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Statement of

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Member, Board of Governors of the Federal Reserve System

before the

Committee on Banking and Currency

House of Representatives

on

H.R. 12646

To Prohibit Federally Insured Banks from Making Unsolicited Commitments to Extend Credit, and for Other Purposes

November 8, 1967

I appreciate this opportunity to explore with you some of the questions raised by the entry of commercial banks into the credit card field, and to comment on behalf of the Board of Governors on H.R. 12646. This bill would prohibit any insured bank from issuing a credit card unless the person to whom the card is issued has requested it and has entered into a written agreement with the bank specifying a dollar limit on the amount of credit that may be outstanding under the card.

The Board welcomes the interest this Committee is showing in the problems associated with large-scale bank entry into the credit card field. We, too, have been concerned about certain aspects of this development, and we have taken several steps to keep ourselves better informed and to strengthen our bank examination procedures. At the same time, however, the Board also believes that any decision as to whether legislation is needed in this field should take into account not only the necessity for assuring the safety and soundness of the banking system, but also other considerations--such as the need to avoid discouraging innovations in banking that will contribute to public convenience. We doubt that the problems involved in guarding against unsafe or unsound practices in this area are so pressing as to require immediate legislative solutions. Time is available--and we think it should be used--for a careful consideration of all relevant issues.

Needed Scope for Bank Innovations

I shall focus on the specific provisions of this bill at a later point. But let me say at the outset that there is an important difference between requiring that banks use care in selecting people to whom they mail credit cards and that they mail cards only to those who have asked for them. It is probable that the latter restriction would seriously hamper banks in launching new credit card plans, giving those banks already in the field a protected position and discouraging competition--at least for a time.

Moreover, we need to be careful not to discourage banks from experimenting in developing improved ways to serve the public, including consumers. Certainly banks have been criticized in the past, often with justification, for their failure to recognize developing needs for credit and for lack of imagination in devising ways to meet these needs. In determining whether statutory restrictions upon bank credit cards are needed, care should be taken not to deny the public the advantages of continued innovation in the provision of banking services.

Development and Scope of Credit Cards

Before proceeding further, it might be helpful if we tried to place the development of bank credit cards in perspective.

Credit cards for consumer purchases have been with us for over half a century. Oil companies and large department stores were the first to find this device a useful method for handling consumer purchases on credit. After World War II, we saw the development of the national travel and entertainment cards such as Diners Club, Carte Blanche and American Express. A few commercial banks entered this field in the 1950's, but many of them found the credit card business unprofitable--or less profitable than anticipated--and discontinued their operations. It was not until late 1966 that banks began to enter the field in significant numbers.

As of April 27, 1967, 627 insured commercial banks reported some outstanding credit under either credit card or check credit plans and the total amount reported was $809 million. We have just completed a tabulation of the comparable information reported to the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Federal Reserve in the October, 1967, Call Report. This latest tabulation shows that, on October 4, 848 insured commercial banks reported total outstanding credit of $1,137 million under credit card and check credit plans. In addition to the banks reporting outstanding credit under credit card plans, almost 700 banks reported participating through agency arrangements under which they hold no outstanding credit.

Increases from April to October, both in number of banks involved and in the amount of credit outstanding, were reported for all sections of the country and for each of the three classes of banks. The Chicago Federal Reserve District--with 173 banks involved--led all others in the number of banks participating in various credit card and check credit plans, with Atlanta, San Francisco, and New York following somewhat further behind.

The 503 national banks again constituted about three-fifths of the total number; State member banks (numbering 121 institutions) remained at one-seventh of the total, and the 224 insured nonmember banks amounted to a little over one-fourth of the total. The expansion in the number of banks involved reflected the entrance into the field of many smaller and medium-sized banks in recent months. Nearly one-half of the increase was accounted for by banks with total deposits between $10 and $50 million, and another one-fourth of the increase represented the entrance of banks with deposits of from $50 to $500 million.

