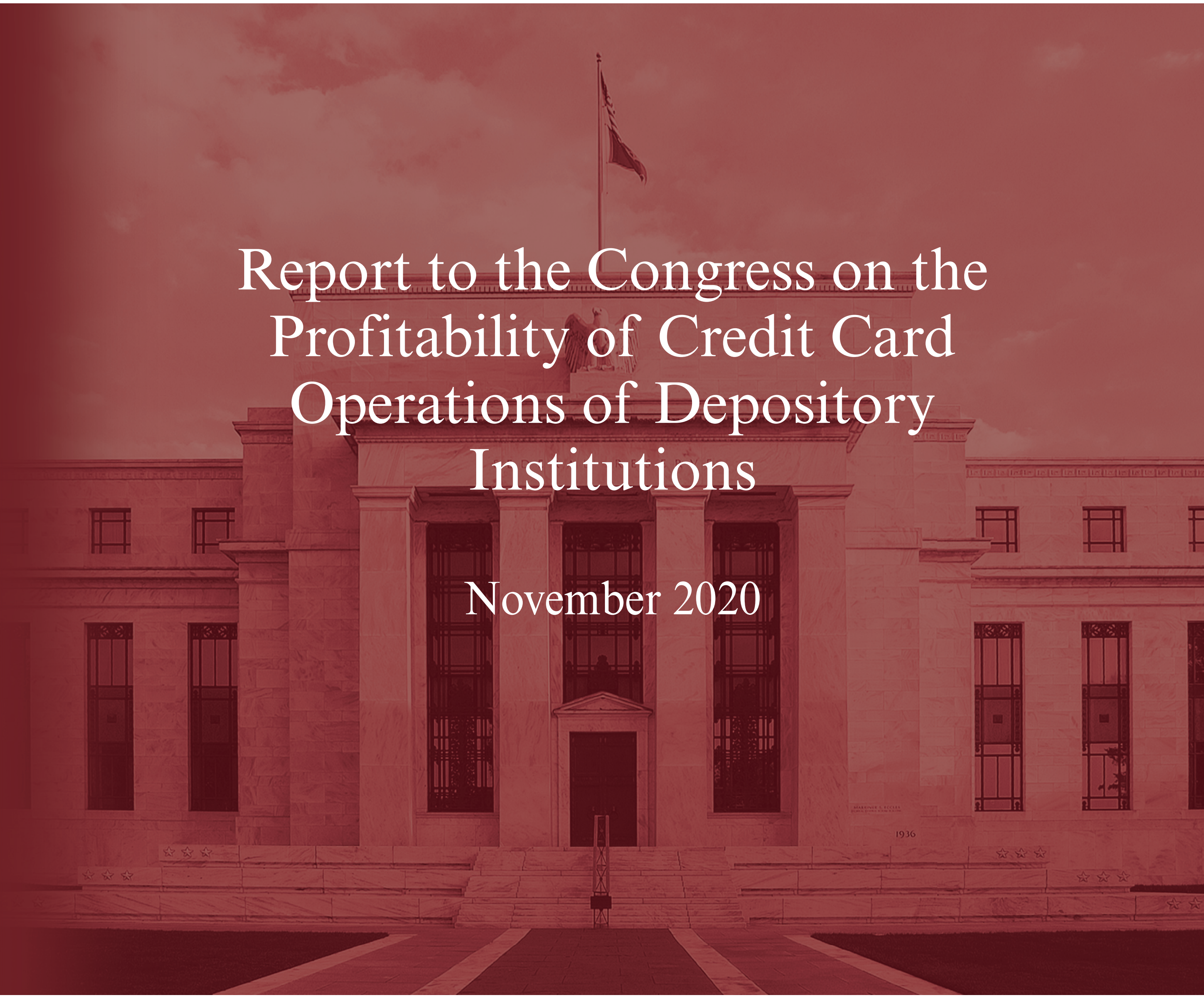

Report to the Congress on the Profitability of Credit Card Operations of Depository Institutions

