Addressing top-of-mind credit card issuer challenges

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Content

Risk and regulatory

The financial industry faces dramatic shifts in risk and regulatory measures. **Late fees** cost American cardholders around $12 billion each year, according to the Consumer Financial Protection Bureau (CFPB). The agency issued a final rule[1] on March 5, 2024 that would amend Regulation Z to "better ensure" credit card late fees are "reasonable and proportional" to late payments. The final rule adopts a late fee safe harbor threshold of $8 for card issuers that have one million or more open credit card accounts ("Larger Card Issuers"). The Final Rule is effective 60 days after publication in the Federal Register.

The Federal Reserve Board (FRB) issued proposed amendments[2] to the **interchange fee cap** in Regulation II (Debit Interchange Fees and Routing), which potentially impacts debit card issuers' revenues. The Board of Governors discussed the rule in October 2023 and noted that certain costs have declined significantly from when the Board developed the current interchange fee cap in 2011. The final rule is set for June 30, 2025, but faces opposition from the American Bankers Association.

In line with global privacy regulations such as the EU's General Data Protection Regulation (GDPR) and the California Consumer Privacy Act (CCPA), the CFPB has proposed a rule[3] to implement "open banking" that would require depository and nondepository entities to share **consumer financial data** with both consumers and authorized third parties, establishing privacy protections and access standards. This was issued on October 19, 2023, and the CFPB's comments-taking period ended December 29, 2023.

Potential actions:

- Monitor the developments in the late-fee rule, including possible litigation, and **assess the operational and IT system impacts** of the late-fee cap, including any updates to customer disclosures.
- Assess the potential impact of interchange fee caps on IT systems and processes involved in interchange activities, including setting up infrastructure to **recalibrate interchange fees on an ongoing basis**.
- **Develop interfaces for consumers** and data providers for safe and secure data sharing.

Thought leadership:

- CFPB Credit Card Late Fees Reg Alert
- FRB Proposal for Interchange Fees
- CFPB Proposed Data Rule

[1] Source: Consumer Financial Protection Bureau, "Credit Card Penalty Fees (Regulation Z)" (February 1, 2023). [2]Source: Federal Reserve System, "Federal Reserve Board requests comment on a proposal to lower the maximum interchange fee that a large debit card issuer can receive for a debit card transaction" (October 25, 2023). [3]Consumer Financial Protection Bureau, "CFPB Proposes Rule to Jumpstart Competition and Accelerate Shift to Open Banking" (October 19, 2023).

Credit

The credit industry continues to experience growth, with credit card balances reaching $1.13 trillion outstanding, a $50 billion increase from the previous measurement by the Federal Reserve Bank of New York. Delinquencies have mostly returned to prepandemic levels, and continue to rise, particularly among those with auto loans or student loans. Household savings account balances are declining as credit card and other household debt balances remain steady, with student loans remaining flat at $1.6 trillion in the fourth quarter.

High interest rates and inflation continue to challenge credit card performance. Cardholders will continue to struggle to make payments due to high interest rates and inflation. As a result, delinquency and losses may continue until both interest rates and inflation have stabilized or declined. The consumer may begin to experience payment shocks across various loan products, especially consumers who have products with variable interest rates that are resetting, such as student loans, mortgages, credit cards, and lines of credit. Additionally, card issuers may begin seeing changes in cardholder behavior, such as transactors becoming revolvers, which may lead to additional risk in credit card portfolios. Transactors represent retail customers with a revolving credit product who pay their balance in full each month, while revolvers carry a loan balance.

As credit performance deteriorates in this changing landscape, banks must revisit their value proposition to overcome emerging headwinds and meet changing customer expectations.

