



The Basel Proposal: What It Means for Retail Lending

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This note is one in a series that will focus on how the capital rule proposed by the U.S. federal banking agencies in July 2023 would affect particular markets.

The federal banking agencies' proposed capital rule includes risk weights for the credit risk of consumer cards and other consumer credit products. These risk weights are based on the standardized approach for credit risk agreed upon by agency staff at the Basel Committee on Banking Supervision, yet they have been calibrated to levels that exceed those agreed upon in Basel. More significantly, while the Basel agreement allows banks to use their own internal default loss data for assigning risk weights to consumer credit exposures—provided the results do not fall below a specified range of the standardized approach—the version proposed by the U.S. agencies discards this option.¹ Finally, the proposed rule would apply a separate operational risk capital charge for consumer loans.

On top of the regulatory capital charges for credit and operational risk applied under this rule, consumer cards and other consumer credit products would continue to incur capital charges determined by the Federal Reserve's stress test. This double charge would be unique to the United States, as a stress test capital charge has not been adopted in any other jurisdiction.

In summary, the findings presented here indicate that the proposed rule lacks empirical support and is unduly punitive to U.S. consumers. We estimate that the all-in credit risk capital charge for credit cards amounts to a risk weight of 174 percent. This risk weight far exceeds the applicable risk weight under the Basel agreement and what historical loss data would support. Furthermore, the proposed credit risk capital charge for other consumer loans, as well as the treatment of operational risk for cards and other consumer loans, are also higher than what would be deemed reasonable.

- The risk weight for the credit risk of consumer cards would increase from the current 100 percent to 111 percent, due to the new capital charge for unused credit lines.² The addition from the stress test would contribute another 63 percentage points to these risk weights, elevating the cumulative risk weight to 174 percent.

¹ In contrast, this option has been exercised in the European Union and United Kingdom. There appears to be no major jurisdiction that intends to follow U.S. proposed practice in this regard.

² All effective risk weights calculated in the note are defined as percentages of on balance sheet amounts to facilitate comparison with the current standardized approach.

- We estimate the combined risk weight (inclusive of stress testing) for the credit risk of other consumer loans would be 100 percent, 25 percentage points above the standardized approaches risk weight under the Basel agreement and about double the advanced approaches risk weight.
- The newly introduced risk weight for credit card operational risk is estimated to vary between 20 percent to over 100 percent. This variation largely hinges on whether card revenues are reported as gross amounts or whether the operational risk charge calculation permits the netting of credit card-related expenses, which is arbitrary. Combined, the capital requirements for operational and credit risk of consumer cards can range between about 200 percent and 250 percent.
- The combined, excessive capital charge for consumer cards is likely to make credit cards less affordable or less available. As such, the proposal would primarily harm more financially vulnerable households, including those needing to build or repair their credit histories through use of a credit card, and low- to middle-income households that depend on unused card credit for meeting unexpected cash shortfalls.
- The higher capital requirement for credit cards incorporates a 10 percent “credit conversion factor” (or CCF, which assumes that 10 percent of the undrawn line will become drawn), which is above what can be rationalized based on historical experience. This could lead to banks reducing credit limits on or canceling infrequently used lines and raises significant concerns about effects on households that prefer to maintain substantial unused amounts. The latter are likely to include many financially more vulnerable households that reserve unused line amounts for emergency expenses.
- The inappropriately high capital charges for other consumer loans would likely constrain banks’ loan growth in important retail segments. In particular, it may harm their efforts to provide small-dollar loans to financially vulnerable consumers as a safe alternative to high-cost credit from nonbanks. Moreover, banks’ share of the auto loan market has been trending down over the past decade, likely due in part to increased regulatory costs, and excessive capital charges will exacerbate this trend, which harms competition and consumer choice.

