

The Credit Card Act of 2009: Its Financial Impact on the Retail Industry

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Abstract

This study analyzes the House passage of the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit Card Act) on the retail industry. Furthermore, this study evaluates the financial impact on those retailers that profit from both: (i) the sale of merchandise and (ii) the financing of the sale through in-house credit card (IHCC) programs. An event study methodology is used to isolate the financial impact on the retail industry by examining changes in market value of equity (MVE). Our results support that retailers with IHCC programs were negatively impacted as two-thirds of these retailers experienced stock prices decline when the House passed the Credit Card Act. Additionally, 78 percent of the large retailers suffered losses and these large retailers, on average, suffered a stock price decline of almost 3.5% which equates to a decline in MVE of \$500 million.

I. Introduction

According to a 2009 Nilson Report, the total credit card debt in America reached \$972 billion in 2008. Myfico.com goes even further and states that the average consumer has access to \$19,000 in credit between all household cards. Additionally, a Federal Reserve Survey indicates that in 2007 nearly 60% of households had store credit cards and over 96% of the households had bank cards (Survey of Consumer Finances, February 2009). Visa, MasterCard, American Express and Discover have approximately 630 million credit cards outstanding with Visa and MasterCard having an additional 500 million debit cards outstanding. The convenience of credit cards and the move towards electronic mechanisms of purchases have driven credit card use from convenience to necessity for many consumers. Bottom line: credit cards are indispensable for consumer use and convenience and have become an important method of paying for goods and services in our economy. Therefore, any change that impacts the ability to use credit cards may have a direct impact not only on consumers, but also on retailers.

The financial crisis began in 2008 with a significant slowdown in the economy that nearly coincided with the bursting of the real estate bubble. Personal residences had been a large source of consumer credit for consumption spending which caused an even more pronounced economic crunch since consumer spending accounts for roughly 70% of the U.S. GDP. These factors along with high unemployment and extreme mortgage delinquencies led a constituent-driven congress to revamp credit card legislation. On May 22, 2009 President Obama signed into law the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit Card Act). The bill originally passed in the House was named the Credit Cardholders' Bill of Rights, but was subsequently named Credit Card Accountability Responsibility and Disclosure Act of 2009. Policy makers passed the Credit Card Act with the intention of better protecting consumers from credit card fees and expenses. Some key provisions of the legislation included:

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(i) amending the Truth in Lending Act to provide consumers more advance notice of card changes; (ii) prohibiting changes in the APR, fees, or finance charges unless specific conditions are met; (iii) prohibiting a creditor from changing the terms governing repayment of an outstanding balance. While it is likely that credit card issuers will be impacted by the Credit Card Act, it is unclear how retailers with in-house credit card programs will be impacted.

This paper evaluates the impact of the Credit Card Act on retailers, especially those retailers whose profit is a function of both: (i) the sale of merchandise and (ii) the financing of the sale through in-house credit card (IHCC) programs. The customers of retailers depend on store credit cards for access to retail credit which directly influences their ability to purchase retail products and services. In turn, retailers use the data and information collected to more effectively market their merchandise to consumers and to maximize profits of the IHCC program. Thus, legislation such as the Credit Card Act may directly impact retailers with IHCC programs by placing a greater compliance burden upon them. If the Credit Card Act is expected to benefit retailers via increased consumer savings and ultimately consumer spending as suggested by legislators, then passage of the Act should be viewed positively by investors. Alternatively, if the passage of the Act is expected to hurt retailers via increase compliance costs, especially for retailers with IHCC programs, then passage of the Act should be viewed negatively by investors. Retailers that would experience greater compliance costs would include retailers with their own store-issued credit cards such as Kohl's and JC Penney. While some retailers will outsource their card operations to a third-party, we expect these third-parties to pass on the compliance costs to the retailer just as if the retailer held these costs in-house. In summary, we anticipate retailers with IHCC programs to experience a *net loss* as the present value of compliance costs will outweigh the present value of any potential benefits.

