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SPECIAL REPORT

Secured Card Market Update

by Larry Santucci[1, 2]

For more than 40 years, secured credit cards (secured cards) have enabled borrowers with limited or damaged credit histories to obtain credit, often with many of the benefits of traditional, unsecured credit cards. While the growth of financial technology (fintech) firms has spurred a variety of credit-building products for borrowers who are unable to access mainstream credit markets, the secured card has not been left behind and, in fact, continues to be a focal point of fintech innovation and new product offerings.[3]

In this Special Report from the Consumer Finance Institute (CFI), we update previous research into the secured card market. Using data on secured card portfolios held by the country's largest financial institutions, we document several new findings, including:

- About 3.7 million general-purpose and private-label secured cards are currently held by the country's largest financial institutions, with $817 million in balances.
- Among large financial institutions with a secured card portfolio, about 2 percent of general-purpose cards are secured, accounting for less than one-third of 1 percent of outstanding balances.
- Despite a strong start in 2020, new secured card originations dropped sharply during the COVID-19 pandemic. The drop in originations was exacerbated by a large lender's

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[1] The views expressed in this report are solely those of the author and do not necessarily reflect the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System. Nothing in the text should be construed as an endorsement of any organization or its products or services. Any errors or omissions are the responsibility of the author. No statements here should be treated as legal advice.

[2] Peter Psathas provided excellent research assistance.

[3] See Consumer Financial Protection Bureau (2021) for a discussion of several recent fintech secured cards.

withdrawal from the secured card market beginning in the previous year. Excluding that lender, new originations fell by more than 9 percent year over year in 2020.

- Between 2013 and 2022, the average credit limit on new secured card accounts fell by almost 25 percent, from $482 to $362.
- Most secured cards opened since 2018 do not require an annual fee, which was once a common feature of secured cards. Only about 4 percent of secured cards opened in 2022 have an annual fee.
- The cost of revolving a balance on a secured card has increased considerably. Between 2015 and 2022, the share of new secured cards with an annual percentage rate (APR) of at least 25 percent increased from two in 100 to eight in 10.
- An increasing number of secured cards now include a rewards program. More than 31 percent of secured cards opened in 2022 were rewards cards, compared with about 14 percent in 2015.
- Secured cards opened by consumers who do not yet have a credit score tend to graduate to unsecured cards more quickly and at higher rates than consumers who have a credit score at account origination.
- Gross charge-off rates (unit) on secured cards opened by borrowers with and without a credit score are similar, but dollar charge-off rates tend to be higher for borrowers without a score. Such borrowers tend to have lower average balances and higher charge-off amounts, both of which tend to worsen charge-off rates.

- Surprisingly, borrowers without a score at account opening are more likely to exhibit timely repayment and higher graduation rates but are also more likely to charge-off than scored borrowers.

The data for this research are from the Board of Governors of the Federal Reserve System's Capital Assessments and Stress Testing report (Y-14M). The Y-14M collects data on the loan portfolios of bank holding companies and intermediate holding companies with $100 billion or more in total consolidated assets.[4] Results presented here, while representative of a large share of the overall credit card market, may

[4] The Y-14M data are collected on a monthly basis and include anonymized application variables such income and credit score at origination, product characteristics, and a wide array of account-level variables, such as credit limit, balance at cycle end, and delinquency status. The Philadelphia Federal Reserve provides summary level Y-14M data in its quarterly Large Bank Credit Card and Mortgage Data report available at https://www.philadelphiafed.org/surveys-and-data/large-bank-credit-card-and-mortgage-data.

not reflect the characteristics of secured cards issued by smaller banks, credit unions, monoline issuers, or fintech lenders.

Background

A *secured card* is a type of credit card that requires the borrower to post a security deposit as collateral against some portion of the credit line, typically the full amount. While this type of collateralized lending is common in automobile and housing markets, most credit cards are not tied to any collateral, and thus, they may be difficult to obtain for borrowers with a limited or damaged credit history. Secured cards typically do not require a credit check and function like traditional unsecured credit cards, allowing borrowers to make purchases and pay bills while adding to their credit history.

In 2016, the Consumer Finance Institute (CFI, then called the Payment Cards Center) published its first paper on secured credit cards when very little was known about the product's origin and history, as well as its current market size, features, and usage characteristics.[5] In the 2016 paper, we traced the history of the secured card from its origins in the 1970s through present-day (see sidebar on page 4 of this report, "A Brief History of Secured Cards"). We explained that these cards — with a credit limit that was collateralized by a cash deposit — primarily served two distinct segments of the consumer credit market: consumers seeking to build a credit history and those hoping to repair a damaged history.[6]

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[5] At the time, the academic literature contained no papers on secured cards or the evolution of consumer credit access beginning with market entry. A white paper by Levy et al. (2016) used interviews with industry experts and a consumer survey to describe the market and lender business model and identify key challenges to market growth. A 2017 report by the Consumer Financial Protection Bureau (CFPB) included a detailed examination of credit card products marketed to nonprime borrowers, such as secured cards (Consumer Financial Protection Bureau, 2017). The academic literature has not addressed secured cards explicitly but has developed around the concepts of credit access and the consumer credit life cycle. See Fulford and Schuh (2017) for a discussion of credit limits and revolving debt over the consumer lifetime. Recently, Kovrijnykh, Livshits, and Zeitlin-Jones (2023) studied the evolution of credit access in emerging borrowers, exploring the credit-building role of entry-level loan products, like secured cards, and how market participants respond to information contained in the consumer's credit history.

[6] Levy et al. (2016) identify two other user segments, described as *transactors* and *savers*. It is unclear why transactors would prefer a secured credit card over an unsecured credit card or why survey respondents described as *savers* would prefer a secured credit card over a certificate of deposit, mutual fund, or other interest-bearing financial instrument. The Consumer Financial Protection Bureau (2017) notes that, at that time, no mass market secured card issuer was paying interest on secured card security deposits.

A BRIEF HISTORY OF SECURED CARDS

The first secured credit cards likely emerged in the late 1970s, with San Francisco Bay-area savings and loan (S&L) institutions playing a pivotal role in the product's development. By early 1981, seven Bay-area S&Ls were offering Visa-branded secured cards backed by savings deposits. These first secured cards had varying minimum deposit amounts, with between 50 percent and 80 percent of the credit limit held as collateral.

Historically, secured cards faced challenges, including limited availability and the emergence of third-party brokers that charged finder's fees and, in some cases, required upfront deposit payments. Secured cards became associated with fraud in the late 1980s, with consumers paying up-front broker fees to receive a card but never receiving one. In response, the Mastercard and Visa credit card networks implemented stricter program registration and approval guidelines, and the Office of the Comptroller of the Currency advised national banks in 2004 against issuing cards with very little available credit after fees and security deposit were considered.

Secured cards can be an effective tool for borrowers to establish or rebuild a credit history and to improve their credit score. Lenders typically report account activity to one or more of the major credit reporting agencies, so responsible usage can positively affect the borrower's credit history. However, since credit scores can incorporate a variety of information in addition to secured card repayment history, not all borrowers will see their credit score improve, even with timely repayment.

— Santucci (2016)

As a result, most secured card borrowers have either no credit score or a very low credit score at the time they open their account.[7] We found that the annual incomes of secured card borrowers were significantly lower than borrowers who were opening new unsecured cards, which may help explain why so many secured card applicants who are approved for a card end up not funding their security deposit and not opening an account. Credit limits on new secured cards tended to be very low; about 76 percent of the accounts in our study had an initial limit of $200, $300, or $500.

After examining the features and pricing of open secured cards, we found that most cards required an annual fee, tended to have higher purchase APRs than unsecured cards, lacked a rewards program, and

[7] There are some notable exceptions, including a small number of secured cards with very high limits that may be offered to individuals who desire a credit card with a limit above what the lender is willing to provide on an unsecured basis.

tended not to be associated with the promotional purchase and balance transfer offers that are common with unsecured credit cards (Santucci, 2016).

Consumers hope to use their secured card to demonstrate their ability to make timely payments on their account over a number of months and, in time, improve their credit score enough to be approved for an unsecured card. When we examined changes in secured card borrowers' credit scores two years from account opening, we found evidence that some secured card account holders did indeed improve their credit scores, but that a substantial fraction did not. Since a consumer's credit score is a function of a variety of credit behaviors, including debt repayment, utilization of existing credit lines, and the existence and severity of public records and accounts in collections, we could not determine whether borrowers' usage and repayment behavior on their secured cards had improved or degraded their score.

The life of a secured card tends to be shorter than an unsecured card because secured credit cards require a security deposit, are more expensive than unsecured cards, and have credit limits that are too low to accommodate the typical borrower's monthly card purchases. As consumers build a clean repayment history, they become candidates for unsecured card offers. To mitigate the loss of borrowers to other lenders, lenders may offer secured card borrowers an automatic graduation to an unsecured card. CFI studied secured card graduation in a 2019 paper. Borrowers who paid the full account balance each month had a higher probability of graduation than those whose accounts were inactive, delinquent for 30 days or more, or had a credit limit utilization rate of more than 80 percent. We found that borrowers who lacked a credit score at account opening were much more likely to graduate than borrowers who had a score at the time they opened their account. In fact, the lower a borrower's (valid) credit score is at account opening, the less likely it is that the borrower will graduate to an unsecured card within the next 24 months. By comparing annual vintages, we also observed a trend in recent years where graduations were occurring sooner in the account life cycle.