Introduction

Currently, credit card balances and other consumer credit exposures are subject to a standardized 100-percent risk weight (the current standardized approach), a legacy from the original Basel I international capital agreement dating back to 1988. One objective of the 2017 Basel agreement was to enhance the risk sensitivity of the standardized approach. For credit cards in particular, this was done by recognizing that non-revolving balances (people who transact with their card but repay in full each month) pose significantly less risk of loss compared to revolving balances. Moreover, it recognized that even the undrawn segment of a line, though unconditionally cancellable by the lender, still presents some level of risk to the bank.

The Proposed Rule. For credit risk, the agencies propose to use the same risk segments as Basel but would add 10 percentage points to the agreed-upon Basel risk weights. (The proposal includes no data to support this add-on.) This means that for cards, the proposal would apply a risk weight of 55 percent to the balances of those who pay the full balance due each month (transactors) and 85 percent to

revolving balances, that is, the balances that incur interest charges because they are not paid in full each month. For most consumer loans and leases, the proposed risk weight also is 85 percent.

Consistent with Basel, the proposal by the U.S. agencies also applies a risk weight to 10 percent of the undrawn portions of credit card lines. Technically speaking, the proposal applies a CCF of 10 percent to the undrawn portion of the credit line for risk quantification purposes.

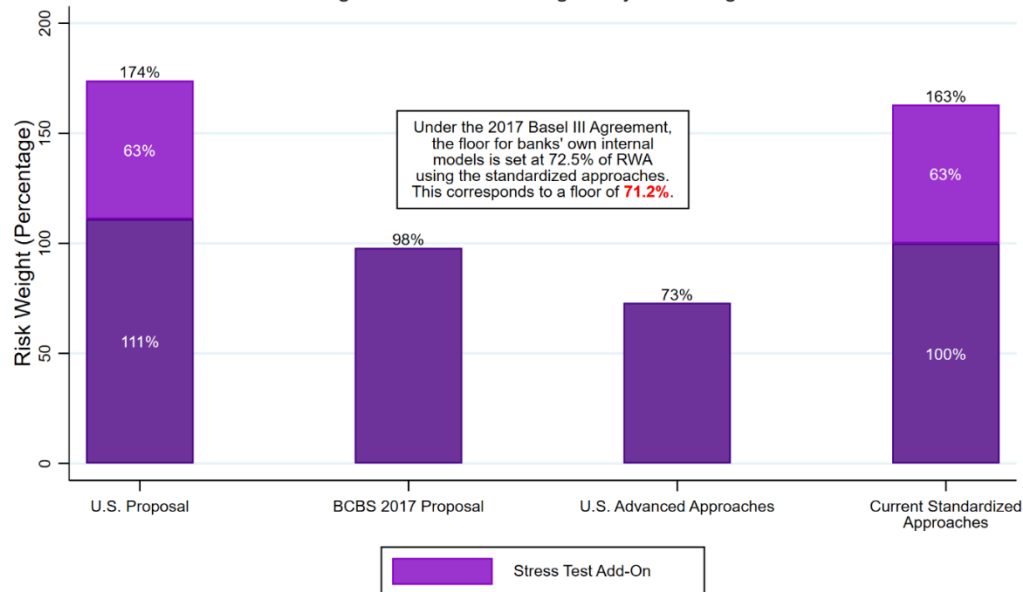
In addition, banks would face a substantial stress capital buffer charge for all credit card exposures, given the large rise in unemployment rates assumed in the stress tests. Our [prior work](#) has shown that the implicit capital charges in the stress tests for credit cards, commercial real estate and commercial and industrial loans are substantially higher than the minimum, 2.5-percent Basel capital conservation buffer requirement and therefore that large banks face substantially higher capital requirement on these types of loans than smaller banks not subject to the stress tests.

Finally, banks operating in the United States would not be allowed to use internally modeled approaches to determine risk-weighted assets provided that the aggregate result does not fall below 72.5 percent of the outcome produced by the standardized approach. Thus, U.S. banks uniquely face a situation where they cannot avoid the stringent standardized approach charges, regardless of whether these are demonstrably excessive in relation to historical losses.

