 1996, and the Black Public Sphere, 12 MICH. J. RACE & L. 235, 240 (2007).

246. Glenn Loury identifies a “self-confirming stereotype” as one that arises because “[o]bservers, by acting on the [statistical] generalization, set in motion a sequence of events that has the effect of reinforcing their initial judgment.” GLENN C. LOURY, *THE ANATOMY OF RACIAL INEQUALITY* 23–29 (2002).

247. Bill Cosby, Address at the NAACP on the 50th Anniversary of *Brown v. Board of Education* (May 17, 2004), available at <http://www.americanrhetoric.com/speeches/billcosbyoundcakespeech.htm>.

sneakers for their children but will not spend \$250 to teach them to read with Hooked on Phonics.²⁴⁸ Similarly, E. Franklin Frazier attacked the “black bourgeoisie” in his bestselling book of that name, and many other African American authors have identified profligate materialism and consumerism in their communities as problematic.²⁴⁹ Other stereotypes that interfere with African Americans’ ability to obtain credit on fair terms are: a belief in African American intellectual inferiority that implies that money is worth more in a white (financially savvy) person’s hands; and the association of African Americans with dishonesty and crime, leading to a perception that African-American money is tainted.²⁵⁰ Credit card companies use these stereotypes to their advantage by offering subprime credit cards to middle-class African Americans.

Latinos experience similar targeting for subprime cards, based in part on the presence of a significant immigrant population in many Latino communities. The term *Latino* represents a very broad spectrum of people living in the United States who have a wide range of interactions with the credit card industry. Exploitation can arise from language barriers, cultural differences, or the need to send remittances—conditions that apply much more strongly to immigrant than to U.S.-born Latinos.²⁵¹ Latinos’ relationships with credit cards may also depend on national origin. For example, Puerto Ricans share a financial culture with the United States, but Cubans and Mexicans do not.²⁵²

A study by the National Council of La Raza revealed that 22% of Latino borrowers have no credit score as compared to only 4% of whites and 3% of African Americans.²⁵³ Latinos also often suffer from misconceptions about how to develop good credit. For example, some Latinos obtain cards with the goal of building their credit but do not understand the impact that a bad credit score caused by late payments, exceeding the credit limit, or canceling accounts has on future credit opportunities.²⁵⁴ Bad credit histories lead to high interest rates, which in turn

248. *Id.*

249. E. FRANKLIN FRAZIER, *BLACK BOURGEOISIE* (First Free Press Paperback ed. 1997); see also KAREN HUNTER, *STOP BEING NIGGARDLY AND NINE OTHER THINGS BLACK PEOPLE NEED TO STOP DOING* (2010).

250. See Austin, *supra* note 57, at 1218, 1251.

251. Steven W. Bender, *Consumer Protection for Latinos: Overcoming Language Fraud and English-Only in the Marketplace*, 45 AM. U. L. REV. 1027 (1996); see also Nicole Lutes Fuentes, Comment, *Defrauding the American Dream: Predatory Lending in Latino Communities and Reform of California’s Lending Law*, 97 CAL. L. REV. 1279, 1305, 1309 (2009); Ezra Rosser, *Immigrant Remittances*, 41 CONN. L. REV. 1 (2008).

252. American banks serve Puerto Rico but other countries have their own dominant banks.

253. BEATRIZ IBARRA & ERIC RODRIGUEZ, NAT’L COUNCIL OF LA RAZA, *LATINO CREDIT CARD USE: DEBT TRAP OR TICKET TO PROSPERITY?* 5–6 (2007), available at http://www.nclr.org/index.php/publications/latino_credit_card_use_debt_trap_or_ticket_to_prosperity/.

254. JANIS BOWLDER, NAT’L COUNCIL OF LA RAZA, *SURVIVAL SPENDING: THE ROLE OF CREDIT CARDS IN HISPANIC HOUSEHOLDS* 3–7 (2010), available at http://www.nclr.org/images/uploads/publications/file_Survival_Spending_Final_Jan_19_10-1.pdf.

make it more difficult to transfer balances to new cards with better rates and terms. Although there are financial education programs in some Latino communities, they tend to offer only limited distribution of materials, are often run by credit card-issuing banks, and in some cases, do the consumer more harm than good.²⁵⁵

Latinos are less likely than whites to shop for a credit card.²⁵⁶ A fear of rejection also causes some Latinos not to apply or to reapply for cards.²⁵⁷ Countering this trepidation, the credit card companies actively seek out Latino customers. All of the major credit card issuers invest money in advertising targeted directly at Latinos.²⁵⁸ They also manufacture affinity cards designed specifically

255. IBARRA & RODRIGUEZ, *supra* note 253, at 14; *see also* Lauren E. Willis, *Against Financial Literacy Education*, 94 IOWA L. REV. 197, 260–64 (2008); Lauren E. Willis, *Evidence and Ideology in Assessing the Effectiveness of Financial Literacy Education*, 46 SAN DIEGO L. REV. 415 (2009).

256. Only seven percent of Latinos who carry a balance reported card shopping as opposed to twelve percent of whites. IBARRA & RODRIGUEZ, *supra* note 253, at 7.

