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Statement of
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Member, Board of Governors of the Federal Reserve System
before the
Subcommittee on Special Small Business Problems
of the
Select Committee on Small Business
House of Representatives

June 10, 1970

I appreciate the opportunity to appear before this Committee to discuss the recent developments in the bank credit card field and to explore with you some of the implications of these developments on the financing of consumer expenditures.

The use of credit cards for consumer purchases is not a new technique. Oil companies and large department stores first developed this device over half a century ago, but it was not until the rapid expansion of credit cards, especially bank credit cards, in recent years that they attracted widespread attention. The first credit cards were developed by the retailers themselves in order to encourage customer loyalty to a particular oil company or retail merchant. The development of the national travel and entertainment cards such as Diners Club, Carte Blanche and American Express after World War II introduced a new concept in which the credit cards were issued by a financial institution for use at a large number of retail merchants located throughout the country. A few commercial banks entered this field in the 1950's dealing primarily with cardholders and merchants in their local areas. But many of these banks found the credit card business unprofitable-- or less profitable than anticipated--and discontinued their operations. In late 1966, however, banks began to enter the field in significant numbers and by now nearly all of the major banks in the country, and a large proportion of the smaller banks, engage in credit card operations. In order to expand their scope of credit card operations and compete with the travel and entertainment cards, the banks soon developed regional

interchange arrangements and these have now expanded to national interchange systems. As you know, most of the banks now engaged in credit card operations are members of either the Interbank (Master Charge) or BankAmericard organizations.

When the rapid expansion of bank credit cards began in late 1966, we in the Federal Reserve System saw the need for studying this development and for instituting current information to permit monitoring the rapid growth of this mode of financing of consumers and merchants. We were concerned with the implications of the widespread use of bank credit cards for the financing of consumer expenditures and the effect on bank competition and the banking structure as well as bank supervision and the management of monetary policy.

Reflecting this concern, in March 1967, the Federal Reserve Board established a System-wide group to assess the implications of the rapid development of bank credit card operations. Throughout the period of this project, I maintained liaison between the System Task Group and Members of the Board. A Federal Reserve System Report on this study, Bank Credit-Card and Check-Credit Plans, was released in July 1968. The conclusions of that study were that credit cards and check credit are both legitimate and useful services of banks and that the System has sufficient supervisory power to take care of unsafe and unsound bank practices in this area. During the period of this study, efforts were made to expand the current reporting of credit information by banks to provide data from semiannual reports of condition on the number of banks with credit card operations and the amount of

receivables involved and also to obtain from our monthly reports of bank consumer credit activities information on the volume of credit extended and the amount of credit outstanding. This current information has enabled us to keep abreast of bank credit card developments subsequent to the completion of the System study.

Also in late 1967, the Federal Reserve System strengthened its examination procedures 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. Under these procedures, the System's examiners review and appraise 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. 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. The other Federal banking agencies are following similar practices with respect to the banks they examine.

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.

Under the criteria being followed by banks for issuing credit cards, bank credit card operations are generally sound from the point of view of the consumer as well as the bank. Banks are taking care to see that the people to whom credit cards are sent are able to meet obligations within the established limits.

A review of reports of examination received during the past nine months for 77 State member banks with credit card plans indicates that they have exercised prudence in credit card management.

While unsolicited mailings were found to have been the principal means of distributing cards, no significant problems were uncovered--certainly none of the magnitude of the difficulties surrounding the Chicago episode of late 1966 and early 1967.

Unsatisfactory features drawing comments of examiners are as follows:

<u>Problem</u>	<u>Number of banks</u>
Inadequate credit investigation	5
Lack of control over unissued cards	1
Inadequate collection policies and practices	4
No preprinted expiration dates ^{1/}	2
Lack of control on customers exceeding limits	2
Slow processing of items	1

^{1/} Plans became effective in the 1950's, and no problems have been encountered.

In each of these instances, steps were taken by bank management to correct the unsatisfactory features noted by Federal Reserve bank examiners.