Detailed Explanation of Credit Risk Charges for Credit Cards

Figure 1 compares the aggregate risk weight under the agencies' proposal, calculated as the ratio of RWA to outstanding balance, to that obtained under the BCBS calibration, for credit card accounts at U.S. banks currently using internal (advanced approaches) models. The dark purple portion of the first bar indicates the risk-weighted asset from the agencies' proposed standardized approach calculation, without the stress-test add-on, while the lighter purple portion is the estimated stress test add-on.

Figure 1: Credit Card Regulatory Risk Weights



Sources: Federal Reserve Bank of Philadelphia: Credit Card Balances Data, FFIEC Form 101: Regulatory Capital Reporting for Institutions Subject to the Advanced Capital Adequacy Framework, Bank Policy Institute Blog: Estimating the Implicit Capital Charges in the Stress Tests.

Note: The Advanced Approaches average risk weight includes the 1.06 scaling factor.

The calculation of the standardized approach portion relies on quarterly data from the Federal Reserve Bank of Philadelphia on average credit card usage over the period 2015 through 2022 for banks subject to Dodd-Frank stress testing. These data are used to determine the percentage of card balances that are non-revolving (transactor), for which the applicable risk weight is 55 percent under the agencies’ proposal and 45 percent under the BCBS calibration. The remaining, revolving portion receives a risk weight of 85 percent under the agencies’ proposal and 75 percent under the BCBS calibration. In addition, the data are used to determine the percentage of total available line that is unused, 10 percent of which would be subject to the same risk weight schedule as the balance sheet portion.³ For comparability, each of the risk weights shown in Figure 1 are expressed ratios of risk-weighted exposure amounts to total balances.⁴

To estimate the implicit risk weight in the stress tests we follow the methodology proposed by [Grenwood et al](#) (2017). This method increases the capital charge for each asset with its net loss rate in the stress tests. The net loss rate is calculated using the projected losses for credit card losses, offset by pre-provision net revenue from those same loans. Following this approach, we estimated a stress capital buffer of 7.5 percent for credit card loans, which is 5 percentage points above the standard capital

³ These data are based on the Y-14 regulatory data submissions of Advanced Approaches banks. The average utilization ratio (balance as a percent of committed line amount) is 19 percent; the average ratio of revolving to total balances is 71 percent. The calculation applies to these shares the risk weights specified under the agencies’ proposal and under the BCBS calibration, respectively.

⁴ The advanced approaches framework incorporates an estimated CCF parameter, whereby for defaulted accounts the exposure at default (EAD) amount on average exceeds the current balance due to additional draws prior to default. The estimated CCF is then, along with the probability of default and loss given default, an input into the derived risk weight.

conservation buffer. To convert the stress capital buffer estimate into a risk weight, we multiply 5 by 12.5, resulting in a 63 percent risk-weight add-on during the stress tests.

In total, under the agencies' version of the standardized approach, the aggregate risk weight for credit card exposures is 111 percent. This is significantly higher than the 98 percent risk weight under the BCBS standardized approach being adopted in other countries, and it greatly exceeds the average risk weight for U.S. banks using the advanced approaches, which is about 72.9 percent, according to these banks' FFIEC 101 reports from 2014 through 2022.⁵ The advanced approaches calculation is empirically based: banks use their own empirically estimated segment-level risk parameters (expected default and loss rates under downturn conditions) in calculating a portfolio risk weight, overseen by agency examiners.

In other jurisdictions, banks are allowed to use the advanced approaches. They only use the standardized approach to set a floor for the advanced approaches RWA, such that the latter cannot go below 72.5 percent of standardized approach RWA. If the United States were to follow the same rules, the 98-percent risk weight under the standardized approach would be equivalent to a 71.2 percent floor (i.e., 98 percent \times 72.5 percent) for the advanced approaches.

The advanced approaches risk weight reflects banks' historical loss and default experience, including the peak losses in 2009-10 triggered by the global financial crisis of 2008-09. Banks have long maintained accurate and reliable credit card data suitable for estimating the advanced approaches risk parameters, and there is no reason to believe that the resulting risk weight is inadequate. The agencies' proposed, 111 percent risk weight from application of the standardized approach is more than 50 percent larger than the advanced approaches risk weight. The stress test add-on itself would offset the effects of a severely adverse scenario on bank capital, so that the combined, effective risk weight is clearly excessive.