November 2020

Board of Governors of the Federal Reserve System

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Introduction

Section 8 of the Fair Credit and Charge Card Disclosure Act of 1988 directs the Federal Reserve Board to transmit annually to the Congress a report about the profitability of credit card operations of depository institutions.[1] This is the 30th report. The analysis in this report is based to a great extent on information from the Consolidated Reports of Condition and Income (Call Reports) and the Quarterly Report of Credit Card Plans.[2]

1 See Fair Credit and Charge Card Disclosure Act, Pub. L. No. 100-583, 102 Stat. 2960 (1988). The 2000 report covering 1999 data was not prepared as a consequence of the Federal Reports Elimination and Sunset Act. The report was subsequently reinstated by law.

2 The data used in this report are as of December 31, 2019, and do not reflect current economic and financial conditions. The Federal Reserve collects the Quarterly Report of Credit Card Plans (Form FR2835a).

Identification of Credit Card Banks

Every insured bank files a Call Report each quarter with its federal supervisory agency.[3] While the Call Report provides a comprehensive balance sheet and income statement for each bank, it does not allocate all expenses or attribute all revenues to specific product lines, such as credit cards. Nevertheless, the data may be used to assess the profitability of credit card activities by analyzing the earnings of those banks established primarily to issue and service credit card accounts. These specialized, or monoline, banks are referred to here as "credit card banks."

For purposes of this report, credit card banks are defined by two criteria: (1) More than 50 percent of their assets are loans to individuals (consumer lending), and (2) 90 percent or more of their consumer lending involves credit cards or related plans. Given this definition, it can reasonably be assumed that the profitability of these banks primarily reflects returns from their credit card operations.[4]

3 The sample of banks used for this report include commercial banks, state savings banks, and thrifts.

4 Two banks (Discover Bank and American Express Bank) included in the sample did not exactly meet these criteria. These banks are major issuers on the Discover and American Express networks, and their balance sheets are largely consistent with the credit-card-focused business model.

The first credit card banks were chartered in the early 1980s; few were in operation before the mid-1980s. To provide a more reliable picture of the year-to-year changes in the profitability of the credit card operations of card issuers, this report limits its focus to credit card banks with at least $200 million in assets. Most of these institutions have been in continuous operation for several years, particularly those with assets exceeding $1 billion, and are well beyond the initial phase of their operations.

As of December 31, 2019, 10 banks with assets exceeding $200 million met the definition of a credit card bank, and, at the time, these banks accounted for 40 percent of outstanding credit card balances on banks' balance sheets. Notably, one major credit card lender, a subsidiary of JPMorgan Chase & Co., no longer separately reports Call Report data because of a reorganization in May 2019.[5]

5 Chase Bank USA, N.A., a subsidiary of JPMorgan Chase & Co., was identified as a credit card bank for the purposes of this report in 2018. In May 2019, it merged with JPMorgan Chase Bank, N.A., the main commercial banking subsidiary of JPMorgan Chase & Co., and the surviving entity does not meet the criteria of a credit card bank. In addition, T.D. Bank, USA N.A., is identified as a credit card bank for the first time in 2019, as it did not meet the criteria for a credit card bank in previous years.

Credit Card Bank Profitability

Tracking credit card profitability over time is complicated. Accounting rule changes implemented in 2010 require banking institutions to consolidate onto their Call Reports some previously off-balance-sheet items (such as credit-card-backed securities). To the extent that previously off-balance-sheet assets have a different rate of return than on-balance-sheet assets, profitability measures based on Call Report data in 2010 and after are not necessarily comparable with those before 2010.

Another difficulty that arises in assessing changes in the profitability of credit card activities over time is that the sample of credit card banks changes somewhat from one year to the next primarily because of changing bank loan portfolios and reorganizations. Thus, overall changes in profit rates from year to year reflect both real changes in activity and changes in the sample. To evaluate the effects of sample changes, the profitability of all credit card banks is reported in table 1 and the profitability of a constant sample of banks is examined in table 2.

