Comptroller's Handbook A-CCL

Safety and Soundness

Capital Adequacy (C) | Asset Quality (A) | Management (M) | Earnings (E) | Liquidity (L) | Sensitivity to Market Risk (S) | Other Activities (O)

Credit Card Lending

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Credit Underwriting Assessment System

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Contents

Introduction

The Office of the Comptroller of the Currency's (OCC) *Comptroller's Handbook* booklet, "Credit Card Lending," is prepared for use by OCC examiners in connection with their examination and supervision of national banks and federal savings associations (collectively, banks). Each bank is different and may present specific issues. Accordingly, examiners should apply the information in this booklet consistent with each bank's individual circumstances. When it is necessary to distinguish between them, national banks and federal savings associations (FSA) are referred to separately.

Overview

The credit card is one of the most universally accepted and convenient payment methods, used by millions of consumers and merchants worldwide as a routine means of payment for a variety of products and services. The rapid growth of the credit card industry indicates the card's value to the financial community, which includes consumers, merchants, and issuing banks.

Because of their profitability, credit cards play a role in the strategic plans of many banks, which may function as issuers, merchant acquirers, or agent banks. There are several major issuers, very few of them community banks. Community banks that issue cards do so mainly as a service to their existing customer bases. Issuing banks hold or sell credit card loans and, therefore, bear some credit risk.

A merchant bank or acquiring bank is an entity that has entered into an agreement with a merchant to accept deposits generated by credit card transactions. Processing merchant sales drafts may result in customer chargebacks and, therefore, create some transaction risk to the merchant bank. For more information, refer to the "Merchant Processing" booklet of the *Comptroller's Handbook*.

An agent bank is a bank that has entered into an agreement to participate in another bank's card program, usually by turning over its applicants for credit cards to the bank administering the program and by acting as a depository for merchants.

This "Credit Card Lending" booklet discusses the operations of issuing banks and provides information for examiners regarding the types of elements usually found in systems maintained by prudent bankers. Specific items identified for inclusion in bank policies, procedures, and guidelines are not presented as a required checklist because each bank and its systems vary. Examiners should consider the circumstances of the individual bank to determine essential system elements.

The Truth in Lending Act (TILA) of 1968 (15 USC 1601 et seq.) was implemented by Regulation Z (12 CFR 1026) and became effective on July 1, 1969, and has since been amended many times. In 2009, Congress passed the Credit Card Accountability Responsibility and Disclosure Act (CARD Act), which further amended TILA. The CARD

Act provisions required creditors to increase the amount of notice consumers receive before the rate on a credit card account is increased or a significant change is made to the account's terms. The amendments allowed consumers to reject such increases and changes by informing the creditor before the increase or change takes effect. The CARD Act provisions also involved rules regarding interest rate increases, over-limit transactions, and student cards. Lastly, they addressed the reasonableness and proportionality of penalty fees and charges and the reevaluation of rate increases. Accordingly, throughout this booklet, there are references to the CARD Act. For more information about CARD Act requirements and examination procedures, refer to the "Truth in Lending Act" booklet of the *Comptroller's Handbook*.

The Home Owners' Loan Act of 1933 (HOLA) (12 USC 1461 et seq.), established the lending and investment limitation of FSAs. The statute is implemented by 12 CFR 160. Although FSAs are generally limited under 12 USC 1464(c)(2)(D) to investing 35 percent of assets in consumer loans and certain securities, section 5(c)(1)(T) of HOLA (12 USC 1464(c)(1)(T)) authorizes FSAs to invest in credit cards and loans made through credit card accounts without a statutory percentage of assets limitation. HOLA's credit card lending authorization is separate from, and in addition to, the investment limits for other loans and investments authorized under HOLA. FSAs do not have to aggregate their consumer-related credit cards with other consumer loans in determining compliance with the limitations on consumer loans and certain other assets in section 5(c)(2)(D) of HOLA (12 USC 1464(c)(2)(D)). Similarly, FSAs do not have to aggregate business-related credit card accounts with loans made under HOLA's commercial loan authority.

Regulations and statutes applicable to national banks and FSAs are discussed throughout this booklet. Further, this booklet contains numerous references to appendix A, "Transaction Testing." Transaction testing is one of the most important steps in the examination process for credit card lending because account-level testing allows examiners to determine exactly what processes the bank is using and then assess those processes. Transaction testing also indicates the bank's level of adherence to its own policies and formal procedures as well as to OCC guidance.