The Operational Risk Add-on

Additionally, the U.S. agencies' proposal aims to incorporate the Basel rule's operational risk capital charge into the capital requirements for credit cards, which would further raise the cost of card borrowing or reduce availability of card credit. This additional charge appears arbitrary given that the existing stress testing framework for large banks already adequately accounts for exposure to operational risk from credit card lending.

To understand the impact of the proposal on banks' costs of extending card credit, we examine two scenarios: (1) where banks report credit card revenues netted of related expenses (such as rewards) and (2) where banks report gross card revenues and card-related expenses are reported separately. For example, most banks report certain expenses (e.g., rewards) as "contra revenues" to their card services fee income, which reduces revenues and thereby the operational risk charge. By contrast, there is at least one bank subject to the proposal that reports the income from credit cards on a gross basis. As shown in the table below, these differences translate to very sizable differences in the operational risk charge for credit card loans.

⁵ We have adjusted the advanced approaches risk weight using the 1.06 scalar as required under U.S. regulatory capital rules.

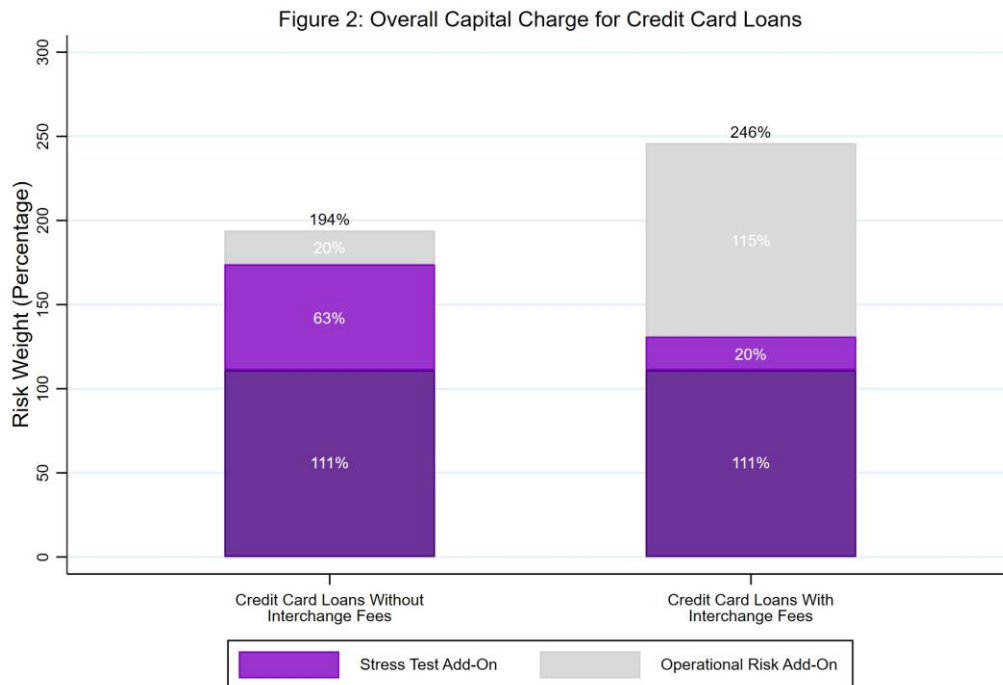
Table 1: Basel Proposal’s Effect on Banks’ Costs of Extending Card Credit

