Bank Credit Card and Check Credit Plans in the Second District*

Bank credit card and check credit plans have become an important feature of commercial banking over the past few years. These two new forms of consumer credit, which have been introduced all over the country, are beginning to have a significant impact in the consumer and personal finance areas. Second District banks have participated in the growth and development of these new programs, and currently more than ninety Second District banks with total deposits of $67 billion have some type of credit card or check credit plan in full operation. This article focuses on the growth and development of bank credit card and check credit programs, with particular emphasis on the Second District.

The material used in the article derives largely from information developed by a Task Group that was established by the Federal Reserve System in March 1967 to make a thorough examination of bank credit card and check credit plans and to provide for the collection of statistical data.[1] As part of the study, the Federal Reserve System conducted late in 1967 a survey of bank credit card and check credit plans. All commercial banks with any such plan were requested to provide information on the basic features. The survey contains the most comprehensive data available on bank credit card and check credit plans.

CHARACTERISTICS OF BANK CREDIT CARD AND CHECK CREDIT PLANS

In many respects, bank credit card plans are similar to the credit card plans developed by major nonbank corporations. The card-issuing bank establishes relationships with merchants who agree to honor its card for retail purchases. Participating merchants maintain an account with the bank and receive credit immediately for all deposited sales slips which originate via the credit card. The bank then bills its cardholders for all purchases made with the card. For its service the bank charges the merchant a fee in the form of a discount on each sales slip.

Affiliation with a bank credit card program helps a merchant reduce his accounting and record-keeping costs. It also reduces his credit losses and collection expenses. Furthermore, since affiliation lessens the amount of credit the merchant has to extend to customers, it tends to reduce his own need for bank credit. Finally, membership in a bank credit card program permits the merchant to offer credit facilities that are competitive with department stores and other large retail outlets, and may help to enlarge the merchant's sales volume.

For a credit card plan to be profitable, a large number of merchants in a given market area must be enrolled and many cardholders are needed. For this reason, most banks initiating a new credit card program resort to mass mailings to insure widespread initial ownership of their card. While banks often prepare their first mailing on an unsolicited basis, some customer screening is usually undertaken. Cards are ordinarily sent only to past customers or other individuals who meet specified credit standards.

Most bank credit card plans permit the cardholder to get cash advances at his bank as well as to charge purchases at all participating retail outlets. Cardholders are billed once a month, and if the bill is paid soon after receipt there is no charge. An interest charge, usually between 1 percent and 1.5 percent monthly, is typically made on any outstanding balances.

Banks that desire a credit card plan but do not wish to devote the requisite resources to the initiation and operation of such a program may become licensees of another bank offering a credit card. Under such a correspondent arrangement, the licensee bank agrees to offer the card to its customers and typically enlists local merchants in the plan. These licensing arrangements give the licensee banks the competitive advantages of a credit card program while reducing the costs and operational difficulties of such a program.

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* Patrick Page Kildoyle, Economist, Financial Statistics Division, had primary responsibility for the preparation of this article.

[1] The group's findings were published in July 1968 under the title "Bank Credit-Card and Check-Credit Plans". The report may be obtained for $1.00 a copy (85 cents each for ten or more) by writing Publications Services, Division of Administrative Services, Board of Governors of the Federal Reserve System, Washington, D. C., 20551.

Until very recently, bank credit cards for the most part have been of a local or regional nature, primarily because of the legal restrictions on branch banking and the comparatively limited market for consumer lending that this has implied for any given bank. In order to permit individual bank credit cards to be used over wider geographical areas, thereby making them more attractive, interchange systems have been developed. A cardholder of any bank in the interchange system may use his card for purchases at merchants signed up by other banks participating in the system. While these interchange systems are still evolving, some consolidation is becoming evident, and they appear to be laying the foundation for nationwide bank credit card systems.

Check credit programs were designed to meet some of the same needs as bank credit cards. While there are differences in the operation of the various plans in use throughout the country, the basic format of these programs, which usually are offered under trade names such as "Advance Credit" or "Instant Credit", is quite similar. In general, check credit programs resemble the credit lines granted to business borrowers, although there are no compensating balance requirements. Under these programs, applicants deemed sufficiently creditworthy are granted a stated line of credit, all or a portion of which may be borrowed simply by writing a check. The majority of banks issue special checks for their check credit accounts, although some attach the credit line to the customer's checking account and allow the customer to overdraw his checking account up to the credit line.