257. *Id.*

258. 2008 data from Nielsen Monitor-Plus revealed that credit card brands and issuers injected \$15.2 million into Spanish television in 2008, \$36.5 million in 2007, and \$43.1 million in 2006. *Hispanic Advertising: Credit Cards*, HISP. MARKET WK., Apr. 16, 2009, available at http://spanishypinfo.com/media/industry_snapshots/Hispanic_Advertising-Credit_Cards.pdf. In 2008, credit card companies invested \$6.7 million in spot television dollars, but invested only \$1.6 million in 2007. *Id.* In 2006, they invested \$2.6 million in spot radio, and \$1.1 million in 2007. *Id.* Visa was the number one advertiser in the Spanish-speaking market with \$19.8 million in 2006, but only \$26.3 million in 2007. *Id.* The decrease was the result of a strategy shift from national media to local initiatives. *Id.* “From 2005 to 2007, Visa increased its total ad expenditure [in the] market from \$16.8 million to \$26.3 million.” *Id.* MasterCard was the second biggest spender in 2005 and 2006 with \$19.2 million. *Id.* In 2007, it was third after Chase with \$6.8 million, and in 2008, it left the national Hispanic television networks and shifted to spot radio, television and magazines. *Id.* One of MasterCard’s more popular ads featured a *luchador* (Mexican wrestler) paying for a makeover with a MasterCard. *Id.* MasterCard also partnered with Chase and Telemundo to create a Latino-themed financial education tour that paired a financial expert with *telenovela* star Natalia Streignard in sessions designed to educate Latinos on finance and credit card use. *Id.* J.P. Morgan Chase emerged as a major investor in the Spanish-speaking market in 2006 and invested \$7.8 million in 2007. *Id.* It subsequently retreated from the market in 2008 due to the credit crisis and its unplanned merger/acquisition of Washington Mutual. *Id.* It did, however, launch a Spanish website tied to its “Clear & Simple” advertising initiative at www.chaseclarosimple.com. *Id.* The site provides financial tools to help customers manage their accounts to avoid fees, maintain good interest rates, and protect their access to credit. *Id.* The bank also ran Spanish ads in Los Angeles to transition Washington Mutual customers to Chase. *Id.* GE Money Bank was the only other company to invest more than \$1 million in the Latino market by advertising a Wal-Mart money card, which is a prepaid Visa card, and investing \$1.7 million in network Spanish television and \$53,400 in Spanish cable television in 2007, but it was not active in 2008. *Id.* Purpose Money MasterCard targeted African Americans and Latinos with less than perfect credit and invested \$782,550 in the Spanish-speaking market in 2007, but vanished in 2008. *Id.* Citigroup invested \$278,600 in advertisements in Spanish-language magazines and Bank of America ran spot television ads targeted at Latinos in 2008 and spent \$187,120 in Spanish glossies. *Id.* HSBC created a website called “El banco local del

for Latinos with less desirable terms than the ones offered to white consumers.²⁵⁹ Additionally, Latinos have greater vulnerability to credit card fraud, which is often associated with these affinity cards.²⁶⁰

Many Latinos are immigrants who are unfamiliar with the U.S. credit system and financial products, have cultural differences regarding finances, and/or face language barriers. The CARD Act mandated the GAO to conduct a study of the effect of lack of proficiency in English on credit card use.²⁶¹ The resulting report stated that most U.S. financial documents and financial educational materials are available only in English; that the information and documents related to financial products are highly complex and confusing, even for native English speakers; and that there are significant problems with translation and interpretation from English to Spanish.²⁶² There is no indication that the results of this study will lead to future amendments to the CARD Act designed to ameliorate these problems.

Immigrant Latinos often fall into credit card debt due to obligations to send remittances to family members in their home countries.²⁶³ At least 35% of remittance senders have a household income under \$20,000 a year and send 15% of their earnings to their country of origin.²⁶⁴ Their ability to do this often reflects a choice to prioritize remittances over paying their own bills, thereby increasing their credit card debt.²⁶⁵ Finally, alarming health disparities between African Americans, Latinos, and whites create a greater likelihood of medical emergencies in African-American and Latino households that necessitate borrowing.²⁶⁶

multimedia” and in 2008 replaced its spot television ads with \$40,000 worth of magazine ads. *Id.* In 2008, many previous advertisers such as American Express, U.S. Bank, Capital One, Discover, Wells Fargo Bank, PNC Bank, Poder, and AmigoMoney, disappeared from the market, *id.*, presumably in response to financial constraints caused by the recession.

259. RAUL GONZALEZ, NAT’L COUNCIL OF LA RAZA, LATINO CREDIT CARD USE: OVERCOMING DISPARITIES, STRUCTURAL CHALLENGES, AND HARMFUL INDUSTRY PRACTICES 5 (2007), available at <http://archives.financialservices.house.gov/hearing110/gonzalez.pdf>.

260. 14.3% of Latinos are fraud victims compared to 6.4% of whites. KEITH B. ANDERSON, FED. TRADE COMM’N, CONSUMER FRAUD IN THE UNITED STATES: AN FTC SURVEY ES-4 to ES-8 & fig. ES-2 (2004), available at http://www.ftc.gov/reports/consumer_fraud/040805confraudrpt.pdf.

261. CARD Act, *supra* note 35, § 513.

262. GAO REPORT, *supra* note 140, at 8–11.

263. Undocumented immigrants, however, face barriers to entering the financial system, such as the lack of a social security number, which force them to deal only in cash.

264. Ezra Rosser, *Immigrant Remittances*, 41 CONN. L. REV. 1, 11–13, 19 (2008).

265. *Id.* at 20.

