# Addressing top-of-mind issues for credit card issuers

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# Content



# Strategy

The Capital One announcement to acquire Discover for over $35 billion this past February shocked the US credit card market, with several lawmakers calling on regulators to block the merger. Stakeholders will get a chance to voice their comments during a joint public meeting held by the Federal Reserve Board and the Office of the Comptroller of the Currency on July 19, 2024.

This potential acquisition puts a spotlight on the increasing pressures of the credit card market in the United States. Issuers continue to battle with fee-capping regulations (e.g., late fee cap final rule), declining credit quality (credit card charge-offs have surpassed pre-COVID-19 numbers), and other impending headwinds (e.g., the Credit Card Competition Act).

Further, the recent failure of Synapse, a banking-as-a-service (BaaS) middleware provider, in late May highlights the vulnerability of BaaS as a channel play for smaller card issuers / partner banks, who relied heavily on fintechs and other BaaS to support card issuing programs.

Rewards continues to drive the consumer selection process and remains on the forefront for issuers to capture market share. The growing role of rewards in the industry prompted the Consumer Financial Protection Bureau (CFPB) to spotlight credit card rewards[1] and consumer complaints related to the administration of those programs.

On the business side, the focus on business-to-business payments in recent years has intensified issuers' attention on virtual cards to simplify travel and business expenses. In April, Mastercard launched its new mobile virtual card app "In Control Pay"; meanwhile, some card issuers are teaming with travel and expense software providers to embed the issuance of virtual cards.

## Potential actions:

- **Conduct scenario planning** related to the various headwinds facing the industry and evaluate your current and future business strategy.
- **Review your current rewards program and related customer segmentation** to determine if your current program is competitive and meets customer needs.

[1]Consumer Financial Protection Bureau, "CFPB Report Highlights Consumer Frustrations with Credit Card Rewards Programs," May 9, 2024

For more information around strategy issues for credit card users, contact **Robert Ruark**, Banking & Fintech Strategy Leader.

# 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 CFPB. The agency **issued a final rule**[2] 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). However, a Texas federal district court entered a preliminary injunction, which has stayed the final rule from going into effect. The timing of the resolution of the litigation, and therefore the implementation of the rule, is uncertain.

The CFPB recently analyzed lending patterns which showed a tenfold increase in Buy Now, Pay Later (BNPL) lending, with loans across merchant categories and ranging in purchase amounts. This analysis prompted them to propose an **interpretive rule**[3] affirming that BNPL lenders are subject to some of the same consumer protection requirements as traditional credit card companies. Under the proposed rule, BNPL lenders would be required to investigate disputes, provide refunds for voided services and returned products, and issue billing statements that disclose any applicable fees and pricing structures.

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**[4] 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. The comment period on the proposed rule closed in 2023, and the timing of a final rule is uncertain.

## Potential actions:

- Monitor the developments in the late-fee rule, including possible litigation, and **assess the operational and information technology (IT) system impacts** of the late-fee cap, including any updates to customer disclosures.
- **Assess the current operation of BNPL products** for alignment with credit card regulations.
- **Develop interfaces for consumers** and data providers for safe and secure data sharing.

## Thought leadership:

- CFPB BNPL Rule
- CFPB Credit Card Late Fees Reg Alert
- CFPB Proposed Data Rule

For more information around risk and regulatory issues, contact **Damian Plioplys**, Financial Services Risk, Regulatory, and Compliance.

[2] Consumer Financial Protection Bureau, "Credit Card Penalty Fees (Regulation Z)," February 1, 2023.
[3] 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.
[4] Consumer Financial Protection Bureau, "CFPB Proposes Rule to Jumpstart Competition and Accelerate Shift to Open Banking," October 19, 2023.

# Credit

In May 2024, the Federal Reserve Bank of New York published its quarterly report on Household Debt and Credit, noting that household debt balances increased by $184 billion to reach $17.69 trillion outstanding. Credit card balances decreased slightly and now stand at $1.12 trillion outstanding. However, the total balance of outstanding credit card balances remains 13.1 percent higher than the level a year ago. The Federal Reserve Bank of New York noted that delinquency transition rates increased for all product types and that over the past year, nearly 8.9 percent of credit card balances were in a stage of delinquency, an increase of 0.1 percent from the previous quarter.

The ongoing high level of interest rates continues to challenge credit card performance. Cardholders may continue to struggle to make payments due to high interest rates and inflationary pressures. As a result, delinquency and losses may continue until both interest rates and inflation have stabilized or declined. The consumer may continue 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.

As credit performance continues to be challenging, and the interest rate environment appears to be higher for longer, banks must continue to assess their value proposition to appropriately manage credit risk and meet 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, then 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 Q2 2024
- Credit Markets Update Q1 2024

For more information around capital issues, contact **Karen Silverman,** Northeast Financial Services.

# Capital

The financial services industry continues to navigate changes in the regulatory environment. On July 27, 2023, the Federal Reserve Board (FRB), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) published a proposed rule[5] 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. While this proposed rule is still being deliberated, several aspects of Basel III Endgame as proposed 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:

- Monitor developments in the **rulemaking process** for proposed "Basel III Endgame" rules.
- 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.
- **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

For more information around capital issues, contact **Mark Nowakowski**, Financial Services Risk, Regulatory, and Compliance.

[5]Federal Register, "Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity," September 18, 2023.

# Legislative landscape

The Credit Card Competition Act (the Act) was first introduced in 2022 and was introduced again in 2023. The legislation is bipartisan and has the stated purpose of enhancing competition and choice as it relates to credit card networks. The bill is currently stalled in Congress, and the likelihood and timing of passing the bill are both uncertain.

The bill proposes to inject more and fair competition in the credit card industry by requiring credit card issuers that have assets over $100 billion to have a minimum of two payment networks, with one being outside the two largest networks. By requiring a network outside of the two largest, the Act intends to create more competition among networks, ultimately resulting in lower processing fees.

The legislation, as currently drafted, may impact the products and services offered as certain revenue streams would be impacted by the legislation if passed. Further, some have raised questions about the impact to credit card reward programs as a result of lower processing fees.

## Potential actions:

- Monitor developments in the legislative process as they relate to the proposed Act.
- Assess the potential impact of the proposed Act on revenue streams and rewards programs.

For more information around the legislative landscape, contact **Damian Plioplys**, Financial Services Risk, Regulatory, and Compliance.

# Accounting

The Financial Accounting Standards Board (FASB) 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.

After considering the comment letters received and deliberating, FASB is currently performing outreach to obtain additional feedback on the proposed ASU, which could result in changes to accounting for credit cards under this standard. The timing of a future ASU is currently uncertain.

## 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

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