Commercial banks typically impose tighter credit requirements for check credit than they do for instalment loans of equivalent size. This is largely because check credit involves a continuous granting of credit. Check credit accounts are constantly scrutinized and examined for overuse or even "line riding" (i.e., continuous borrowing of the maximum permitted) as well as for late payments. In addition, each account is usually given a reasonably thorough periodic credit examination, in which changes in income, employment, and other borrower characteristics considered indicative of the borrower's ability to handle debt are evaluated to determine whether the borrower continues to merit his line of credit. Some banks also require a financial statement from those customers requesting large credit lines.

Many banks, according to the 1967 survey, have established relationships with American Express and Carte Blanche, two major transportation and entertainment (T & E) credit card companies that enable the banks to offer T & E cardholders a hybrid form of check credit. For the most part, T & E companies do not provide financing for charges made on their cards, and they require full payment for purchases, with certain exceptions, soon after receipt of the billing statement. However, T & E cardholders who have established check credit accounts with banks that have set up special relationships with T & E companies may have their T & E card charges financed by these banks.

HISTORY OF THE PLANS

The development of bank credit card plans has been erratic. The first bank credit card plan was launched in 1951 by the Franklin National Bank, Mineola, New York. Other banks soon followed, and by 1953 it was estimated that almost 100 commercial banks throughout the country had announced plans to enter the field. Many of the bankers initiating programs during those years overestimated the potential rewards to be gained from the operation of a credit card plan. When the vast requirements of a fully comprehensive credit card operation became apparent, many of the early participants decided to cut their losses and discontinue these operations.

Very little new activity took place on the bank credit card front until 1958-59, when the Bank of America in California initiated its Bank Americard and the Chase Manhattan Bank in New York City launched its Chase Manhattan Charge Plan. Again there was a brief burst of renewed enthusiasm, with many new entrants, but activity soon tapered off a second time. It was not until two or three years ago that the latest—but certainly not the last—phase of the history of bank credit cards began. Since about 1965, the development of bank credit cards has once more been gaining momentum, with many banks initiating credit card programs. As of June 1968, 416 banks throughout the country had credit card plans in full operation, with outstanding consumer credit under these plans totaling $953 million.

Check credit plans have had an even briefer history than bank credit cards, having originated only in the mid-1950's. There have been two spurts of activity: in the late 1950's and in the second half of the present decade. The plans have proved quite popular with both bankers and the general public. The public has reacted favorably to the one-time credit review aspect of the plans and to the convenience of a line of credit. At the same time, many bankers tend to prefer them to credit cards because of their comparatively lower start-up and operating costs, and because many consumer credit officers feel they are better equipped to handle the problems of check credit plans than of credit cards. As of June 1968, 844 banks in the nation had check credit plans, with $646 million of outstanding check credit balances.

DEVELOPMENT OF THE PLANS AT SECOND DISTRICT BANKS

The development of credit card and check credit plans in the Second District appears to have followed the national pattern fairly closely, but there have been some significant differences. While no data are available either nationally or for this District on the number of banks that have begun and subsequently terminated credit card or check credit plans, an indication of the pattern of development in this District may be derived from information on existing plans. The figures in Table I show the number of credit card and check credit plans in operation at the end of September 1967 at Second District banks, instituted each year between 1951 and September 1967. Some banks offer both credit card and check credit plans, and a number have more than one type of check credit plan.