Home Depot can be used as an example of the compliance costs of the Credit Card Act. For example, Home Depot previously offered consumers a no-interest and no-payment option prior to the legislative change. The change in the legislation mandates that retailers require consumers to make monthly payments which could impact Home Depot in several ways. A consumer may now choose to make his purchase at a different home improvement store whereby Home Depot would lose the profit from the sale of the merchandise. A consumer may now choose obtain his financing from his financial institution whereby Home Depot would lose the profit from the financing of the sale. In fact, Home Depot may even lose the customer entirely, thereby losing both: (i) the profit from the sale of the merchandise and (ii) the profit from the financing of the sale. Further, a change in marketing strategies has to take place going forward which will add costs and eliminate a way of doing business with many consumers. Home Depot will experience a large negative impact today from the costs associated with changing statement presentations, managing pre- and post-Act purchases, informing customers, and other similar activities. The benefit of consumers having additional savings will enhance spending at some point, but it is unlikely these benefits will outweigh the costs of compliance.

II. Literature Review

Consumer use of credit and debit cards has continued to evolve as society moves towards a paperless transaction system. The recent consolidation of the commercial banking industry combined with gains in efficiencies of larger card issuers is driving smaller issuers into unique segments (e.g., Health Savings Accounts) or causing store credit issuers to sell their portfolios to

other third-party firms (Mercator Advisory Group 2005). Credit has historically played an important function in generating sales with store credit playing a unique role because of the alternative financing medium, but these operations are increasingly being sold to third-party entities (Bloomberg 2009, Lee and Kwon 2002). In the Bloomberg report, the CFO of Target is attributed to stating that the Credit Card Act could shave up to $\frac{1}{2}$ of 1% off same store sales growth (open at least one year) and that available consumer credit on cards shrunk by nearly one-fourth from a peak in 2008 to 2009.

Governmental regulatory changes are known to impact cash flows through either the revenue or expense side of operations as well as changing the underlying risk factor facing individual firms or entire industries (Reynolds 2008). The probability of such regulatory changes is altered as possible policies or legislation are discussed or introduced. The resolution of some portion of the change in uncertainty occurs as the legislation fails or passes (Cornett and Musumeci 1999; Hoag 2002; and Lamdin 1999).

Llewellyn (1999) argues that effective competition is a key component of consumer protection as well as competitive pricing so that market imperfections are corrected by regulations and makes markets operate even more efficiently. In doing so, he states there are six avenues of generating benefits from regulation: (i) lower consumer transaction costs; (ii) greater market efficiency; (iii) increased consumer confidence; (iv) ability to remove problem firms; (v) externality gains; and (vi) greater transparency. In this case, the Credit Card Act is driven with a stated focus on lowering the costs for consumers and increasing transparency to the public.

Following the efficient-market hypothesis, information that is released to the public will alter investors' views on future earnings as well as the uncertainty of those earnings (Fama 1965, 1970). We accept the validity that information is quickly assimilated by the stock market and that stock prices react quickly to that new information. Common stock valuation models employ variations of the Capital Asset Pricing Model into a cash flow discounting approach that drives asset valuations. As such, the event study methodology is a widely accepted model that can be used to evaluate the initial and immediate response of the market place on regulatory changes.

III. Data

To be included in the sample, a retailer must have: (i) a primary four-digit SIC code of 5200, 5300, 5600, or 5700; (ii) daily stock return data available for the event window on Compustat North America; (iii) no major news announcement reported in the *Wall Street Journal* during the event window. There are 85 retailers that meet these criteria.