Recent Trends in Credit Card Banking

At the end of 1969, 1,207 insured commercial banks were offering credit card plans with a total of \$2.6 billion of credit outstanding. In addition, several thousand banks participated as agents for the banks with credit card plans but did not hold any receivables. In just a little more than two years since September 30, 1967, the date of the Federal Reserve System Study, the number of banks operating their own plans has increased six times while the amount of credit outstanding has quadrupled (See Table 1). Expansion of bank credit card activity was especially rapid in 1969 when the number of banks with plans increased by 697 or 137 per cent and the amount of credit outstanding doubled.

The share of total credit card balances held by each class of bank has changed little during this period. National banks continue to hold about three-quarters of the total while another one-sixth is held by Federal Reserve State member banks. Although the amount of credit outstanding at nonmember banks under credit card plans remains small, about 3 per cent, the number of such banks with credit card plans has been increasing more rapidly than for any other class of bank. At the end of 1969, 434 nonmember banks reported credit card receivables, over one-third of all credit card banks. This is evidence of the increasing role that the smaller banks are playing in the credit card field.

More direct evidence of the increasing credit card activity of the smaller banks is given in Table 2. As of the end of last year 544 banks with deposits of less than \$25 million in total deposits had credit card plans in operation as compared with 61 banks of that size on September 30, 1967. These banks, which constituted over two-fifths of the total number of credit card banks, however, held only about 2 per cent of the total credit card receivables, about the same as twenty-seven months earlier. The very large banks continue to hold the bulk of the credit card receivables, but their share is gradually declining. At the end of 1969, the credit card banks with total deposits of \$1 billion and over held 46 per cent of the total of such credit outstanding, down from the 64 per cent that the credit card banks in this size group held twenty-seven months earlier.

As of the end of 1969, supplementary information on bank credit cards was obtained from the Report of Call. This report shows that at that time all insured commercial banks had nearly 60 million credit cards outstanding, and about 17.5 million credit card accounts had balances outstanding at the end of the year. (See Table 3). The accounts with balances outstanding at any one time cannot be taken as the complete measure of the number of active accounts since not all credit card accounts are used every month.

The year-end report also showed total charge-offs on credit card accounts for the year 1969 to be about \$70 million. This was equal to 2.7 per cent of the amount of credit outstanding on such accounts at the end of the year.

Monthly Series

In addition to the bank credit card information obtained every six months in the Call Reports, monthly data on credit extensions, repayments and amounts outstanding have been collected since the beginning of 1968 (See Table 4). This series has been published as part of the Board's monthly report on consumer credit since June 1968. The monthly data show little increase in the amount of credit outstanding under bank credit card plans during the first quarter of 1970. This stability in the early months of the year, however, appears to be primarily a seasonal pattern that also occurred in early 1968 and 1969. Also, the April expansion has been less than in either of the two preceding years.

Another measure of the rapid growth in bank credit card operations is the increase in the amount of credit extended over the last two years, as shown in Table 4. In 1969, credit extended under bank credit card plans amounted to an estimated \$3.8 billion, about 80 per cent more than in 1968. Approximately \$1.1 billion of such credit was extended in the first quarter of this year, an increase of nearly 75 per cent from the first quarter of last year.

After more experience has been gained with this monthly series it will be possible to quantify the seasonal factors involved and to prepare a seasonally adjusted series. Another limitation of the reported monthly totals is a slight understatement because of the lag in allowing for additional banks that continue to enter the credit card field. Because of the sharp expansion in the number of banks entering the credit card field in the last half of 1969, the disparity increased to \$300 thousand, or a little over 10 per cent at the end of 1969. We are now in the process of developing adjustment factors to correct for this understatement.

Regional Growth Patterns

The western section of the country, which was the first to develop bank credit cards on a large scale, continues to be the area most active in credit card banking, but this technique of consumer financing is spreading rapidly in other regions of the country (Table 5). At the end of last December, 132 both member and nonmember banks in the San Francisco Federal Reserve District had \$694 million of receivables outstanding under credit cards, representing 11 per cent of all the banks

with such plans and about one-fourth of the total credit. This was a substantial decline from the share held by the San Francisco District at the time of the System study when it accounted for one-third of the banks with credit card plans and nearly one-half of the credit outstanding.