Most commercial banks in this District, mindful of the costly experiences of some banks in past years in operating credit card programs, have chosen the check credit route instead. The latest year for which data are available, 1967, was by far the most active period of development of check credit plans, with forty-seven new check credit plans coming into existence in this District during the first nine months. (Thirty-three of these were affiliated with American Express or Carte Blanche.) As of June 1968, the Second District ranked third, behind the San Francisco and Chicago Federal Reserve Districts, in terms of credit outstanding under bank credit card plans, but in terms of credit outstanding under check credit plans they were tied for first place with the San Francisco District (see Table II).[2]

A credit card program is an expensive undertaking, requiring sophisticated electronic data-processing equipment and specialized personnel. Not many banks have been willing or able to undertake the expense of a credit card program. As Table III indicates, in June 1968 there were only twenty-seven banks with credit card programs in the Second District, but eighty-one with check credit plans. These

Table II

CREDIT OUTSTANDING ON BANK CREDIT CARD AND CHECK CREDIT PLANS

As of June 30, 1968, by Federal Reserve District
In millions of dollars

Federal Reserve District	Credit card plans	Check credit plans	Total
Boston	37	64	101
New York	120	142	262
Philadelphia	14	83	97
Cleveland	36	44	80
Richmond	47	27	74
Atlanta	49	35	84
Chicago	153	62	215
St. Louis	26	16	42
Minneapolis	1	9	10
Kansas City	12	16	28
Dallas	21	6	27
San Francisco	435	142	577
Grand total	953	646	1,599

Note: Because of rounding, figures may not add to totals.
Source: Board of Governors of the Federal Reserve System.

Table I

NUMBER OF CREDIT CARD AND CHECK CREDIT PLANS INITIATED EACH YEAR AT SECOND DISTRICT BANKS

In operation September 30, 1967*

Year	Credit card plans	Check credit plans
1951	1	0
1952	1	0
1953	2	0
1954	2	0
1955	0	1
1956	0	1
1957	0	0
1958	0	3
1959	7	26
1960	0	2
1961	0	1
1962	0	0
1963	0	1
1964	0	4
1965	0	3
1966	2	13
1967 (through September)	3	47

Note: These figures represent the number of *plans* initiated each year by Second District banks, not the number of banks with plans.
* Plans initiated and terminated prior to September 1967 are excluded.

[2] These Second District rankings suggest a comparatively favorable degree of penetration of the potential consumer credit market, when the latter is measured by the total amount of consumer credit outstanding at commercial banks. The Second District was third in the volume of such outstandings, behind the San Francisco and Chicago Districts.

latter plans were offered by all size-groups of banks, while credit cards were offered by only the five largest size-groups. No Second District bank with total deposits of less than $25 million reported having outstandings under credit card programs, while five banks of this size reported check credit outstandings. A total of fourteen banks offered both credit cards and check credit; the smallest of these banks had deposits of $100 million or more. Banks with deposits in the $100 million to $499.9 million range had the largest number of plans of each type. Seventeen banks, or approximately two thirds of the District banks with credit card programs, were in this size-class, as were thirty-three of the eighty-one District banks with check credit plans.

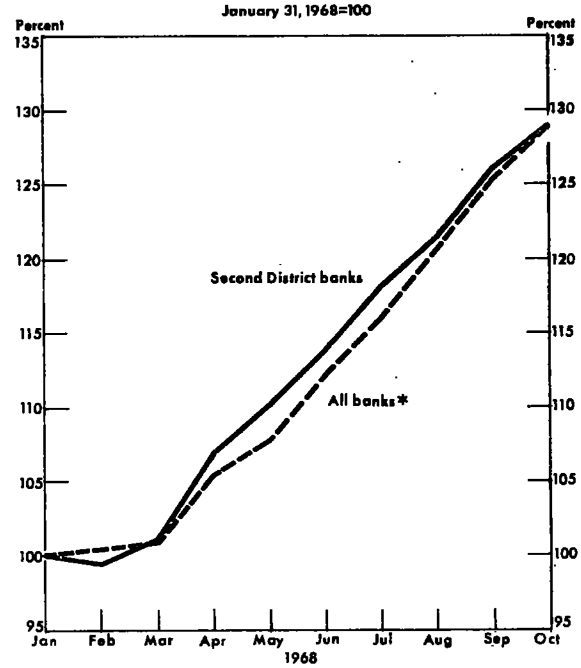
In October 1968, Second District banks held only about 13 percent of the total credit outstanding nationally under bank credit card plans, but they held about 23 percent of the national total of check credit outstandings. This difference is due, for the most part, to the fact that only a few of the major banks in the New York metropolitan area have introduced credit cards, while almost all have some type of check credit plan in operation. A number of the large New York City banks, however, have recently indicated that they plan to enter into credit card operations in the near future.

