DISCUSSION PAPER
PAYMENT CARDS CENTER

The Secured Credit Card Market

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Summary: *In this paper, we present a brief exposition of the history of the secured credit card, beginning with its origins in California in the 1970s. We present a series of stylized facts based on a December 2015 cross section of the secured card market. We find that most secured cards require an annual fee, tend not to have promotional offers or rewards, and often have higher purchase annual percentage rates than their unsecured counterparts. We also find that the percentage of secured card accounts in a delinquency status is more than double that of unsecured cards and that far fewer secured cards are inactive compared with unsecured cards. In addition, the annual income of secured card consumers is about 43 percent lower than unsecured card consumers. Last, we examine how the credit scores of consumers opening a secured card account change during the first two years of account history. We find that keeping a secured card account open is correlated with improved creditworthiness, while closing an account, either in good standing or in default, is correlated with significantly reduced creditworthiness.*

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I. Introduction

Secured credit cards ("secured cards") are a small and often misunderstood segment of the credit card market. At less than 1 percent of the total consumer credit card market, secured cards are a niche product often associated with subprime credit risk segments. In fact, secured cards tend to appeal to two distinct segments of the consumer credit market: consumers seeking to build a credit history and consumers hoping to repair a damaged credit history.[1] While the latter group may include many consumers with subprime credit scores, the former is composed of consumers who do not have enough data on file with the credit bureaus to be scored by a traditional credit risk scoring model.

As the name suggests, secured cards differ from traditional credit cards in that all or part of their credit limit is secured against a cash deposit provided by the consumer at the time of account opening.[2] Otherwise, most secured cards look and operate in a manner indistinguishable from unsecured cards and carry many of the same network benefits (e.g., auto rental insurance) and fraud protections (e.g., zero liability). Nonetheless, requiring an upfront cash deposit creates a variety of challenges for consumers, who may not have the cash on hand to fund the deposit account or may confuse the product with a prepaid debit card.[3] However, unlike prepaid debit cards, secured cards are a form of credit. A purchase made with a secured card, as with an unsecured card, is a loan from the credit card issuer in the amount of the purchase. Thus, issuers typically report secured card balance and delinquency data to the credit bureaus, which, in turn, means that secured card usage can affect the consumer's credit score, while activity on a prepaid card is not reported.

While there are dozens of product comparison websites and sites instructing consumers on the basics of secured cards — including how they differ from checking account-linked debit, prepaid debit,

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[1] Secured cards are not restricted to consumers with poor or no credit history. Historically, banks have also offered the cards to consumers who want a higher credit limit than what their bank was willing to lend them on an unsecured basis.

[2] In this paper, we limit our discussion to credit cards secured by a cash deposit, although other assets generally may secure credit cards, including home equity or 401(k) balances.

[3] See, for example, Sandberg (2016).

and unsecured cards — secured cards have received little attention in the trade press or academic publications.[4] However, as banks, regulatory agencies, and consumer advocacy groups continue to focus on efforts to bring marginalized consumers into mainstream banking, interest in secured cards is likely to grow.[5] With this paper, we hope to add to the understanding of the existing secured card market by presenting a series of stylized facts based on a recent cross section of the market.

We first profile consumers at the time of account opening. Consumers opening a new secured card account differ from those opening an unsecured card account in many important ways. As we might expect, the distribution of credit risk scores for secured card accountholders who have a credit score at the time of account opening is much more skewed toward high risk. In addition, the median (self-reported) individual income for secured card accountholders at the time of account opening is 43 percent lower than for unsecured accountholders ($35,000 versus $50,000).

Looking at a recent snapshot of the secured card market, we find that it is composed mostly of "plain vanilla" general purpose credit cards. Extra features tend to be lacking on secured cards. For example, only about 12 percent of secured cards have a rewards program. This may be due to the relatively low credit limits on secured cards (90 percent of cards in our sample have a limit of $500 or less), which restricts the volume of transactions that can occur on the card each month and thus the cardholders' ability to earn rewards by making purchases. In addition, despite being fully or partially collateralized, secured cards tend to have less favorable pricing terms than unsecured cards. Most secured cards require an annual fee, tend not to have promotional offers, and often have higher purchase annual percentage rates (APRs) than their unsecured counterparts.

We then examine changes in median credit scores for secured card customers, measured at the time of account opening and again at either the time of account closure or 24 months later, whichever

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[4] See, for example, Irby (2016) and Curry (2016).

[5] Recently, the Center for Financial Services Innovation published a white paper that positioned secured cards as a dual purpose vehicle, both for saving as well as building credit. See Levy et al. (2016).

comes first. We find that keeping a secured card account open is correlated with improved creditworthiness, while closing an account, either in good standing or in default, is correlated with significantly reduced creditworthiness.

The paper is organized as follows. In Section II, we discuss the data used to conduct our analysis and several important methodological points. Section III provides some background on the secured card product, including a brief summary of its history. Section IV includes a description of the secured card market and a profile of consumers at the time they open a secured card account. Results of a cross-sectional analysis of December 2015 data are presented in Section V. In Section VI, we examine changes in credit scores over a two-year period for consumers opening a secured card account. We conclude in Section VII.

II. Data

The primary source of data for this research is the Board of Governors of the Federal Reserve System's Capital Assessments and Stress Testing report ("FR Y-14M"). The FR Y-14M collects data on the loan portfolios of bank holding companies (BHCs) and intermediate holding companies (IHCs) with $50 billion or more in total consolidated assets.[6] The credit card portion of the FR Y-14M is composed of monthly account-level and portfolio-level data. Our analysis focuses on the account-level data for revolving credit card accounts opened as of December 2015.[7] Since we are relying on data from large BHCs and IHCs subject to Federal Reserve reporting requirements, our findings represent a very specific — albeit large — segment of the overall market. We cannot provide details on cards issued by smaller banks, credit unions, or monoline issuers and are unable to determine to what extent the stylized facts presented herein are also representative of that market segment.[8]

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[6] For more information about the FR Y-14M, refer to www.federalreserve.gov/apps/reportforms/reportdetail.aspx?sOoYJ+5BzDYnbIw+U9pka3sMtCMopzoV.

[7] For the rest of the discussion, these data will be referred to as the "December 2015 account snapshot."

[8] Monoline issuers specialize in a single type of financial service, such as consumer credit cards.

In several sections of this paper, we supplement the FR Y-14M data with additional data sources, including direct mail solicitations from Mintel Comperemedia as well as consumer- and tradeline-level credit bureau data from the Federal Reserve Bank of New York's Consumer Credit Panel (CCP) and the Federal Reserve Bank of Philadelphia's CCP tradelines data, respectively. When data other than from the FR Y-14M are being referenced, it will be noted in either the text or footnotes. Otherwise, the data used in the analysis should be assumed to be from the FR Y-14M.