In terms of amount of credit outstanding, the New York Federal Reserve District was second with \$438 million or 17 per cent of the total. This represented a substantial increase from the 10 per cent share held on September 30, 1967. Rapid expansion of credit card operations have occurred in both the Richmond and Atlanta Districts. At the end of 1969, these two Districts accounted for a little over one-fourth of the banks with credit card plans and hold about one-fourth of the amount outstanding, more than twice the shares they held on September 30, 1967. The Boston and Cleveland Federal Reserve Districts have also shown a rapid expansion in bank credit card activities, particularly in the last half of 1969. While the Chicago District had 13 per cent of the banks with credit card plans, at the end of 1969 they held a little less than one-tenth of the amount of credit outstanding, as compared with nearly one-fifth of the total twenty-seven months earlier.

Holder Characteristics

Evidence that the public accepts the credit card as a useful innovation in banking is contained in a Survey of Consumer Awareness of Credit Costs, conducted for the Board in mid-1969. Just over one-quarter of the 5,137 respondents interviewed in that survey possessed a bank

credit card (See Table 6). The proportion of households with bank credit cards increased steadily as the level of education and income rose.

While only 13 per cent of the respondents with grade school educations had bank credit cards, the proportion was 27 per cent for high school graduates and 40 per cent for college graduates.

With respect to personal income, the same trend is evident. Only 10 per cent of respondents with incomes under \$3,000 reported having a bank credit card. In the income range \$5,000-7,999, about one-fifth of the households reported having such a card. In the range \$10,000-14,999, the proportion was 34 per cent, while for those with incomes over \$15,000 the ratio reached 44 per cent.

Economic Impact

One can approach the economic impact of bank credit cards from two general viewpoints: (1) how cards affect the aggregate economic variables, such as total consumer credit, consumption spending and the general level of prices, and (2) how cards influence certain specific areas of the economy, such as the competitive situation of banks versus other consumer lenders and competition among banks.

Credit card loan volume has increased rapidly in the last two years. Credit outstanding rose from \$.8 billion at the end of 1967 to \$2.6 billion in December 1969. It should be noted, however, that this amount still represents only 2.6 per cent of total consumer instalment credit from all sources and 6.5 per cent of bank instalment credit to consumers. The \$1.8 billion increase in credit card outstandings from the end of 1967 to the end of 1969 accounts for about 10 per cent of the \$17.2 billion increase in total consumer instalment credit over the same period.

This increase in the amount of credit outstanding under bank credit card plans cannot be regarded as a net addition to total consumer credit available, however, since the credit card facility is being used in part as a substitute for other forms of credit, particularly for small personal loans and to finance small purchases.

If bank credit card activity were to continue to expand at recent rates, it could become a major portion of total consumer credit within a few years. But several factors militate against continuation of such rapid growth. The 1966-69 period was one in which great numbers of banks initiated credit card plans. But, as discussed earlier, most large banks, and a good number of small and medium-sized banks, already operate such plans. Thus, in the future, the launching of new plans will have less impact on the growth of card credit volume than in the 1966-69 period. Furthermore, as credit card plans are introduced, many consumers may switch to cards for some purchases from other, more traditional, means of finance. But at some point this switchover effect will be mitigated, and the growth of bank card credit will be limited by the growth in total sales of the types of goods and services for which cards can be used.

If the impact of bank credit cards on total consumer credit is moderate, the impact on consumer spending is even more so. For not only does bank card credit, in part, substitute for, rather than add to, other types of credit, it also substitutes, in part, for cash buying.

It may well be that the kinds of goods and services bought with bank credit cards will expand somewhat. The current credit limit

which is typically \$300 to \$500 for most new cardholders may be raised gradually in time, but we certainly do not visualize the widespread use of bank credit cards to make major purchases, such as automobiles, in the near future.