266. For example, Latinas and black women have the highest rates of cervical cancer, *Cervical Cancer Rates by Race and Ethnicity*, CENTER FOR DISEASE CONTROL, <http://www.cdc.gov/cancer/cervical/statistics/race.htm> (last updated Dec. 19, 2012), black men have the highest incident rate of and are more likely to die from prostate cancer than any other group, *Prostate Cancer Rates by Race and Ethnicity*, CENTER FOR DISEASE CONTROL, <http://www.cdc.gov/cancer/prostate/statistics/race.htm> (last updated Dec. 19, 2012); and have the highest rates of lung cancer, *Lung Cancer Rates by Race and Ethnicity*, CENTER FOR DISEASE CONTROL, <http://www.cdc.gov/cancer/lung/statistics/race.htm> (last

B. Proposed Amendments to the CARD Act

The following proposals for amendments to the CARD Act would facilitate oversight of the industry's predatory practices by increasing transparency, imposing reasonable restrictions on the companies, and financially strengthening the communities harmed by these practices.

1. Require Industry Disclosures

Extensive disclosures by financial institutions, such as those required by the Securities and Exchange Commission ("SEC") of publicly traded companies, constitute an important part of financial regulation that the credit card industry presently lacks.²⁶⁷ The ability of credit card companies to hide their practices enables their focus on profit at a high social cost.²⁶⁸ It allows them to offer different cards to different consumers based purely on zip code, name, or ethnicity.²⁶⁹ It lets the companies require substantial proof of financial stability from African Americans to receive the same cards that whites receive with minimal documentation.²⁷⁰ It also keeps secret a number of industry practices: how statistical models help identify low-income neighborhoods to target with preapproved offers of cards with unreasonable terms;²⁷¹ the exact amount of profit generated from the lowest-income consumers; the number of card applications from African Americans and Latinos rejected without sufficient justification;²⁷² the data underlying market segmentation; and the methods used to determine the price points of a vast array of cards.

The CARD Act should require all credit card companies to make a full accounting of their products and processes. The CFPB should oversee these

updated Dec. 19, 2012). Black women have higher rates of high blood pressure, high cholesterol, and diabetes than white women, and, according to the American Heart Association, a significantly greater percentage of African-American men and women than whites suffer from heart disease, *Heart Disease, Race, and Ethnicity*, LIFEHEART.COM, <http://www.lifeheart.com/patient/angina/ethnicity.asp> (last updated June 1, 2009). Some of these disparities may be attributable to credit card use. See Manoj Thomas et al., *How Credit Card Payments Increase Unhealthy Food Purchases: Visceral Regulation of Vices*, 38 J. CONSUMER RES. 126 (2011), available at <http://www.jstor.org/pss/10.1086/657331>; see also Kevin Outterson, *Tragedy & Remedy: Reparations for Disparities in Black Health*, 9 DEPAUL J. HEALTH CARE L. 735, 735–92 (2005); VERNELLIA R. RANDALL, *DYING WHILE BLACK* (2006).

267. The SEC does not presently require disclosure by financial institutions of credit card pricing or profits. It has recently, however, sought to expand disclosure requirements for short-term borrowing, which could indicate a move in the direction of greater supervision over credit card practices. See Proposed Rule for Short-Term Borrowing Disclosure, 75 Fed. Reg. 59866 (proposed Sept. 17, 2010) (to be codified at 17 C.F.R. pts. 229 & 249), available at <http://www.sec.gov/rules/proposed/2010/33-9143fr.pdf>.

268. Bar-Gill & Warren, *supra* note 18, at 56–69.

269. See, e.g., Cohen-Cole, *supra* note 33.

270. See Lin, *supra* note 33, at 46.

271. Mann, *supra* note 61, at 6, 8.

272. See Lin, *supra* note 33.

disclosures, in line with its commitment to fairness in the industry.²⁷³ These disclosures would allow for the calculation of reasonable usury rates and regulation of exploitative practices.

2. Reinstate Usury Laws and Regulate Exploitative Practices

The CARD Act should impose restrictions on the amount of interest and fees that a credit card company can charge. Rates and charges should relate to costs and risks. Additionally, the CARD Act should regulate deceptive and manipulative practices, such as teaser rates, mass mailings of preapproved cards, and fee-harvesting cards. These regulations would be similar to existing prohibitions on universal default and the previous practice of charging late fees as of 2 p.m., instead of 5 p.m., on a bill's due date.

Usury laws prohibit money lending at unreasonably high interest rates. They have protected consumers from exploitation for centuries, and their recent unpopularity in the United States reflects the power of big banks and corporations over individual consumers and government.²⁷⁴ Cass Sunstein, ordinarily an advocate of choice architecture, favoring default provisions over “paternalistic” law-making,²⁷⁵ concedes that, in the credit card market, “prohibitions on voluntary agreements might be justified.”²⁷⁶ He describes the “very structure of [the credit card] market” as one that “lead[s] many companies to appeal to bounded rationality, rather than to attempt to counteract it.”²⁷⁷ Sunstein describes the market

273. See Jessica Silver-Greenberg, *American Express Says It Will Refund \$85 Million*, NY TIMES, Oct. 1, 2012, at B1; Tyler Kingkade, *CFPB Launching Investigation of College Debit Cards, Financial Products Marketed to Students*, HUFFINGTON POST (Jan. 31, 2013, 2:14 PM), http://www.huffingtonpost.com/2013/01/31/cfpb-college-debit-cards_n_2590611.html.

