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Statement
of
Chairman ~~K. A. Randall~~
Federal Deposit Insurance Corporation
before the
House Banking and Currency Committee
November 8, 1967

I am pleased to have the opportunity to appear before your Committee to testify on H.R. 12646, "a bill to prohibit federally insured banks from making unsolicited commitments to extend credit, and for other purposes." The bill proposes to add a new section to the Federal Deposit Insurance Act preventing the issuance of credit cards by federally insured banks except at the request of a prospective cardholder and then only if a written agreement is concluded between the issuing bank and the credit cardholder specifying the maximum amount of credit that can be outstanding at any one time.

The two provisions of the bill under consideration impose restraints on the issuance and use of bank credit cards. Viewed in the broader context of bank credit-granting activities, that is, the determination of creditworthiness and safeguards against the accumulation of excessive debt, the proposed restraints constitute but two facets of the sound credit practices already followed by every responsible bank management. This is not by itself sufficient, however, to warrant legislation at this time.

Recently the attention of bank managements and the supervisory authorities among others concerned with banking has been attracted by the activities of commercial banks in the field of credit cards and related plans. There are several reasons for the interest in this development. In the first place, these cards facilitate the extension of credit to consumers in new ways. Whether this amounts to anything more than a shift in the form of consumer financing and is actually a substantive change remains to be seen. Another important reason for this interest stems from the fact that individual banks make up a system with money-creating capabilities. Thus, any novel development in this field requires careful study with respect to the consequences in this vital sector of our economy. Finally, because bank credit cards are a relatively recent phenomena, they deserve attention so that problems can be discovered or anticipated before they become serious. For both bank and nonbank plans, it is obvious that abuses must be avoided or eliminated in order to protect the public interest.

The principal point that should be stressed at the present time is the fact that bank credit cards are an innovation in banking -- and for this reason are more likely to be afflicted with "growing pains" and oftentimes unanticipated difficulties. Many of these have proved in the past to be transitory in nature rather than fundamental. Once this stage is passed, the fundamentals of the situation emerge more clearly. Some innovations become an accepted part of our economy, while others are rejected through the test of the marketplace. In a private enterprise economy such as ours, this "winnowing-out" process is most effective.

A look at certain characteristics of our nation's development provides some clues as to why credit card plans are attracting great interest. Our population, in the first place, has become highly mobile as people move from rural areas to cities and as businesses operate increasingly on a national scale. As personal incomes rise and job security increases too, more people are willing to incur debt to finance current consumption of both durable and nondurable goods. With the advent of computers and improved methods for handling masses of data, moreover, the use of bank credit cards offers a possible means of eventually reducing the clerical workload presently involved in the clearance of financial transactions.

Credit cards and related plans being offered by banks can have a number of implications. Not only may they have some general impact on the economy by possibly altering patterns of consumer spending and saving, modifying the role of financial intermediaries, and revolutionizing our payments mechanism, but they can affect an individual bank's position significantly. An institution's loan portfolio may be more heavily weighted with the financing of consumption -- whether the consumer or the retailer, while the inflow of individual saving may decline relatively as consumption rises. Failure to enter the credit card business could place an institution at a competitive disadvantage. Participation, on the other hand, could make portfolio management more complicated because of outstanding lines of credit and necessitate the development of more sophisticated bank managers. In addition, a number of practical operating problems must be faced by a bank -- such as large start-up costs, the importance of a volume operation to spread overhead costs, and the need to develop good internal controls over various aspects of the program. This brief listing only touches on some of the ramifications of credit cards, but it serves to illustrate the complexity and multiplicity of problems and interactions that may be involved.

The Corporation is following the credit card situation in several ways. A page on bank credit cards and related plans has been added to our standard bank examination report. This material has been distributed to our fourteen District Offices for current use in field examinations. A copy is attached for your information. At the same time, we are cooperating with the Federal Reserve System in its study on bank credit cards and related plans and have asked insured nonmember banks for pertinent information.

Since last April, when the three Federal banking agencies first collected information on the number of banks holding credit card receivables and the amounts of credit outstanding, the number of banks adopting such plans has increased. (The April figures did not include banks that were carrying no credit under various plans.) A similar survey was conducted as of October 4, 1967. 224 insured nonmember banks reported $65 million in outstandings in October, compared to 165 insured nonmember banks with $52 million outstanding in April. Approximately 50 insured nonmember banks presently offer their own plans -- either as a full member of a statewide or regional plan or as an independent localized operation, while some 400 other insured nonmember banks -- out of 7,300 such banks -- provide credit card facilities of another bank but do not participate in the extension of credit.