	Credit Card Loans Revolver (GAAP-Driven Netting)	Credit Card Loans Revolver (Grossing of Card Revenues)
Operational Risk Add-On	<p>Assume the bank holds \$100bn in revolving CC balances and receives a \$5bn in credit card fees (GAAP-netting).</p> <p>$12.5 \times 1.2 \times 0.18 \times (0.025 \times \\$100 + \\$5) = \\20.3bn or a 20% risk weight add-on for operational risk</p>	<p>Assume the bank holds \$100bn in revolving CC balances and receives a \$40bn in credit card fees (includes both interchange fees and other card fees and no netting).</p> <p>$12.5 \times 1.2 \times 0.18 \times (0.025 \times \\$100 + \\$40) = \\115bn or a 115% risk weight add-on for operational risk</p>

In the table above, if a bank is permitted to report certain credit card expenses as contra revenues, a bank holding \$100 billion in credit card loans would record annual credit card fees of \$5 billion. This results in a capital charge for operational risk of \$20.3 billion, which is roughly equivalent to a 20 percent risk weight for operational risk.⁶ In a second scenario, the bank itemizes expenses related to credit card loans and consequently reports \$40 billion in annual fees and interchange fees, without subtracting the rewards it distributes on its credit card loans. In this case, the unadjusted representation of credit card fees equates to a capital charge for operational risk of \$115 billion or an added risk weight of 115 percent.

In sum, when combining the operational risk charges with credit risk, the capital requirements for credit cards can range between about 200 percent and 250 percent. These capital requirements for credit card loans are excessive because banks are not allowed to use internal models for credit risk subject to the standardized floor. In addition, the combination of both the new standardized approach operational risk and the stress test capital charge for operational risk [overstates](#) the appropriate capital requirement for operational risk. Also, the grossing of fee revenues reduces the implicit capital charge in the stress tests. For that reason, we have lowered the stress capital charge when banks report card revenues in gross amounts.

⁶ The example assumes a 1.2 internal loss multiplier and that the bank reports over \$30 billion in total annual revenues, thereby making the 18 percent applicable (see Table 8, page 64086 in the Basel Proposal). The multiplication by 12.5 is needed to convert the capital charge into risk-weighted assets.



Higher Capital Charges for Credit Cards May Harm Financial Inclusion

The capital proposal released by the U.S. banking agencies in July 2023 for implementing the final phase of the Basel III agreement significantly increases the effective risk weight for retail credit card exposures, well beyond what can be rationalized based on historical loss experience. The resulting, excessive regulatory capital requirement likely would increase the cost of card borrowing and reduce the affordability and availability of card credit. In particular, it would likely be more difficult for those with limited or no credit record and those with impaired credit histories to qualify for affordably priced cards.

Consequently, the excessively large capital requirement for card credit may entail significant social costs. It is important that policymakers consider these social costs in deliberating on new capital rules.

A credit card arguably is the most important building block of financial inclusion for American households after a bank account. This is primarily because it is most often the first credit product to appear on the credit report of those who previously lacked a credit history (so-called “credit invisibles”). This is not necessarily the case in other countries that are parties to the Basel agreement.⁷

For instance, a 2017 study from the Consumer Financial Protection Bureau (Brevoort and Kambara 2017) found that credit cards by far are the most common avenue for initiating a consumer credit record. As shown in Table 2, for 37.6 percent of credit-visible individuals initiated their credit record by obtaining a

⁷ In Germany, for example, individuals often gain access to credit or generate a credit score via a savings account history, non-credit-related information such as length at current residence, and bill payment records. See <https://www.schufa.de/> for details on credit scores in Germany.

credit card, more than double the percentage who began with a student loan (15.8 percent) and three times the percentage whose first item of record (unfortunately) was a debt collection (12 percent).