274. For an account of the long history of usury laws, see Timothy A. Canova, *The Transformation of U.S. Banking and Finance: From Regulated Competition to Free-Market Receivership*, 60 BROOK. L. REV. 1295, 1336 n.136 (1995).

For many centuries, lending at high interest rates has been considered morally indefensible, violating religious dictates and the laws of civil society. See, e.g., THE BIBLE: Exod. 22:25; Neh. 5:7; Prov. 28:8; Lev. 25:36; Ps. 15:5; Ezek. 18:08, 18:13, 18:17, 22:12; Matt. 6:12, 18:27, 18:30, 18:32; see also THE KORAN (N.J. Dagwood trans., 4th ed. 1974): Sura II:276, III:130, XXX:39; THE POLITICS OF ARISTOTLE 29 (Ernest Barker trans., 1978). In acknowledging the primary purpose of money “as a means of exchange” Aristotle also recognized that “usury” (the charging of interest) tries to make money increase as though it were an end in itself. “The trade of the petty usurer,” said Aristotle, “is hated most, and with most reason: it makes a profit from currency itself, instead of making it from the process (i.e. of exchange) which currency was meant to serve.” *Id.* at 28–29.

Id.

275. See, e.g., RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS* (2009).

276. Sunstein, *supra* note 25, at 267.

277. *Id.* Bounded rationality in the credit card context refers to excessive borrowing that leads to financial distress.

as a “perverse system of redistribution, from less wealthy people who maintain debt to relatively wealthy people who pay on time.”²⁷⁸ He therefore asserts that usury laws, a form of strong paternalism, might be appropriate in this context because of their potential to restructure the credit card pricing system for consumers’ benefit.²⁷⁹

Sunstein’s analysis focuses on the work of behavioral economists, but other prominent financial scholars have recognized the necessity of applying redistribution principles to credit regulation. In their paper successfully arguing for a consumer financial protection agency, Elizabeth Warren and Oren Bar-Gill decried the disadvantages experienced by African Americans, Latinos, and women in the credit market and acknowledged that previous legislation had likely benefited only well-educated, affluent borrowers.²⁸⁰ To protect all credit consumers, an amendment to the CARD Act should reinstate federal usury laws that preempt permissive state laws. The definition of interest rates for this purpose should include fees.

Amendments to the CARD Act should either abolish or severely restrict teaser rates. Although a small number of consumers benefit from teaser rates by borrowing at the low introductory rates and either paying off or transferring their balances in the initial six-month period, most do not.²⁸¹ Even if they did, the question remains whether there is positive social value in a card that is profitable only when misused by the consumer. Mann asserts that, to ban these rates, policymakers must view borrowing on a credit card as an exercise that a consumer cannot or will not evaluate adequately. Alternatively, he advocates a ban if the practice imposes external social harms.²⁸² Both of these conditions apply to borrowing based on teaser rates. Cognitive processes make accurate assessment of one’s own borrowing conduct extremely difficult, and the crises that result from the imposition of high interest rates and associated fees on subsistence users create high social costs. The prohibition of teaser rates thus satisfies Mann’s tests.

Additionally, amendments to the CARD Act should ban mass mailings of preapproved cards with exploitative terms to consumers living in red-lined zones.²⁸³ Credit card companies in the United States generate more than two-thirds of their new accounts through mass mailings.²⁸⁴ Recognizing their potential harm, amendments to the Fair Credit Reporting Act in 1996 created a process by which

278. *Id.* at 269

279. *Id.* at 267–69.

280. *See* Bar-Gill & Warren, *supra* note 18, at 64–69.

281. *See* Bar-Gill, *supra* note 9, at 1392–93.

282. Ronald J. Mann, *Unsafe at Any Price?*, 157 U. PA. L. REV. PENNUMBRA 167, 173–74 (2009).

283. These consumers receive offers for the worst cards. *See supra* Part III.A.

284. *See* Littwin, *supra* note 22, at 484.

consumers could opt out of these mailings.²⁸⁵ Information about the ability to opt out, however, has largely failed to reach consumers.²⁸⁶

Angela Littwin suggests substituting an opt-in system for the present opt-out one to protect vulnerable consumers from temptation. She cautions, however, that a shift away from preapproved offers could “devastate” the industry.²⁸⁷ The process of applying for a credit card allows consumers to engage in at least some level of forethought regarding the consequences of acquiring a card and facilitates card-shopping or attempts to negotiate rates, fees, and terms. Additionally, it is unclear that any consumers benefit from preapproved cards in light of their disadvantageous terms. Instead, therefore, of attempting to immunize the industry from financial harm at consumers’ expense, regulation should protect consumers and allow the market to adjust if necessary.

3. Require Banks to Create Individual Development Accounts

The CARD Act should mandate the creation of matched savings accounts in the form of individual development accounts (“IDAs”) for low-income individuals by credit card-issuing banks. IDAs are a form of asset-based policy designed to allow people to get ahead instead of merely getting by, as income-based policies do.²⁸⁸ IDA savings typically go toward home ownership, education, small business capitalization, and occasionally to the purchase of vehicles or computers.²⁸⁹ IDA participants must attend both general and asset-specific financial education classes.²⁹⁰ The benefits of IDAs adhere both to their recipients and the banks that provide them.