III. Background

Credit cards play an important role in today's marketplace as a ubiquitously accepted payment instrument that can be used for payment regardless of whether the consumer has cash on hand. For some businesses, particularly those providing consumers with the use of a rental asset, such as an automobile or hotel room, the process of requiring consumers to pay by credit card reduces the possibility that the business will be responsible for the bill if the consumer attempts to avoid payment after using the service. Charging the bill to a credit card ensures that payment is made and transfers the liability of nonpayment to the card issuer. While all credit cards tend to function in very similar ways as payment instruments, the space is rich with differentiation along other dimensions. Banks have created hundreds of variants on the basic value proposition of convenience, acceptance, and safety. For example, cobranded and affinity cards appeal to consumers' existing loyalties, and premium cards appeal to our sense of privilege.[9]

Secured cards are a particular type of market innovation, initially designed to provide credit access to consumers who would not ordinarily be approved for unsecured cards. In doing so, secured cards helped expand the availability of credit to constrained borrowers. Most secured cards require a cash deposit as collateral against the credit limit. If a secured card account enters default (severe delinquency resulting in account closure and charge-off), the bank can offset the unpaid balance by liquidating the collateral account, thereby lowering the amount that must be charged off. Thus, secured cards enable

[9] *Cobranded* cards bear the symbol of a partner company. *Affinity* cards are offered to members and supporters of a particular organization, and may also bear the symbol of that organization.

banks to approve segments of consumers whose loss rates would be prohibitive with an uncollateralized product.

At the same time, requiring a cash deposit upfront has several important consequences for the appeal and marketing of secured cards, the net effect of which is that the product generally appeals to a few narrow segments of the credit-seeking population and is an imperfect tool for relieving credit constraints on consumers who are unable to save. First, with some exceptions, the cash deposit tends to limit the appeal of the product to consumers who otherwise would not be approved for an unsecured card.[10] Second, because the consumer must either have cash savings on hand or be able to accumulate it over a relatively short period of time, it screens out those consumers who are too close to their budget constraint to save.

A. Origins of the Secured Credit Card

While we were unable to identify the first bank to issue a secured card, the innovation is believed to have occurred sometime in the late 1970s.[11] Savings and loan institutions (S&Ls) in the San Francisco Bay area played a significant role in the product's early growth and development.[12] By January 1981, seven Bay area S&Ls were offering Visa-branded credit cards backed by savings deposits.[13] These early secured cards required that a deposit be held in an interest-bearing savings or term account (e.g., a certificate of deposit). While minimum deposit amounts varied from $400 to $3,000, not all of the collateral was available to the consumer in the form of available credit. Indeed, collateral ratios (i.e., available credit divided by deposit amount) varied from 50 percent to 80 percent.

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[10] Exceptions include parents opening a joint account with a college age child as well as wealthy consumers willing to freeze some portion of their assets on deposit with the bank.

[11] Consumer Action, a San Francisco-based nonprofit education and advocacy group, first examined secured card programs in the 1970s. See "Build a Healthy Credit Record With a Secured Bank Card" (1997–1998) and Sloane (1991).

[12] Mandell (1990).

[13] Sonntag (1981).

1. The 1980s and 1990s: Reputational Issues

Historically, the combination of a cash deposit requirement and the limited availability of cards in most areas of the country created some unintended consequences that cast the product in a poor light for many years. In 1988, there were fewer than 50 banks offering secured cards.[14] By 1993, the number had doubled to 100 but still represented a small fraction of banks nationwide.[15] With very few banks issuing secured cards, consumers found it difficult to procure an application. This led to the development of third-party services (i.e., credit repair agencies and credit clinics) acting as brokers to find offers for interested consumers, in exchange for a finder's fee.[16] In addition, some third-party brokers would also request the deposit money to be paid to them upfront. As a result, the 1980s saw the emergence of fly-by-night brokers defrauding consumers out of their security deposit and finder's fees and providing no secured card in return. By the late 1980s, the fraud had become rampant. According to Mandell (1990), in 1988, an estimated 1.125 million Americans paid more than $50 million to brokers of secured cards, although only about 10 percent of these applicants ended up with a secured card.

As a result, in the early 1990s, the credit card networks began to implement stricter guidelines around secured card programs of their member banks. In 1991, Mastercard required that all institutions operating a secured card program register with them by September 1.[17] In addition, all new programs had to be approved by Mastercard before any cards would be issued. Several issuers were fined by the networks for deceptive marketing, and both Mastercard and Visa banned the use of telemarketing via 900 numbers.[18]

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[14] Duffy (1988). Note that savings and loans and other thrifts may not be included in this count.

[15] Fickenscher (1993).

[16] "Credit Repair: Save Money, Do It Yourself" (1987).

[17] "Mastercard Tightens Rules for Secured-Card Issuers" (1991).

[18] Conn (1993).

2. The 2000s: Regulatory Scrutiny

While the actions of Mastercard and Visa may have helped to reshape the public perception of secured cards, the product continued to receive scrutiny from bank regulators. In 2004, the Office of the Comptroller of the Currency (OCC), which supervises and regulates all nationally chartered banks and federal savings associations, issued an advisory memo regarding secured cards.[19] In particular, the OCC addressed secured card programs in which the upfront security deposit was charged to the account, in addition to any account opening fees, such that the consumer was left with little available credit on the card. In the memo, the OCC advised national banks not to offer secured cards in which the security deposit and/or fees charged to the card would substantially reduce the amount of credit available to the consumer.

Secured Cards and the Ability to Pay Requirement

Under the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act), as implemented by Section 51 of Regulation Z (12 C.F.R. §1026.51), consumers opening a secured card account are subject to the same ability to pay (ATP) requirements as an unsecured card. The Credit CARD Act's ATP provision requires banks to consider the consumer's ability to make the required payments when providing or increasing a credit limit. To do so, banks must calculate a debt-to-income or debt-to-assets ratio for the consumer based on his or her income or assets and current debt obligations, or banks must check that the consumer's residual income is greater than the minimum payment amount. Thus, a consumer opening a secured card account with $500 in deposit collateral must undergo the same ATP test as someone opening an unsecured account with no cash deposit. The question of whether having a fully collateralized credit limit is sufficient to meet the requirement was raised by at least one industry commenter in the run up to a final rule (Papadimitriou, 2012). For its part, the Consumer Financial Protection Bureau (CFPB) made note of the suggestion but did not change the rule. See 78 Fed. Reg. 25818, 25830, fn 35 (May 3, 2013).

The issuance of insufficient credit lines due to charging upfront fees was again addressed by the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act).[20] The Credit CARD Act restricted the issuance of so-called fee harvester subprime credit cards by placing a limit on the amount of *required* fees that banks were allowed to charge

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[19] Office of the Comptroller of the Currency (2004).

[20] Benton (2010). The Credit CARD Act regulates a wide variety of issuer behavior, including billing and payments, account communications, payment affordability, interest rate changes, and fees. It also includes special provisions for Americans under 21 years of age. Both secured and unsecured cards are covered by the Credit CARD Act; small business credit cards are not.

during the first year an account was open. Section 226.52 of the Credit CARD Act limits fees to a maximum of 25 percent of the credit limit.[21] Thus, required fees cannot exceed $50 on a $200 credit limit or $75 on a $300 limit, so that the consumer retains $150 or $225 of the available credit line for purchases.