The dynamics of the credit card market require the successful issuing bank to manage every aspect of the lending process. Every step in the lending function, consistent with consumer compliance, is crucial to maximizing profits in this competitive environment, with rapidly changing products, terms, and technologies. This booklet discusses each segment of an issuing bank's credit card operation, from marketing and account acquisition to account management and collections.

Competition, market saturation, and changing consumer demographics and attitudes have forced successful issuing banks to be innovative with the credit card products they offer, their customer selection, and management methods. This booklet discusses various types of credit card programs, such as affinity and cobranded cards, and the unique characteristics, risks, and controls necessary for each. This booklet also includes a discussion of credit scoring, because all major issuers use this technology to help identify possible customers and then manage cardholder accounts.

Banks also use securitization as a funding source for credit card lending. This provides banks some flexibility with respect to availability and cost of funding for the portfolios. Banks should ensure that these securitizations are accounted for in accordance with Accounting Standards Codification (ASC) 810, “Consolidation,” and ASC 860, “Transfers and Servicing,” which generally do not allow for derecognition of the card receivables in most traditional credit card securitization structures. For more information, refer to the “Asset Securitization” booklet of the *Comptroller’s Handbook*.

Several factors have caused the credit card business to become one of the most complex and competitive areas in the financial services industry. The market environment, through ever-evolving technology, has become one of speed and volume. Due to the inherently significant credit and operational risks, issuing banks should have written operating policies tied to well-designed business plans and risk management systems.

Generally, banks that offer credit cards to their own customers or stay within their local market area present less risk than institutions that market their credit card program outside the local area. Community banks have difficulty competing successfully with national issuers that have more expertise, technology, and economies of scale.

Credit Card Products

Credit card products generally fall into the following broad categories:

- General purpose cards (including charge cards).
- Proprietary or private-label cards.
- Corporate or commercial cards.
- Secured cards.

General Purpose Cards

General purpose bank cards, including affinity and cobranded cards, are branded credit cards that are accepted by a wide variety of merchants and service providers. Banks that offer general purpose cards are typically members of Visa or MasterCard, the two primary systems for the settlement of interbank credit card transactions. Issuers may offer a “charge” card (on which the balance must be paid in full each month) and a “credit” card where (the balance can revolve month-over-month). Bank cards generate transaction-based interchange income (generally a small percentage of each transaction to compensate the bank for processing the transaction) in addition to finance charge and fee-related income.

Issuers of general purpose cards may form partnerships with businesses, associations, and not-for-profit groups to market their credit cards. These credit cards, called affinity or cobranded cards, are typically issued as MasterCard, Visa, or American Express cards. The cards normally carry the affinity group or cobranding partner’s name and logo. These cards can be used for purchases anywhere the applicable processing network (e.g., Visa, MasterCard) is used and can sometimes be used for purchases of a partner’s products and services. A bank issues the card under a contractual agreement with a partner. Although compensation arrangements can vary, the partner typically endorses the bank's card in return for negotiated financial compensation based on customer acceptance and use of the card.

Although the terms "cobranded" and "affinity" are sometimes used interchangeably, there are differences. Generally, affinity cards are issued for a variety of groups and not-for-profit organizations, such as alumni associations, professional organizations, and sports enthusiasts. The cards provide cardholders with access to credit and a way to identify with the group. The affinity group is compensated for endorsing the issuer's card. Compensation can include a portion of annual credit card fees, fees paid on renewal, a percentage of the interchange income, or a share of the interest income. This arrangement provides groups with a relatively low-cost source of income. The issuing bank expects to benefit from the affinity group's endorsement; while the affinity group introduces the bank to what the bank hopes are high-quality and loyal customers. Members of affinity groups also may be more responsive to credit card solicitations than consumers are to generic cards, providing the issuer with more effective target marketing initiatives.

In cobranded card programs, the issuing bank forms partnerships with for-profit organizations, such as retailers, hotels, gasoline companies, automobile manufacturers, and airlines. The cobranding partner may receive part of the income that would normally go to the issuer, such as interchange income, or may receive other compensation based on the volume or activity of accounts opened through the card partnership. The cobranding partner may also agree to share in a portion of credit losses or other expenses associated with the card receivables. The partner is willing to share various income and expenses with the card issuer because the issuer brings customer service and expertise in consumer lending to the partnership. A bank card issuer generally benefits from a cobranding program through increased credit card receivables.