Asset-based policy directed at the poor is necessary because, although the U.S. government currently spends more than \$300 billion a year on asset-based benefits, more than 90% of these subsidies go to people in the upper half of the income distribution.²⁹¹ Experiments with IDAs demonstrate that low-income individuals also can and do save under the right institutional structures and conditions, refuting behavioral economists’ assertions that the inability to save

285. 15 U.S.C. §§ 1681–1681x (2012).

286. For a thorough explanation of how the system works, or does not work, see Littwin, *supra* note 22, at 481–84.

287. *Id.* at 484.

288. Michael Sherraden, *Individual Development Accounts and Asset Building Policy*, in *INSUFFICIENT FUNDS SAVINGS, ASSETS, CREDIT, AND BANKING AMONG LOW-INCOME HOUSEHOLDS* 191, 192 (2009).

289. *Id.* at 193.

290. *Id.* Studies of existing programs indicate that ten hours of financial education positively affect saving performance. *Id.* at 200.

291. Sherraden, *supra* note 288, at 192; see also CHRISTOPHER HOWARD, *THE HIDDEN WELFARE STATE: TAX EXPENDITURES AND SOCIAL POLICY IN THE UNITED STATES* 31, 250 (1997) (explaining that asset-based benefits tend to go to workers in “larger companies, unionized industries, and better paying occupations,” thereby disproportionately benefiting more affluent families and individuals).

derives entirely from individual capacities and virtues.²⁹² For example, in one study group, IDA account holders had \$5,892 more in real assets and had \$6,181 more in total assets than the control group of individuals without IDAs.²⁹³ The researchers noted that “[a]lthough the significance level is small, the differences in the values of real assets and total assets are meaningful, especially for a low-income population.”²⁹⁴ A study also revealed that the positive impact on homeownership for African Americans in IDA programs exceeded that for IDA participants as a group.²⁹⁵

Most IDA funding currently comes from the government.²⁹⁶ Additionally, some banks, particularly in the South, have set up IDAs for eligible customers.²⁹⁷ The Federal Deposit Insurance Corporation (“FDIC”) encourages banks to create IDAs as “a relatively low-risk way . . . to introduce underbanked individuals to the financial mainstream” and “help banks tap into new markets.”²⁹⁸ Instead of encouraging banks to provide low-income individuals with IDAs, the government should make their creation obligatory.

Pilot IDA programs have encountered obstacles due to high administrative costs.²⁹⁹ Banks are in the best position to bear these costs and may, in fact, benefit from their investment in the ways described by the FDIC. More importantly, the introduction of IDAs on a massive scale has the potential to create class mobility for some of their participants.

4. Implement Subsistence Amnesty

The temporary suspension of fees and interest on credit card subsistence purchases made by poor consumers—or subsistence amnesty—would represent a

292. *Id.* at 198–200. One salient example of increased saving based on structural factors is the change in participation in 401(k) plans that go from an opt-in to an opt-out format. One study demonstrated a rise in participation for women from 35% to 86%, for Latinos from 19% to 75%, and for people earning under \$20,000 a year from 13% to 80%. *Id.* at 199.

293. See Chang Kuen-Han et al., *Assets Beyond Saving in Individual Development Accounts* 15–17 (Wash. Univ. in St. Louis, Ctr. for Soc. Dev., Working Paper No. 07-25, 2007), available at <http://www.usc.edu/dept/chepa/IDApays/publications/assets%20beyond%20IDA.pdf> Documents/WP07-25.pdf (reporting that IDA participants had more real and total assets than members of a control group without such accounts).

294. *Id.*

295. Sherraden, *supra* note 288, at 202. IDA participants significantly increased their rate of home ownership by five percentage points, from six to 11. *Id.*

296. *Id.* at 193.

297. Some examples of these are the Good Faith Fund, Southern Development Bank Corporation; the South Carolina Association of Community Development Corporations; the North Carolina IDA and Asset Building Collaborative; the Economic Opportunity Agency of Washington County, Ark.; the Greater New Orleans IDA Collaborative; and United Way of Metropolitan Atlanta IDA program. SCOTT DORON & ELAINE RIDEOUT FISHER, *BLACK WEALTH/WHITE WEALTH: AN ISSUE FOR THE SOUTH* 8–11 (2002), available at http://www.southerngrowth.com/pubs/pubs_pdfs/pp0402_wealth.pdf.

298. Sherraden, *supra* note 288, at 204 (quoting Chairperson Sheila C. Bair).

299. See *id.* at 209.

significant step toward reducing the exploitation of low-income credit card users. Subsistence amnesty would increase the amount of disposable income available to poor households. This amnesty would also increase market efficiency by compelling the credit card companies to adjust their fees and interest rates to reflect risk instead of the potential to generate profit.