B. Collateral Types

Card issuers have been experimenting with different types of collateral since at least 1985. At that time, Default Proof Credit Card System Inc. of Miami introduced a credit card backed by the cash surrender value of the accountholder's life insurance policy.[22] By 1990, card issuers were partnering with insurance companies to offer secured cards to consumers who were willing to pay about $50 per month for life insurance with virtually no cash value. In July 1994, Merrill Lynch Capital Corp. began issuing a credit card collateralized by the value of the consumer's securities held with Merrill.[23] The credit card had a maximum limit of $300,000 and an annual fee of $65. Every dollar of credit limit had to be secured by $1.40 of assets.

C. Account Opening

When consumers open a secured card account with a bank, they are typically opening two accounts: a credit card account and a deposit account.[24] Consumers pledge cash collateral as security for the credit card account, and the cash is transferred to the deposit account.

The credit card agreement typically contains one or more paragraphs governing the deposit account in which the collateral funds are saved.[25] In general, such agreements have three key elements. First, the consumer grants the bank the authority to open a deposit account in his or her name, which the

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[21] Required fees include application or processing fees and annual or monthly maintenance fees but do not include late, over-the-limit, or insufficient funds fees. Note that the security deposit is not considered a fee.

[22] "You Bet Your Life" (1993).

[23] Lucas (1994).

[24] In some cases, consumer deposits are held in a pooled savings account.

[25] See, for example, sample agreements from Wells Fargo (https://www.wellsfargo.com/credit-cards/agreements/secured-card-agreement) and Capital One (https://www.capitalone.com/media/doc/credit-cards/Credit-Card-Agreement-for-Consumer-Secured-Cards-in-Capital-One-Bank-USA-N.A.pdf).

consumer must then fund before receiving the card. The account may or may not be interest bearing; this will typically be explained in the agreement. Second, consumers agree to cede control of the deposit account to the bank so that they cannot make any withdrawals from the account, nor can they close the deposit account without also closing the credit card account. Under certain circumstances, some banks will allow consumers to increase their credit limit by adding funds to the deposit account.[26] Third, the bank may withdraw the funds in the event of default or account closure. If the consumer defaults, the collateral can be used to reimburse the bank for interest and fees as well as transactional charges. If, after the bank is reimbursed, there are still funds in the deposit account, the bank agrees to return them to the consumer within a certain period of time.

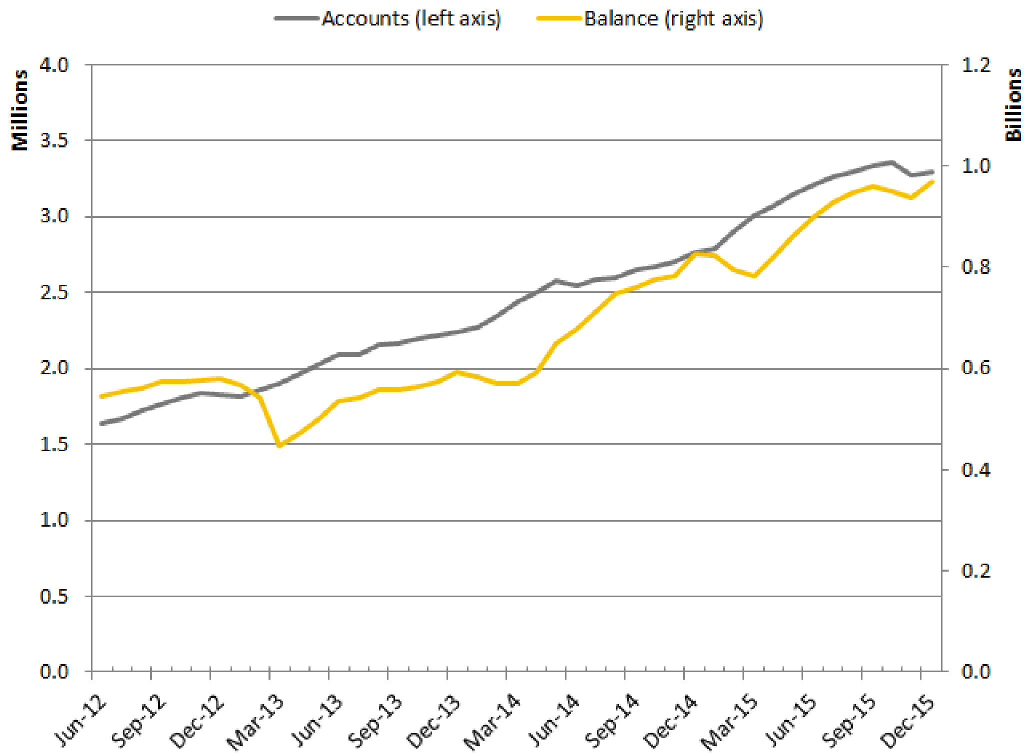
IV. Market Structure and Consumer Profile

A. Market Structure

Although secured cards are available through a variety of commercial and community banks, thrifts, and credit unions, the market is dominated by a handful of large issuers, many of whom also dominate the unsecured card market. Since the Board of Governors of the Federal Reserve System began collecting the FR Y-14M data in June 2012, the number of open secured card accounts held by large BHCs and IHCs has grown at an annualized rate of 22 percent, from 1.6 million in June 2012 to 3.3 million in December 2015 (Figure 1, gray line). Outstanding balances have likewise increased by 17.6 percent annually, from $570 million to nearly $1 billion (Figure 1, yellow line).

[26] While most banks require a one-time deposit, some banks allow consumers to fund their deposit account with multiple deposits. For example, Capital One allows consumers to make partial payments within 80 days of being approved. See https://www.capitalone.com/credit-cards/secured-mastercard/.

Figure 1. Open Secured Cards[27]



Looking at a sample of open accounts reported by large bank holding companies (BHCs) as of December 2015, we find that secured cards represent less than 1 percent of open accounts and even less as a percentage of outstanding balances.[28] The market is highly concentrated because many smaller banks and many of the banks in our sample do not offer a secured card at all. In fact, six of the 19 large BHCs reporting do not offer a secured card product. For another seven of the 19 large BHCs, secured cards represent less than 2 percent of their portfolio.