Credit Builder Market

For many years, the secured card served as one of the few means by which risky or unproven consumers could establish or improve their credit history and still access mainstream credit markets.[8] The recent growth of fintech has led to the creation of innovative products

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[8] Retail store credit cards also have lower credit requirements but can only be used at the particular retailer and often have high interest rates (Lee and Kwon, 2002). Consumers can also establish credit via an authorized user account (Brevoort et al., 2013). Under such an arrangement, the consumer is permitted to use another person's card, but the responsibility for making a timely payment remains with the primary cardholder. The lender reports the card's payment history to the credit bureaus for both the primary cardholder and the authorized user.

designed to help borrowers achieve that goal, often with minimal risk to the lender and less up-front collateral required by the borrower.[9] As a result, consumers have a wider array to choose from when selecting a credit-building product.[10]

Because credit-building products may be structured like loans, credit cards, charge cards, lines of credit, or even debit cards, different products may have different effects on the borrower's credit score (Silberman, 2023). The up-front costs and periodic fee structures can also vary. Thus, it is not clear which product offers the best value for a given consumer, and consumers are encouraged to shop around and compare products before opening an account.[11]

Market Size

In this section, we examine trends in the overall size of the secured card market as measured by the Y-14M data. We include data on all Y-14M reporting financial institutions, but note that these trends do not include data on secured cards issued by smaller banks, credit unions, monoline issuers, or fintech lenders, since those lenders are not included in the Y-14M data.

On both an account and (nominal) balance basis, the secured card market has more than doubled since June 2012, the first month data was collected. At that time, the Y-14M data contained 1.57 million open secured cards carrying $398 million in balances. As of the last month of our sample in September 2023, the Y-14M data contained 3.7 million open secured cards with $817 million in balances.

Between 2012 and 2023, the market experienced two periods of growth but has been shrinking since 2021. **Figure 1** shows that after a period of rapid growth from 2012 to 2016, the number of open secured cards remained flat through 2017–2018 before resuming growth in 2019. As we discuss in the next section, growth continued through 2021, despite a drop in originations during the first months of the COVID-19 pandemic. The number of open secured cards peaked in July 2021 at 4.96 million, with $1.05 billion in balances, but has been contracting since then. In 2022, the secured card market shrank by 12.2 percent and has continued to contract through 2023.

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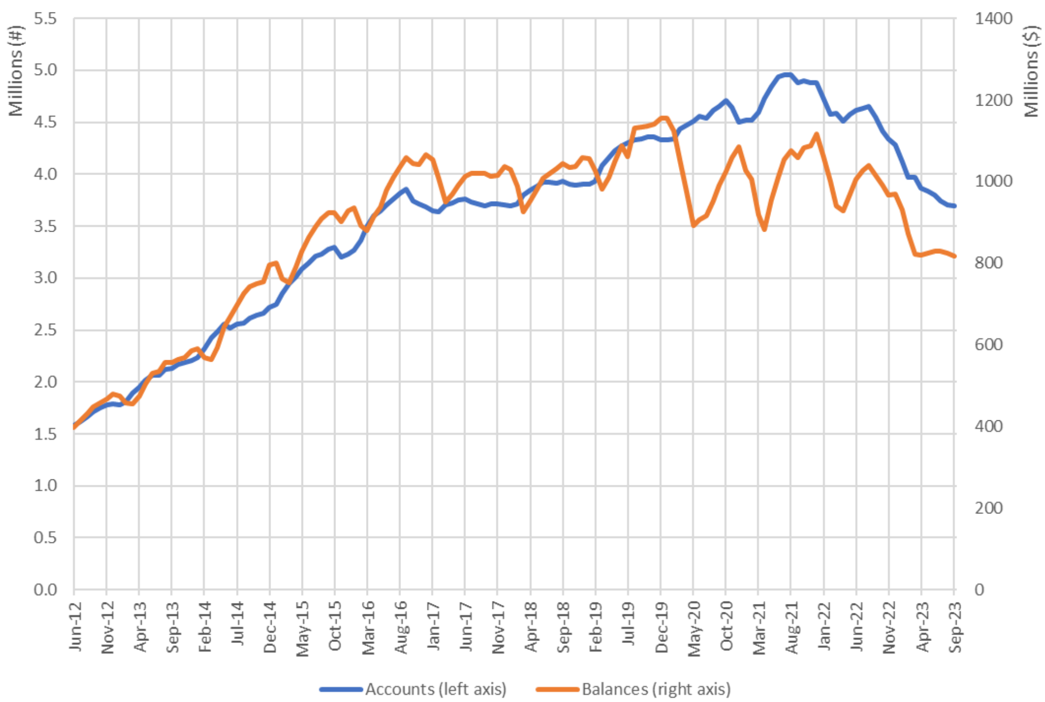
[9] Fintech lenders are also innovating in underwriting traditional credit products by incorporating alternative data sources — such as rent and utility payment histories — and advanced machine learning and artificial intelligence models into lending decisions (Allen et al., 2021).

[10] Credit builder loans — installment loans in which the principal is held in escrow while the borrower makes payments — are also widely available. See Burke et al. (2023) for an examination of the effects of credit builder loans on consumer credit scores.

[11] The Consumer Financial Protection Bureau (2023) provides a discussion of the risks and benefits of so-called credit builder cards.

Figure 1. Open Secured Cards, All Y-14M Reporting Financial Institutions



Source: Author's calculations using Y-14M data

Portfolio Analysis

Herein, all statistics and charts will be based on an analysis sample of financial institutions that reported secured card portfolios from 2012 to 2022. This analysis sample includes eight banks that account for 89 percent of all secured cards and 89 percent of all secured card balances in September 2023.[12] Whenever necessary, the records have been cleaned to address errors, outliers, and other issues.

Portfolio Share Secured cards are a small percentage of the credit card portfolio at large financial institutions. From 2013 to 2022, secured cards in the sample accounted for about 2.2 percent of all open general-purpose cards, but they only accounted for about 0.3 percent of outstanding balances. During that same time, new secured card accounts made up about 7 percent of total general-purpose card originations.

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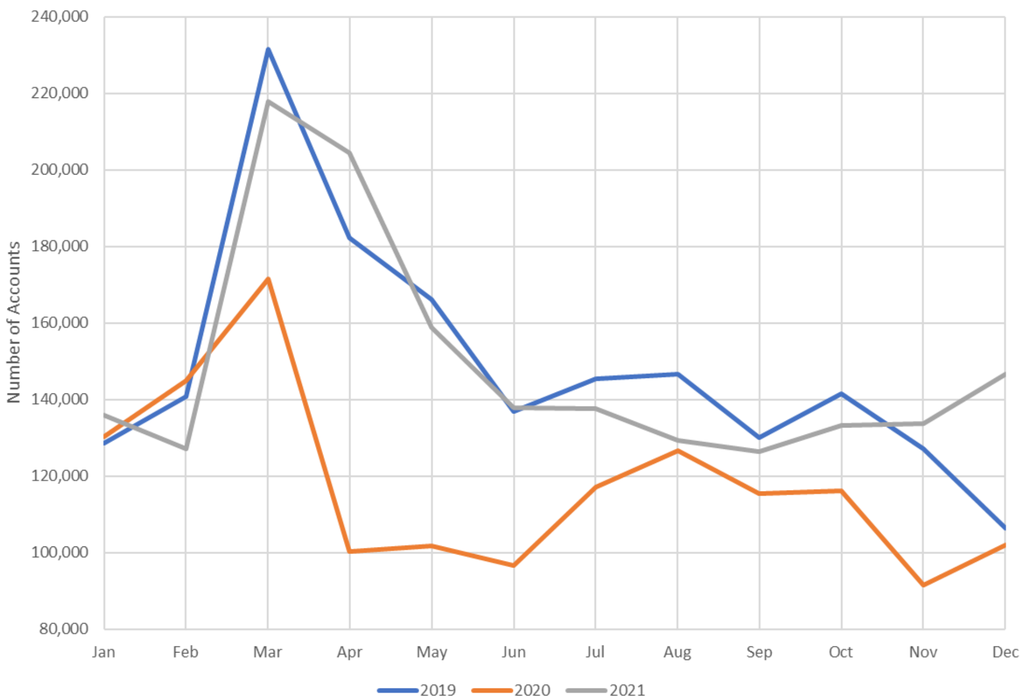
[12] All the banks in the analysis sample reported secured card portfolios continuously from 2012 to 2022, with the exception of one. That lender ceased originating secured cards at the end of 2019 and continued to wind down its existing secured card portfolio through 2020. Because the lender had once accounted for almost one-third of secured card originations in the sample, we included those accounts in the data set. The sample excludes four lenders with very small, secured card portfolios, and one lender that intermittently reported a private-label secured card portfolio beginning in 2020. The secured cards in the sample are all general purpose, meaning that they can be used at any retailer.

On average, lenders in our sample originated about 22 million new unsecured general-purpose cards each year and about 1.67 million new secured cards.

Originations During COVID-19 In our analysis sample, almost 1.8 million new secured card accounts were opened during 2019 — an increase of 6.7 percent from the previous year — but new originations dropped sharply in 2020. Demand for credit contracted as businesses, employers, and governments instituted stay-at-home restrictions to slow the spread of the COVID-19 virus. Credit supply also contracted, with offers to new customers and spend on digital marketing campaigns both shrinking rapidly beginning in mid-March (Santucci, 2020). The COVID-19 pandemic also coincided with one lender's decision to exit the secured credit card market. The lender's last secured card accounts were opened in 2019 and early 2020, and the remaining portfolio was aged off in the subsequent years. Including both the COVID-19 pandemic and the lender exit, new secured card originations in our sample were 21 percent lower in 2020 than in 2019. Excluding that lender, new originations fell by about 9.4 percent in 2020.