Table 2: Distribution of Earliest Credit Report Item by Age Group

Age Range	Auto (%)	Credit Cards (%)	Mortgages (%)	Personal (%)	Retail (%)	Student (%)	Collections (%)	Other (%)
Under 25	9.0	35.6	0.5	5.3	13.7	19.9	12.4	2.6
25-29	9.1	47.0	1.7	4.9	13.4	2.5	11.3	3.6
30-34	8.6	46.7	2.2	4.8	14.6	1.3	10.4	3.9
35-39	8.5	44.7	2.9	5.1	15.4	1.2	10.3	4.4
40-44	8.4	43.8	3.5	5.7	15.4	1.2	10.2	4.3
45-49	8.2	41.6	3.5	6.0	15.9	1.5	10.7	4.6
50-54	7.9	40.4	4.0	6.0	15.9	1.3	9.8	4.9
55-59	7.5	38.7	4.1	6.0	16.7	1.1	9.7	4.5
60-64	7.6	35.5	4.2	7.2	20.6	0.7	8.4	4.2
65-69	7.2	33.7	4.5	7.0	22.5	0.6	8.1	4.7
Total	8.9	37.6	1.0	5.3	14.1	15.8	12.0	3.0

Source: Brevoort and Kambara (2017)

Individuals who lack a credit record, and who therefore cannot access traditional bank credit, may have to rely on high-cost credit from auto or consumer finance companies or on payday loans, making them vulnerable to further financial difficulties. Logically, it follows that credit invisibility might be particularly harmful to lower-income individuals, who are more vulnerable to financial stresses. This may be one reason why Brevoort and Kambara (2017) find that individuals residing in lower-income areas are more likely to have their first credit record be a collection item or other derogatory item compared to those in middle or higher-income areas.

Moreover, credit cards, particularly secured cards, facilitate restoration of access to affordable credit for households with impaired credit histories that are impeding such access. The CFPB recommends obtaining and responsibly using secured credit cards in particular as an effective strategy for rebuilding credit.⁸

A final point to consider is that the broader regulatory and macroeconomic context encompassing the agencies’ capital proposal can be aptly described as a “perfect storm” harming the affordability of credit cards for low- to middle income households. Inflation and the resulting rise in interest rates have saddled these households with larger card balances and monthly minimum payments. The proposed reduction in allowable late fees recently announced by the Consumer Financial Protection Bureau is likely to lead to offsetting increases in card interest rates, particularly for individuals with lower credit scores. The Federal Reserve’s proposed lowering of regulatory caps on debit card interchange fees, while not directly affecting credit cards, could lead to offsetting increases in fees charged to consumers for use of debit cards, which might spill over into credit card pricing, based on standard arguments regarding prices of goods and services that are economic substitutes.

In sum, the proposed, unduly high capital requirements for card credit lines would likely have adverse consequences for financial inclusion. If credit cards become more difficult or costly to obtain, it will

⁸ See [How to rebuild your credit \(consumerfinance.gov\)](https://www.consumerfinance.gov/how-to-rebuild-your-credit/)

become more challenging for many young or immigrant households and other so-called “credit invisibles” to build a credit history, and for households with impaired credit to restore their good standing. This in turn could have further adverse consequences for the financial health of such households.

Potential Harms to Household Financial Well-Being from Reduced or Eliminated Credit Lines

The agencies’ proposed rule adopts without modification the element of the Basel agreement that applies a capital charge to 10 percent of undrawn amounts (a 10 percent CCF). In the United States, the unused portion of credit card lines sums to about 81 percent of the total committed lines, and this average available line amount has been near constant over time, according to FFIEC 101 submissions. The additional risk weighting applied to this unused portion comprises about one third of the 111 percent average risk weight for credit cards under the proposed rule.

Consequently, banks will find it significantly more costly to provide credit lines that are infrequently or never used, or that have a large unused portion. They may be compelled to close infrequently used accounts and to reduce credit limits on low utilization accounts. This could, in turn, have materially adverse implications for the financial health of many households, especially lower income households.

The 10 percent CCF is excessive based on empirical loss experience. Even without considering the potential harm to consumers from increasing banks’ cost of providing low-utilization credit lines, there is little reason to believe that the proposed 10 percent CCF is justified—the banking agencies have not provided data or analysis to confirm that this is the appropriate CCF for U.S. banks. Available evidence suggests that the CCF should be lower. For instance, an [empirical analysis](#) using data collected by BPI in 2016 indicates that the implied CCF for credit cards at Advanced Approaches banks was 6.5 percent, and it estimates an aggregate CCF for credit card loans at 3 percent. In addition, we have conducted a “reverse engineering” of the CCF implicit in the advanced approaches risk weight, based on an estimated regression equation, which suggests an implied CCF of about 5 percent.⁹