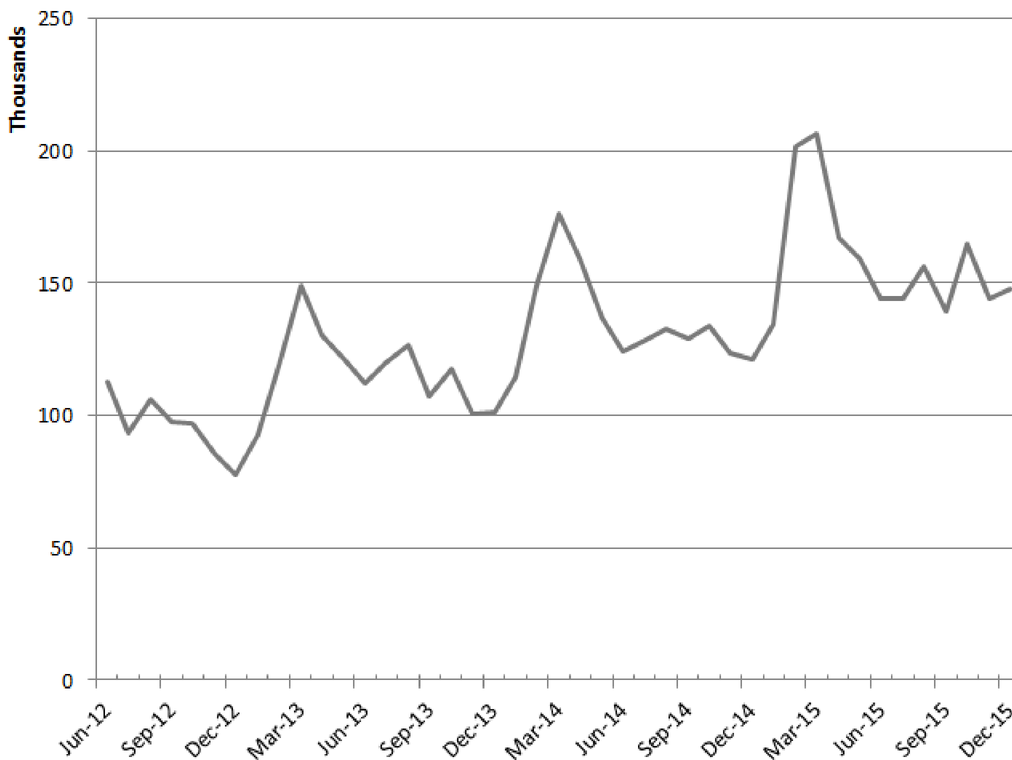
Figure 2 plots the growth in new secured card accounts. New account bookings have generally trended upward during the three and a half years in our sample. The peaks in new accounts coincide with

[27] Source: FR Y-14M

[28] Source: FR Y-14M

March of each reporting year, suggesting that customers may be using a portion of their tax refund for the security deposit.

Figure 2. New Secured Card Accounts[29]



B. Consumer Profile

In this subsection, we use CCP data to profile consumers at the time they open a new secured card account.[30] As might be expected, we find that these consumers tend to be new to credit or have had their credit damaged in the past. Table 1 shows that, for consumers opening a credit card account between June 2012 and June 2015, secured card consumers tend to have fewer open bankcards and less credit

[29] Source: FR Y-14M

[30] We include accounts marked as either secured cards or partially secured in the Equifax narrative codes. Narrative codes record a variety of account information, such as account type, past due status, inclusion in bankruptcy filing, and charge-off or closure. We caution that this method may not capture all secured cards reported to Equifax since some banks may report secured cards under a different narrative code. In addition, while there may be many narrative codes assigned to a particular account, the CCP contains only the first two codes. Thus, we will be unable to identify secured cards for which the first two narrative codes reflect information other than card type.

extended to them. At the same time, what little credit these consumers have is used about 50 percent less than unsecured card openers, suggesting that many consumers who open a secured card are doing so to improve their credit scores or as an additional payment method, as opposed to needing additional credit on which to borrow. Table 1 also shows that, on average, consumers who open a secured card account have 0.43 other open bankcards, with less than $1,400 in total bankcard credit, of which 14.5 percent is currently being utilized.[31] In contrast, consumers who open an unsecured card account have, on average, 2.58 open credit card tradelines and more than $24,000 in credit with a 31.4 percent utilization rate.

Table 1. Consumer Snapshot at Account Opening[32]

Card Type	Average Number of Other Open Cards	Average Credit Limit on Existing Accounts	Average Utilization of Existing Credit
Secured	0.43	$ 1,379	14.5%
Unsecured	2.58	24,032	31.4

V. Market Snapshot

In this section, we provide an overview of the secured card market. We provide some stylized facts about the types of accounts currently open. Whenever possible, we compare these accounts with their unsecured counterparts, with the caveat that the two products generally serve different segments of the credit card market.

A. Credit Score at Origination

Since secured cards always require an upfront cash deposit and typically come with an annual fee, a customer who qualifies for an unsecured card will generally be better off with the unsecured card.[33] Consequently, the credit score distributions of secured and unsecured card customers share very little

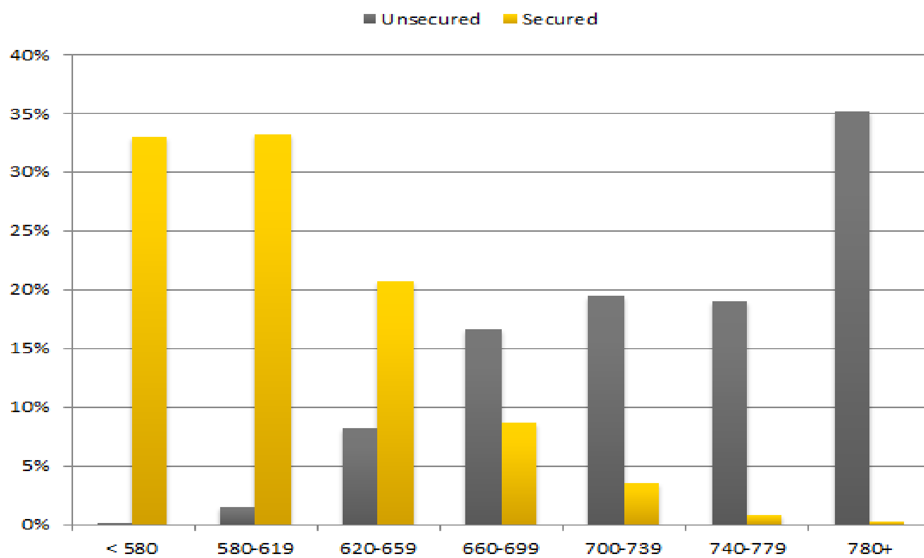
[31] Credit card utilization is the statement ending balance as a percentage of the credit limit.

[32] Sources: New York Federal Reserve CCP and Philadelphia Federal Reserve CCP tradelines data. The data include consumers who opened a credit card account between June 2012 and June 2015.

[33] This is not strictly the case, because several monoline credit card issuers offer fee-heavy unsecured cards to the subprime population, in which case, some consumers may qualify for an unsecured card but may be better off with a secured one.

overlap.[34] Figure 3 compares the distribution of FICO risk scores at the time of account origination for secured and unsecured cards.[35] At the low end of the score distribution, about 33 percent of secured card accountholders had a FICO score below 580 at the time of account origination compared with 0.1 percent of unsecured card accountholders. At the high end of the distribution, 4.5 percent of secured card accountholders had a score of 700 or greater compared with 73.6 percent of unsecured card accountholders.

Figure 3. FICO Score Distribution at Account Origination[36]



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[34] While some secured card applicants may not have sufficient credit history to be scored by a credit risk model, we were unable to distinguish between accountholders with no score versus those for whom a record was missing. Thus, we do not present information on missing records.