Figure 2 shows secured card originations for the years 2019, 2020, and 2021 by calendar month. Secured card originations in January and February 2020 were higher than in 2019, but they fell with the onset of pandemic-related shutdowns and other emergency measures in March 2020 and did not return to 2019 levels that year. Notwithstanding the lender exit, new account originations rebounded to pre-pandemic levels in 2021, suggesting that a significant portion of the lender's volume may have been absorbed by the remaining lenders in the sample.

Figure 2. Monthly Secured Card Originations, 2019–2021

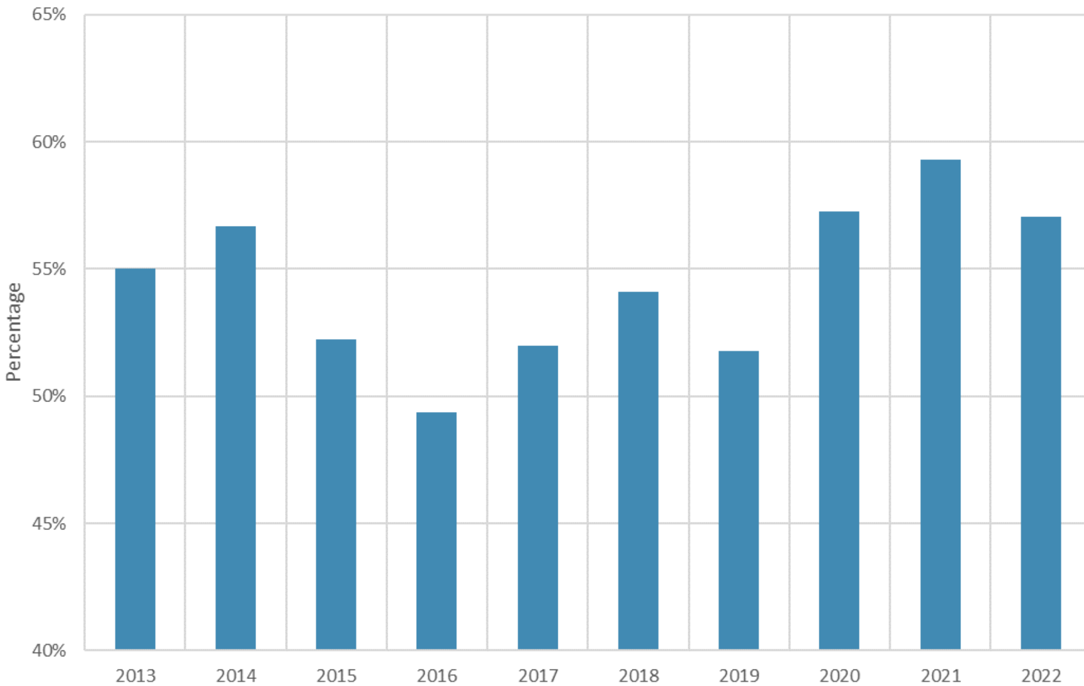


Source: Author’s calculations using Y-14M data

Composition Secured credit cards primarily appeal to two distinct populations: consumers looking to build a credit history where none exists and consumers seeking to repair a damaged credit history. As a result, secured cards tend to be opened by consumers with no credit score or deep subprime credit scores (Consumer Financial Protection Bureau, 2017).

As shown in **Figure 3**, the majority of new accounts are opened by consumers without credit scores. For every year since 2013 (except 2016), more than one-half of all new secured cards were opened by consumers without a credit score. The share peaked in 2021 when about 59 percent of new secured cards went to consumers without a credit score.

Figure 3. Annual Share of New Secured Card Borrowers Lacking a Credit Score at Origination



Note: Vertical axis begins at 40 percent. Source: Author’s calculations using Y-14M data

The monthly data (not shown) show that the share of accounts opened by consumers without credit scores at origination tends to increase between February and April each year, coinciding with the post-holiday tax refund season. The year 2021 was an exception; the share of new accounts without a credit score remained relatively steady at 59 percent throughout the year. This strongly suggests that stimulus payments and other COVID-era benefits relieved the budget constraints of consumers who otherwise might not be able to fund the security deposit on their secured card, allowing them to begin to build credit.[13]

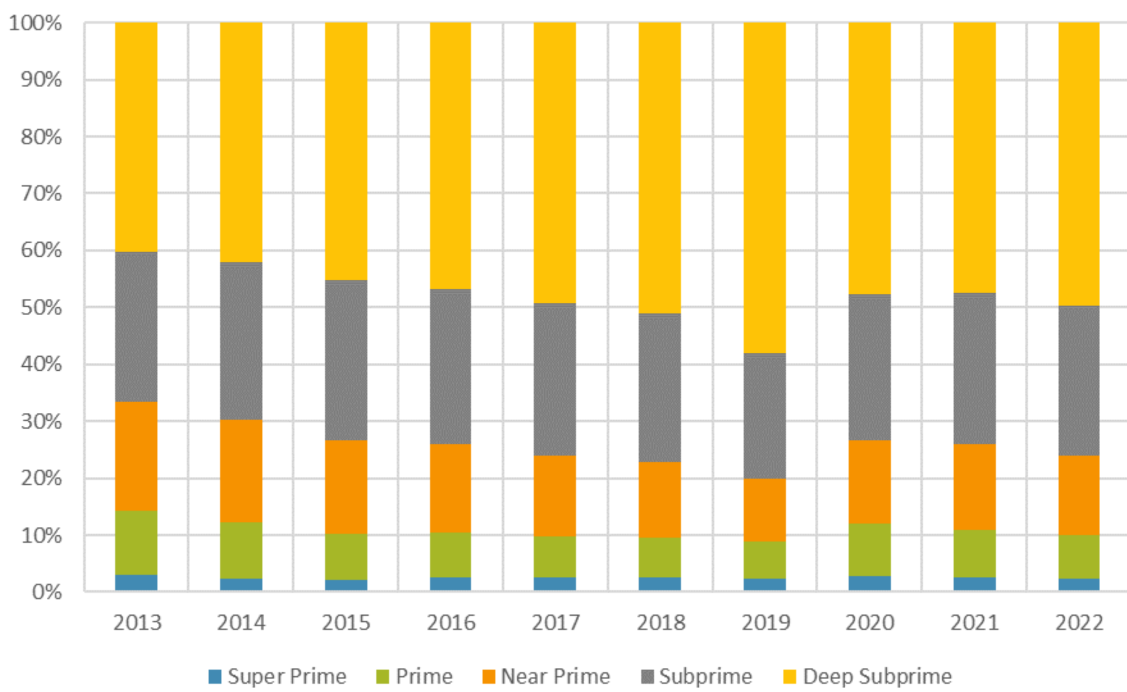
Score Distribution Secured card borrowers with a credit score at account opening tend to have very low credit scores. Following the Consumer Financial Protection Bureau (2017), we group credit scores into five categories: deep subprime for credit scores below 580, subprime for credit scores from

[13] The Coronavirus Aid, Relief, and Economic Security (CARE) Act provided U.S. households with economic impact payments starting in March 2020. The Tax Relief Act (December 2020) also provided payments of up to $600 per adult for eligible individuals and an additional $600 for each qualifying child under the age of 17. In March 2021, the American Rescue Plan provided economic impact payments of up to $1,400 for eligible individuals or $2,800 for married couples, plus an additional $1,400 for each qualifying dependent.

580 to 619, near prime for credit scores between 620 and 659, prime for credit scores between 660 and 719, and super prime for credit scores of 720 or above.

Deep subprime comprises the largest share of new accounts (with a score), and the deep subprime share has increased over time. The share of new secured card borrowers with a deep subprime score increased from 40 percent in 2013 to almost 50 percent in 2022. As shown in **Figure 4**, most of the increase in the deep subprime share came from the near prime and prime score groups, whose shares fell by 5.3 percent and 3.6 percent, respectively, over the period.

Figure 4. New Account Score Distribution

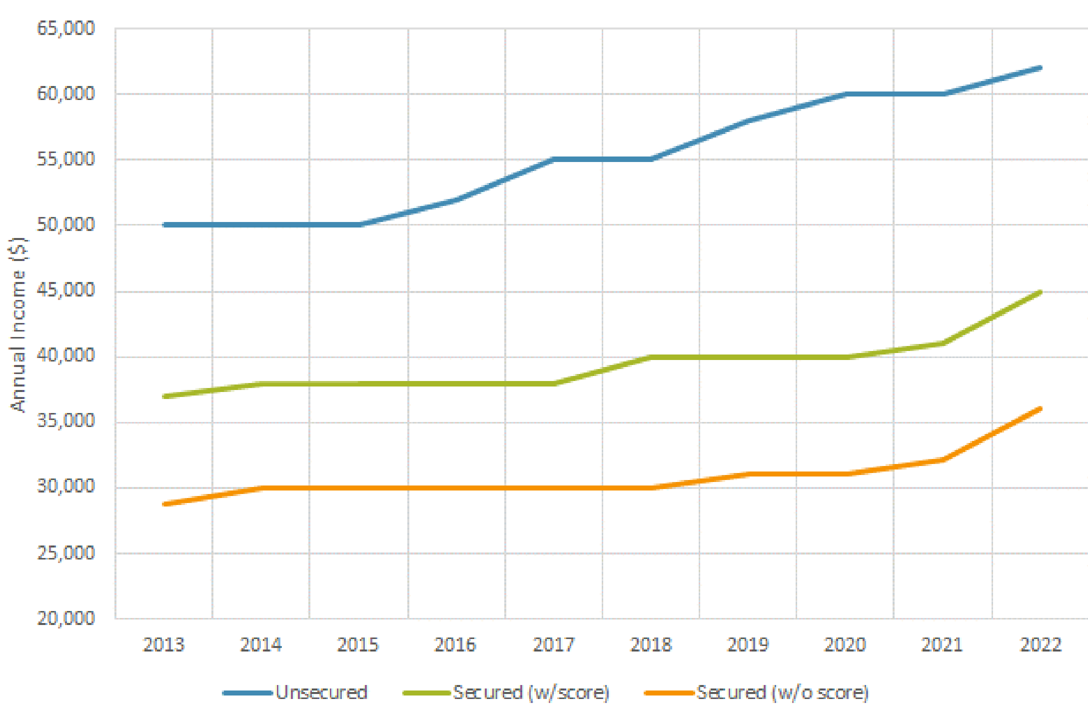


Source: Author's calculations using Y-14M data

Income at Origination Secured card borrowers tend to have lower incomes than borrowers opening unsecured cards (Santucci, 2016). The median income for new secured card borrowers tends to be between 30 percent and 40 percent lower than for borrowers opening new unsecured cards.[14] In 2022, the median income for all new secured card borrowers was $40,000, compared with a median of $62,000 for unsecured general-purpose card borrowers.