General purpose cards, including affinity and cobranded cards, often offer rewards programs as an incentive for cardholders to use a specific card. For cobranded and affinity cards, the nonbank partner offers financial rewards, such as discounts tied to the partner's product, points, or even some percentage of cash back. Recently, these types of programs have been adopted by other general purpose cards, although the rewards they offer are not tied to a specific entity. (Refer to the "Reserving for Rebate Programs" section in the "Risk Management" section of this booklet for a discussion of risks associated with rebates.)

Issuing banks should not materially alter underwriting standards, account management activities, or collection practices that are important to safety and soundness simply to accommodate prospective affinity or cobranded card customers. Examiners should review and discuss with bank management any modifications to terms, account management activities, or collection practices to determine that any impact to portfolio quality does not serve as the basis for a safety and soundness concern or compliance risk.

Issuing banks with numerous partnership program accounts tied to affinity or cobranded programs can be seriously affected by partners' viability and commitment to the program. Bank management should thoroughly analyze potential credit card lending partners before finalizing contracts. Negative publicity about the partner could reflect poorly on the bank.

Issuers of affinity cards should obtain verification from an independent source that a potential partner is legitimate. Bank management should determine and monitor the financial status of its cobranding partners, because the bank might be exposed to liability for unpaid rebates if the partner is not financially sound.

Contract terms should specify that control over the partnership program rests with the issuer.[1] Issuers should track and monitor each partnership program, and should pay particular attention to aspects of the program such as response and approval rates, utilization rates, purchase volume, delinquencies, and charge-offs. The bank's planning strategies should consider the possibility of high attrition rates if a partner withdraws its endorsement from the bank. The bank should periodically assess the profitability of each relationship to ensure that it is financially feasible to continue offering the cobranded or affinity card. Although the product may be profitable initially, the issuing bank may find that the contract is no longer profitable as circumstances change.

Proprietary or Private-Label Cards

Proprietary or private-label cards are generally accepted at only one retailer to facilitate the purchase of that particular retailer's goods and services. In addition to traditional retailers, many sellers of high-cost goods (such as furniture, kitchen appliances, etc.) often offer their own credit cards.

Proprietary or private-label card agreements may include various revenue and expense-sharing arrangements as described in the section above. One additional feature commonly associated with private-label cards, particularly for retailers of high-cost goods, is the promotional period. Such programs often allow the consumer a period of no interest on purchases they make from the retailer. Examples of this type of offer appear in advertisements for various consumer goods from furniture stores offering "No Interest for Two Years" on purchases made by a certain date.[2] These programs can be structured in two ways: (1) interest accrues during the promotional period, and, if the balance is not paid in full

[1] Refer to OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance" (October 30, 2013), which sets forth regulatory guidance for third-party relationships.

[2] Issuers should be sure that any solicitations, application, account-opening materials, or other disclosures comply with Regulation Z and do not violate section 5 of the Federal Trade Commission Act (FTC Act), which prohibits unfair or deceptive acts or practices (UDAP), or section 1036(a)(1) of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank Act), 12 USC 5536(a), which prohibits unfair, deceptive, or abusive acts or practices (UDAAP). Marketing materials for promotional annual percentage rate (APR) programs may risk being deceptive if they do not clearly and prominently describe the material costs, conditions, and limitation of such offers and the effect of promotional APR offers on the grace period for new purchases. The Consumer Financial Protection Bureau (CFPB) has issued a bulletin advising credit card issuers of the risks associated with the marketing of credit card promotional offers. Refer to CFPB Bulletin 2014-2, "Marketing of Credit Card Promotional APR Offers."

when the promotion expires, it is added to the outstanding balance at the end of the period;[3] or (2) no interest accrues during the promotional period, but interest begins to accrue if the balance is not paid in full when the promotional period expires.[4]

Promotional programs should not, however, defer principal payments or have a deferred payment option, which features a period during which no payments are required of the consumer. Minimum monthly payments that amortize the current balance over a reasonable period of time are a key tenet of safe and sound retail lending. Regular monthly payments add structure and discipline to the lending arrangement, provide regular and ongoing contact with the borrower, and allow the borrower to demonstrate, and the bank to assess, continued willingness and ability to repay the obligation over time. Conversely, the absence of a regular payment stream may result in protracted repayment and mask true portfolio performance and quality.

