Bankcard Changes: Consumer Impact

April 2011

INTRODUCTION

Bankcard companies successfully grew their businesses in the 1990s and early 2000s with a strategy that relied upon winning new customers through easy access to credit, while awarding existing customers with frequent credit line increases and multiple card accounts originated from the same lender. As a result, many consumers accumulated four to five credit cards, with $100,000 or more in collective available credit.

In the context of the economy during that period—driven first by the dot-com boom and then by the real estate bubble—this strategy generated strong revenues and a growing customer base.

Dramatic changes, however, rippled through the U.S. economy beginning late in 2007. A recessionary cycle began suddenly with the failure of financial institutions whose asset bases were linked to a declining housing market. The result was a sense of generalized anxiety among U.S. financial institutions that led to a fundamental reappraisal of many tested strategies, including the traditional 'high-credit limit, plentiful account' model used by bankcard companies over the preceding decade.

Coincidentally, as home equity declined and recessionary national unemployment began its climb to 10 percent, consumers who had become accustomed to relying on real estate as their primary asset to access capital began instead to look to unsecured lines of credit to meet their financial needs.

However, just when the consumer needed credit, in many cases bankcard companies began limiting access to credit by tightening standards for new accounts and reducing credit limits with existing customers. These changing lender strategies caught the attention of the media and this tension made for compelling articles. As is often the case though, there was more to the story. Credit line reduction and card closings are not unusual, but have traditionally been focused on consumers with deteriorating risk profiles. The decreases that occurred in Q1 2009 touched a broader population, and therefore garnered greater media focus.

SUMMARY INSIGHTS

In the midst of an economic downturn, driven in large-part by a housing bubble and the resulting mortgage crisis, in Q1 2009 many lenders engaged a strategy to ease portfolio exposure by reducing credit lines on a large number of consumer accounts. Widespread media coverage suggested that this credit line decrease action by lenders caused severe credit score reductions for those consumers who received the line decreases. While credit scores on average fell throughout 2009, the study results arrive at a different conclusion and demonstrate both a dynamic environment and many contributing factors to why credit scores dropped:

- Credit score decreases were seen on average among consumers at all levels of credit quality, without regard to the direction of credit limit actions by lenders.

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SUMMARY INSIGHTS (Cont.)

  - » Credit line decreases had minimal impact on credit scores.
  - » In a previous study, we found that a consumer who experiences even as much as a 40% credit line reduction sees on average a VantageScore® credit score drop of only 10 points.

- Lenders did not apply a universal strategy to reduce credit limits on all consumers—49% of consumers saw a decrease, 14% experienced an increase and 37% saw no change to their bank card credit limits.
- Many consumers whose credit limits were lowered started out with very high limits and even after the reductions, still had relatively high credit limits.
- Utilization rates increased almost universally for all consumers regardless of whether their credit line was decreased, increased or not changed by lenders in Q1 2009.
- An uptick in delinquencies occurred across all categories of consumers, beginning in Q2 2009, regardless of whether credit limits were increased, decreased or left unchanged.
- Increased delinquencies and increased use of credit lines by consumers in 2009 were the primary drivers of score movement and risk deterioration, rather than specific credit line adjustment strategies by lenders.

In the current economic environment, credit card strategies deployed in the early 2000s that rely on high credit limits and multiple accounts appear to be less effective, and in fact, have led to increased exposure for both lenders and consumers. Reductions in credit limits in early 2009 reflect lenders' acknowledgement for a needed change in strategy.

Appropriately, changing credit scores and risk—whether caused by shifting macroeconomic factors, or by individual consumer behavior—must be accounted-for by lenders. The challenge to lenders is identifying qualified consumers in a difficult economic climate, and to engage those consumers with an effective, targeted marketing strategy.