The massive redistribution of wealth from the poor to the banks that has already occurred requires a corresponding shift of funds flowing back from the credit card companies to poor consumers. To level the playing field to some degree between corporations and low-income consumers, the CARD Act should require credit card companies to treat subsistence purchases by poor cardholders differently from other purchases. The CARD Act should identify items that it deems necessary for subsistence, such as non-luxury food items, gasoline, diapers, electricity bills, and toiletries. This type of categorization already exists in the context of taxation, where certain items are subject to sales tax and others that the government identifies as essentials, such as food and prescription drugs, are not.³⁰⁰ These existing exemptions are very specific. For example, in Utah, food sold on the shelves of grocery stores is exempt from sales tax, but food purchased from the same store's deli counter is not.³⁰¹ In North Dakota, food is generally exempt from sales tax, but not fruit juices containing less than fifty percent juice, carbonated beverages, candy, or food purchased for consumption on or near the premises where it was sold.³⁰² This system can serve as a model for dividing products into subsistence and non-subsistence items. Subsistence purchases would appear on a separate section of the credit card bill, and the credit used to acquire them would not be subject to interest or late fees. Any other purchases would be treated as described in the credit card agreement.

In 2010, the U.S. Census Bureau devised a new method of measuring poverty, which it implemented for the first time in 2011.³⁰³ The new measurement takes into account receipt of government benefits, cost of living, taxes, child care costs, and work expenses to arrive at a more accurate calculation of annual income than the previous method.³⁰⁴ Under the new measurement, one-third of American

300. See, e.g., FED'N OF TAX ADM'RS, STATE SALES TAX RATES AND FOOD & DRUG EXEMPTIONS (2013), available at <http://www.taxadmin.org/fta/rate/sales.pdf> (graphically showing that in a majority of states, food and prescription drugs are exempt from sales tax); NAT'L CONF. OF STATE LEGS., TAX POLICY HANDBOOK FOR STATE LEGISLATORS 7 (3d ed. 2010), available at <http://www.ncsl.org/documents/fiscal/TaxPolicyHandbook3rdEdition.pdf> (noting the policy of supporting low-income consumers by exempting some necessities from taxation).

301. See UTAH STATE TAX COMM'N, UTAH! SALES AND USE TAX GENERAL INFORMATION (2012), available at <http://tax.utah.gov/forms/pubs/pub-25.pdf>.

302. CORY FONG, N.D. OFFICE OF STATE TAX COMM'R, SALES TAX EXEMPTIONS GUIDELINE 2 (2006), available at <http://www.nd.gov/tax/salesanduse/pubs/guide/gl-21814.pdf>.

303. See Pam Fessler, *New Measure Shows Higher Poverty Rate in U.S.*, NPR (Nov. 7, 2011, 5:15 PM), <http://www.npr.org/2011/11/07/142105558/new-measure-shows-higher-poverty-rate-in-u-s>.

304. Sabrina Tavernise & Robert Gebeloff, *Poverty Gets New Measure at Census Bureau*, N.Y. TIMES, Nov. 7, 2011, at A17.

households subsisted below the poverty line of \$24,343 annual income for a family of four in 2010.³⁰⁵ Subsistence amnesty should apply to all households and individuals who fall under the poverty line based on this formula. Regular and frequent re-evaluation of the amnesty by the Consumer Financial Protection Bureau would ensure that it stays in place only as long as needed.

Special protection for a specific group of credit consumers is not without precedent. For example, the 2007 John Warner National Defense Authorization Act imposed a 36% annual interest rate cap on certain types of consumer loans to military borrowers.³⁰⁶ This amendment to the Servicemembers Civil Relief Act came in the wake of scholarly arguments in favor of enhanced protection from predatory lending for military personnel.³⁰⁷ Legal scholars have also made persuasive arguments for regulation to protect vulnerable populations, such as students and the elderly, from abuses by the credit card industry, and to eliminate barriers to credit for ex-felons.³⁰⁸ The CARD Act responded to concerns about student borrowing by implementing restrictions on credit card agreements with students.³⁰⁹ The protection afforded by subsistence amnesty would benefit many individuals in these groups already identified as vulnerable.

a. Challenges

The strongest objection to subsistence amnesty from the left is a fear of the unintended consequence of removing or restricting access to credit cards for low-income consumers, leaving them less equipped to deal with emergencies, juggle finances, and fully participate in society. This concern also arises in connection with some scholars' advocacy of a return to a system where only low-risk consumers receive credit.³¹⁰ Littwin offers a response to this contention. Based on her study of credit use by low-income women, Littwin contends that restricting credit cards to middle- and high-income consumers might have positive net effects

305. *Id.*

306. Talent Amendment to the Servicemembers Civil Relief Act, Pub. L. No. 109-364, § 670, 120 Stat. 2083, 2266 (2006) (codified at 10 U.S.C. § 987(b)).

307. *See, e.g.,* Steven M. Graves & Christopher L. Peterson, *Predatory Lending and the Military: The Law and Geography of "Payday" Loans in Military Towns*, 66 OHIO ST. L.J. 653 (2005).

308. *See* Donna S. Harkness, *When Over the Limit is Over the Top: Addressing the Adverse Impact of Unconscionable Consumer-Credit Practices on the Elderly*, 16 ELDER L.J. 1 (2008); Taja-Nia Y. Henderson, *New Frontiers in Fair Lending: Confronting Lending Discrimination Against Ex-Offenders*, 80 N.Y.U. L. REV. 1237 (2005); Nelson, *supra* note 136.

309. *See* CARD Act, *supra* note 35, §§ 304–305.