There are also considerable income differences within the secured card population. As shown in **Figure 5**, median incomes are consistently the lowest for secured card borrowers without a credit score at origination. In 2022, secured card borrowers with a credit score at account origination had a median income of $45,000, while those without a score had a median income of $36,000. Income differences between these groups may in some part be attributable to differences in the age distribution. The Consumer Financial Protection Bureau (2017) found that a majority of young consumers (under the age of 35) applying for secured cards did not have a credit score.

Figure 5. Median Income at Account Origination



Source: Author's calculations using Y-14M data

[14] *Income* is the median stated individual income for borrowers at the time of account origination. The results are similar for borrowers reporting household income.

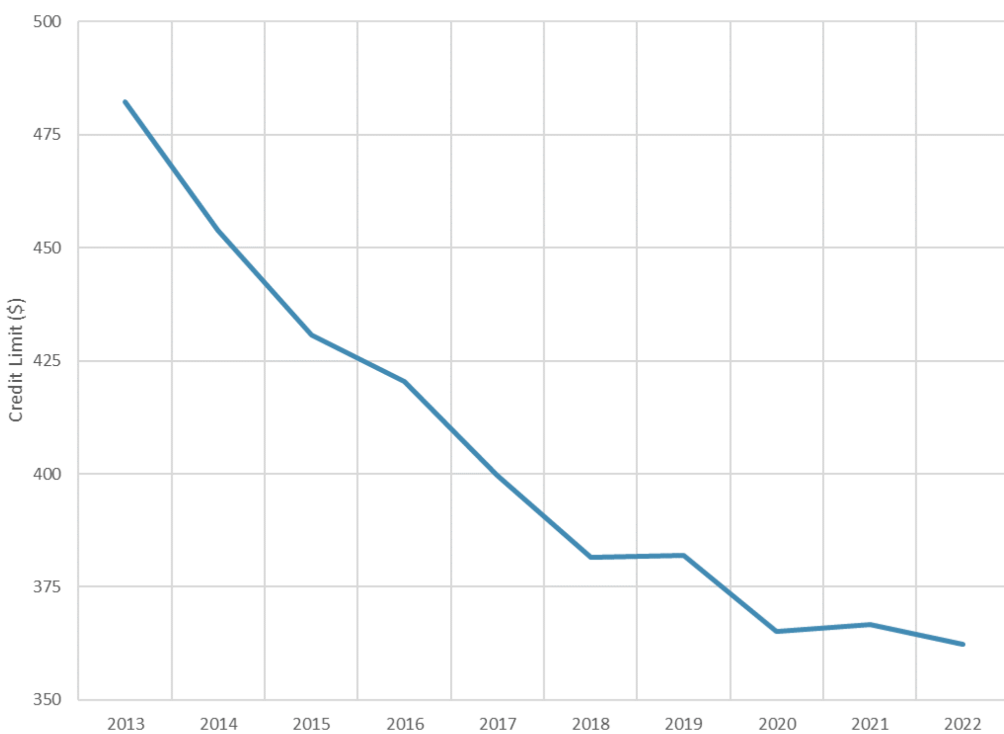
New Account Characteristics

Next, we analyze the primary characteristics of new secured card accounts, including credit limits, interest rates, annual fees, and rewards.

Credit Limits

The average credit limit on new secured cards has drifted downward throughout the sample period. As shown in **Figure 6**, the average limit was $482 in 2013, but by 2022, it had fallen to $362, a decline of almost 25 percent. This decline does not appear to have been caused by lower incomes in the approved population, since median income did not decrease during this time (Figure 5). It also does not appear to be caused by changes in the percentage of consumers without a score, which varied between 49 percent and 59 percent during the period, or by the average credit score of approved borrowers, which declined from 2013 to 2019 but increased thereafter.

Figure 6. Average Credit Limit at Account Origination

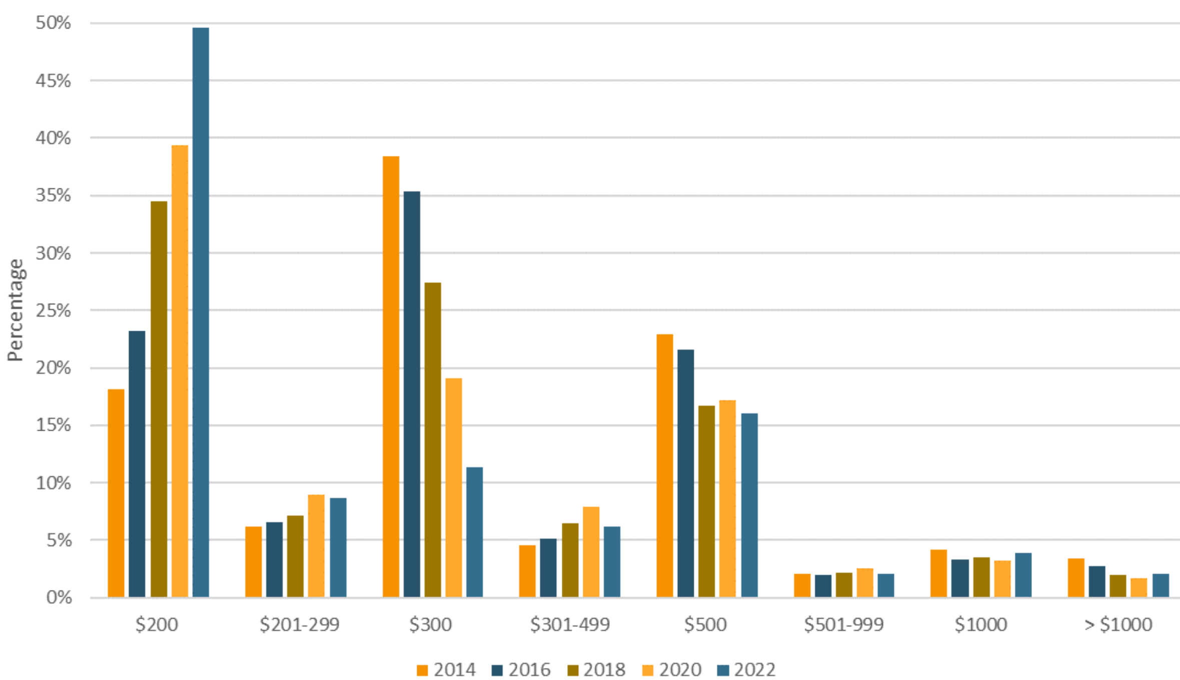


Source: Author’s calculations using Y-14M data

While changes in the approved borrower pool may not provide an answer, an examination of the credit limit distribution reveals that about one-half of all secured card borrowers now have $200 credit limits. **Figure 7** shows that, while almost 66 percent of credit limits were between $300 and $500 in 2014, the share of secured card accounts with a $200 limit has grown from 18.1 percent in 2014 to 49.6 percent in 2022.[15] Once the modal credit limit, the share of consumers with a $300 limit in the sample fell from 38 percent in 2014 to 11.4 percent in 2022.

Note that the initial credit limit does not necessarily equal the value of pledged collateral. At least one large lender offers a secured card with a $200 limit at origination that may be 25 percent, 50 percent, or 100 percent secured, as determined by the lender.[16]

Figure 7. Distribution of Credit Limits on New Secured Cards



Source: Author's calculations using Y-14M data

[15] While there are some secured card accounts with limits below $200, the share is always less than 0.05 percent during the sample period and is not shown in Figure 7.