Between January and October 1968, check credit outstandings in the Second District grew considerably faster than the national average, while credit card outstandings at Second District banks rose at the same rate as the national average. The growth in outstandings under both types of plans was rapid, however, at both Second District banks and nationwide. Second District credit outstanding under bank credit card and check credit plans expanded by 29 percent and 40 percent, respectively (see Charts I and II). Nationally, both series grew 29 percent. The figures for both the Second District and the nation reflect the entry of new banks into the field as well as the growth of outstandings under existing plans.

Chart I

GROWTH OF OUTSTANDING BANK CREDIT CARD BALANCES

January 31, 1968=100



* Source: Board of Governors of the Federal Reserve System.

The 1967 survey of bank credit card and check credit plans indicated that about 35,500 merchants were honoring a total of 1.4 million credit cards issued by banks in the Second District. About 40 percent of these card accounts (or 550,000) were considered active accounts. Check credit accounts numbered 210,000, of which 70 percent was active. The average active credit card account in the Second District had an outstanding balance due of $117, while the average active check credit account had a balance due of $662.

Commercial bank income from credit card programs is derived from two major sources: merchant discounts and cardholder charges. Merchant discounts, which are calculated as a percentage charge on each sales slip, vary according to industry, with airlines typically charged the lowest discount. The discounts charged the merchants are

Table III

NUMBER OF SECOND DISTRICT BANKS WITH CREDIT CARD AND/OR CHECK CREDIT PLANS, BY SIZE OF BANK

June 30, 1968

Size of bank (total deposits in millions of dollars)	Number of Second District banks	Banks with credit card plans	Banks with check credit plans
Under 10	144	0	2
10-24.9	121	0	3
25-49.9	74	2	14
50-99.9	44	3	14
100-499.9	64	17	33
500-999.9	9	2	5
1,000 and over	12	3	10
All size-groups	468	27	81

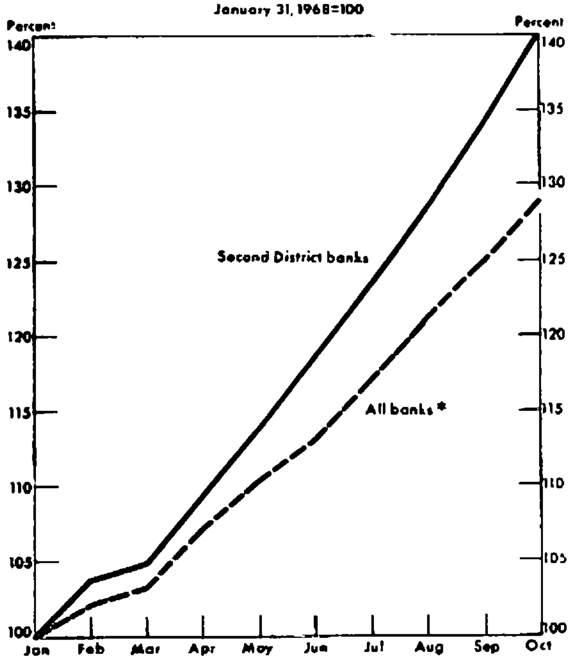
Source: Call Report for June 30, 1968.

sometimes, in effect, reduced through rebates, the amount of rebate depending on the volume of sales generated by the credit cards. At least one bank has established a schedule that gears the rebate also to the average size of sale, with merchants having higher dollar charges per sale being given higher rebates.

Banks in this District charge merchants (excluding airlines) discounts ranging from as low as 1 percent to as high as 8 percent, with 5 percent the most typical discount rate. Airlines generally are charged 2 percent. Insofar as the service charge to the cardholder is concerned, almost all banks in this District make a uniform monthly charge of 1 percent of the unpaid balance for cash advances to credit cardholders and 1½ percent of the unpaid balance on retail purchases. The rates are in some cases held at these levels because they are at state legal maximums. There is some evidence that increased competition between credit card programs has resulted in lower merchant discounts, and that over the long run the cardholder charges have become the more important revenue source for the credit card banks.