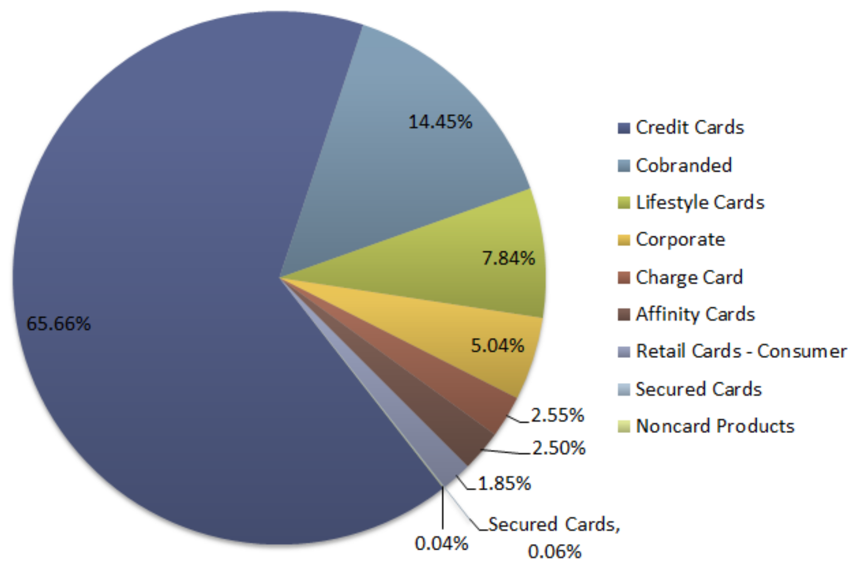
[35] In the FR Y-14M data, not all issuers report the same credit score at account origination. In Figure 3, we report on accounts with a FICO 08 score since these represent the largest plurality (43 percent). While the data are not representative of the entire sample, the data are an adequate representation of the comparative risk distributions of secured and unsecured cards. An additional 34 percent of accounts were reported with a FICO Classic score. We included a frequency distribution by FICO Classic score in the Appendix. FICO is a registered trademark of Fair Isaac Corporation.

[36] Source: FR Y-14M, December 2015 account snapshot; accounts reported during the month of December 2015 with primary borrower origination score are noted as FICO 08

B. Acquisition Channel

Using direct mail solicitation data from Mintel, we calculated the share of total direct mail credit card offers for various types of credit cards in 2015. As shown in Figure 4, secured card offers made up just 0.06 percent of total direct mail volume, which is less than one-tenth of the product's share of outstanding accounts. Thus, consumers must be acquiring secured cards via alternative means.

Figure 4. Share of Credit Card Acquisition Mail by Category (2015)[37]



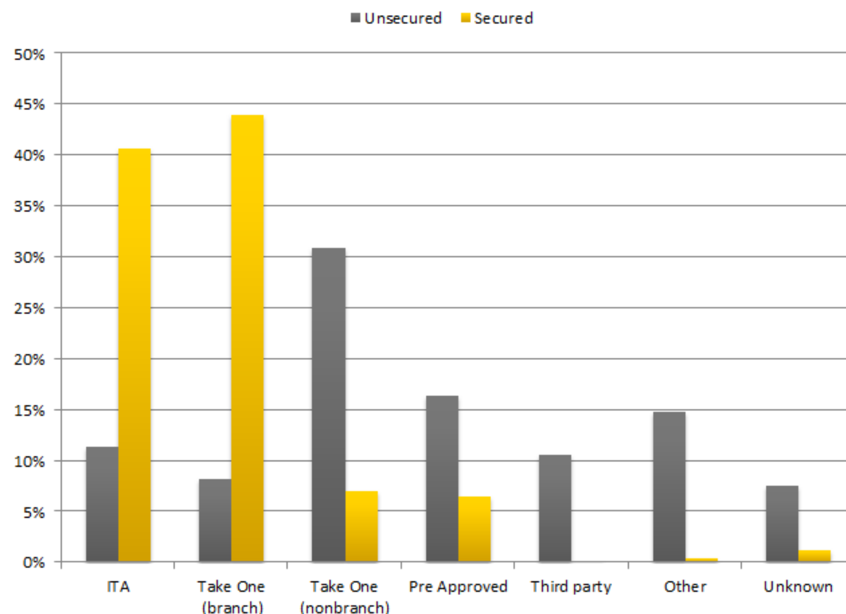
Fortunately, the FR Y-14M reports the acquisition channel of every account. Figure 5 presents the account distribution by acquisition channel. About 44 percent of secured card applications originate from an in-branch paper application (known as a "take-one").[38] A substantial fraction of secured card customers are acquired by mail: 6.5 percent came from pre-approved direct mail offers, and 41 percent of

[37] Source: Mintel Comperemedia interactive analysis tool

[38] "Take-one" applications are often provided by customer service agents to existing banking clients walking into their local branch but may also be given to consumers without an existing relationship.

secured card applications originate from an invitation to apply (ITA) mail offer.[39] Internet applications do not yet appear to be a substantial source of secured cards. Figure 5 shows that 7 percent of secured card applications come from unsolicited nonbranch "take-ones," including Internet applications, compared with 31 percent for unsecured card accounts.

Figure 5. Credit Card Acquisition Channel[40]



C. Income at Origination

The income distribution of secured card accountholders at the time of account opening is centered at a significantly lower level than that of consumers opening unsecured card accounts. Table 2 shows that,

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[39] Pre-approved offers for secured cards may result from banks presenting customers who applied for and were turned down for an unsecured card with a secured card counteroffer. Invitation to apply (ITA) offers differ from pre-approved offers in that the consumer's credit bureau records typically are not accessed before mailing. Similar to accepting a "take-one" application, prospective ITA applicants must undergo a credit review upon submitting their application and, thus, may be declined.

[40] Source: FR Y-14M, December 2015 account snapshot; ITA refers to accounts originated based on a solicitation that required a customer to undergo a full credit review prior to approval. *Take-one (branch)* refers to unsolicited accounts based on the customer completing an application obtained at the bank. *Take-one (nonbranch)* refers to unsolicited accounts based on a customer completing an Internet, magazine insert, or event marketing application. *Pre Approved* refers to accounts originated under a program where the issuer solicits a list of potential customers to which it will make an offer of credit. *Third party* refers to accounts added as a result of portfolio acquisition or mergers. *Other* refers to a known channel not included in the previous channels.

for consumers reporting individual income, the median annual income is 30 percent lower for consumers opening secured card accounts than unsecured card accounts ($35,000 versus $50,000). The gap is wider for those reporting household income; at the median, consumers opening secured card accounts report a median annual household income of $37,000 compared with $70,000 for consumers opening unsecured card accounts. Using tradeline-level credit bureau data from June 2015, we examined whether some of this difference may be attributable to consumer demographics: Younger consumers tend to have lower income than older ones and may be more likely to open a secured credit account.[41] We found that consumers who opened a new secured card account during the first six months of 2015 were an average of 8.5 years younger than consumers who opened an unsecured credit account (37.5 versus 46). Thus, some part of the discrepancy between incomes of consumers with secured and unsecured card accounts could be accounted for by an upward sloping age-income relationship.