The sample is then subdivided into retailers: (i) without an IHCC program and (ii) with an IHCC program. We examine external websites of retailers in December 2009 to determine which retailers have an IHCC program. There are 43 retailers without an IHCC program and 41 retailers with an IHCC program. The retailers with an IHCC program include those firms with a traditional credit card program, a store credit card program, or both. A traditional credit card program includes cards issued through Visa, Mastercard, Discover, and American Express that are branded for the retailer. Retailers with such card programs include Costco, Abercrombie & Fitch, and Coldwater Creek. A store credit card program includes cards that are branded with the retailer's name and can only be used in that family of stores. Retailers with such card programs

include Eddie Bauer, GAP, and Kohl's. In GAP's case, the card can be used at GAP, Old Navy and Banana Republic stores. Some retailers in our sample have both a traditional credit card program and a store credit card program. Retailers with both card programs include Sears and Target. Customers with strong credit histories qualify for either card whereas consumers with weak credit histories may qualify for only the store credit card. The retailers with an IHCC program are listed in Table I along with their market value of equity.

The retailers with an IHCC programs are then subdivided by size into two samples: (i) large retailers and (ii) small retailers. Retailers with a market value of equity (MVE) of \$1 billion or more are defined as large retailers while retailers with less than \$1 billion in MVE are defined as small retailers. There are 18 large retailers with an average MVE of \$10 billion. The large retailers include Home Depot, the largest with \$36.5 billion in MVE, and Abercrombie & Fitch, the smallest with \$1.6 billion in MVE. There are 23 small retailers with average MVE of \$326 million. The average small retailer is about 1/30th of the size of a large retailer. The small retailers include Buckle, the largest with \$983 million in MVE, and Eddie Bauer, the smallest with \$15.7 million in MVE. We choose the subsamples in this manner out of curiosity so we can appraise how large and small retailers are impacted. We speculate that large retailers might have the ability to mine customer data, cross-sell more products, and exploit extensive and targeted marketing campaigns. One might then expect to find these large retailers suffered greatly due to greater costs related to their reliance on these activities. We might also speculate that these large retailers suffered little because they can spread large fixed compliance costs over many customers. Similarly, small retailers with fewer customer accounts and smaller customer balance might face a large negative impact by the Credit Card Act.

IV. Methodology

We use an event study methodology to determine the immediate impact of the Credit Card Act on the stock prices of retailers (Brown and Warner 1985; Peterson 1989; Schweitzer 1989). It is possible to isolate the immediate impact of the Credit Card Act on stock prices because of two unique stock price characteristics. First, expected future earnings drive stock prices. Second, the U.S. stock market is efficient such that stock prices react quickly and efficiently to the announcement of an event that impacts expected future earnings. Thus, if investors conclude the Credit Card Act will decrease future sales of retailers with IHCC programs, thereby decreasing future earnings, then stock prices will decline. On the other hand, if investors perceive retailers with IHCC programs can circumvent the Credit Card Act such that future earnings do not decline, then stocks will not decline. This means that policy makers can immediately gauge the expected economic impact on retailers with IHCC programs by examining their stock price reaction to the Credit Card Act via an event study methodology. The event study methodology divides a stock return into two components. The stock return's first component is driven by a general stock market movement. The stock return's second component is driven by the informational event, the Credit Card Act.

We define an event window that was centered on the announcement date that we call day zero ($t = 0$). On April 30, 2009 the House passed the bill by a recorded vote of 357-70. This event was the critical event as the strong bipartisan support behind the bill was immediately followed by the White House putting forth a Press Release indicating that the President strongly supported the intent of the bill while stating he would be working with Congress in "the weeks to

come" to generate an acceptable piece of legislation. Congress Daily is quoted upon House passage that the result is now "placing additional pressure on Senate negotiators to strike a deal on a measure that resonates with the public." Clearly, the quintessential event was the overwhelming House passage and the associated signals clearly indicating to the market that the legislation would eventually pass the Senate and be signed by the President. This process culminated with the President signing the bill three weeks later on May 22, 2009.¹

To capture how the Credit Card Act affected stock prices, we use a six-day event window surrounding the announcement date as shown in Exhibit 1. Day zero, (t = 0), is the announcement date while day minus one, (t = -1), is one trading day before the announcement date. Day plus one, (t = +1), is one trading day after the announcement date, and so forth where day plus four, (t = +4), is four trading days after the announcement date.