In 2019, credit card banks with assets in excess of $200 million reported net earnings before taxes and extraordinary items of 4.14 percent of average quarterly assets (table 1). The increase in profitability from 3.79 percent in 2018 to 4.14 percent in 2019 is almost completely due to the change in sample. The data for 2018 included earnings of the credit card bank subsidiary of JPMorgan Chase & Co., whereas the data for 2019 do not because of the reorganization mentioned earlier. Using a constant sample of credit card banks for both 2018 and 2019 shows that credit card profitability remained almost constant, increasing a shade from 4.17 percent in 2018 to 4.21 percent in 2019 (table 2).

Changes in overall returns to credit card operations from 2018 to 2019 can be better understood by reviewing how individual expense and revenue items changed among the constant sample of credit card banks (table 2). Net interest income decreased slightly for credit card banks from 2018 to 2019 because of both lower interest income and higher interest expense. At the same time, credit card banks slightly decreased their provisions for loan losses. Delinquency rates and charge-off rates for credit card loans across all banks increased modestly in 2019 but remained below their historical averages.

Credit card earnings have almost always been higher than returns on all bank activities, and earnings patterns for 2019 were consistent with historical

Table 1. Return on assets, large U.S. credit card banks, 2001–19

Percent

Year	Return
2001	4.83
2002	6.06
2003	6.73
2004	6.30
2005	4.40
2006	7.65
2007	5.08
2008	2.60
2009	-5.33
2010	2.41
2011	5.37
2012	4.80
2013	5.20
2014	4.94
2015	4.36
2016	4.04
2017	3.37
2018	3.79
2019	4.14

Note: Credit card banks are banks with average assets greater than or equal to $200 million, with a minimum 50 percent of assets in consumer lending and 90 percent of consumer lending in the form of revolving credit. Profitability of credit card banks is measured as net pretax income as a percentage of average quarterly assets.

Source: Federal Financial Institutions Examination Council, Consolidated Reports of Condition and Income (Call Reports), https://www.ffiec.gov.

Table 2. Income and expenses for U.S. banks in 2018 and 2019

	Constant sample of credit card banks		All banks
	2019	2018	2019
Total interest income	12.27	12.42	3.91
Total interest expenses	2.16	1.97	.89
Net interest income	10.10	10.45	3.03
Total noninterest income	4.45	4.48	1.52
Total noninterest expenses	7.00	7.04	2.63
Net noninterest income	-2.54	-2.55	-1.11
Provisions for loan losses	3.35	3.70	.31
Return	4.21	4.17	1.65

Note: Credit card banks are banks with average assets greater than or equal to $200 million, with a minimum 50 percent of assets in consumer lending and 90 percent of consumer lending in the form of revolving credit. Columns 1 and 2 reflect data only for the constant sample of nine credit card banks that filed Call Reports in both 2018 and 2019.

Source: Federal Financial Institutions Examination Council, Consolidated Reports of Condition and Income (Call Reports), https://www.ffiec.gov.

experience.[6] The average return on all assets, before taxes and extraordinary items, was 1.65 percent for all banks, compared with 4.14 percent for the sample of all large credit card banks (as shown in tables 1 and 2).

[6] This report focuses on the profitability of large credit card banks, although many other banks engage in credit card lending without specializing in this activity. The profitability of the credit card activities of these other banks is difficult to discern. The cost structures, pricing behavior, cardholder profiles, and, consequently, profitability of these diversified institutions may differ from that of the large, specialized card issuers considered in this report.