310. *See, e.g.,* Nelson, *supra* note 136, at 33–34; LAUREN K. SAUNDERS, NAT'L CONSUMER LAW CTR., *BEYOND THE CREDIT CARD ACT: FEATURES OF SAFER CREDIT CARD 7* (2010), available at http://www.nclc.org/images/pdf/credit_cards/features-safer-credit-card.pdf ("No credit should be granted if the consumer cannot handle additional obligations.").

for poor consumers. These consumers already rely on a variety of formal and informal sources of credit but find credit cards to be the most harmful.³¹¹

Low-income consumers, however, have come to depend on credit cards and appreciate the significant benefits that they offer; such as anonymity; social status; and privileges, including car rental, hotel reservations, and the purchase of airline tickets. The credit card companies created this reliance through targeted preapproved mailings, marketing, and advertising, and would likely fight aggressively to keep their most profitable consumers, despite risk of default. A middle ground exists. The companies can continue to profit from lending to low-income consumers, even if the profits are not excessive. Most cardholders pay money on their credit cards every month.³¹² Even if these small payments went in part to the loan principal, the credit card companies still stand to gain from these relationships.

The technology that has enabled the top issuers to predict the profit potential of low-income, high-risk consumers will facilitate strategic shifts, including product adjustment and alternative profit sources, in addition to the maintenance of a portfolio of low-income consumers.³¹³ It is therefore more likely that the companies would revise their business models to compensate for a reduction in profit from regulatory measures designed to protect low-income consumers, including a temporary subsistence amnesty, rather than abandon these customers altogether.

A major objection to subsistence amnesty from the right is moral hazard. This is the fear that eligible consumers would take advantage of the law to use other sources of income to make luxury purchases, while reserving credit cards for subsistence purchases, thereby “cheating” the companies out of their rightful profits. At the root of this objection is a belief that poor people do not deserve luxuries or even opportunities, as the money freed by the amnesty could go to investments in education or entrepreneurship that would hasten a household’s journey out of poverty.³¹⁴ Most likely, the extra money would go to both.

The money that poor people presently owe credit card companies derives not from a calculation of the actual risk of default associated with their loans but from an assessment of the amount companies can charge in fees and interest without pushing their customers into bankruptcy.³¹⁵ Subsistence users pay significant portions of their overall income to credit card companies, receiving nothing in return. Subsistence amnesty would therefore represent the rightful return of money to the subsistence user. What the user chooses to do with that money upon its retrieval is irrelevant to an assessment of the potential value of subsistence amnesty.

311. See Littwin, *supra* note 28, at 444.

312. See DAVID K. SHIPLER, *THE WORKING POOR* (2004).

313. See Mann, *supra* note 11.

314. See Andrea Freeman, *Credit Card Ills: Reducing Racial Disparities in Debt* 60–62 (2011) (unpublished manuscript), available at http://works.bepress.com/andrea_freeman/2/.

315. See Mann, *supra* note 11.

Poor people deserve luxuries as much as middle- and high-income individuals do. Poverty results from social stratification and unequal distribution, social forces beyond individuals' control. It is fundamental to human dignity that people should be able to spend their money as they wish.³¹⁶ Luxury purchases, from electronics to chocolate, reflect a "basic human need for a pleasant life."³¹⁷ Thus, poor people may reasonably choose to go without food to afford the purchase of a television that relieves some of the boredom of isolation and unemployment, or a cell phone that maintains their participation in a social network and eligibility for job opportunities.³¹⁸

Moral hazard exists in any social welfare system, including food stamps, social security, and welfare. This danger, however, does not outweigh the benefits of these programs. It is therefore simply a necessary evil that society chooses to tolerate in order to give concrete assistance to those who need it most.

From a market perspective, subsistence amnesty would trigger immediate adjustment on the sellers' side. The elimination of exploitative interest rates and fees would lead to a more efficient market, where sellers compete to offer products that meet consumers' needs. It would also alleviate the social costs of the industry's predatory practices by pushing those costs back on to the companies responsible for them.

Irrespective of its advantages, subsistence amnesty would face great resistance from the credit card companies, which protect their interests through aggressive lobbying and close personal and financial ties between banks and politicians. Visa, MasterCard, and American Express each donated more than \$1 million to federal candidates in the 2010 elections.³¹⁹ Lobbyists paid politicians more than \$300,000 before and after the vote on the CARD Act.³²⁰ This lobbying appears to have been effective, as the CARD Act ultimately left the industry and its profits basically intact.³²¹ Additionally, after initially envisioning a strong role

316. For a discussion of human dignity as an essential legal principle, see Rhonda V. Magee Andrews, *The Third Reconstruction: An Alternative to Race Consciousness and Colorblindness in Post-Slavery America*, 54 ALA. L. REV. 483, 533–44 (2003).

317. BANERJEE & DUFLO, *supra* note 168, at 37–38 (asserting that indulgences are "not the impulsive purchases of people who are not thinking hard about what they are doing. They are carefully thought out, and reflect strong compulsions, whether internally driven or externally imposed.").

318. *Id.*

319. Sarah Bryner, *The Credit Card Lobby, Wal-Mart's Politicking and More in Capital Eye Opener*, OPENSECRETS.ORG (April 13, 2011, 12:20 PM), <http://www.opensecrets.org/news/2011/04/the-credit-card-lobby-wal-marts-pol.html>.

320. Kim Zetter, *Bank Lobbyists Paid Nearly \$300,000 to Politicians Before and After Vote on Credit Card Bill*, WIRED (Aug. 26, 2009), <http://www.wired.com/threatlevel/08/bank-lobbyists/>.

321. See CFPB Report, *supra* note 78, at 12. In spite of early reported losses by banks, consumers have not reduced their payments to credit card companies since the Act took effect.

for the CFPB,³²² the Obama administration abandoned a key proposed provision requiring banks to offer low-interest, low-fee credit cards.³²³ The tendency of high-profile individuals to revolve positions between industry and government also guarantees the prioritization of corporate interests over consumer protection.³²⁴

Nonetheless, the extreme pressures of the ongoing financial crisis may well lead to public demand for stronger regulation. Consumers demonstrated the strength of their feelings about banks' practices through a massive consumer activist initiative in reaction to a proposed imposition of a \$5 fee on debit card use by Bank of America, among other banks, in the fall of 2011.³²⁵ Opponents of the fee declared November 5, 2011, Bank Transfer Day and encouraged consumers, via social media, to move their funds out of major banks and into credit unions.³²⁶ The campaign was a success.³²⁷ In response to the protests, Bank of America canceled the fee, although it and its competitors continue to impose new, less visible fees on consumers.³²⁸

The Occupy Wall Street movement mobilized thousands of people against economic inequality across the country. By providing a more extreme end of the spectrum of protest, Occupy Wall Street made room for a broader range of innovative solutions to the credit crisis. Occupy Wall Street also tackled the problem of consumer debt directly with a debt cancellation program called Rolling Jubilee.³²⁹ In this program, the organization buys consumer debt from the banks

322. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, tit. X, 124 Stat. 1376 (2010) (establishing the Bureau of Consumer Financial Protection).

323. Jim Puzzanghera, *Reform Plan Is Likely to Get Rewrite*, L.A. TIMES, Sept. 24, 2009, at B1.

324. Examples include Donald Regan, who went from Goldman Sachs to being Treasury Secretary under Ronald Reagan; Robert Rubin, who went from Goldman Sachs to being Treasury Secretary under Clinton and then to Citigroup; Henry Paulson, who went from being Goldman Sachs' CEO to being Treasury Secretary under George W. Bush; Timothy Geithner, former New York Federal Reserve Bank President, who succeeded Paulson under Barack Obama; and Mark Patterson, former Goldman Sachs lobbyist became Geithner's Deputy Secretary. Kathleen McCarthy, *"Inside Job": A Wall Street Government*, RIVER CITY'S READER (Mar. 30, 2011), <http://www.rcreader.com/commentary/inside-job-wall-street-government/> (reviewing the film *Inside Job*, a documentary about the financial crisis).

325. Pallavi Gogoi, *Bank Fees Quietly Coming Back After Backlash*, HUFFINGTON POST (Mar. 1, 2012, 8:42 PM), http://www.huffingtonpost.com/2012/03/02/bank-fees_n_1315828.html.

326. See *Bank Transfer Day*, FACEBOOK, <http://www.facebook.com/Nov.Fifth> (last visited Jan. 17, 2013).

327. See Suzanne Kapner, *Credit Unions Poach Clients*, WALL ST. J. (Nov. 7, 2011), <http://online.wsj.com/article/SB10001424052970203733504577021972358085822.html>.

328. Eric Dash, *Banks Quietly Ramping Up Costs to Consumers*, N.Y. TIMES, Nov. 14, 2011, at A1.

329. See, e.g., Charles Eisenstein, Comment, *Why Occupy's Plan to Cancel Consumer Debts Is Money Well Spent*, GUARDIAN (Nov. 12, 2012), <http://www.guardian.uk/commentisfree/2012/nov/12/occupy-plan-cancel-consumer-debt>; Catherine New, *Rolling*

for the same price that debt consolidation companies do, then cancels the debt. Social justice organizations and individuals care about what banks do, and this recognized stake in their practices may eventually lead to innovative financial regulation.

CONCLUSION

Credit card debt restricts the financial and social freedom of an increasing number of individuals. It precludes self-improvement through entrepreneurship and education and leads to debilitating states of depression and despair. It also serves to discipline a significant portion of the population, encouraging people to keep their heads down and work without protest.³³⁰

It is a testament to the power of the credit card companies that, in a time of protest against income inequality in general and outrage against exploitation and discrimination in the mortgage lending industry, the structure of the credit card industry remains relatively unchallenged. A shift in public opinion is a necessary catalyst to systemic reform. Going forward, scholars, policymakers, and economists with the objective of solving the credit card problem must include structural analysis in their work. Without it, changes will be piecemeal and ultimately beneficial only to the most powerful financial constituents, the institutions who created and continue to perpetuate the problem. “[I]n any consideration of debt, the concept of the balance is pivotal: Debtor and creditor are two sides of a single entity, one cannot exist without the other, and exchanges between them—in a healthy economy or society or ecosystem—tend toward equilibrium.”³³¹

Jubilee Offshoot of Occupy Wall Street to Offer Debtors \$1 Million Bailout, HUFFINGTON POST (Nov. 12, 2012, 6:39 PM), http://www.huffingtonpost.com/2012/11/12/jubilee-occupy-wall-street_n_2117792.html.

330. For a fascinating exploration of this role of debt in society, see Tayyab Mahmud, *Debt and Discipline: Neoliberal Political Economy and the Working Class*, 101 KY. L.J. 1 (2012).

331. MARGARET ATWOOD, *PAYBACK: DEBT AND THE SHADOW SIDE OF WEALTH* 163 (2008).