The October report provided separate information for the major types of credit card and check credit plans. A sizable number of banks were involved in more than one type of plan. Thus, while 848 banks reported outstanding credit balances, the outstandings were--in fact--generated by more than 970 different plans.

Another finding of considerable interest and significance was that the number of banks offering check credit plans was much larger than the number of banks with credit card operations. Indeed, the ratio of the check credit banks to credit card institutions was more than 2 to 1--579 banks to 258. On the other hand, the total business generated by check credit plans was not nearly so great as that arising under credit cards. Credit card outstandings amounted to $640 million as of October 4, while check credit balances came to only $481 million.

Finally, it may be noted that a sizable number of banks--136 in all--have working arrangements involving cards issued by the national travel and entertainment credit card companies. Most of these banks, however, have their own check credit plan as well.

Tables summarizing the credit card information from the April and October Call Reports are attached to this statement.

The total amount reported outstanding by all insured commercial banks under credit card and check credit programs now amounts to only about 3 per cent of the total consumer instalment credit held by banks and to a little over one per cent of total consumer credit outstanding. As existing programs are expanded, however, and as additional banks enter the credit card field, the volume of such credit will grow and its ultimate impact on the economy will become more evident.

Thus, it is reasonable to expect that bank credit cards will contribute to the growth of consumer credit; but it is also reasonable to expect that this growth will continue at about the rate that has existed throughout much of the period since World War II. Over the last decade, the total amount of consumer credit outstanding has grown from a little under 14 per cent of disposable personal income to about 17.5 per cent. The rate of growth of retail charge accounts and revolving credit, the segment which will be primarily influenced by bank credit cards, has been quite modest, increasing from about 1.8 per cent to 2 per cent of disposable personal income over the last ten years. We have no basis for concluding that bank credit cards will cause any sharp divergence from these trends, which have primarily been a reflection of gradual changes in the payments habits of consumers.

Moreover, there are several factors limiting the expansionary impact of bank credit cards that will probably continue for some time in the future. First, some of the credit extended under bank credit card plans has been a replacement for existing credit. Many of the merchants signed up under bank credit card plans are using the bank plans to substitute for their own former credit arrangements. This is particularly true of speciality shops and small- and medium-size retail merchants. In addition to this kind of substitution, the cash advances provided under both credit card and check credit plans are frequently being used in place of small personal loans.

Many holders of bank credit cards have used them primarily as a convenience in facilitating payments rather than as a means of increasing their debt balances. Between a fifth and a third of cardholders under established plans pay off their credit card balances each month; in the initial stages the proportion is higher. Those that pay off in instalments are repaying substantial portions each month. Under existing plans, the minimum monthly repayments permitted range from 5 to 10 per cent and the average repayments exceed this minimum.

Federal Reserve System Research Effort

The Federal Reserve System in March of this year organized a special research effort to study bank credit card and check credit operations. This study will assemble comprehensive information on the nature of the various credit card and check credit plans now in use by banks; assess the implications of bank activities in this area for bank competition, bank supervision, and banking structure; compile data on the amount of this type of credit in relation to the total volume of consumer credit; and evaluate the impact that its further expansion may have on the financing of consumer expenditures and on consumer savings.

Substantial headway has been made on this assignment. A considerable number of personal interviews have been conducted with bank officials and other executives responsible for the development and management of the principal credit card and check credit plans. With the cooperation of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, special questions on the amount of bank credit outstanding under such plans were added to the April and October Call Reports to provide benchmark information on the extent of bank activity in this field. A system of current monthly reporting of credit extended and the amount outstanding under bank credit card and check credit plans has been developed. The first statistical report under this program will cover operations during the coming month.