Exhibit 1. Event Window for Credit Card Act of 2009						
Event Day	-1	0	+1	+2	+3	+4
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Event: House Passage of Bill	4/29	4/30	5/1	5/4	5/5	5/6

After identifying the six-day event window, we calculate the predicted return for each retailer for each day in the event window. The predicted return is what one would expect if there were no Credit Card Act. The predicted return is the daily market return of the S&P 500 Index which is commonly used as the predicted return since it represents America's 500 largest firms that account for approximately 75% of the U.S. stock market's value.

We then calculate the daily abnormal return for each retailer stock for each day over the six-day event window. The daily abnormal return, AR_{it} , for each retailer i on day t is defined as:

$$AR_{it} = R_{it} - R_{mt} \quad (1)$$

where R_{it} is the return on the stock of retailer i on day t and R_{mt} is the predicted return (S&P 500 Index) on day t . The daily abnormal return represents the return not predicted by the market index and is an estimate of the change in the stock price on that day due to the Credit Card Act.

We calculate cumulative abnormal returns for each retailer because in many cases the market reaction to the announcement of an event may linger for days. For example, it may take financial analysts and investors several days to determine the impact of the Credit Card Act upon future expected earnings. Thus, the cumulative abnormal return is an estimate of the stock return

¹ Credit card reform legislation has been long discussed in this country. Beginning in January 2009, the possibility of action started to take form. The difficulty in legislative actions is that bills can be killed, changed, delayed or let die in a variety of ways. Sunlight Foundation notes that in the 110th Congress just 4% or 442 of the 11,059 bills introduced became law. As such, we carefully read news releases to determine the point in which we believed the market could foresee that the possibility of passage moving towards the probability of passage. We determine that this occurs at the point of house passage. The authors have available, upon request, the results of the initial bill introduction which were statistically insignificant.

caused by the event over the six-day event window. The cumulative abnormal return, CAR_i , for each retailer i for the six-day event window beginning with day -1 through day +4 is defined as:

$$CAR_i = \sum_{t=-1}^{+4} AR_{it} \quad (2)$$

where AR_{it} is the daily abnormal return for retailer i on day t .

We then calculate the average cumulative abnormal return, $ACAR$, for the retailers in the sample which is defined as:

$$ACAR = \frac{1}{N} \sum_{i=1}^N CAR_i \quad (3)$$

where CAR_i is the cumulative abnormal return for retailer i and N is the number of retailers in the sample. The average cumulative abnormal return, $ACAR$, can be viewed as a diversified portfolio which eliminates unique individual stock returns by offsetting random positive stock returns with random negative stock returns. In summary, if the Credit Card Act did not impact the future earnings of retailers, then the $ACAR$ should not be significantly different from zero.

Lastly, we examine the percent of cumulative abnormal returns, CAR_i , that are negative for each event window. If the Credit Card Act did not impact the future earnings of retailers, then the percent of cumulative abnormal returns that are negative should not be significantly different from fifty percent.

V. Results

a. All Retailers

We examine all retailers in the sample and find they experienced an $ACAR$ of +2.87% which is significant at the ten percent level. This means these retailers, on average, saw their stock price increase 2.87% above expectations when the House passed the Credit Card Act. However, 58% of the retailers experienced a negative CAR . Thus, the results are mixed so we find little support that the House passage of the Credit Card Act impacted retailers either favorably or unfavorably as a group. Likewise, these results do not support that consumers necessarily benefited from the passage in the House. Table II provides a summary of all the test results.