Potential actions:

- Assess **current reserving methodologies** to ensure they accurately incorporate relevant macroeconomic factors and industry trends.
- If defaults and losses have not yet been reflected in the current models, evaluate **whether model adjustments or overlays are required** to accurately predict the expected future losses in the portfolio.
- **Assess the level of consumer credit risk**, with a particular focus on nonprime borrowers who are more susceptible to higher rates of delinquencies and defaults.
- **Assess loan portfolios and implement early warning indicators** to identify high-risk customers and segments.

Thought leadership:

- CECL Pulse Check Q1 2024
- Credit Markets Update Q4 2023

Capital

The financial services industry continues to navigate changes in the regulatory environment. On July 27th, 2023 the Federal Reserve Board (FRB), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) published a proposed rule[4] for the so-called "Basel III Endgame," which updates and enhances capital requirements, including risk-weighted assets, for all US Bank Holding Companies exceeding $100 billion. Several aspects of "Basel III Endgame" are significant for credit card issuers.

One proposed change within Basel III Endgame would require a capital charge against unused lines of credit, frequently referred to as "off balance sheet exposures." The proposed rule would require a 10 percent weight to be applied to unused lines of credit. While the 10 percent weight is lower than other credit exposures, the proposed rule may require institutions to consider their portfolio of credit product offerings, including credit cards, as they would be required to hold capital against those unused lines of credit.

A second proposed rule change within Basel III Endgame. would impact stress testing through the implementation of an enhanced risk-based approach. Specifically, the proposed rule would require institutions to consider credit exposure to both "revolvers" and "transactors." "Transactors" are defined as retail customers with a revolving credit product who pay the balance in full for 12 consecutive months. The proposed rule allows institutions to consider the lower credit risk associated with creditworthiness of their customers.

Potential actions:

- Assess the **potential impact of the proposed rulemaking** on capital for unused lines of credit, including an understanding of the impact of capital impact on credit limits not utilized.
- Monitor developments in the proposed "Basel III Endgame" rules and **assess the operational and IT system impacts** of obtaining and maintaining the data required to demonstrate the "transactor" status of customers.

Thought leadership:

- Proposed "Basel III Endgame" & GSIB Capital Surcharges
- Basel III Endgame – Potential impact to tax departments

[4] Source: Federal Register 'Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity" (September 18, 2023)

Accounting

The Financial Accounting Standards Board (FASB or the Board) has proposed an Accounting Standards Update (ASU) related to purchased financial assets with credit deterioration. The proposed update would expand the scope of financial assets accounted for using the gross-up approach at acquisition. The proposed update would apply to "seasoned" financial assets and would eliminate the concept of purchased financial assets that have experienced a "more than insignificant" credit deterioration. Therefore, it would eliminate the need for an acquirer to make the judgmental assessment of whether a purchased asset has experienced such credit deterioration.

Companies that purchase credit card portfolios may face operational challenges due to the proposed standard, if finalized as proposed, including the distinction between acquired and originated loans for revolving credit arrangements. Moreover, the retrospective application would require restating prior purchase arrangements due to the unavailability of relevant data and limitations of current IT systems for analysis.

Investors, accounting firms, and other stakeholders have submitted comment letters to the FASB regarding these concerns along with suggestions to ease the operational burden for credit cards, including practical expedients. While some comment letters were in favor of the project, others, along with the Joint Banking Regulators, opposed.

FASB is currently redeliberating the transition guidance and evaluating stakeholders' comments. In the meeting on February 28, 2024, the Board discussed feedback and began redeliberations. At that meeting, the Board affirmed the scope to require all financial assets, with some exceptions, to be accounted for under the gross-up approach when acquired through an acquisition of an asset portfolio or a business.

Potential actions:

- **Review the current IT and data infrastructure**, assessing whether changes are required to capture incremental information for the new accounting model for purchased loans.
- Establish **a dialogue with investors and analysts** to help them understand the impact of the proposed changes on yield due to portfolio acquisitions. This communication can help stakeholders to better understand the changes so they can make informed decisions.

Thought leadership:

- ASU Topic page
- 2023 AICPA Conference on Banks & Savings Institutions