Lines of credit under check credit plans offered by Second District banks typically range from about $1,000 to $2,000, but some are as small as $100 and some as large as $5,000. The use of special checks for these plans remains more common than allowing overdrafts on regular checking accounts, although this latter arrangement is now offered by about 40 percent of all plans. Monthly service charges on check credit accounts usually run about 1 percent per month on the unpaid balance, including insurance charges.

Chart II
GROWTH OF OUTSTANDING CHECK CREDIT BALANCES
January 31, 1968=100



* Source: Board of Governors of the Federal Reserve System.

DELINQUENCIES AND CHARGE-OFFS

Ever since the launching of the first bank credit card plan and the first check credit plan, there has been considerable concern regarding the quality of the credit extended under these programs. Credit of this sort appears to have a higher potential for default or fraud than standard consumer credit, and greater vigilance is required. It is, therefore, encouraging to note that estimates of delinquency rates for both credit card and check credit plans in this District seem to be fairly well in line with delinquencies on other kinds of consumer credit. For September 1967, the New York State Bankers Association indicated that 2.0 percent of all standard consumer credit loans was delinquent thirty days or more. Figures from the September 1967 System survey of bank credit card and check credit plans indicate that delinquencies for Second District bank credit cards at that time were 2.2 percent of active accounts and delinquencies on check credit were 2.0 percent.[3]

Actual dollar losses, or charge-offs, at Second District banks for both credit card and check credit plans also do not seem excessive when compared with banks in other Districts. In the first six months of 1967, Second District banks wrote off a total of $332,000 of credit card outstandings, amounting to 0.51 percent of the total credit card outstandings in September 1967. Nationally, however, the charge-off rate amounted to a much larger 1.97 percent. This latter, comparatively high, charge-off rate reflects to some extent the recent proliferation of new bank credit card programs. When banks initiate a credit card program, they anticipate that charge-offs will be fairly high for the first year or two, until the program gets off the ground. Once the program has become fully operational, there is usually a sharp decline in charge-offs.

[3] These delinquency rates on credit card and check credit plans may not be fully comparable to the delinquency rates published by the New York State Bankers Association, due to slight differences in the method of computation.

When, for example, charge-off rates are calculated only for the commercial banks that began their credit card programs prior to 1966, the national rate declines from 1.97 percent to 1.18 percent.

Charge-offs under check credit plans at Second District banks were also below the national average. During the six months ended June 1967, Second District banks wrote off $135,000 of check credit outstandings. This amounted to 0.14 percent of the September 1967 outstandings. Nationally, the comparable check credit charge-off rate was 0.23 percent.

RELATIVE IMPORTANCE OF BANK CREDIT CARD AND CHECK CREDIT PLANS

While bank credit card and check credit plans are rapidly growing segments of the banking industry, it must nevertheless be kept in mind that at present they still are relatively insignificant when compared with other types of consumer credit. For example, bank credit card and check credit outstandings on October 31, 1968 amounted to only 3.0 percent and 3.4 percent, respectively, of the total $4.6 billion of consumer instalment credit outstandings at Second District banks. Nevertheless, should these forms of credit extension continue to grow at anywhere near their recent rates, they will become in a relatively short time a far more significant factor in Second District banking—as well as in the entire banking industry—than they are now.

While it is true that these new credit techniques have not as yet garnered a large share of the consumer credit market, their impact on the individual banks operating the programs has been more consequential. When the consumer loan portfolios of only those banks with credit card and check credit plans are examined, it is found that credit card banks in the Second District currently have about 9 percent of their consumer credit in the form of credit card outstandings, and check credit banks have about 5 percent of their consumer credit in the form of check credit outstandings. Some banks rely far more heavily than others on these instruments for consumer loans. A few, for example, have more than 15 percent of their consumer instalment credit in the form of credit card outstandings, and at least one bank has more than 20 percent in the form of check credit outstandings.

CONCLUDING COMMENT

Bank credit card and check credit programs, although only fairly recent banking innovations, are becoming of greater importance both to Second District banks and the entire banking industry. While the programs have caused some problems, commercial banks on the whole have come to grips with these problems and are solving them. Although the future of these new credit techniques cannot be foreseen in detail, there is ample evidence that the programs will continue to expand and thus have a greater impact on the banking system in the future.