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PURPOSE

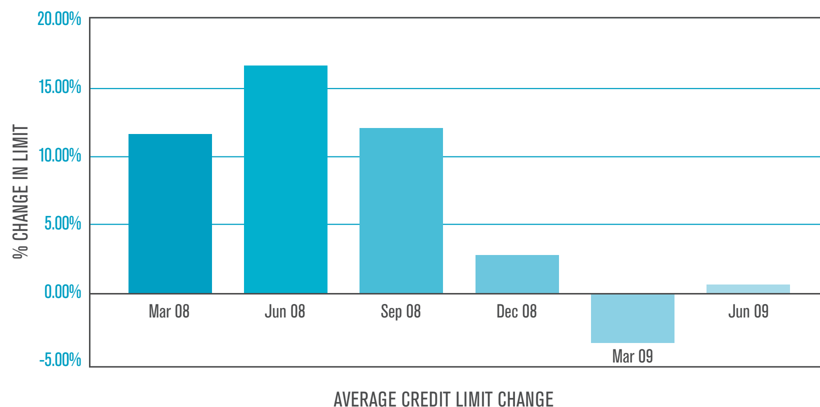
With a sizeable window of actual consumer behavior performance available following Q1 2009 credit limit decreases, VantageScore Solutions constructed a study to identify and explain the impact of lender credit line adjustment strategies to the consumer. The strategies are identified in this paper as "line increase," "line decrease," or "no change." A database of two million consumers were randomly selected from the TransUnion credit files and their behavior tracked by quarter from December 2007 through December 2009.[1] Consumers with active bankcards were assigned to one of these strategy groups according to the credit line adjustment they experienced in Q1 2009. Subsequent behavior for the consumers in each of these strategy groups was then measured over the next nine months. In addition, the study provides the impact of these strategies on key metrics for each strategy group and by the following score bands: 501-600, 601-700, 701-800, 801-900, and 901-990 (the VantageScore® range is 501-990).

This study also contrasts the extent to which consumers were impacted by broader recessionary behaviors in the midst of these credit line strategies. Finally, several overarching credit and consumer trends are isolated and commentary is provided on a possible opportunity for lenders.

CREDIT LIMIT REDUCTIONS AND CARD CLOSURES

As described above, when the economy began to show signs of slowing in 2008, lenders continued to increase bankcard credit limits for the first half of the year. Figure 1 reflects the percentage change in the credit limit relative to the preceding quarter for a representative sample of active U.S. bankcard consumers. While average credit limits were increased by more than 15% in the second quarter of 2008, increases were less than five percent on average in the fourth quarter of 2008. By Q1 2009, credit limits were decreased on average by nearly five percent.

FIGURE 1
CHANGES IN CREDIT LIMITS COMPARED TO PRECEDING QUARTER



[1] Personally identifiable information was removed from the consumer data prior to the data being furnished to VantageScore Solutions. VantageScore Solutions does not have nor maintain consumer credit files with personally identifiable information.

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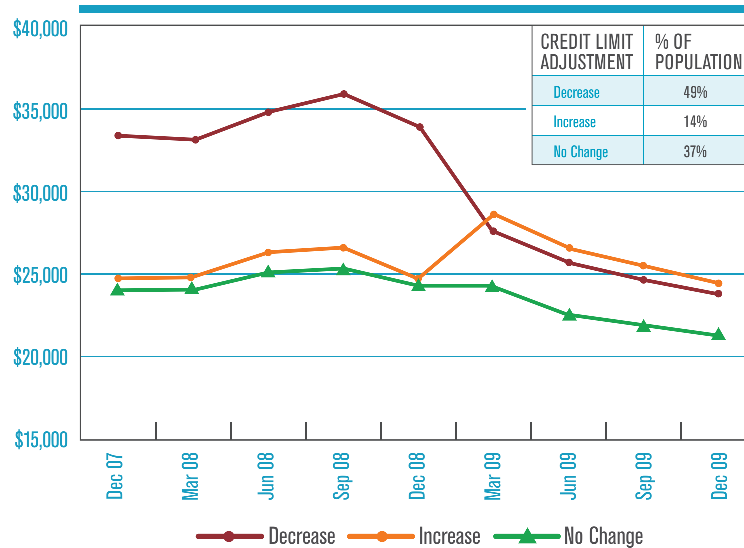
WHAT ACTUALLY HAPPENED TO CONSUMER CREDIT LIMITS?

While this high level data—showing an overall reduction in average credit limits in Q1 2009—is instructive and indicative of an overall trend which began in mid-2008, closer examination to the Q1 2009 study population improves understanding of the implications and impacts from the changing credit limits.

FIGURE 2
TOTAL ACTIVE BANKCARD CREDIT LINE



The data reveals that 49% of consumers experienced a credit limit reduction in Q1 2009, 37% of consumers experienced no change to their credit limits and 14% actually experienced increases to their credit limits.

WHAT ACTUALLY HAPPENED TO CONSUMER CREDIT LIMITS?

(Cont.)

For consumers whose credit limits were decreased in Q1 2009 (Figure 2 - red line) or left unchanged (green line), decreases in the average credit lines began in September 2008, prior to the more widespread limit decreases in Q1 2009. It is noteworthy that throughout 2009, there was a general decline of the total active bankcard credit line among all three groups, as lenders continued to apply their strategy of targeted exposure reduction to their portfolios.

Significantly, it is important to recognize that many consumers whose credit limits were lowered in Q1 2009 started out with very high credit limits, and even after the reductions, still had relatively high credit limits, particularly those in higher score bands (Figure 3).

FIGURE 3
CREDIT LIMIT STRATEGIES BY SCORE, Q1 2009

SCORE BAND	CREDIT LIMIT ADJUSTMENT	% OF SCORE BAND	% OF POPULATION	% ADJUSTMENT TO LIMIT	NEW LIMIT
501-600	Decrease	58%	3%	-31%	$6,555
	Increase	20%	1%	13%	$4,795
	No Change	22%	1%	0%	$4,375
601-700	Decrease	48%	8%	-17%	$14,971
	Increase	18%	3%	12%	$11,685
	No Change	34%	5%	0%	$9,902
701-800	**Decrease**	**42%**	**9%**	**-16%**	**$25,007**
	Increase	18%	4%	15%	$25,442
	No Change	40%	9%	0%	$17,856
801-900	**Decrease**	**48%**	**16%**	**-19%**	**$27,871**
	Increase	13%	4%	17%	$34,637
	No Change	39%	13%	0%	$25,195
901-990	**Decrease**	**56%**	**13%**	**-20%**	**$39,280**
	Increase	10%	2%	16%	$50,215
	No Change	34%	8%	0%	$40,700

For example, in the 901-990 score band, 13 percent of the population had an average credit line decrease of 20 percent in Q1 2009. Even after that reduction, however, the average credit limit was still $39,280.

Conversely, while more than half of the consumers in the lowest score band (501-600) had their credit limits reduced by 31 percent, these consumers represented only three percent of the population, and in real dollar terms their reductions were far less than those in higher score bands. Lenders are understandably most sensitive to the risk in these lower score bands, and it is not surprising that they would be more aggressive—in percentage terms—in their strategies in these bands.

Referring again to the graph in Figure 2, it could be argued that the net result of these changes was the normalization in credit limits. In other words, those consumers whose credit limits had increased significantly in the preceding quarters were brought more into line with other populations of consumers. Employing this methodology, banks successfully lowered their exposure with only minimal or negligible impact to the consumer.

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LENDERS ALSO CLOSED NUMEROUS INACTIVE CARD ACCOUNTS

Limit reductions continued throughout 2009 and were accompanied by lenders taking action to reduce the number of unused bankcard accounts. As mentioned earlier, a core credit card strategy was to offer consumers as many accounts—and therefore cards—as possible, with the highest possible credit limits. The hypothesis was that the consumer was more likely to use the card if it was handy and had a sufficient credit limit to meet needs. As a result, many consumers carried cards they no longer used, or perhaps had never used.

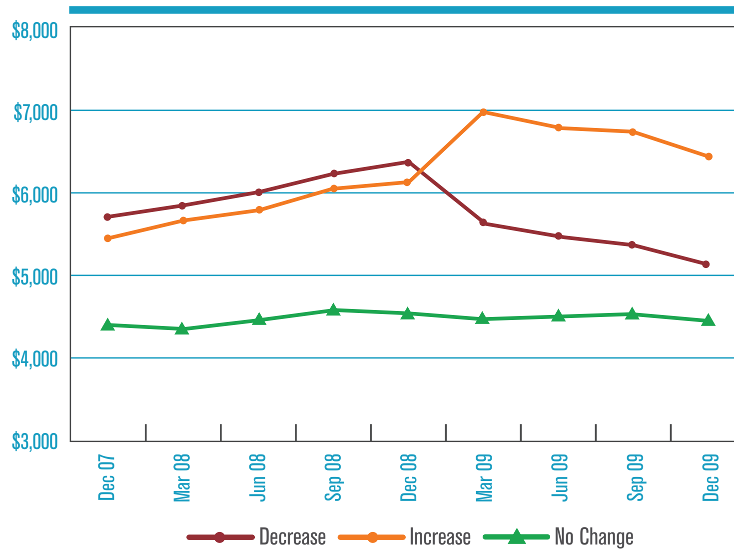
Beginning in mid-2008 and continuing through mid-2009, lenders took the opportunity to close these unused or inactive accounts. From Q2 2008 to Q2 2009, the total number of open credit cards fell by 19 percent – almost 75 million, from 399 million bankcards to 324 million bankcards. Just as lower credit limits served to reduce risk for the lender, so did the closure of accounts, while causing only negligible impact to the consumer.

HOW DID CONSUMERS ADJUST THEIR CREDIT CARD SPEND?

Consumers responded as expected to lenders' credit limit adjustment strategies. Even credit card users who had credit limits raised began to behave more conservatively in the months that followed the much-publicized reductions in Q1 2009 (Figure 4). While there was a brief uptick in the total average balance of the "increase" group (orange line), almost immediately balances began to trend lower, along with balances in the "decrease" and "no change" groups.

The "increase group" is defined as consumers with active bankcards who had the credit limit increased during the period Q4 2008 - Q1 2009. The "decrease group" is defined as consumers who had their bankcard credit limits decreased during the same time period.

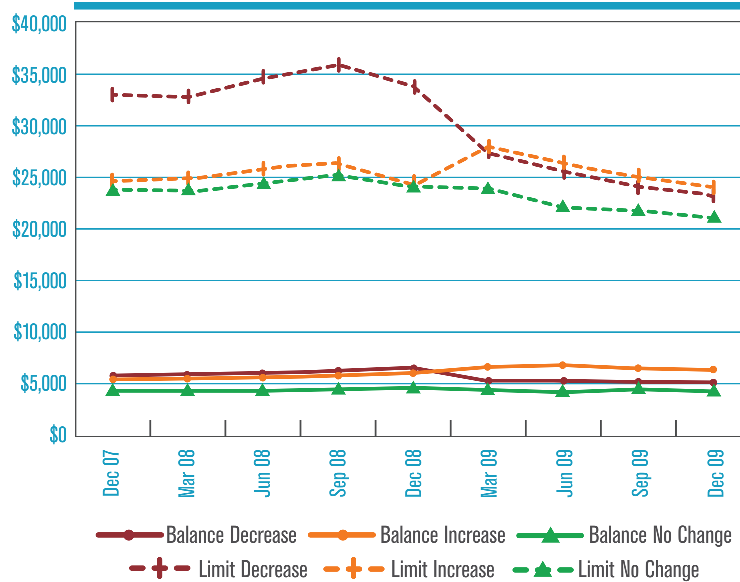
FIGURE 4
TOTAL BALANCE ON OPEN BANKCARDS



HOW DID CONSUMERS ADJUST THEIR CREDIT CARD SPEND? (Cont.)

Viewed in isolation, we might be tempted to attribute this apparently more conservative behavior solely to the decreases in credit line. As we draw back, however, and compare the total balances with total available credit lines, a different picture emerges (Figure 5).

FIGURE 5
TOTAL LIMIT AND BALANCE ON OPEN BACKCARDS



We see that while credit limits had been lowered (dashed lines), the gap between credit limit and balance (solid lines) remained remarkably high, meaning the average amount of credit available remained substantial (Figure 5). As suggested earlier, it thus becomes apparent that even in the face of lower credit limits and account closures, the reduced amount of credit has only minimally impacted consumers.

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HOW DID CONSUMERS CARD UTILIZATION AFFECT CREDIT SCORES?

In the VantageScore model, utilization levels contribute an average of 23% to the consumer's credit score. Bankcard credit limit decreases can drive major changes in utilization levels and as a result potentially cause a significant drop in credit scores.

FIGURE 6
CHANGES IN UTILIZATION BEFORE AND AFTER LIMIT STRATEGIES WERE APPLIED

		SIMULATED IMPACT		ACTUAL IMPACT		
	UTILIZATION Dec 08	UTILIZATION Dec 08 Spend, Mar 09 Limit	SCORE IMPACT Compared to Dec 08 *	UTILIZATION Mar 09 Spend, Mar 09 Limit	%AGE CHANGE IN UTILIZATION	SCORE IMPACT Compared to Dec 08
Dec 501-600	85%	123%	Down	79%	-7%	Up
Inc 501-600	88%	78%	Up	90%	3%	Down
NC 501-600	68%	68%	NC	68%	0%	NC
Dec 601-700	60%	72%	Down	69%	15%	Down
Inc 601-700	70%	63%	Up	84%	19%	Down
NC 601-700	55%	55%	NC	62%	12%	Down
Dec 701-800	23%	28%	Down	42%	80%	Down
Inc 701-800	30%	26%	Up	52%	76%	Down
NC 701-800	25%	25%	NC	39%	55%	Down
Dec 801-900	8%	10%	Down	18%	119%	Down
Inc 801-900	11%	9%	Up	22%	98%	Down
NC 801-900	9%	9%	NC	14%	58%	Down
Dec 901-990	6%	8%	Down	8%	22%	Down
Inc 901-990	10%	9%	Up	10%	0%	NC
NC 901-990	6%	6%	NC	8%	19%	Down

*Assumes all else remains constant

Figure 6 shows the results of a simple simulation utilization analysis focusing on consumer activity in the time window from December 2008 to March 2009 when the majority of credit limit decreases were occurring.

Each group 'Dec' (Decrease), 'Inc' (Increase) and 'NC' (No Change) is represented for each score band in the table. For example, "Dec 501-600" (row one, column one) are consumers in the 501-600 score band who, in March 2009 (Q1 2009), had their credit lines decreased. In Dec 2008 (Q4 2008), these consumers ("Dec 501-600") were utilizing credit lines on average at 85%. When the credit limits of this group were lowered in Q1 2009—assuming balances remained unchanged from Q4 2008 ("Simulated Impact")—their utilization would have increased on average to 123% (column 3). Again, keeping in mind that the VantageScore algorithm weights utilization at 23% of the overall credit score, this simulated change would have resulted in a lower credit score for this group.

However, as actual consumer behavior is compared with the simulated data, different results are found. So, in the case of the Dec 501-600 group, consumers in Q1 2009 only utilized 79% of their available credit (column 5), a decrease from the December 2008 rate (85%) of seven percentage points. This decreased utilization would have caused the credit scores of this group, on average, to rise (column 7).

HOW DID CONSUMERS CARD UTILIZATION AFFECT CREDIT SCORES? (Cont.)

This example, however, was the exception. The actual utilization levels in Q1 2009 (column 6: "Percentage Change in Utilization") increased almost universally for all other groups. In the mid-score tiers (701-800 and 801-900), for example, utilization increased, without regard to the credit line strategies made in Q1 2009. Meaning, even for those whose credit lines were increased in Q1 2009 ("Inc 701-800" and "Inc 801-900"), utilization—as noted in column 6—increased by 76 percent and 98 percent respectively. Again, these data strongly suggest that the broader effects of seasonality and the recession were driving consumer behavior—including increased need for credit—rather than the credit line strategies in Q1 2009.

This trend toward increased utilization continued broadly throughout 2009 (Figure 7). Consumer credit scores were negatively impacted as a result.

FIGURE 7
CHANGES IN UTILIZATION FY08 COMPARED TO FY09

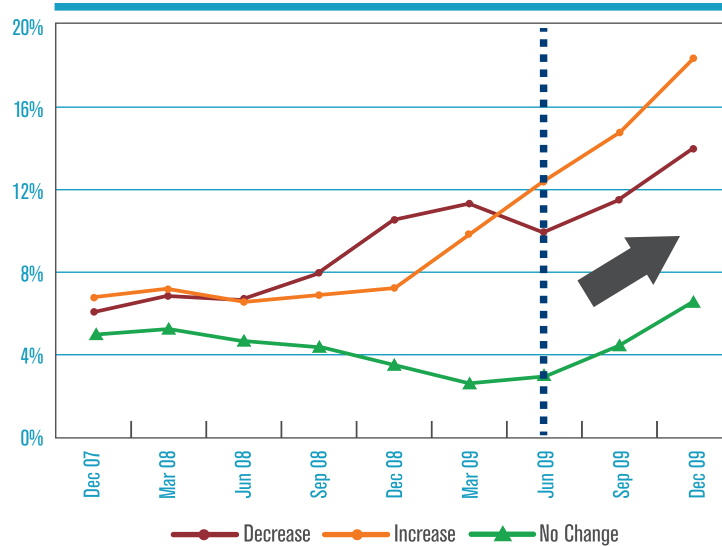
SCORE BAND	GROUP	UTILIZATION		
		FY 08	FY 09	DIFFERENCE
501-600	Decrease	82%	81%	-1%
	Increase	86%	88%	3%
	No Change	73%	76%	3%
601-700	Decrease	61%	74%	13%
	Increase	70%	83%	13%
	No Change	61%	71%	10%
701-800	Decrease	28%	53%	24%
	Increase	34%	60%	26%
	No Change	31%	51%	19%
801-900	Decrease	11%	27%	16%
	Increase	17%	32%	15%
	No Change	13%	24%	11%
901-990	Decrease	7%	12%	5%
	Increase	11%	16%	4%
	No Change	10%	11%	2%

HOW DID DELINQUENCIES TREND?

Reinforcing the thesis about consumer behavior in the context of credit limit strategies—i.e., that credit line strategies had no substantive impact on consumer behavior—a strong uptick in delinquencies (30+ days late) is observed beginning in June 2009. This uptick in delinquencies occurred across all categories of consumers, regardless of whether credit limits were increased, decreased, or left unchanged (Figure 8).

FIGURE 8

NUMBER OF BANKCARDS 30+ DAYS DELINQUENT



Particularly in the case of consumers whose credit limits were decreased in Q1 2009 (red line), <u>their prior delinquencies likely contributed to these consumers receiving a limit decrease.</u>

Nevertheless, delinquency rates rose strongly beginning in Q2 2009 for consumers with scores between 601 and 900, the majority of the population, suggesting again that the challenges presented by the broader economy were weighing heavily on consumers (Figure 9).

HOW DID DELINQUENCIES TREND? (Cont.)

FIGURE 9

DELINQUENCY BY SCORE BAND (RATES INDEXED TO DEC 08 LEVELS)

SCORE BAND	GROUP	PERCENT OF BANKCARD TRADES 30+ DELINQUENT Compared To Dec 08				
		DEC 08	MAR 09	JUN 09	SEP 09	DEC 09
501-600	Decrease	100%	103%	96%	93%	93%
	Increase	100%	101%	102%	104%	109%
	No Change	100%	87%	88%	98%	102%
601-700	Decrease	100%	120%	138%	153%	**167%**
	Increase	100%	112%	133%	150%	**161%**
	No Change	100%	102%	114%	131%	**144%**
701-800	Decrease	100%	114%	133%	151%	**168%**
	Increase	100%	108%	124%	155%	**175%**
	No Change	100%	101%	113%	125%	**140%**
801-900	Decrease	100%	106%	113%	125%	**138%**
	Increase	100%	104%	109%	132%	**160%**
	No Change	100%	101%	101%	110%	**125%**
901-990	Decrease	100%	100%	101%	104%	111%
	Increase	100%	104%	112%	113%	134%
	No Change	100%	97%	96%	99%	101%

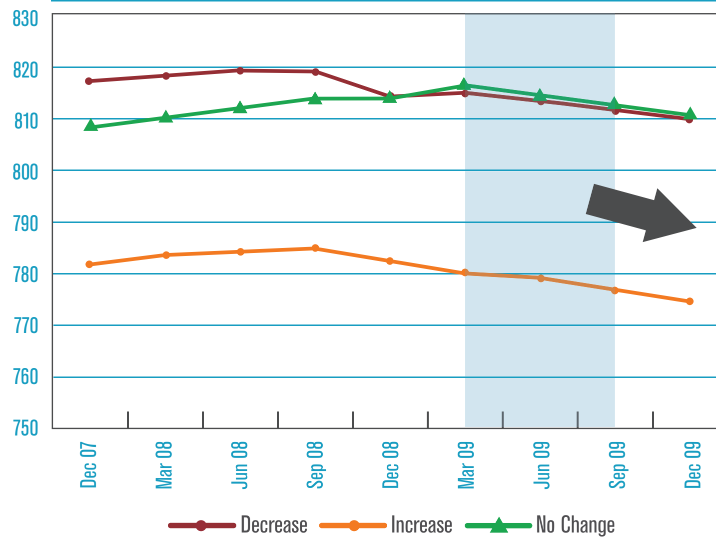
Rising delinquency rates were concentrated in the mid-tier score bands and rose without regard to the size or direction of the Q1 2009 credit line strategies. For example, in the 701-800 score band, consumers whose credit lines were decreased in Q1 2009 had 68 percent higher delinquency rates in Q4 2009 when compared with Q4 2008. Likewise, for those in that same score band whose credit limits were raised, delinquency rates were 75 percent higher in Q4 2009 compared with Q4 2008. Even those without any change in credit limits had 40 percent higher delinquency rates in that period. Clearly, factors other than the credit line strategies and account closures were the primary drivers of these changes.