Table 2. Annual Income at Origination[42]

		Percentile				
Income Type	Card Type	10th	25th	50th	75th	90th
Individual	Secured	$16,000	$24,000	$35,000	$50,000	$100,000
	Unsecured	$15,000	30,000	50,000	80,000	165,000
Household	Secured	9,000	22,000	37,000	60,000	94,400
	Unsecured	16,800	38,600	70,000	111,000	170,000

D. Original Credit Limits

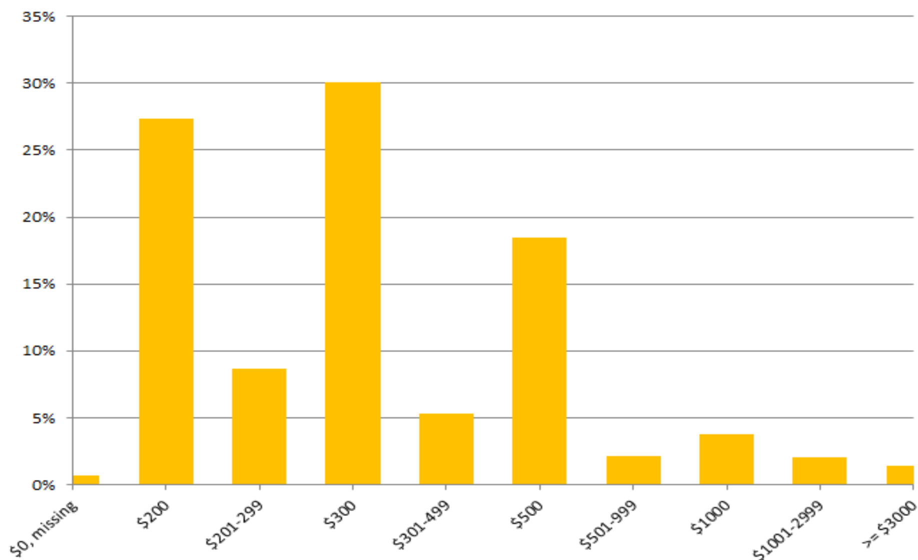
Credit limits on secured card accounts tend to be very low. The vertical bars in Figure 6 represent the distribution of original credit limits on all secured cards in the December 2015 snapshot. We note that the credit limit reported in our data set may be less than the limit approved by the bank. It represents the amount of security deposit the consumer chose to provide after receiving notification of approval and a

[41] Source: Philadelphia Federal Reserve CCP tradelines data

[42] Source: FR Y-14M, December 2015 account snapshot; excludes borrower income type = "other," banks with a large percentage of missing data, and banks reporting monthly income

maximum secured credit limit. We do not observe the approved credit limit. More than 76 percent of accounts have an initial credit limit of $200, $300, or $500. This is likely due to a combination of banks' reluctance to extend too much credit — even on a secured basis — to risky (or unproven) consumers and consumers' reluctance or inability to provide a larger upfront cash deposit, which can be equal to the size of the credit limit.

Figure 6. Credit Limit Distribution[43]



E. Current Status

In this section, we examine the distribution of secured cards by account status as of December 2015. To do so, we classify open accounts as transacting, revolving, delinquent, or inactive. *Transacting accounts* paid their previous statement balance in full, while *revolving accounts* paid an amount greater than or equal to their minimum payment but less than their full balance. We classify open accounts as *delinquent* if they paid less than their minimum payment (including making no payment). *Inactive accounts* had no previous statement balance. In addition, we classify closed accounts into three

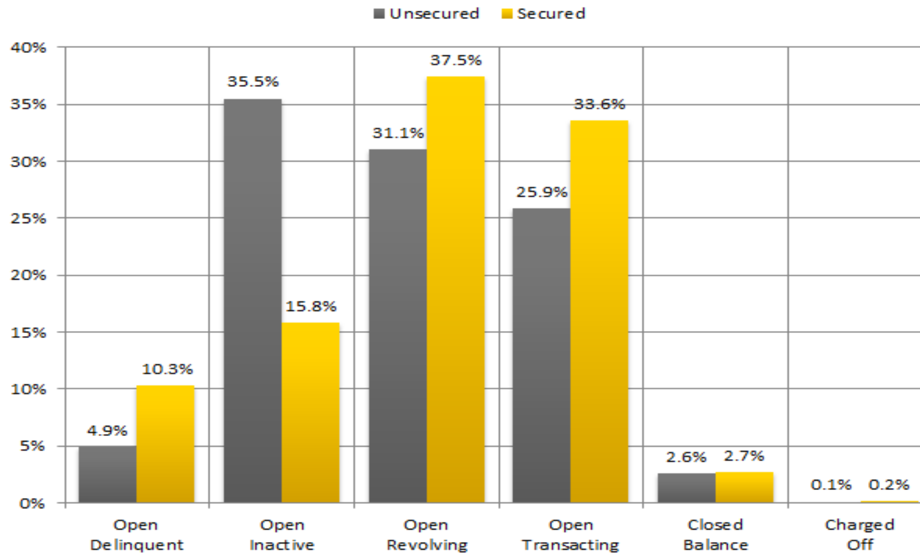
[43] Source: FR Y-14M, December 2015 account snapshot

subgroups: closed with a balance, closed without a balance, and charged off this month.[44] Accounts *closed with a balance* are marked as closed but have a positive balance as of December 2015, while accounts *closed without a balance* do not.

Figure 7 presents the distribution of account status as of December 2015 for both secured and unsecured cards. This figure identifies several important features of the secured card market. First, there are considerably fewer inactive accounts in the secured card population, 15.8 percent compared with 35.5 percent of unsecured cards. One possible reason for this is consumers' desire to withdraw the collateral balance on an unused secured card, a concern not present for an unsecured card. Another reason might be that, as shown in Table 1, secured card customers have fewer other credit cards with which to transact. Second, the percentage of secured card accounts in a delinquency status is more than double that of unsecured (10.3 percent versus 4.9 percent), perhaps reflecting differences in the respective risk distributions. Third, a large percentage of secured card accounts are revolving (not paying their balance in full each month). This is interesting, given that secured cards tend to have considerably lower credit limits than unsecured cards. We note that, while Figure 7 shows a higher percentage of secured card accounts are revolving than unsecured card accounts, the result reverses when we remove inactive accounts from the denominator. Excluding inactive accounts, 44.5 percent of secured cards are revolving compared with 48.2 percent of unsecured cards.

[44] Accounts charged off in previous months are required to remain in the data set for 12 months; however, we exclude them from the analysis.

Figure 7. Account Status Distribution[45]



F. Contract Terms: Fees and Annual Percentage Rates (APRs)

Although secured by a cash deposit, pricing on secured cards tends to be less favorable than on unsecured cards. In the December 2015 snapshot, most secured cards require an annual fee, tend not to have promotional offers, and often have higher purchase APRs than unsecured cards.[46] Figure 8 shows that 83 percent of secured cards have an annual fee compared with 10 percent of unsecured cards. Annual fees on secured cards range from $18 to $125, with a mode of $29, as shown in Table 3. While Table 3 presents data on both secured and unsecured card fees, we caution against comparing the numbers because most secured cards do not have rewards; in addition, the typical secured card customer will not qualify for many of the high-fee prestige cards. There are also few comparable unsecured accounts at the high-risk end of the spectrum.