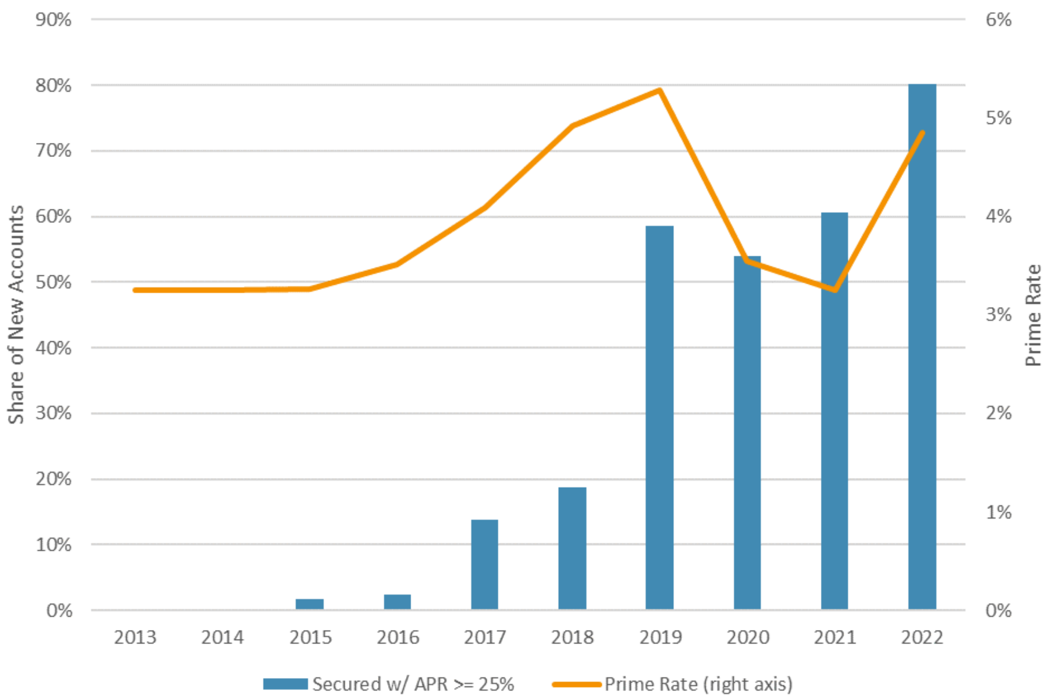
[16] See https://www.capitalone.com/credit-cards/platinum-secured/. The Consumer Financial Protection Bureau (2017) notes that some lenders allow for secured cards to become partially secured as a result of credit limit increases above the amount of the security deposit.

Annual Percentage Rate The cost of revolving a balance on a secured card has increased considerably since we last examined the secured card market.[17] As shown in **Figure 8**, about 2 percent of new secured cards originated in 2015 had an APR of 25 percent or more. Between 2015 and 2022, the share of new secured cards with an APR of at least 25 percent increased from 2 percent to 80 percent.

Some portion of the increase in APRs on secured credit cards is attributable to changes in the broader interest rate environment. All but a handful of secured credit cards have a variable APR that fluctuates with changes in the *prime rate* — the benchmark lending rate for most credit cards — which itself moves in line with changes in the Federal Reserve's monetary policy goals. The prime rate, shown in orange in Figure 8, was 3.25 percent during much of 2013–2015, when the vast majority of secured cards had APRs below 25 percent. The prime rate began to increase in December 2015, peaking at 5.5 percent in 2019 before falling again in August 2019, and returning to 3.25 percent in March 2020. While the share of new secured card accounts with APRs of at least 25 percent increased along with the prime rate, the share changed little when the prime rate later fell.

[17] Santucci (2016) examined the APR distribution of all secured cards open in December 2015, finding that about 95 percent of open cards had an APR between 15 percent and 25 percent, and 0.2 percent had an APR above 25 percent.

Figure 8. Share of New Secured Cards with Purchase APR >= 25%



Source: Author's calculations using Y-14M data and Federal Reserve Board, Bank Prime Loan Rate Changes: Historical Dates of Changes and Rates [PRIME], https://fred.stlouisfed.org/series/PRIME.

Annual Fees While the cost of revolving a balance on a secured card has increased substantially in recent years, the prevalence of annual fees has declined.[18] As shown in **Figure 9**, the share of new secured cards with an annual fee has fallen from almost 100 percent in 2013 to 4 percent in 2022. In fact, most secured cards opened since 2018 have not required an annual fee.

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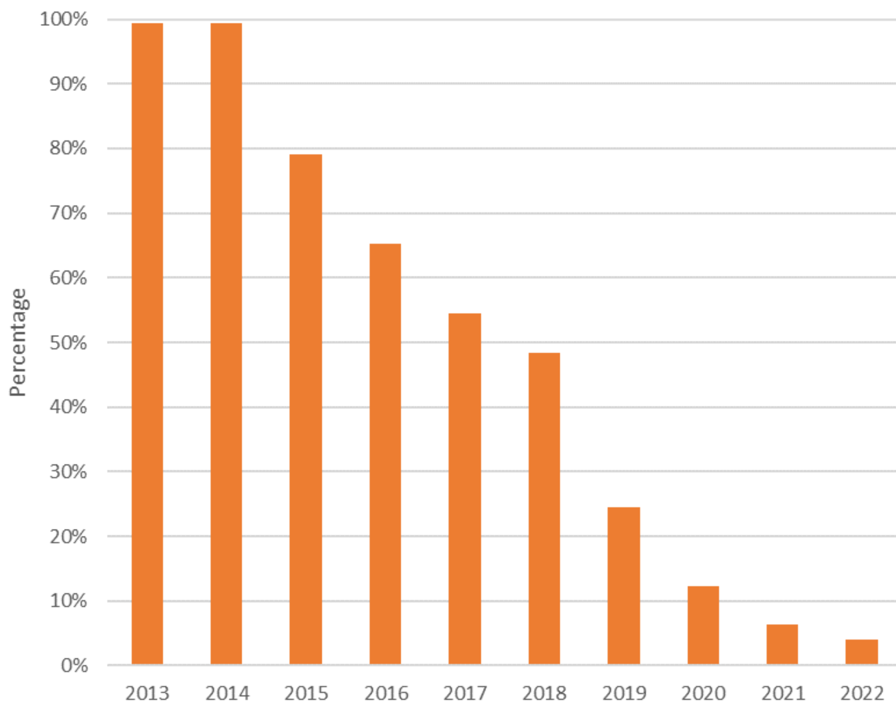
[18] Some secured cards have periodic fees that are assessed on a monthly basis. We sum the monthly fees and consider such cards to be annual fee cards.

Figure 9. Share of New Secured Cards with an Annual Fee



Source: Author's calculations using Y-14M data

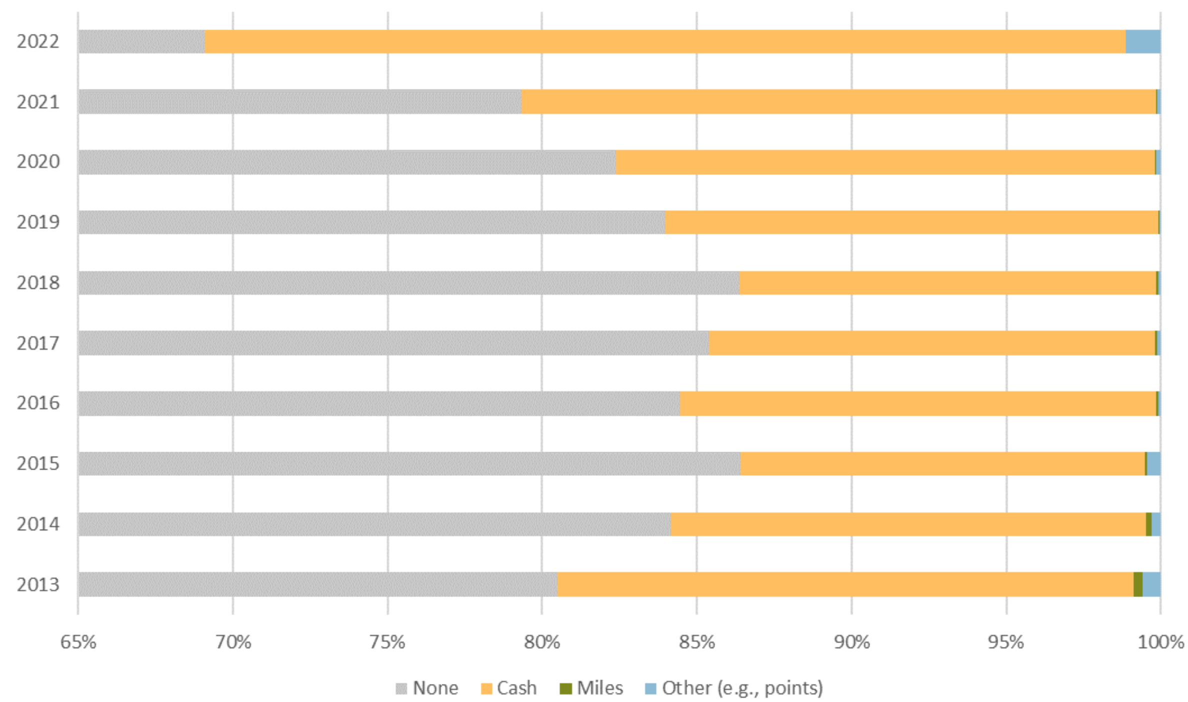
Rewards

Rewards programs — particularly cash rewards — are becoming more prevalent in secured card offerings. As shown in **Figure 10**, about 31 percent of secured cards opened in 2022 featured a rewards program, up from 14 percent in 2015.[19] Cash rewards continue to be the predominant form of rewards on secured cards, though a small share (about 1 percent) of accounts opened in 2022 had points-based rewards programs. About 30 percent of secured cards opened during 2022 included cash rewards.

The limited availability of rewards programs in secured card offerings contrasts starkly with the rewards programs available with unsecured cards. We observed that 60 percent of unsecured cards included a rewards program in 2022. The difference in reward program availability between secured and unsecured cards may in part be because of the limited value that rewards programs add to cards with very low credit limits that are intended to be short-term stepping stones to unsecured credit.

[19] Santucci (2016) found 12 percent of cards had rewards in a December 2015 sample; whereas here, we calculate a 14 percent share based on all accounts originated during 2015.

Figure 10. Share of New Secured Cards with Rewards, by Type



Notes: Horizontal axis begins at 65 percent. The *None* category extends leftward to axis.

Source: Author's calculations using Y-14M data

Account Usage

We next examine several measures of account usage and performance, comparing the behavior of accounts opened by borrowers lacking a credit score with those having a score at the time of account opening.[20] These results are presented in vintage format, with account age on the horizontal axis, and are based on observations from the 2015 to 2022 secured card vintages. We compute average performance by weighting vintages by their share of accounts.