HOW WERE CONSUMER CREDIT SCORES AFFECTED?

Not surprisingly, increased delinquencies and increased utilization in 2009 resulted in credit scores that fell throughout the year—again, without regard to the direction of limit strategies (Figure 10).

FIGURE 10

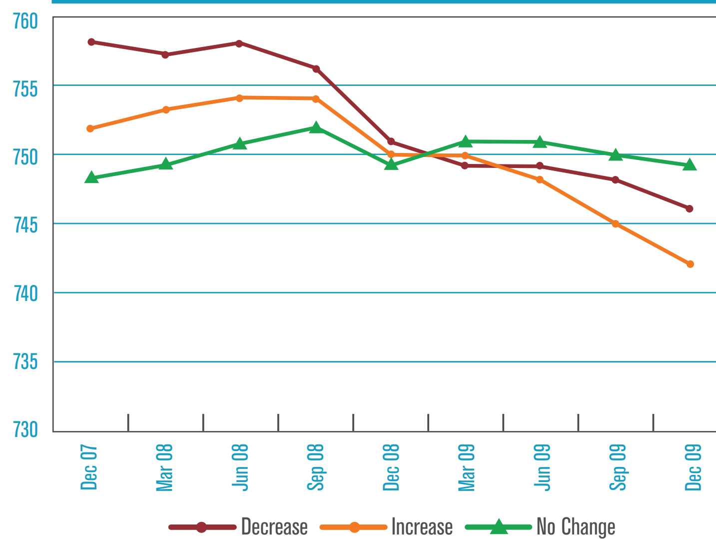
DECLINING CREDIT SCORES ACROSS ALL CATEGORIES OF LIMIT STRATEGIES AVERAGE VANTAGESCORE



Looking more closely at the credit limit adjustment groups in the 701-800 score tier, we observe scores dropping by approximately 10 points on average Dec 07 to Dec 09 (Figure 11).

FIGURE 11

DECLINING CREDIT SCORES ACROSS ALL CATEGORIES OF LIMIT STRATEGIES, 701-800 SCORE TIER



CONCLUSION

As the U.S. economy entered a recessionary cycle, consumers were forced to adjust to a new personal economic reality. Homeowners could no longer view real estate as "the only sure investment" and a ready source of cash through rising equity. Instead, shrinking home values led consumers to increasingly look to available lines of credit for financial security.

In the context of a softening economy, at the same time credit card lenders began to make credit line reductions while also reducing the number of bankcard accounts as a way to diminish their risk exposure. Figure 12 summarizes the net effect of credit limit changes and account closures.

FIGURE 12
SUMMARY OF TOTAL BANKCARDS AND LIMIT REDUCTIONS, JUNE 2008–JUNE 2009

	JUNE 2008	JUNE 2009	DIFFERENCE	DIFFERENCE
TOTAL NUMBER OF OPEN BANKCARDS	399,398,505	324,066,226	-19%	(75,332,279)
TOTAL CREDIT LIMIT ON OPEN BANKCARDS	$3,321,425,173,165	$2,665,010,717,735	-20%	$(656,414,455,429)
TOTAL BALANCE ON BANKCARDS	$573,298,609,432	$527,477,828,627	-8%	$(45,820,780,805)
AVERAGE CREDIT LIMIT	$8,316	$8,224		
AVERAGE BALANCE	$1,435	$1,628		
AVERAGE UTILIZATION	17%	20%		

Perhaps not surprisingly, increased utilization and delinquencies among all consumer credit quality segments have driven substantive shifts in consumer credit scores rather than lender line decrease strategies.

With these factors in view, lenders are reexamining traditional credit card marketing approaches. Continued high amounts of unused credit along with the apparently negligible impact to the consumer when unused cards are closed by banks, suggest that consumers are no longer motivated to use credit cards simply because the cards are available, or because they have high limits.

For lenders, the challenge, and the opportunity, in this dynamic environment is to identify creditworthy consumers who are most likely to remain so, and engage with those consumers in a much more focused way—a topic explored in detail in the VantageScore white paper *Finding Creditworthy Consumers in a Changing Economic Environment*, available online at www.vantagescore.com/research/creditworthyconsumers/

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