b. Retailers without in-house credit card programs

Next, we examine the subsample of retailers without IHCC programs. When the House passed the Credit Card Act, these retailers experienced an $ACAR$ of +3.27% which is also significant at the ten percent level. Again, this result is tempered by the fact that the 50% of these retailers experienced a negative CAR . So the results provide little support that consumers benefited from the act as touted by legislators.

c. Retailers with in-house credit card programs

We now examine those retailers whose profit is a function of both: (i) the sale of merchandise and (ii) the financing of the sale through IHCC programs. While we find these retailers experience $ACAR$ of +2.44%, the result is not significant. As a secondary test, we

examine the binomial statistic and find just 66% of the retailers have a negative CAR which is significantly different from fifty percent at a ten percent level. The results are mixed and we find little or no support that the House passage of the Credit Card Act had a favorable impact on retailers with IHCC programs.

d. Size effect: large and small retailers with in-house credit card programs

In this section test whether there is a size effect by examining large and small retailers with IHCC programs. As with the earlier samples, we examine: (i) the ACAR and (ii) the percent of retailers that experience a loss, negative CAR. We also examine the retailer's absolute dollar change in market value of equity (ΔMVE) when the House passed the Credit Card Act. The ΔMVE is calculated by multiplying each retailer's MVE by its CAR. The ΔMVE represents the dollar amount that stockholders have gained or lost.

We find the large retailers experienced an ACAR of -3.46%. Additionally, we find that 78% of the large retailers experienced a negative CAR when the House passed the Credit Card Act. The test statistics on the ACAR and CAR are significant at the one and five percent levels, respectively. These test results strongly support that large retailers were negatively impacted by the passage of the Credit Card Act. Next we calculate the median and mean ΔMVE for the large retailers. For large retailers, we find the median and mean ΔMVE to be -\$143 million and -\$551 million, respectively. Based on the mean and median, the stockholders lost between \$143 million and \$551 million. This means that collectively, the stockholders of these eighteen large retailers lost \$9.9 billion (18 retailers x \$551 million loss). These results clearly support that large retailers suffered when the House passed the Credit Card Act.

The impact on small retailers is much different than that of the large retailers. We find the small retailers experienced a robust ACAR of +7.05%, but this number is not significantly different from zero at even the ten percent level due to significant variation in the ACARs of the sample. The binomial test supports this statistical finding as only 44% of the CARs are positive. When we examine the dollar impact (ΔMVE) on the small retailers, we find the median and mean ΔMVE to be -\$354,000 and +\$5 million, respectively. Thus, one summary measure shows stockholders lost money while the other measure shows stockholders gained. These results are weak and support that the House passage of the Credit Card Act had little impact on small retailers.

Our last test is to determine whether the ACARs of large retailers are statistically different from small retailers by conducting a difference of means test on the ACARs of both groups. There is a 10.5% difference in ACARs, significant at the five-percent level, which supports there is a major difference between the ACARs of the large and small retailers. In summary, when the House passed the Credit Card Act, investors perceived this as a significantly negative event for large retailers, but a nonevent for small retailers.

VI. Conclusions

On April 30, 2009 the House of Representatives passed the Credit Cardholders' Bill of Rights which subsequently became the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit Card Act). After passing in the House, the bill was quickly passed by the Senate on May 19, 2009 and signed into law by the President on May 22, 2009. While the Credit

Card Act was meant to impact commercial banks that issue credit cards, it also impacted retailers with in house credit card (IHCC) programs. Thus, we examine the impact of the House passage of the Credit Card Act on the retail industry. An event study methodology is used to isolate the immediate financial impact on that segment of the retail industry. When retailers without IHCC programs are examined, we find there is little financial impact on the retail industry. We find a similar result when we examine retailers with IHCC programs. However, when the retailers are subdivided into a sample of large and small retailers, we find only the larger retailers suffered significant losses when the House passed Credit Card Act. Large retailers, on average, suffered a loss of -3.46% in their stock price and 78% of the large retailers suffered losses. In dollar terms large retailers, on average, suffered a \$500 million loss in MVE and cumulatively, the eighteen large retailers lost almost \$10 billion in MVE. While the Credit Card Act may have benefited consumers, our results do not conclusively support this hypothesis. Furthermore, when we look specifically at large retailers with IHCC programs, we find they are significantly negatively impacted. When we examine the small retailers, we find they experienced neither significant gains nor losses.