Questions have been raised concerning the competitive effect of bank credit cards on other consumer lenders. Bank card plans are growing much faster now than revolving credit plans of other lenders. While credit under bank card plans was increasing threefold between December 1967 and December 1969, outstandings under all revolving credit plans grew from \$11.5 billion to \$15.3 billion, or 33 per cent (See Table 7). Bank plans accounted for \$1.8 billion, or nearly one-half of the \$3.8 billion total increase. Although banks have accounted for the major share of the increase in recent years, none of the other lenders in the revolving credit field have shown a decline in credit outstanding.

The ability of other financial institutions to compete effectively should not be underestimated. In many cases, bank card credit is simply not readily substitutable for other, even seemingly similar, types of credit. It might seem, for instance, that bank credit cards would offer strong competition in the personal loan field. But the loans made by consumer finance companies tend to carry a higher risk than banks normally accommodate and many of the customers of consumer finance companies would not be eligible for bank credit cards.

The fact that nearly all of the banks operating credit card plans are now members of either the Interbank (Master Charge) or

BankAmericard systems has raised the question of the effect upon competition among banks in this field. Memberships in these two systems permit the banks to enter the national market through interchange arrangements, thus allowing the bank credit cards to offer a service comparable to the national travel and entertainment cards. At the present time, these interchange systems appear to be open to any bank desiring memberships. If either of these interchange systems were to initiate restrictive anticompetitive arrangements, serious anti-trust questions would be raised.

In the local markets for credit card services, membership in the national interchange systems does not appear to have imposed any limitations upon competition among banks. In many local markets two or more banks operating Master Charge or BankAmericard plans are now competing vigorously with each other for both merchant and cardholder accounts. It is our understanding that this competition takes many forms including variations in merchant discount rates and variations in the package of services offered to merchants and to cardholders. As long as this situation continues there is no reason to be concerned. The Board, however, plans to continue to watch for any anticompetitive developments that might emerge.

Retail outlets and service establishments offer perhaps the greatest potential for bank credit cards, particularly small to medium-sized businesses. Many small businesses find bank plans an attractive way to sell goods on credit. Even if a small merchant has been operating his own credit facilities, he may find it less troublesome and less

costly to participate in a bank plan. On the other hand, large department stores have generally resisted honoring bank credit cards. Many fear that customer loyalty to the store might suffer, and that they would lose an important marketing tool if they did not use their own card or credit plan. Such considerations as these suggest that bank credit cards on balance enable smaller merchants to compete more effectively with larger retailers, primarily by making it possible for them to offer the sort of credit arrangements that their large competitors offer.

The rapid and widespread acceptance of bank credit cards by consumers should, by now, have erased all doubt about the extent to which this innovation in bank financing serves the needs and conveniences of the public. The full impact of bank credit cards cannot be completely determined at this time but we are continuing to follow developments in this area closely and will be alert to the economic effects and implications on both the banks and their customers.

Table 1
 Credit Card Plans by Class of Bank
 (Amounts in millions of dollars)

	All banks		National banks		State member banks		Nonmember banks	
	Number having plans	Amount outstanding	Number having plans	Amount outstanding	Number having plans	Amount outstanding	Number having plans	Amount outstanding
September 30, 1967 ^{1/}	197	633	119	496	34	100	44	37
December 30, 1967 ^{2/}	390	828	187	636	50	145	153	47
June 30, 1968 ^{2/}	416	953	219	731	64	170	133	52
December 31, 1968 ^{2/}	510	1,312	272	1,019	65	210	173	83
June 30, 1969 ^{2/}	699	1,705	359	1,317	93	275	247	113
December 31, 1969 ^{2/ 3/}	1,207	2,639	618	1,960	155	470	434	209

^{1/} Federal Reserve study, Bank Credit-Card and Check-Credit Plans, July 1968.

^{2/} Federal Deposit Insurance Corporation, Report of Call.

^{3/} Preliminary.