In continuing our study, we will conduct within the next few weeks a complete survey of all banks with credit card and check credit plans to supplement the information we now have and to obtain the necessary information for a comprehensive analysis by size of bank and geographic distribution. This survey will cover not only the major features of the various plans, but also information on operations, such as number of cardholders, number of active accounts, number of merchants, and delinquency and loss experience. We shall also develop information on the major non-bank credit card plans to provide the necessary perspective for evaluation of the bank plans.

We hope that the results of our study and analysis, as they become available, will assist the deliberations of this Committee in this area.

Strengthening of Bank Examination Procedures

In the meantime, to identify any major deficiencies in the credit card and check credit plans operated by State member banks and to keep informed of developments in their operation, the Federal Reserve System has strengthened its examination procedures to include a supervisory review of such plans.

Under the new procedures, the System's examiners are reviewing and appraising the policies and practices followed by State member banks in establishing and operating these plans, as they do with all other forms of bank credit. As indicated on the attached copy of the examination report page recently adopted for these plans, examiners ascertain the trend in total volume of receivables or billings since inception of each plan and the maximum volume the bank expects to attain, as well as the credit limits and repayment requirements in effect under each plan. They also look into the total number and volume of delinquent accounts, the bank's policy for charging off such accounts, and its loss experience. More importantly, however, any unsatisfactory features or deficiencies in the operations of the plan--such as failure to investigate properly the creditworthiness of the individual customers and the integrity of the participating merchants, ineffective collection practices, lack of control over unissued cards, or inadequate procedures for reclaiming delinquent cards--are called to the attention of management and immediate correction is requested.

But I would also like to stress that we do not look upon our strengthened examination procedures as a vehicle for relieving banks of their own responsibilities in the credit card field. We must rely in the first instance on bank management to exercise particular caution in venturing into this new field and to weigh carefully the lessons that may be learned from the experience of the innovating banks. It is reassuring that those banks that experienced the most difficulty with their initial mailings of credit cards have subsequently taken steps to tighten their procedures. Other banks that have entered the credit card field more recently have taken precautions against a repetition of the earlier experiences of banks that ran into difficulties.

These hearings should aid in evaluating these practices and in reminding bankers that the essential requirements of sound credit administration--including maintenance of proper credit appraisals, controls to minimize losses from unauthorized or improper use, and insistence on appropriate collection methods--apply to credit cards and check credit plans as well as to other forms of credit.

Loss Experience

As is generally known, it is costly to launch a credit card operation, and many banks have had to absorb losses during the start-up phase. However, to date, the losses have had a relatively minor effect on bank earnings because lending through credit cards has represented a minor share of total bank operations. We know of no instance in which a bank's capital was impaired because of losses incurred through credit cards.

With respect to current operations, the information that we have been able to gather on well-established credit card plans indicates that losses on credit extended to cardholders compare favorably with comparable types of consumer credit extensions. Data for a few banks show credit card losses ranging from one-half to one per cent of the amount of credit extended. For all banks, losses on consumer instalment credit have averaged about one-half of one per cent in recent years. In comparison, the loss ratio on personal loans has been roughly two-thirds of one per cent.

Distribution of Unsolicited Credit Cards

The mailing of unsolicited bank credit cards has attracted considerable attention. We have attempted to analyze this practice with some care, and we would like to share our tentative conclusions with the Committee.

Inducements for Mass Mailings: Mass mailings need not involve unsolicited issuance of credit cards. However, banks have found both practices to be desirable in launching credit card operations. This does not mean that the individuals to whom cards have been sent have not been selected with some care. Experience has varied on that point. All of the banks that we have contacted reported that they found it desirable in launching their credit card plans to send out cards unsolicited to mailing lists in order to develop a body of active accounts as quickly as possible. The banks did this with the realization that there would be some problems and some losses during the initial stages. But, as a matter of business judgment, they found this procedure helpful in order to sign up merchants. They believed that the total costs of launching their plans would have been less, even including losses, than would have been the case if a slower buildup had been undertaken through requiring individual applications for credit cards. All of the banks contacted, however, indicated that after their plans had been launched in this fashion they relied primarily on applications as a source of new cardholders.