Market Structure

Bank cards are widely held and extensively used by consumers. According to the Federal Reserve's Survey of Consumer Finances (SCF), about 71 percent of families had at least one credit card in 2016, the most recent year for which survey results are currently available. Consumers use credit cards for borrowing, as standby lines of credit for unforeseen expenses, and as a convenient payment device. As a source of credit, credit card loans have substituted for borrowing that, in years past, might have taken place using other loan products, such as closed-end installment loans and personal lines of credit. As a convenient payment device, a portion of the outstanding balances reflects primarily "convenience use"—that is, balances consumers intend to repay within the standard "interest free" grace period offered by card issuers. In fact, consumer surveys, such as the SCF, typically find that over half of cardholders report they nearly always repay their outstanding balance in full before incurring interest each month.[7]

The general-purpose bank credit card market in the United States is dominated by cards issued on the Visa and Mastercard networks, which, combined, accounted for nearly 576 million cards, or about 83 percent of general-purpose credit cards, in 2019.[8] In addition, American Express and Discover networks accounted for another 115 million general-purpose cards in 2019. The combined total number of charges and cash advances using such cards in 2019 reached 45 billion transactions, amounting to a dollar volume of almost $4 trillion.

A relatively small group of card issuers holds most of the outstanding credit card balances, with the top 10 holding 81.4 percent.[9] Several thousand other financial institutions offer credit cards to consumers, and these institutions are free to set their terms and conditions.[10] In the aggregate, the Federal Reserve Statistical Release G.19, "Consumer Credit," indicates that consumers carried slightly less than $1.1 trillion in outstanding balances on their revolving accounts as of the end of 2019, about 3.8 percent higher than the level at the end of 2018.[11] In recent years, a new trend has emerged of some borrowers turning to personal loans for debt consolidation, including the refinancing of credit card debt. Such loans are offered by both traditional banks and financial technology lenders, often in partnership with banks.

Based on credit record data, the amount of available credit under outstanding credit card lines far exceeds the aggregate balances owed on such accounts. Credit record data indicate that as of the end of 2019, individuals were using less than one-fourth of the total dollar amount available on their lines under

[7] The numbers from the 2016 SCF—the most recent survey available—are little changed since 2010; for a discussion of credit borrowing in 2016, see Jesse Bricker, Lisa J. Dettling, Alice Henriques, Joanne W. Hsu, Lindsay Jacobs, Kevin B. Moore, Sarah Pack, John Sabelhaus, Jeffrey Thompson, and Richard A. Windle (2017), "Changes in U.S. Family Finances from 2013 to 2016: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin,* vol. 103 (September), pp. 1–42, https://www.federalreserve.gov/publications/files/scf17.pdf.

[8] Figures cited in this sentence and the remainder of the paragraph are from the *Nilson Report*. See HSN Consultants, Inc. (2020), *Nilson Report,* no. 1169 (Carpinteria, Calif.: The Nilson Report, February).

[9] Five of the top 10 card issuers are in the sample of credit card banks used in this report. The other five issuers do not meet the requirements for inclusion in the sample.

[10] Currently, depository institutions, including commercial banks, credit unions, and savings institutions, and a small number of finance companies and nonfinancial businesses issue Visa and Mastercard credit cards and independently set the terms and conditions on their plans. Many other institutions act as agents for card-issuing institutions. In addition to the firms issuing cards through the Visa and Mastercard networks, a few institutions issue cards on two other large networks, American Express and Discover. However, the vast majority of cards issued on the American Express and Discover networks are originated by direct subsidiaries.

[11] The G.19 release is available on the Board's website at https://www.federalreserve.gov/releases/g19/Current. Revolving credit consists largely of credit card balances but also includes some other types of open-end debt, such as personal lines of credit.

credit card plans.[12] Credit card line utilization rates vary by credit score, with high-credit-score borrowers using approximately 15 percent of the total available and low-credit-score borrowers using approximately 85 percent of the total available.[13] The total dollar amount of available credit has risen since 2010 and at the end of 2019 was higher, in nominal terms, than its previous peak in the third quarter of 2008.

In soliciting new accounts and managing existing account relationships, issuers segment their cardholder bases along a number of dimensions. For example, issuers offer more attractive rates to customers who have good payment records while imposing relatively high rates and fees on higher-risk or late-paying cardholders. Card issuers also closely monitor payment behavior, charge volume, and account profitability, and they adjust credit limits accordingly both to allow increased borrowing capacity as warranted and to manage credit risk.