Although the increase in credit outstanding under these various plans has been moderate, the potential for expansion is significant. One major plan did not begin operations until last July; thirty insured nonmember banks are members of this statewide plan that is also part of a proposed nationwide card interchange system. On October 4, 1967, these thirty banks reported some $6 million in outstandings under the plan. Another major regional system that entered the credit card field about a year ago provides for the eventual participation in varying degrees of the smaller banks affiliated with the plan as it becomes established. Thus, the involvement of banks in credit card activities is still only in its initial phases.

The broad ramifications of bank credit cards and related plans for consumer spending and financing, for economic activity in general, and for banking suggest that incorrect action could at this stage either hinder the development of a useful innovation or produce unforeseen and undesirable effects. We first need to know more about the basic implications of bank credit cards and related plans.

Bank managements, generally, and the supervisory authorities are in complete agreement that care in the issuance of credit cards and management control over their usage is absolutely essential. In this respect, bank credit cards are like any other phase of banking activities.

Irresponsible and high pressure efforts to persuade consumers to incur debt beyond their means certainly have undesirable social consequences. Not only is overextension of credit by banks bad for the individual bank and the entire banking community but all credit overextensions are bad irrespective of who extends the credit. Bank credit card plans typically require procedures for maintaining a very close tether on the individual card holder's use of the instrument. This is obviously good banking because a customer obligated beyond his means is simply a problem rather than an asset to the bank. Furthermore, bank examiners are concerned with unsound credit extensions -- however they occur -- and weak procedures in controlling the extension of credit to consumers through the medium of credit cards or otherwise. Such situations would be brought to the attention of the supervisory authorities, bank managements, and bank directors by means of the bank examination report as undesirable practices that should be discontinued.

Viewed narrowly, bank participation in credit card plans to date has not increased the exposure of the deposit insurance fund nor called for action by the Corporation beyond routine examination procedures. Most, if not all, banks and plans maintain controls and safeguards on the issuance and use of credit cards. Some situations that occurred in the inauguration of bank credit card plans engendered losses, some of them large and of an obviously unusual nature. Typically, these were not credit losses. These losses, moreover, have not been of such proportions as to necessitate action by the Corporation.

Premature and inappropriate legislation on credit cards could damage the banking system. As with any innovation, there is need for a period of testing. The supervisory authorities have sufficient powers to give banks a desirable degree of freedom to experiment within the framework of responsible banking. By permitting such testing, bank customers will benefit from the development of new and better methods of doing business. In this way, consumers will gain access to sources of credit that they can use properly and consistently with their earning power. This is a socially desirable objective.

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Examined Close of Business ____________ Number ____________

INSTALMENT CREDIT QUESTIONNAIRE (3)

7. Credit cards:

(a) Name of charge plan ____________ Date services offered by subject bank ____________

Bank's own plan ( ); Franchise plan ( ).

(b) Trade area serviced ____________. Number of credit card plans presenting significant competition operating in the bank's normal trade area: Offered by banks ____________; By others ____________.

(c) Approximate number of outlets ____________; Card holders ____________; Active card holders ____________; Accounts settled during interest free period ____________.

(d) Features included in credit card plan: Cash advance privilege ( ); Check cashing ( ); Overdraft privilege ( ); Travel and entertainment ( ); Revolving credit ( ); Other ( ) explain.

(e) Record of credit cards and related records of credit extensions are kept on own computer ( ); Off-premises computer service ( ); Other ( ) explain.

(f) Are cards issued without formal application? If answer is yes, describe basis for distribution.

(g) What limitations are imposed on issuance of cards with respect to annual income, net worth, maximum credit for each account, or other conditions?

(h) What credit checks are made?

(i) What is the expiration period of cards?

(j) What limits are in effect at outlets and what system is used to check transactions above these limits?

(k) What method is employed to prevent the use of lost, stolen or cancelled cards?

(l) What provision has been made for control of unissued cards?

(m) If bank's own plan and start-up costs have not been recovered, state approximate amount expended and date expected to be recovered.

(n) If not bank's own plan, state franchise cost ____________; Annual renewal charges ____________; Other costs of maintaining plan ____________ (explain).

(o) If not bank's own plan, what revenues accrue to the bank and on what basis are they computed?

(p) Average percentage of discount charged participating retailers ____________; Maximum ____________; minimum ____________.

(q) What is the monthly interest rate to consumer?

(r) What monthly payment is required (1/10, 1/20, etc.)?

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Examined Close of Business ______________ Number ______________

INSTALMENT CREDIT QUESTIONNAIRE (4)

7. Credit cards: (Continued)

(s) What is the charge-off policy?

(t) Comparative report of average quarterly balances outstanding and net charge-offs for the past three calendar years:

	19____	19____	19____
Average balance	______	______	______
Net charged off (or recovered)	______	______	______
Net charge-offs to average balance	______%	______%	______%

(u) Does the bank carry special insurance to cover losses resulting from misuse of credit cards? If a franchise plan, does the sponsoring organization absorb or share such losses?

(v) Other comments:

8. Comments: