

Dynamic Pricing of Credit Cards and the Effects of Regulation*

Suting Hong[†]

Robert M. Hunt[‡]

Konstantinos Serfes[§]

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Abstract

We construct a parsimonious two period model of revolving credit with asymmetric information and adverse selection. In the second period, lenders are able to exploit an informational advantage with respect to their own customers. These prospective rents induce lenders to compete to attract customers in the first period. Lenders re-price accounts in the second period, depending on changes in the apparent credit quality of the consumer and other shocks. We derive a number of comparative static results to illustrate the informational advantage the current lender enjoys relative to its competitors and the consequences for interest rates and credit supply. We are able to model the equilibrium effect of limiting re-pricing of accounts via regulations similar to the ones imposed under the 2009 CARD Act. The model suggests some promising identification approaches to quantify empirically the effects of the CARD Act.

Keywords: Financial contracts; Credit Card Accountability, Responsibility and Disclosure Act; Hold-up; Risk-based pricing; Credit supply

JEL classifications: D14, D18, D86, G28, K12

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[†]Department of Economics, Wabash College, Crawfordsville, IN 47933. Email: hongs@wabash.edu.

[‡]Payment Cards Center, Federal Reserve Bank of Philadelphia, Ten Independence Mall, Philadelphia, PA 19106. E-mail: hunt@phil.frb.org.

[§]School of Economics, Bennett S. LeBow College of Business, Drexel University, Philadelphia PA 19104. Email: ks346@drexel.edu.