Characteristics of Mailing Lists: The initial mailings of credit cards, while unsolicited, were on a selective basis. The banks started with lists of their customers--some using primarily demand deposit customers while others also used savings deposit and loan customer lists. Some banks also used lists of prominent individuals compiled by their bank officers. All of the banks undertook some screening of customer lists, although some banks were more careful in checking the lists than others. In some cases, a credit check was made through outside credit bureaus, but in a few instances screening was limited to eliminating those names which had balances below a certain minimum or adverse credit repayment records. It does appear that a very few banks also used mailing lists obtained from outside their banks.

Objections to Unsolicited Mailings: One objection has been that many people received two or more credit cards and that cards were sent to babies and small children. This did occur to some extent because deposit account lists were used and the checking to eliminate duplicate names was not always as thorough as it should have been. Furthermore, some persons have several accounts under slightly different names or at different banks, and the elimination of all such duplication is almost impossible. Babies with sizable savings accounts (frequently opened by grandparents) could not readily be distinguished from adults. While this situation gave rise to some annoyance, it does not appear to have caused any serious problems.

Another objection to the unsolicited mailing is that bank customers have been irritated by receiving one or more credit cards which they did not want and have felt obliged to take the trouble to destroy them. But our information is that the proportion of complaints that banks have received has been quite low, amounting to much less than one per cent of the cards mailed, and the number of such complaints has been far exceeded by the number of people who have welcomed the receipt of an unsolicited card sufficiently to use it. Indeed if this were not the case, bank credit cards would rapidly decline in number, and their usage would shrink sharply.

Opportunity for Fraud: The opportunity for fraud that accompanies some of the mass mailing has been viewed with considerable concern. The Federal Reserve System shares that concern. The difficulty appears to stem not only from problems of security control in the initial mailing arrangements, but also from other thefts, and from cards being sent to persons who are bad credit risks and who misuse their credit cards. Most of the banks have taken adequate precautions in the mailing process, sometimes working closely with the postal authorities, and most have done an adequate job of screening their customer lists to remove most of the poor credit risks. The headlines have been made in the few cases in which careful procedures have not been followed. As I mentioned before, those banks that have launched credit card programs most recently appear to have learned this lesson well and the problems have been kept to a minimum.

Dollar Limits on Credit Outstanding

In addition to prohibiting insured banks from issuing unsolicited credit cards, H.R. 12646 would require a written agreement between the bank and the cardholder specifying a dollar limit on the credit that may be outstanding under the card.

To a considerable degree such a requirement would duplicate existing practice. All of the bank credit card and check credit programs of which we have knowledge specify a credit limit for each customer's account. They also have an additional control through the "floor limit" on individual credit card purchases. This limit, which is usually $25 or $50, requires the merchant to call the bank for specific authorization for any purchase that is above the limit.

As they gain experience, some banks raise the total credit limits for those customers who have good repayment records and whose credit purchases are pressing on their existing credit limits. For some banks, these changes in credit ceilings require the specific application of the customer--but for other banks they do not. In the latter cases, the customer may not be aware that his credit limit has been changed. We believe that the credit card customer should be fully informed at all times as to his credit limit. In particular, we are hopeful that the practice--already followed by some banks--of noting the credit limit on each monthly bill will be generally adopted.

Concluding Comments

In summary, the Board is concerned about the problems inherent in bank entry into the credit card field. We have strengthened our examination procedures to help ensure that sound credit standards are maintained in credit card operations by State member banks. But supervisory procedures cannot substitute for the exercise of sound judgment by bank management; we expect banks to recognize the risks in this field and make special efforts to ensure that the risks they take are prudent ones. We are engaged in a careful study of the implications of bank credit cards and check credit plans not only from the standpoint of safety and soundness of bank operations, but from other points of view as well. We will be glad to share the results of this study with the Committee.