Table 2

Credit Card Plans by Size of Bank
(Amount in millions of dollars)

<u>Size of Bank</u> (Total deposits, in millions of dollars)	<u>September 30, 1967</u> ^{1/}		<u>December 31, 1968</u> ^{3/}		<u>December 31, 1969</u> ^{4/}	
	<u>Number</u>	<u>Amount Outstanding</u>	<u>Number</u>	<u>Amount Outstanding</u>	<u>Number</u>	<u>Amount Outstanding</u>
Under 5	2	<u>2/</u>	29	1.2	56	1.2
5-10	25	1.1	58	2.6	157	7.7
10-25	34	7.8	123	15.7	331	42.2
25-50	27	5.6	80	22.0	227	75.3
50-100	26	17.8	67	48.5	153	134.2
100-500	52	104.5	109	267.5	209	709.2
500-1,000	13	91.2	19	152.7	41	460.8
1,000 and over	18	404.9	25	801.3	33	1,208.1
All size groups	197	\$633.0	510	\$1,311.5	1,207	\$2,638.7

^{1/} Federal Reserve Study, Bank Credit Card and Check Credit Plans, July 1968.

^{2/} Less than \$50,000.

^{3/} Federal Deposit Insurance Corporation, Report of Call.

^{4/} Preliminary tabulation from December 31, 1969 Report of Call.

Table 3

Credit Card Plans: Insured Commercial Banks
December 31, 1969

	All insured banks	National	State member	Nonmember
Number of unexpired credit cards (000)	59,823	37,328	8,829	13,666
Accounts with outstanding balances:				
Number (000)	17,465	10,526	2,836	4,103
Amount (\$000)	2,638,723	1,959,465	470,094	209,164
Net charge-offs during 1969 (\$000)	70,419	48,694	9,245	12,480
Charge-offs as % of end-of-year outstandings	2.67	2.49	1.97	5.97
Accounts with balances outstanding on December 31, 1969 as a per cent of total number of credit cards	29	28	32	30

Preliminary tabulation from December 31, 1969 Report of Call.

Table 4

Bank Credit Card and Check Credit Plans^{1/}
(Amounts in millions of dollars)

	<u>Outstandings</u> <u>end of month</u>		<u>Extended</u> <u>during month</u>		<u>Repaid</u> <u>during month</u>	
	<u>Credit</u> <u>card</u>	<u>Check</u> <u>credit</u>	<u>Credit</u> <u>card</u>	<u>Check</u> <u>credit</u>	<u>Credit</u> <u>card</u>	<u>Check</u> <u>credit</u>
<u>1968</u>						
January	815	531	147	85	139	71
February	817	543	120	78	118	66
March	822	549	125	76	120	70
April	859	570	158	95	121	74
May	878	586	152	97	133	81
June	914	600	155	93	119	79
July	945	622	172	103	141	81
August	983	644	175	103	137	81
September	1,024	665	176	105	135	84
October	1,066	687	195	111	153	89
November	1,111	694	188	98	143	91
December	1,265	739	318	134	164	89
<u>1969</u>						
January	1,292	762	228	125	201	102
February	1,321	769	190	113	161	106
March	1,341	782	219	120	199	107
April	1,457	814	270	147	154	115
May	1,541	834	277	137	193	117
June	1,631	859	299	138	209	113
July	1,694	882	321	136	258	113
August	1,759	901	312	130	247	111
September	1,862	926	354	139	251	114
October	1,935	941	370	137	297	122
November	2,011	951	335	119	259	109
December	2,282	982	581	156	310	125
<u>1970</u>						
January	2,362	998	347	138	267	122
February	2,384	1,006	351	122	329	114
March	2,397	1,002	394	130	381	134

^{1/} Data for reporting banks representing approximately 95 per cent of the dollar volume of bank credit card and check credit outstandings.

SOURCE: Consumer Credit and Finances Section,
Board of Governors of the Federal Reserve System.