Various channels are used for new account acquisition and account retention.[14] The most important channel in recent years is generally referred to as the digital channel, which includes email solicitations, website advertisements, and social media advertisements. These solicitations could stem directly from the bank or from third-party firms. By the end of 2019, approximately half of applied-for offers were received digitally. Branches, kiosks, and ATMs are other significant channels for account acquisition as banks take advantage of cross-selling opportunities. Finally, direct mailings continue to be an important channel, with about 3.3 billion offers mailed in 2019.[15] Approximately 20 percent of applied-for offers were obtained by direct mail at the end of 2019.

12 See the *Quarterly Report on Household Debt and Credit 2019:Q4,* available on the Federal Reserve Bank of New York's website at https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/hhdc_2019q4.pdf.

13 The numbers in this sentence are based on data from the FRBNY Consumer Credit Panel/Equifax. Borrowers with a high credit score are those with an Equifax Risk Score above 720, and borrowers with a low credit score are those with an Equifax Risk Score below 620. Borrowers with an Equifax Risk Score between 620 and 720 use about 55 percent of the dollar amount available on their credit card lines.

14 Information and acquisition channels data in this paragraph are based on proprietary data from Mintel Comperemedia.

15 Direct mail solicitations are down considerably from their height of 7.1 billion in 2006.

Recent Trends in Credit Card Pricing

The topic of credit card pricing and how it has changed in recent years has been a focus of public attention and is consequently reviewed in this report. Analysis of the trends in credit card pricing here focuses on credit card interest rates because they are the most important component of the pricing of credit card services. Credit card pricing, however, involves other elements, including annual fees, fees for cash advances and balance transfers, rebates, minimum finance charges, over-the-limit fees, and late payment charges.[16] In addition, the length of the interest-free grace period, if any, can have an important influence on the amount of interest consumers pay. It is also important to note that interest rates charged vary considerably across credit card plans and borrowers, reflecting the various features of the plans and the risk profile of the cardholders served.

Over time, pricing practices in the credit card market have changed. Today, card issuers offer a broad range of plans with differing fees and rates depending on credit risk, consumer usage patterns, and the benefits of the card. The economic downturn and new credit card rules spurred changes in interest rate pricing in 2009 and 2010.[17] In most plans, an issuer establishes a rate of interest for customers of a given risk profile; if the consumer borrows and pays within the terms of the plan, that rate applies. If the borrower fails to meet the plan requirements—for example, the borrower pays late or goes over their credit limit—the issuer may reprice the account to reflect the higher credit risk revealed by the new behavior. Regulations that became effective in February 2010 limit the ability of card issuers to reprice outstanding balances for cardholders who have not fallen more than 60 days behind on the payments on their accounts. Issuers may, however, reprice outstanding balances if they were extended under a variable-rate plan and the underlying index used to establish the rate of interest (such as the prime rate) changes.[18] These rules do not explicitly restrict initial pricing of new accounts.

The credit card pricing information used in this report is obtained from the Quarterly Report of Credit Card Plans (Form FR 2835a). This survey collects information from a sample of credit card issuers on (1) the average nominal interest rate and (2) the average computed interest rate. The former is the simple average interest rate posted across all accounts; the latter is the average interest rate paid by those accounts that incur finance charges. These two measures can differ because some cardholders are convenience users who pay off their balances during the interest-free grace period and therefore do not incur finance charges. Together, these two interest rate series provide a measure of credit card pricing. The data are made available to the public each quarter in the Federal Reserve Statistical Release G.19, "Consumer Credit."