The fact that the 10 percent CCF was a consensus among countries that are parties to the Basel agreement does not mean that the calibration is necessarily appropriate for U.S. banks. There are huge differences across countries in the number of cards people hold, the extent to which consumers use credit cards for payments, the share of card balances that are revolving, and other relevant aspects of card utilization, as overviewed in Financial Conduct Authority (2015). Moreover, in contrast to what the agencies have proposed for the U.S., other countries provide to banks the option of using the advanced approaches, under which CCFs are calibrated based on banks’ internal models, not arbitrarily set at 10 percent.

⁹ Using a panel data set of annual (Q4) bank-specific observations from the 2014 through 2022 Q4 FFIEC 101 reports, we regress the ratio of risk-weighted assets to current balance against the ratio of total committed line to current balance, with inclusion of bank fixed effects. Results indicate that the implicit risk weight for a 100 percent utilized credit line (represented by the estimated intercept term) is at least 20 times larger than that applied to undrawn line amounts (represented by the slope coefficient).

Potential adverse consequences for consumer financial health.

Federal Reserve survey data on household financial well-being indicate that credit cards are the first line of defense for those facing an unanticipated cash shortfall, absent which they would have to fall behind on a payment obligation or utilize the services of a payday lender or other high-cost alternative.¹⁰ It follows that the large increases in capital requirements for unused lines are likely to reduce the amount of line available to consumers to meet unanticipated or emergency expenses. Such a concern seems particularly relevant in light of a recent CFPB study on the effects on consumers of credit card line decreases.¹¹

Another financial benefit to consumers from holding at least one, low-utilization credit card line is to minimize interest costs. Simple economic logic dictates that if a household can pay off some but not all of their total balance due in a given month, they can lower their monthly interest costs by splitting their expenditures between two cards, using one as a transactor and reserving the other for revolving balances.¹²

For instance, a household may only need the second card for short-term borrowing for occasional, large purchases, so that most of the time the second card would have zero or low utilization. Should banks become more hesitant to provide low-utilization credit lines, the consumer will lose this important benefit provided by the second card.

A final, important benefit to consumers from holding multiple cards, some of which may be infrequently utilized, is that this can facilitate household budgeting and expenditure management. For instance, Gelman and Roussanov (2023) demonstrate that “associating and grouping expenses by card can be a helpful tool for mitigating the complexity of tracking various expenditures and optimizing consumption decisions at the level of the entire household budget.”

Potential impacts on credit scores from reduced credit lines.

Consumers who are closer to their overall credit limit based on summing across all of their credit lines will have lower credit scores, all else equal, based on how credit scoring models in the U.S. generally are constructed. Utilization rates on each individual card a consumer holds matter as well. For example, as described by Black (2023):

“According to simulations published by FICO, a consumer with a 26% utilization rate, who lowered it all the way down to 1%, might expect to boost their FICO Score by up to 20 points... the biggest impact was for consumers with high FICO Scores that maxed out their credit cards. The simulations showed that a consumer who saw their utilization rate jump from 12% all the way to 100% might see their score drop by nearly 130 points.”

Therefore, to the extent that the proposal compels banks to cut back on credit limits or close low-utilization accounts, credit scores will immediately decline for the affected consumers, harming their access to credit. More generally, the accuracy and reliability of credit scoring models would suffer. Over

¹⁰ Survey respondents indicate their most common approach to confront major unexpected expense is to “use a credit card and then carry a balance. See Board of Governors of the Federal Reserve System (2023).

¹¹ See Herman et. al (2022).

¹² The increased interest expense derives from the fact that they will lose the grace period for ongoing expenditures once they no longer pay in full each month, even if they continue to pay more than the minimum payment amount.

time, as the models get re-estimated and updated, these effects would be reversed. But that could take years, due to the time needed to accumulate the necessary data, re-estimate models, and adapt loan origination processes and risk management systems to the new models.