[45] Source: FR Y-14M, December 2015 account snapshot; excludes accounts closed without a balance

[46] In addition, 96 percent of secured cards have a variable APR that will fluctuate with the prime rate or LIBOR compared with 88.9 percent of unsecured cards.

Figure 8. Fee Type[47]

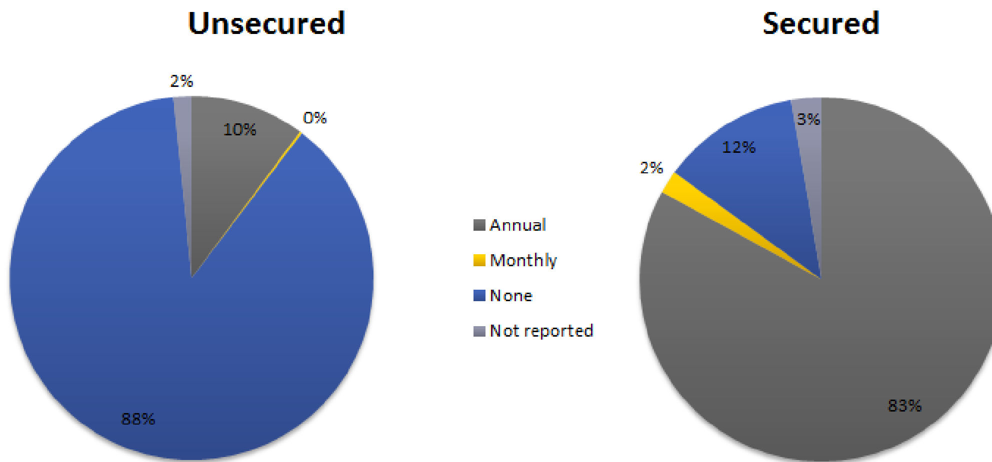


Table 3. Annual and Monthly Fees[48]

	Annual		Monthly	
	Secured	Unsecured	Secured	Unsecured
Min	$18.00	$18.00	$3.00	$1.00
Max	125.00	950.00	3.00	30.00
Mean	29.60	63.94	3.00	4.25
Median	29.00	55.00	3.00	5.00
Mode	29.00	39.00	3.00	5.00

Compared with unsecured cards, the distribution of purchase APRs for secured cards is concentrated in a fairly narrow range. Table 4 shows that more than 95 percent of secured cards have an APR greater than 15 percent and less than or equal to 25 percent. On the other hand, APRs for unsecured cards appear to be more evenly distributed, from 10 percent to 25 percent. We note that just 0.2 percent of secured cards have a current purchase APR greater than 25 percent compared with 14.4 percent for unsecured cards.

[47] Source: FR Y-14M, December 2015 account snapshot

[48] Source: FR Y-14M, December 2015 account snapshot, accounts with an annual fee > $1.00

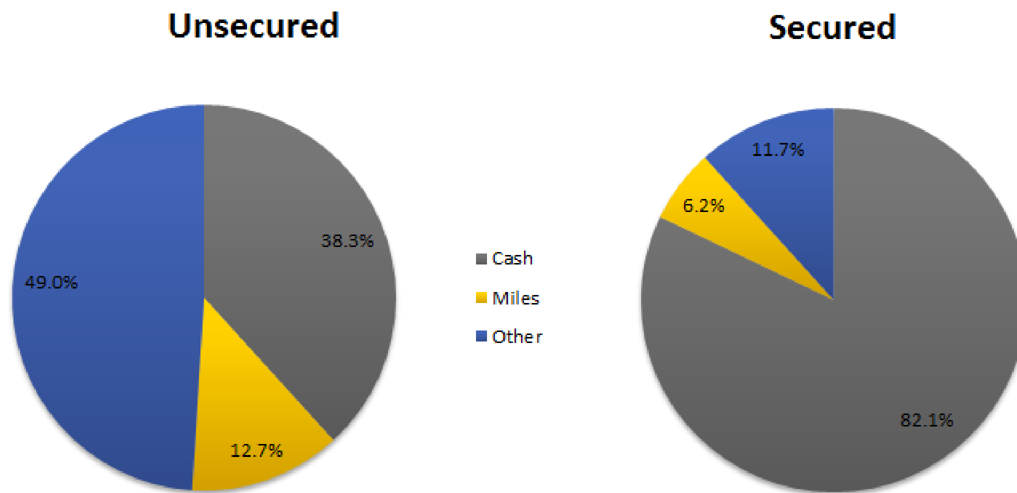
Table 4. Purchase APR Distribution[49]

Purchase APR	Secured	Unsecured
0%	2.4%	3.9%
(0,10%]	0.0	5.1
(10,15%]	1.4	24.7
(15,20%]	31.6	22.1
(20,25%]	64.3	29.8
> 25%	0.2	14.4

G. Rewards Programs

Secured cards tend not to have an associated rewards program. In our data set, just 12 percent of secured cards had a rewards program of any kind compared with 47 percent of unsecured cards. For the accounts that do have a rewards program, Figure 9 shows that 82.1 percent offer cash back, 11.7 percent offer points and other rewards, and 6.2 percent offer travel miles.

Figure 9. Rewards Type[50]



[49] Source: FR Y-14M, December 2015 account snapshot. Issuers are asked to report the purchase APR unless the account is in default or workout, in which case they must report the default or workout APR; excludes accounts for which APR is not reported.

[50] Source: FR Y-14M, December 2015 account snapshot. *Other* category includes point rewards programs.

H. Network and Card Type

The majority of secured cards are issued through the Visa network. Secured Visa cards account for 55.5 percent of open secured card accounts, while about 43.9 percent of accounts are issued through Mastercard and 0.6 percent are on the Discover network. No banks in our data set offer a secured card through the American Express network.[51] While about 70 percent of unsecured cards are considered general purpose cards and 30 percent are private label, all secured cards are general purpose.[52] In addition, a small percentage of secured cards bear the symbol of a partner company, known as a cobranded card.

I. Additional Users

Most secured cards are underwritten based on the creditworthiness of a single borrower who is also the only person authorized to use the account. We found that 98.4 percent of secured cards are individual accounts, while only 3.5 percent have more than one authorized user. In contrast, 95.1 percent of unsecured cards are individual accounts, while 18.6 percent have more than one authorized user.

VI. Changes in Credit Score

In this section, we examine how consumers' credit scores change after opening a secured card account. Since usage and payment on a secured card are just two of the many factors that influence changes in credit score over time, our observations are not meant to be interpreted as causal. We first construct a distribution of account status after two years of performance, noting that many accounts reach a terminal status prior to the end of two years. We then calculate the change in median credit scores after segmenting by terminal status.

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[51] To our knowledge, there is at least one financial institution currently offering a secured American Express credit card.

[52] A general purpose credit card may be used to make purchases at any location that accepts cards on its particular network (e.g., Visa, Mastercard). In contrast, private label credit cards may only be used at the retailer, dealer, or manufacturer whose name they bear.