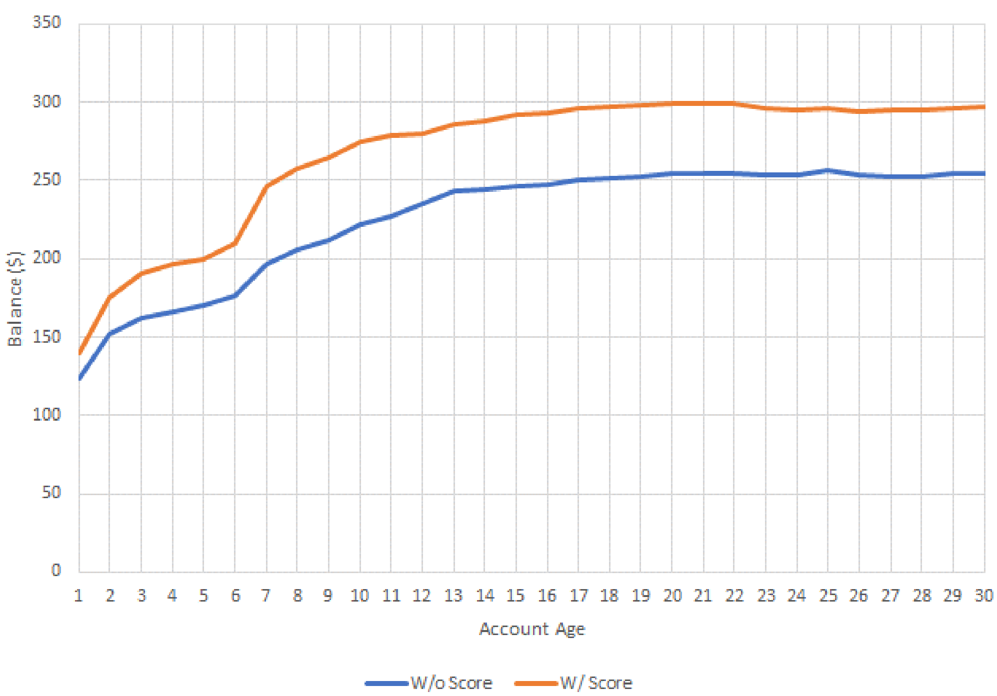
The usage patterns of secured card borrowers with and without a credit score at origination can be very different. Scored borrowers — typically opening a secured card because they cannot be approved for an unsecured card — tend to have higher balances and utilization rates, are more likely to revolve a balance, and will keep their account open longer.

[20] See the Consumer Financial Protection Bureau (2017) for a comparison of secured card account usage with other product types for a sample of accounts originated in 4Q 2014.

Figure 11 shows average balance by account age for borrowers with and without scores. While average balances at month one may only vary by $10 or $20, scored borrowers quickly ramp up their balances. After about 18 months of account usage, average balances level out at about $300 for scored borrowers and about $250 for unscored borrowers. Credit limit utilization (**Figure 12**) follows a similar pattern. Scored borrowers are consistently using a higher percentage of their credit limit than unscored borrowers. Utilization, too, levels out by about month 18, with average utilization for scored borrowers at about 60 percent, compared with 48 percent for unscored borrowers.

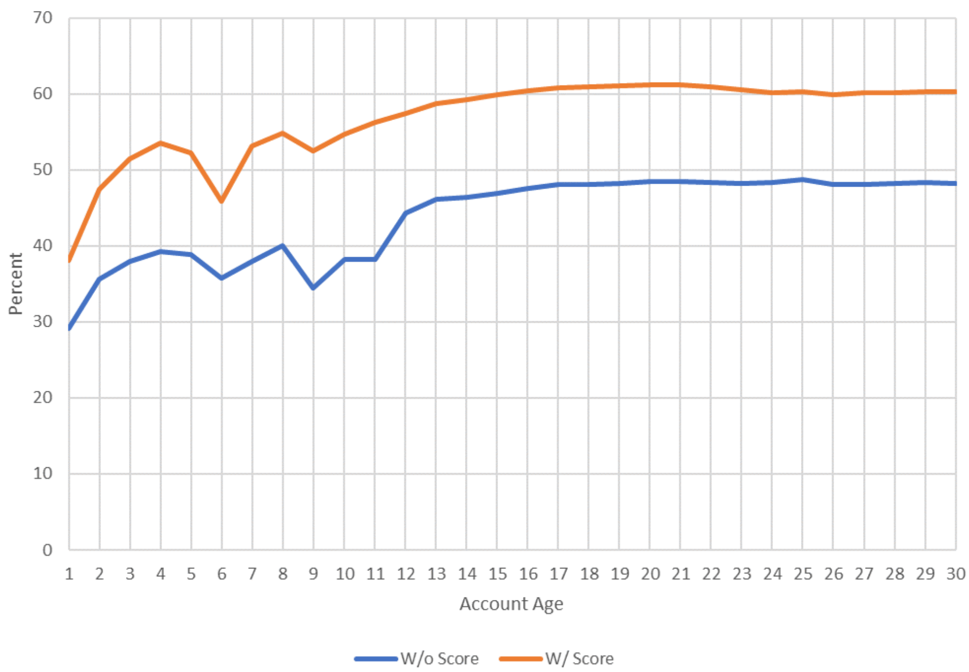
When examining these patterns of account usage, it is important to note that the composition of each vintage is changing as the vintage ages. Accounts may be closed by the borrower or become delinquent and be closed by the lender. In addition, some borrowers may graduate to an unsecured card and thus exit the vintage. We will consider each of these outcomes next.

Figure 11. Average Balance, by Account Age



Source: Author's calculations using Y-14M data

Figure 12. Utilization Rate, by Account Age



Source: Author's calculations using Y-14M data

In the previous section, we noted how the cost of borrowing on a secured card has increased considerably over the past several years (Figure 8). Since credit card borrowers who pay their balance in full each month do not incur finance charges, the cost of borrowing matters only for those borrowers who are unable to pay their balance in full. Despite their low credit limits, secured card portfolios can have fairly high revolver rates, and thus, high APRs can affect many secured card borrowers.

Figure 13 plots revolve rates for borrowers with and without a score at origination. Scored borrowers are consistently more likely to revolve a balance on their secured card. By month four, about 50 percent of scored borrowers are not paying their full statement balance and thus are revolving some portion of their balance. In contrast, about 39 percent of unscored borrowers are revolving a balance at month four. By month 12, about 54 percent of unscored borrowers are revolving a balance, compared with 62 percent of scored borrowers. This differential decreases over time and, after 24 months, is only about 5 percent, with 69 percent of scored borrowers and 64 percent of unscored borrowers revolving a balance.[21]

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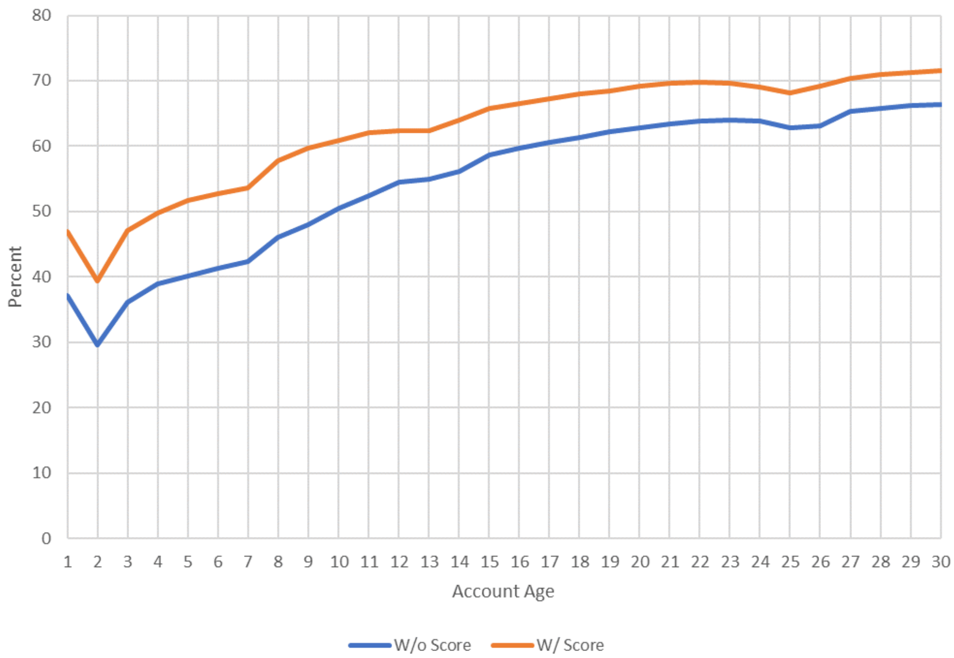
[21] The convergence in revolve rates may be because of the changing composition of the two populations. Accounts exit the groups through graduation, default, and account closure, potentially leaving more homogeneous populations behind.