Table 5

Bank Credit Card Plans by Federal Reserve District
All Insured Commercial Banks

(Amounts in millions of dollars)

Federal Reserve District	September 30, 1967 ^{1/}		December 31, 1967 ^{2/}		December 31, 1968 ^{2/}		December 31, 1969 ^{3/}	
	Number offering plan	Amount outstanding	Number offering plan	Amount outstanding	Number offering plan	Amount outstanding	Number offering plan	Amount outstanding
Boston	14	21.8	16	27.9	21	57.5	155	133.4
New York	16	64.8	23	109.5	20	155.3	60	438.1
Philadelphia	6	12.3	10	11.2	9	25.4	12	26.4
Cleveland	6	26.9	14	31.2	48	63.7	186	176.1
Richmond	5	28.2	13	38.9	28	92.7	75	319.0
Atlanta	20	30.6	43	40.0	53	99.5	243	301.4
Chicago	35	126.2	86	153.2	107	181.6	152	246.6
St. Louis	10	12.3	36	22.2	57	52.8	69	91.6
Minneapolis	5	.1	25	1.8	11	1.0	11	7.3
Kansas City	6	6.4	19	10.2	19	32.5	75	123.8
Dallas	7	8.1	22	12.4	22	18.9	37	81.5
San Francisco	67	295.3	83	369.9	115	530.6	132	693.5
All districts	197	633.0	390	828.4	510	1,311.5	1,207	2,638.7

^{1/} Federal Reserve Study, Bank Credit Card and Check Credit Plans, July 1968.

^{2/} Federal Deposit Insurance Corporation, Report of Call.

^{3/} Preliminary tabulation from December 31, 1969 Report of Call.

Table 6

Ownership of Bank Credit Cards

June 1969

Selected Household Characteristics	Households in Subsample		Has Bank Credit Card		Does Not Have Bank Credit Card	
	Number	Per Cent	Number	Per Cent	Number	Per Cent
Total Responses*	5,137	100.0	1,324	25.8	3,813	74.2
<u>Education Level</u>						
Grade school or less	917	100.0	122	13.3	795	86.7
Some high school	1,136	100.0	233	20.5	903	79.5
Graduated high school	1,548	100.0	422	27.3	1,126	72.7
Some college	676	100.0	213	31.5	463	68.5
Graduated college	521	100.0	209	40.1	312	59.9
Post-graduate college	297	100.0	118	39.7	179	60.3
<u>Income Level</u>						
Less than \$3,000	609	100.0	62	10.2	547	89.8
\$3,000 - 4,999	615	100.0	100	16.3	515	83.7
\$5,000 - 7,999	1,180	100.0	252	21.4	928	78.6
\$8,000 - 9,999	856	100.0	246	28.7	610	71.3
\$10,000 - 14,999	958	100.0	323	33.7	635	66.3
Over \$15,000	629	100.0	274	43.6	355	56.4

Source: Federal Reserve Board Survey of Consumer Awareness of Credit Costs.

*Note: The sum of the education or income classes does not add to the total since not all respondents indicated education or income level.

Table 7

Revolving Credit Plans
(Amount outstanding - in billions of dollars)

Type of Credit	December 31, 1967	June 30, 1968	December 31, 1968	June 30, 1969	December 31, 1969
Bank credit cards ^{1/}	.8	1.0	1.3	1.7	2.6
Oil companies ^{2/}	1.0	1.1	1.2	1.3	1.5
Department store revolving credit	3.5	3.6	3.7	3.8	4.2
Retail charge accounts	5.9	5.3	6.5	5.6	6.7
Travel and entertainment cards ^{2/}	.1	.1	.1	.1	.1
All other ^{3/}	<u>.2</u>	<u>.2</u>	<u>.2</u>	<u>.2</u>	<u>.2</u>
All types	11.5	11.3	13.0	12.7	15.3

^{1/} Excludes check credit plans.

^{2/} Consumer portion only.

^{3/} Including large independent credit card firms and revolving credit accounts of nondepartment stores.

SOURCE: Consumer Credit and Finances Section,
Board of Governors of the Federal Reserve System.