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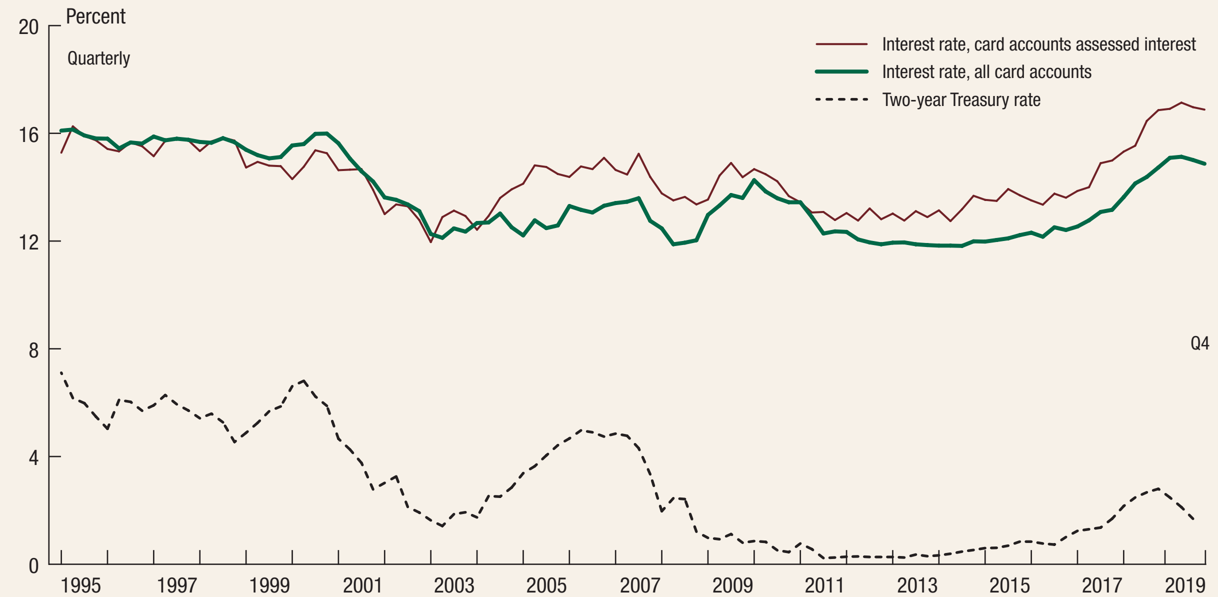
[16] In June 1996, the Supreme Court ruled that states may not regulate the fees charged by out-of-state credit card issuers. States have not been permitted to regulate the interest rates that out-of-state banks charge. In making its decision, the Court supported the position previously adopted by the Office of the Comptroller of the Currency that a wide variety of bank charges, such as late fees, membership fees, and over-the-limit fees, are to be considered interest payments for this purpose. This ruling will likely ensure that banks will continue to price credit cards in multidimensional ways rather than pricing exclusively through interest rates. See Valerie Block (1996), "Supreme Court Upholds Nationwide Card Charges," *American Banker,* June 4.

An assessment of the fees charged by credit card issuers is provided in U.S. Government Accountability Office (2006), *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers,* report to the ranking minority member, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate, GAO-06-929 (Washington: GAO, September), www.gao.gov/new.items/d06929.pdf.

[17] New rules include the Credit Card Accountability Responsibility and Disclosure (CARD) Act of 2009 and amendments to Regulations Z and AA passed in 2010.

[18] According to the Mintel Comperemedia data, more than 96 percent of credit card mail offerings in 2019 were for variable-rate cards. Other data sources on credit card accounts confirm this observation.

Figure 1. Average interest rates on credit card accounts



Source: Federal Reserve Board, Form 2835a, Quarterly Report of Credit Card Plans.

Data from Form FR 2835a indicate that the average credit card interest rate across all accounts increased to 15.1 percent during 2019 before decreasing to just below 15 percent in the fourth quarter of 2019. At the same time, the two-year Treasury rate—a measure of the baseline, or "risk free," rate—fell to about 1.6 percent (figure 1). Average interest rates on accounts that assessed interest are reported to be higher, increasing above 17 percent during 2019 but closing the year at 16.9 percent.