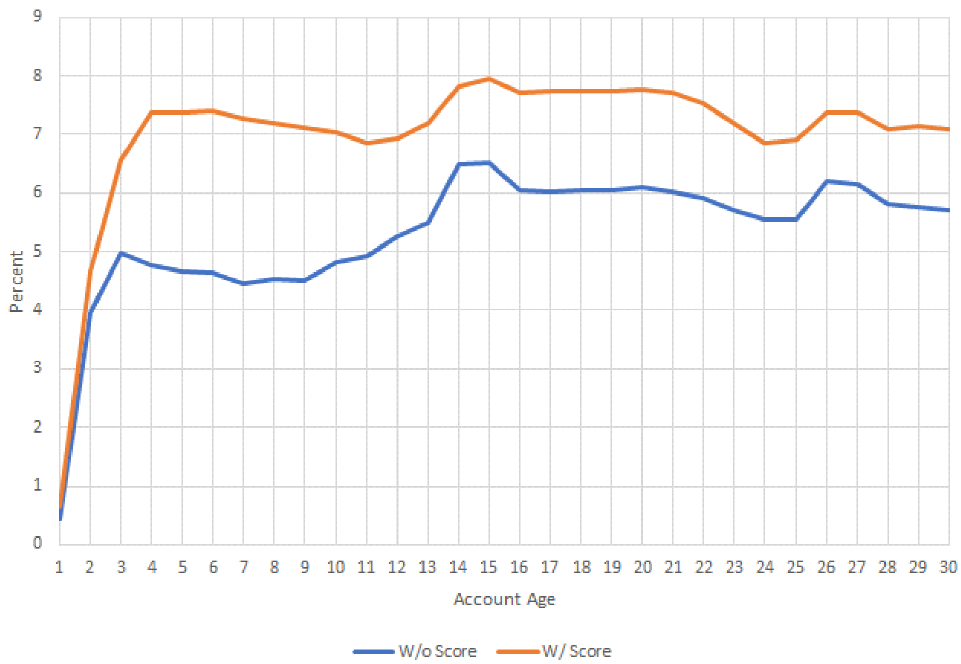
Figure 13. Revolve Rate, by Account Age



Source: Author's calculations using Y-14M data

In addition to the cost of borrowing, secured card borrowers can also incur late fees if they are unable to pay at least the minimum payment prior to the due date. **Figure 14** shows that, between months four and 24, about 7.5 percent of scored accounts are at least 30 days delinquent. Unscored accounts tend to fare better, particularly during the first year. But by month 14, about 6 percent of unscored accounts are at least 30 days delinquent each month.

Figure 14. Percent of Accounts Delinquent, by Account Age



Source: Author's calculations using Y-14M data

Graduation

Secured card borrowers who manage to build a positive credit history may qualify for an unsecured credit card from their lender or another lender. When a lender converts a secured credit card to an unsecured card, the borrower is said to have *graduated*. At graduation, the borrower's purchase and repayment activity is transferred to an unsecured card and the full security deposit is released.

Most secured card issuers begin automatically reviewing accounts for graduation once they reach a certain age of eligibility, which can be anywhere from four months to 12 months after origination (Consumer Financial Protection Bureau, 2017).

Graduation can be very advantageous for borrowers. In addition to demonstrating timely repayment behavior and an improved (or new) credit score, borrowers who graduate to an unsecured card are no longer required to maintain a security deposit with the lender. In addition, an unsecured credit card may have lower fees and interest charges, higher credit limits, and more attractive rewards programs than a secured card (Santucci, 2016).

Secured card graduation rates vary by cohort, but graduation has become fairly common and tends to occur early in the account's life. In a sample of secured cards originated in 2012, about 20 percent of accounts had graduated after 61 months, whereas it had taken only 11 months for 20 percent of accounts in a 2017 cohort to graduate (Santucci, 2019).[22]

Figure 15 shows the cumulative graduation rates by account age for secured card borrowers with and without a score at origination. Graduation begins to occur as early as three to four months into an account's life. Most graduations occur between months six and 12. Unscored borrowers are much more likely to graduate during this time. In our weighted vintage sample, almost 33 percent of unscored borrowers had graduated by month 12, whereas about 15 percent of scored borrowers had graduated by then.

Although both graduation rate curves begin to level off after month 12, they continue to increase steadily, suggesting that lenders continue to review secured cards for graduation on an ongoing basis throughout the account's lifetime. By month 30, about 50 percent of unscored borrowers in our weighted sample had graduated, compared with 29 percent of scored borrowers.[23, 24]

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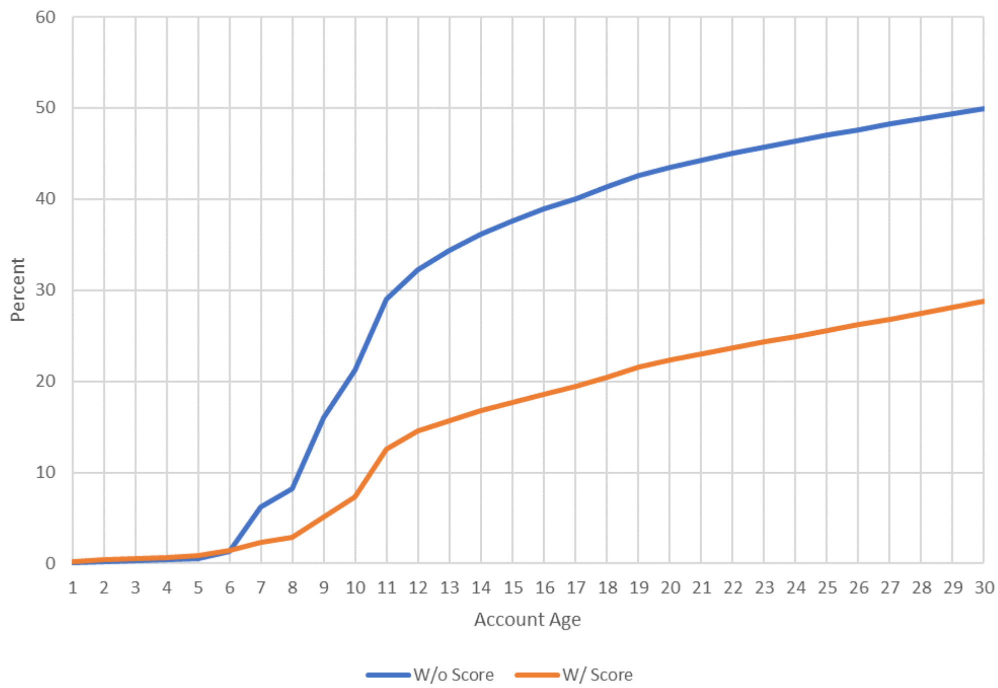
[22] Examining two-year graduation rates on annual cohorts from 2012 to 2016, Santucci (2019) found that borrowers without a credit score at origination are more likely to graduate than those with a score, and that the lower a borrower's credit score at account origination, the less likely the borrower was to graduate.

[23] This is broadly consistent with the Consumer Financial Protection Bureau (2017), which analyzed a sample of secured cards originated in 4Q 2014 and found that about one-third of scored borrowers and almost one-half of unscored borrowers graduated by the end of the second year.

[24] The long tail of graduation affects the average time to graduate, which was about 13 months for unscored borrowers compared with 15 months for scored borrowers.

Figure 15. Cumulative Graduation Rate, by Account Age



Source: Author's calculations using Y-14M

Charge-Off Secured card accounts that become severely delinquent may be charged-off. The Consumer Financial Protection Bureau (2017) notes that some lenders will close a secured card once the account is 60 days delinquent, while other lenders will wait until the borrower becomes 120 days delinquent before closing the account, with charge-off tending to occur after 120 days of delinquency. At that point, the borrower's security deposit is liquidated to offset the charge-off balance.

Figure 16 shows the annualized unit charge-off rate for the weighted vintages. The unit charge-off rate for unscored borrowers tends to be about 80 basis points higher than the charge-off rate for scored borrowers.[25] This result is surprising, since unscored borrowers are less likely to be delinquent and more likely to graduate than scored borrowers.

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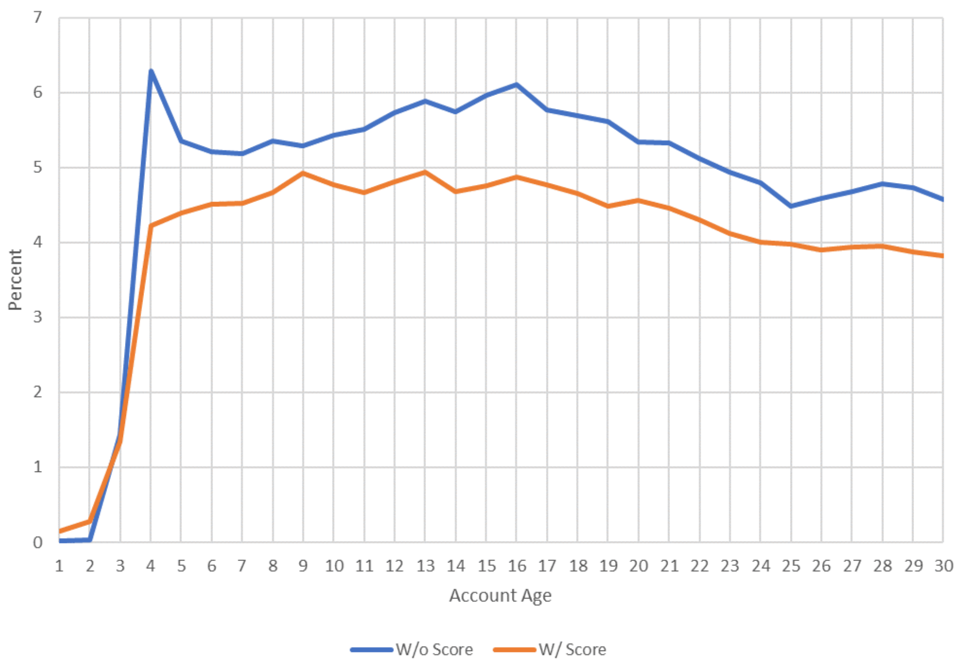
[25] Note: 100 basis points equals 1 percentage point.