The Board suggests that it would be wise to defer action on legislation in this area until further experience, study, and systematic appraisal have shed additional light on the extent and character of the problems involved.

TABLE I

BANK CREDIT CARDS AND CHECK-CREDIT PLANS
Total Credit Outstanding as of October 4, 1967
(Amounts in millions of dollars)

ALL BANKS

Federal Reserve District	Credit Cards		Executive Credit and Related Plans*		Check-Credit		All Plans	
	No. of banks	Total credit	No. of banks	Total credit	No. of banks	Total credit	No. of banks**	Total credit
1. Boston	17	22	7	#	55	54	65	76
2. New York	16	66	33	8	57	95	84	169
3. Philadelphia	6	17	4	#	40	62	47	79
4. Cleveland	7	27	3	#	39	34	43	61
5. Richmond	8	29	6	#	25	17	37	46
6. Atlanta	25	33	26	2	65	22	101	57
7. Chicago	69	126	14	1	111	53	173	180
8. St. Louis	15	12	8	1	45	11	57	25
9. Minneapolis	12	#	2	#	36	5	49	6
10. Kansas City	5	6	10	#	42	10	52	16
11. Dallas	9	8	3	#	29	4	40	13
12. San Francisco	69	294	20	2	35	114	100	410
Total	258	640	136	16	579	481	848	1,137

* Revolving credit tied in with the Credit Cards issued by American Express, Carte Blanche, Diners Club.
** May not add across, since some banks offer more than one type of plan.
\# Less than $500,000.

TABLE II

BANK CREDIT CARDS AND CHECK-CREDIT PLANS
Total Credit Outstanding as of October 4, 1967
(Amounts in millions of dollars)

Federal Reserve District	National Banks		State Member Banks		Insured State Nonmember Banks		All Banks	
	No. of banks	Total credit	No. of banks	Total credit	No. of banks	Total credit	No. of banks	Total credit
1. Boston	43	52	14	21	8	3	65	76
2. New York	36	90	30	67	18	12	84	169
3. Philadelphia	28	26	9	45	10	8	47	79
4. Cleveland	30	60	5	#	8	#	43	61
5. Richmond	21	28	5	16	11	2	37	46
6. Atlanta	70	48	7	4	24	5	101	57
7. Chicago	93	125	22	45	58	10	173	180
8. St. Louis	28	21	6	2	23	2	57	25
9. Minneapolis	37	5	3	#	9	#	49	6
10. Kansas City	39	14	5	2	8	#	52	16
11. Dallas	25	4	3	2	12	7	40	13
12. San Francisco	53	364	12	31	35	16	100	410
Total	503	838	121	235	224	65	848	1,137

Less than $500,000.

Table III

Distribution of Insured Commercial Banks
Reporting Credit Card and Check-Credit Plans
October 4, 1967

By size of bank

Amount of deposits (millions of dollars)	Number of banks			
	Credit Cards	Executive Credit*	Check-Credit	Total**
Under 5	12	6	21	38
5 - 10	39	9	37	85
10 - 25	46	18	117	170
25 - 50	38	21	111	157
50 - 100	34	28	87	130
100 - 500	56	39	144	194
500 - 1,000	15	6	32	38
over 1,000	18	9	30	36
	258	136	579	848

By amount of credit outstanding

Amount of credit (thousands of dollars)	Number of banks			
	Credit Cards	Executive Credit*	Check-Credit	Total**
Under 25	85	75	173	287
25 - 50	16	15	66	91
50 - 100	18	12	76	95
100 - 250	25	19	87	110
250 - 500	24	6	52	71
500 - 1,000	18	6	45	62
1,000 - 10,000	60	3	68	103
over 10,000	12	-	12	29
	258	136	579	848

* Revolving credit tied in with the Credit Cards issued by American Express, Carte Blanche, Diners Club.