Table 5 shows that, after two years, 82.2 percent of secured card accounts remain open, while 17.6 percent are reported as closed or charged off. The majority of accounts are nondelinquent with a revolving balance (45.4 percent), while 22.4 percent are transacting and paying their balance in full. Just 5.2 percent of accounts are open but inactive after two years, and 9.2 percent are open but delinquent by one or more billing cycles.

Table 5. Secured Card Account Status After 24 Months[53]

Status	Substatus	Percentage
Closed	Without a balance	7.0%
	With a balance (not charged off)	2.4
	Charged off	8.2
	Total Closed	17.6
Open	Transacting	22.4
	Revolving, nondelinquent	45.4
	Inactive	5.2
	Delinquent	9.2
	Total Open	82.2

The 17.6 percent of accounts that are closed within two years are composed mostly of charged-off accounts (8.2 percent) and accounts closed in good standing, or without an outstanding balance (7.0 percent). Accounts marked closed but with an outstanding balance represent 2.4 percent. Thus, fewer than half of closed accounts are charged off, while more than half of accounts are closed without a balance or close and enter a repayment-only period.

In Table 6, we present data on changes in median FICO scores for secured card accountholders, grouped by terminal status as shown in Table 5. Due to sample size restrictions, we group all open account statuses into a single category. We find that the scores for those consumers who keep their secured account open rise by about 24 points over the course of two years. In contrast, consumers whose accounts close without a balance, close with a balance, or charge-off tend to have much lower credit scores. The credit scores of consumers whose secured card account is closed within two years, either with

[53] Source: FR Y-14M; secured card accounts opened June 2012 to January 2014 with updated FICO risk scores

or without a remaining balance, fall by 42 and 46 points, respectively. Consumers whose secured card account charges off within two years see a 60-point drop in credit score.

Table 6. Changes in Median Risk Scores[54]

Account Grouping	Median Risk Score at Origination	Median Risk Score After Two Years	Change in Score
Open	589	613	+24
Closed with a balance	569	527	-42
Closed without a balance	568	522	-46
Charged off	574	514	-60

Thus, while we cannot say that keeping a secured card open leads to higher credit scores, it seems to be correlated with behaviors, circumstances, or luck that suggest improving creditworthiness. On the other hand, failing to maintain an open secured card account is associated with a substantial decrease in creditworthiness.

VII. Conclusion

We presented a brief exposition of the history of the secured card, a credit instrument designed primarily for consumers who are looking to build or repair their credit history but who tend not to qualify for most unsecured cards. The first secured cards were originated by S&Ls in California during the late 1970s. Growth was slow through the 1980s and early 1990s as fewer than 100 banks offered secured cards nationally. Difficulty in locating a bank with a secured card program led some consumers to send money to disreputable third-party services offering card broker services. With public perception of the benefits of secured cards being outweighed by negative experiences and publicity, in the early 1990s Mastercard and Visa implemented guidelines governing the offerings of secured cards by their member banks. In 2004, the OCC addressed the problem of consumers being left with little available credit after

[54] Source: FR Y-14M; secured card accounts opened June 2012 to January 2014 with updated FICO 08 risk scores

fees and security deposits were charged to the account and issued a memo advising national banks not to engage in such activities. The Credit CARD Act of 2009 placed further restrictions on upfront fees by placing a limit on the amount of required fees that banks were allowed to charge during the first year an account was open.

We documented a series of stylized facts based on a December 2015 cross section of the secured card market. The market is highly concentrated, and many banks do not offer a secured card at all. The distribution of credit risk scores for secured card accountholders who have a credit score at the time of account opening is highly skewed; for consumers with FICO 08 scores, about 67 percent have a score below 620 compared with 1.6 percent for consumers with unsecured cards opened during the same time period. The annual income of secured card consumers is about 43 percent lower than unsecured card consumers. Median annual incomes range from $32,000 to $37,000 for the 90 percent of secured card accountholders whose cards have a limit between $200 and $500.

Despite being fully or partially collateralized, secured cards tend to have less favorable pricing terms. Most secured cards require an annual fee, tend not to have promotional offers, and often have higher purchase APRs than their unsecured counterparts. In addition, only 12 percent of secured cards offer a rewards program.

Looking at the distribution of accounts by status as of December 2015, we found that there are considerably fewer inactive secured card accounts than there are unsecured (15.8 percent compared with 35.5 percent). In addition, the percentage of secured card accounts in a delinquency status is more than double that of unsecured (10.3 percent versus 4.9 percent). Last, a high percentage (37.5 percent) of secured card accounts revolves a balance.

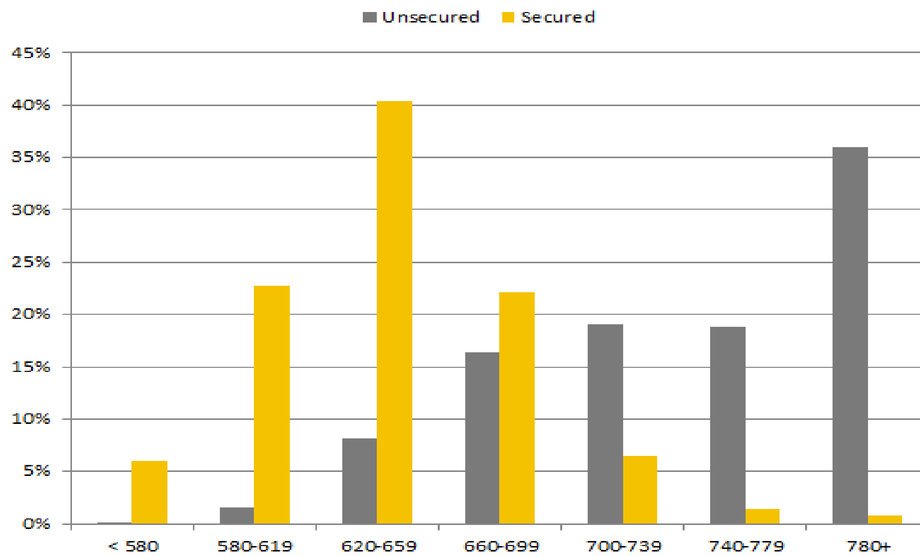
We then examined changes in median credit scores for secured card customers, measured at the time of account opening and again at either the time of account closure or 24 months later, whichever came first. We found that keeping a secured card account open for a full two years is associated with a 24-point increase in median credit scores, while closing an account due to default is associated with a 60-point decrease in median credit score.

While secured cards represent a small fraction of the total credit card market, they remain an important payment mechanism and credit building tool for consumers unable to acquire an unsecured card. There may be opportunities for the product to evolve into a tool for building cash savings as well.[55] We will continue to monitor developments in the secured card market as they occur.

[55] Levy et al. (2016).

Appendix

Figure A1. FICO Classic Score Distribution at Account Origination[56]



[56] Source: FR Y-14M, December 2015 account snapshot; accounts reported during the month of December 2015 with primary borrower origination score identified as FICO Classic

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