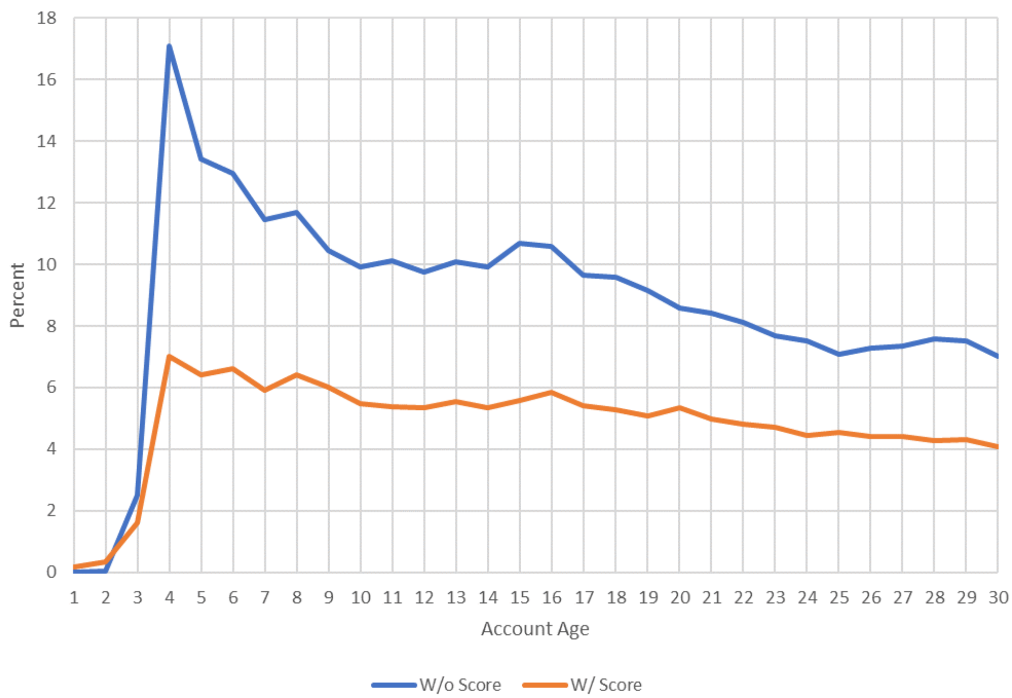
Figure 16. Unit Charge-Off Rate, by Account Age



Source: Author's calculations using Y-14M data

We also examined charge-off rates on a dollar basis. **Figure 17** shows the annualized dollar charge-off rate for weighted vintages. We observe significantly higher charge-off rates for unscored borrowers than scored ones. It is also striking to notice that the charge-off rate for unscored borrowers peaks at about 17 percent in month four. We confirmed that this was the case for all of the individual 2015–2022 vintages. The charge-off peak in month four coincides with the peak of first payment defaults — borrowers who fail to make any payments on their account beginning with the first billing statement. About 80 percent of all first payment defaults in our sample are charged-off in month four.

Figure 17. Annualized Dollar Charge-Off Rate, by Account Age



Source: Author's calculations using Y-14M data

To better understand how the unscored borrower sample could have higher charge-off rates, we examined average charge-off amounts for both groups. In all the vintages, the average charge-off amount is higher in the unscored group than in the scored group. When we combine this observation with the fact that average balances are lower in the unscored group (Figure 11), it is easy to see how the dollar charge-off rate, computed as the dollar charge-off amount divided by average outstanding balances and multiplied by 12, could be higher in the unscored group.

Charge-off balances might be higher in the unscored group if fraud was more likely to occur in those accounts. This is because, for fraud on a secured card to be profitable, the fraudster would have to default on a balance greater than the security deposit.[26] If this were the case, we might expect to observe a higher share of charge-offs attributed to fraud. We examined reason codes for all charged-off accounts in both

[26] For example, it is well known that secured cards continue to be a means by which fraudsters create a synthetic identity, which they later use to commit fraud on an unsecured card with a much higher limit. See https://content.transunion.com/print/278060?raw_file=true.

samples and found that the unscored sample did not contain a higher share of total fraud charge-offs, nor did fraud account for a higher proportion of charge-offs.

A Puzzle

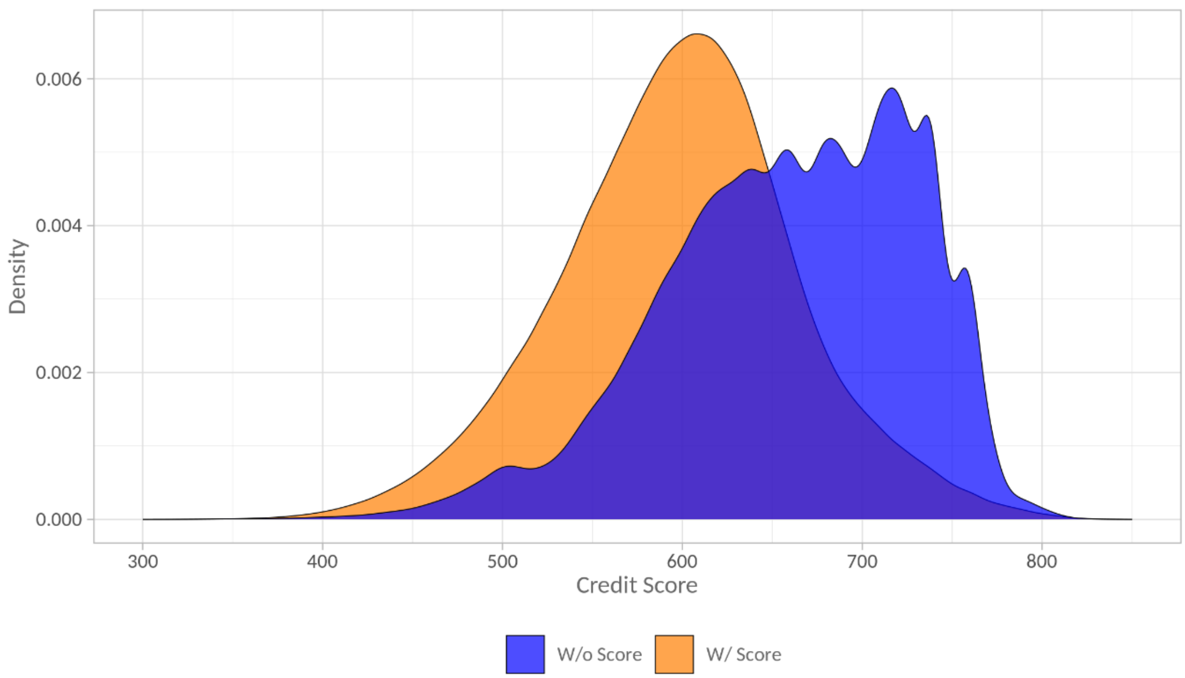
Our data indicate that the group of secured card borrowers who lack a score at the time of account opening display somewhat contradictory behavior. While unscored borrowers are more likely to exhibit positive behavior over the account life cycle, such as timely repayment and higher graduation rates, they are also more likely to charge-off than scored borrowers. How can the puzzle of both high graduation rates and high charge-offs be explained?

A comparison of the (smoothed) credit score distributions of scored and unscored borrowers suggests that unscored borrowers vary more in their ability to demonstrate credit-building behavior. **Figure 18** compares the credit score distribution of unscored and scored borrowers after six months of secured card usage, providing us with an early look at the effects of borrowers' credit-building efforts on their credit score. Because unscored borrowers are beginning their credit history with a secured card, one might expect that a significant proportion of their credit scores would fall into a narrow range after just six months.[27] Instead, the score distribution for borrowers without a score at account opening is asymmetric (negative skew) and wide (high variance).[28] This suggests that, while the earliest credit scores of borrowers new to credit tend to skew upward, there may be a wide range of usage and repayment experiences influencing their scores. Indeed, the mass point around a score of 500 suggests some borrowers may experience repayment difficulty soon after opening a secured card account.

[27] Borrowers may obtain other debt and credit products after opening their secured card. We only suggest that they should have fewer tradelines in their credit history than scored borrowers. Santucci (2016) found that, overall, new secured card borrowers tend to have 0.43 other open bankcards, compared with 2.58 open cards for borrowers opening a new unsecured card. At the same time, we cannot rule out the possibility that the shape of the credit score distribution is, in some part, due to the paucity of data upon which the score is calculated.

[28] In comparison, the distribution for scored borrowers after six months with a secured card resembles a typical symmetric bell-shaped curve.

Figure 18. Credit Score Distribution at Account Age Six



Notes: Kernel density estimates of the credit score distribution of secured card accounts at six months of age. Excludes accounts that graduate or close prior to month six.

Source: Author's calculations using Y-14M data

Conclusion

In this paper, we have continued our work to better understand the secured credit card market and the behavior of consumers who use these cards. Building on more than 10 years of data from some of the largest financial institutions in the country, we have shed light on a wide array of market sizing and borrower performance metrics, calling specific attention to distinct differences between borrowers with and without a credit score at the time their account is opened.

Despite being more than 40 years old, the secured card market has been a hotbed of fintech innovation in recent years, with no end in sight. Recent changes to the Community Reinvestment Act (CRA) may expand the availability of secured credit cards and other credit-building products in the coming years (Office of the Comptroller of the Currency et al., 2023). The final rule implements a test for large banks that will encompass credit-builder loans and secured credit cards and evaluate their contribution toward the bank's CRA requirements.[29]

We will continue to monitor developments in the secured card market and provide insights as needed.

[29] The new requirement will only apply to large banks and will take effect on January 1, 2026 (Office of the Comptroller of the Currency et al., 2023). The final rule also classifies large banks as those with assets of at least $2 billion as of December 31 in both of the prior two calendar years.

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