** May not add across, since some banks offer more than one type of plan.

Table IV

BANK CREDIT CARD AND CHECK-CREDIT PLANS
Total Credit Outstanding as of April 25, 1967
(Amounts in millions of dollars)

Federal Reserve District	National banks		State member banks		Insured State non-member banks		All banks	
	No. of banks	Total credit	No. of banks	Total credit	No. of banks	Total credit	No. of banks	Total credit
1. Boston	28	44	11	13	8	2	47	59
2. New York	34	61	25	46	11	9	70	116
3. Philadelphia	23	20	7	40	9	6	39	66
4. Cleveland	27	54	1	*	8	1	36	55
5. Richmond	16	18	5	12	7	2	28	31
6. Atlanta	51	40	7	3	23	5	81	48
7. Chicago	78	95	12	18	48	9	138	122
8. St. Louis	22	10	6	2	17	2	45	13
9. Minneapolis	15	4	1	*	6	*	22	4
10. Kansas City	29	10	6	1	5	*	40	12
11. Dallas	19	3	3	2	11	5	33	10
12. San Francisco	30	248	6	13	12	11	48	272
Total	372	607	90	150	165	52	627	809

* Less than $500,000.

Table V

Distribution of Insured Commercial Banks
Reporting Credit Card and Check-Credit Plans
April 25, 1967

By size of bank

Amount of deposits (millions of dollars)	Number of banks
Under 5	27
5 - 10	58
10 - 25	113
25 - 50	103
50 - 100	98
100 - 500	159
500 - 1,000	36
Over 1,000	33
	627

By amount of credit outstanding

Amount of credit (thousands of dollars)	Number of banks
Under 25	194
25 - 50	50
50 - 100	71
100 - 250	87
250 - 500	61
500 - 1,000	65
1,000 - 10,000	77
Over 10,000	22
	627

CREDIT CARD AND CHECK CREDIT PLANS

CREDIT

1. Briefly describe the nature and type or types of (1) credit card or check credit plans operated by the bank, (2) credit card plans with which the bank is affiliated and acts as licensee or agent, and (3) credit card plans of an association of banks in which the bank participates. Indicate name of plans, date each plan was placed in operation, and, where applicable, include terms of any licensing arrangements, number of cards distributed or accounts approved, number of active cards or accounts, number of merchants participating, total unpaid balance of receivables or billings acquired for each type of plan offered.

2. Describe any credit card interchange system in which the bank participates and indicate terms of the interchange agreement.

3. Indicate the trend in the total volume of receivables or billings since inception of each of the plans offered and state the bank's estimate of the maximum volume it expects to attain.

4. Does the bank obtain adequate credit information on individual customers before granting credit cards or approving check credit?

5. What are the maximum credit limits under each plan?

6. Describe the repayment requirements of each plan.

7. Are participating merchants required to obtain prior approval on credit card transactions over a stated amount? If so, what are the limits?

8. (a) What are the rates charged cardholders and check credit accounts?
   (b) State the initial fee charged the participating merchants, the discount rate for sales drafts, and rebate terms, if any.

9. (a) State the bank's charge-off policy on delinquent accounts and indicate the number and total amount of delinquent accounts.

PAST DUE
(000 omitted)

	30-89 days		90 days or more		Total		Per Cent of Total Outstanding		Estimated Losses	
Accounts	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount
Credit cards										
Check credit										

(b) State the amount of net losses during the past three calendar years:

19........ $............................... 19........ $............................ 19........ $...............................

10. Describe any unsatisfactory features of the operation of the plans offered, other than those discussed above, such as lack of control over unissued credit cards, ineffective collection policies and practices, inadequate procedures for reclaiming credit cards when accounts become delinquent, lack of preprinted expiration dates on credit cards, failure to investigate merchants before they are enrolled in the plan, lack of provisions which limit the amount for which a check in a check credit plan can be drawn, and any other deficiencies in policies or practices.