Consequences of the Proposed Rule for Other Retail Exposures

Aside from residential mortgages and credit cards, the agencies' proposed rule will apply an 85 percent risk weight to most consumer credit exposures, including auto loans and leases and personal loans. While this is below the 100 percent risk weight applied under the current Standardized Approach, it adds 10 percentage points to the BCBS version of the Standardized Approach, which specifies a 75 percent risk weight.

The agencies' proposal further diverges from the BCBS version by ruling out use of the Advanced Approaches risk weights for these other retail categories, which are calibrated based on historical loss experience for these categories. Using data from the FFIEC 101 reports of Advanced Approaches banks from 2014 through 2022, we calculate an average risk weight of about 50 percent, below the floor determined by the BCBS version, which is 0.725 times 75 percent, or 53.4 percent, implying that the floor will typically be binding.

Not only is the proposed 85 percent risk weight higher than that agreed upon by the BCBS and apparently much larger than appropriate based on historical loss experience, but it appears to have little merit given that the annual stress tests help ensure that banks hold sufficient capital to absorb extreme downturn losses. Following the same methodology as for credit card loans, we estimate a 13-percentage points risk weight add-on for other retail loans.

The likely consequence of imposing such an excessive capital charge on the other retail categories will be to constrain the growth of bank lending. Banks' share of the auto loan market has been trending down over the past decade, likely due in part to increased regulatory costs, and excessive capital charges will exacerbate this trend that harms competition and consumer choice.¹³ Particularly in the case of smaller dollar, personal loans, which the agencies have encouraged as a substitute for high cost consumer credit from nonbanks, the higher capital charges will be a significant impediment. Banks have been expanding their offering of such products, and unnecessarily high capital requirements may derail this positive development.¹⁴

In general, the operational risk charge for the other retail categories seems modest, as the interest component of this charge cannot surpass a small percentage (2.25 percent) of the loan amount. However, an exception is the operational risk charge for operating lease revenues, essentially loans to auto companies. Since this revenue is reported as fee income and is not capped, it could lead to an additional increase of 20 percentage points in the operational risk add-on. This unwelcome development will likely have an adverse effect on affordability of auto lease credit and curtail the credit options available to consumers when purchasing a new car.

¹³ Between 2011 and 2018, banks lost substantial market share to credit unions; see Calem, Ramasamy, and Wang (2020). More recently, there has been a shift in market share from banks to finance company subsidiaries of auto manufacturers; see Zabritski (2023)

¹⁴ For discussion of the benefits of bank-provided small-dollar loan programs, see Calem and Covas (2020).

Conclusion

The proposed rule has significantly adverse implications for a bank's cost of providing credit cards and other consumer loans, with consequent adverse effects on all consumers but particularly on financially vulnerable households. Most importantly, the agencies provide no foundation—no supporting data or analysis—for the high risk weights specified in the proposed rule. To the contrary, these risk weights run counter to historical experience and the calibration planned in all other countries.

Arguably of greatest concern is the potential for adverse effects on financial inclusion that are likely to result from driving up the cost of card borrowing and reducing the affordability of card credit. In particular, individuals with limited or no credit record may find it more difficult to obtain affordably priced cards, which for many is the first step toward building a credit history.

The proposed rule's introduction of a capital charge on the unused portion of credit card lines likewise is potentially harmful for the financial health of at-risk households. Banks may be compelled to close infrequently used accounts and to reduce credit limits on low utilization accounts, harming lower income or other financially vulnerable households that require access to these lines should the face an unanticipated cash shortfall. Reduced credit limits or closing of low-utilization accounts will also cause credit scores to drop for the affected consumers, harming their access to credit. The increased capital charges also are likely to constrain banks' ability to compete in the auto market and discourage them from offering safe, affordable, small-dollar loan alternatives to financially vulnerable consumers.

Disclaimer: The views expressed do not necessarily reflect those of the Bank Policy Institute's member banks, and are not intended to be, and should not be construed as, legal advice of any kind.

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