This topic is open to additional future research in the areas related to the benefits and costs of store credit cards on the value of the operations. In our study, we divided the initial sample into two smaller subsamples based on the retailer's MVE for exploration. While the results were interesting, the next step for researchers would be to develop a data set with specific account information that details how store credit cards are utilized. This would enable the researcher to determine the value-added differentials of each practice or choice and help explain our results. This would then allow legislators to more better understand how their legislation will impact different organizations in the future.

Table I. Retailers and their market value of equity (MVE) as of December 31, 2008.

Large Retailers	MVE (\$ millions)	Small Retailers	MVE (\$ millions)
1. Home Depot, Inc.	36,493	1. Buckle Inc.	983
2. Costco Wholesale Corp	29,175	2. Dress Barn Inc.	972
3. Lowe's Companies, Inc.	26,802	3. PriceSmart Inc.	631
4. Target Corp.	23,487	4. J. Crew Group, Inc.	625
5. Best Buy Co. Inc.	11,915	5. Mens Wearhouse, Inc.	603
6. Kohls Corp.	11,186	6. Children's Place Retail Stores	553
7. TJX Companies, Inc.	8,085	7. HHGregg, Inc.	458
8. Gap Inc.	7,964	8. Saks Inc.	358
9. Bed Bath & Beyond, Inc.	5,532	9. Dillard's, Inc.	320
10. Sears Holdings Corp.	5,115	10. Lumber Liquidators Holdings	283
11. Macy's Inc.	3,764	11. AnnTaylor Stores Corp.	281
12. J.C. Penney Co., Inc.	3,720	12. Stage Stores Inc.	273
13. Nordstrom Inc.	2,733	13. Conn's, Inc.	273
14. American Eagle Outfitters	1,849	14. Coldwater Creek Inc.	257
15. BJ's Wholesale Club, Inc.	1,685	15. Charming Shoppes Inc.	123
16. Abercrombie & Fitch Co.	1,554	16. New York & Company Inc.	119
17. RadioShack Corp.	1,493	17. Talbots Inc.	112
18. Big Lots Inc.	1,094	18. Pacific Sunwear of California	81
		19. Syms Corp.	79
		20. Stein Mart Inc.	50
		21. Cache Inc.	27
		22. Casual Male Retail Group	16
		23. Eddie Bauer Holdings, Inc.	16

Table II. The impact of the U.S. House passage of the Credit Card Act of 2009 on retailers with and without in-house credit card programs (IHCCP) based on the average cumulative abnormal returns (ACAR), percent negative of cumulative abnormal returns (CAR), mean change in market value of equity (Δ MVE) per retailer, and cumulative Δ MVE for sample.

	Sample Size	ACAR (%)	Percent Negative CAR	Mean ΔMVE (\$ millions)	Cumulative ΔMVE (\$ billions)
I. Retailers with and without IHCCP	85	2.87***	57.7	-130	-11.0
A. Retailers without IHCCP	44	3.27***	50.0	-28	-1.2
B. Retailers with IHCCP	41	2.44	65.8**	-239	-9.8
1. Large Retailers with IHCCP	18	-3.46*	77.8**	-551	-9.9
2. Small Retailers with IHCCP	23	7.05	56.5	5	0.1

*, **, and *** denote significance at the 1, 5 and 10 percent levels, respectively; large retailers have a market value of equity of \$1 billion or greater; small retailers have a market value of equity of less than \$1 billion

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