Corporate or Commercial Cards

Corporate or commercial charge cards are usually issued to facilitate corporate or government travel and entertainment (T&E) or procurement. Some banks also issue consumer charge cards. Generally, the balance is due in full at the end of each billing cycle. Although T&E cards are typically general purpose in nature, procurement cards may be either general purpose or proprietary. Corporate cards are generally less profitable to banks than consumer credit cards because users of corporate cards normally do not incur finance charges. Rather, annual fees, interchange income, and other service fees are the primary sources of income for banks that issue these cards. As a result, banks should closely analyze the costs and risks associated with these programs and have the necessary expertise in place before engaging in this type of business. Corporate and commercial cards are subject to the same regulatory guidance as consumer cards with respect to safety and soundness issues.

Secured Cards

Secured cards look and function like traditional, unsecured credit cards, but the credit extended by the issuer is partly or wholly secured by borrower collateral, typically in the form of a bank deposit. These cards are generally marketed to individuals with limited or blemished credit histories, who may not be eligible for unsecured credit. The cards may serve

[3] Under this program structure, accrued interest can be imposed only if the specified period is six months or longer and, before the commencement of the promotional period, the issuer discloses in a clear and conspicuous manner the length of the period and the rate at which interest will accrue. Refer to 12 CFR 1026.55(b)(1).

[4] Assuming the issuer promotes such a waiver, the cessation of the waiver if the balance is not paid in full at the end of the promotional period constitutes an increase in the APR for the purposes of Regulation Z. Refer to 12 CFR 1026.55(e). Such an increase is permissible under 12 CFR 1026.55(b)(1) if the promotional period is six months or longer and, before the beginning of the promotional period, the card issuer clearly disclosed the length of the period and the APR that would apply after the period ended.

as a means for those individuals to establish or improve their credit and to qualify for or "graduate" to more traditional unsecured credit.[5]

In a traditional secured card program, funds are transferred to the issuing bank by the consumer at account opening, pledged as security for the credit card account, and placed on deposit (at the issuer or another depository institution) in the name of or for the benefit of the consumer. The consumer generally may not access those funds. Rather, the funds remain on deposit so that if the consumer defaults on his or her credit card account, the deposited funds may be used to help satisfy the debt. Minimum bank deposits under secured credit card programs typically range from $100 to $500, although customers are often permitted to deposit more if they choose. The deposit account may earn interest, depending on the terms of the agreement. In secured card programs, it is imperative that issuing banks have strong controls in place to ensure that the collateral is not unintentionally released.

In some programs, security deposits and account opening fees are charged to the credit card account. The CARD Act and Regulation Z limit fees issuers can charge before account opening and during the first 12 months after account opening. For more information, refer to the "Truth in Lending Act" booklet of the *Comptroller's Handbook*.

Risks Associated With Credit Card Lending

From a supervisory perspective, risk is the potential that events will have an adverse effect on a bank's current or projected financial condition[6] and resilience.[7] The OCC has defined eight categories of risk for bank supervision purposes: credit, interest rate, liquidity, price, operational, compliance, strategic, and reputation. These categories are not mutually exclusive. Any product or service may expose a bank to multiple risks. Risks also may be interdependent and may be positively or negatively correlated. Examiners should be aware of this interdependence and assess the effect in a consistent and inclusive manner. Examiners also should be alert to concentrations that can significantly elevate risk. Concentrations can accumulate within and across products, business lines, geographic areas, countries, and legal entities.

The primary risks associated with credit card lending are credit, operational, liquidity, strategic, reputation, interest rate, and compliance. These are discussed more fully in the following paragraphs. Although all of these risks are embedded in credit card lending, the primary focus of this booklet is credit risk, with some emphasis on operational, strategic, and reputation risk.

[5] Cards that are marketed as improving credit must have clear explanations to consumers to ensure these products and their marketing do not constitute a UDAP or UDAAP.

[6] Financial condition includes impacts from diminished capital and liquidity. Capital in this context includes potential impacts from reduced earnings and market value of equity.

[7] Resilience recognizes the bank's ability to withstand periods of stress.

Credit Risk

Credit risk poses the most significant risk to banks involved in credit card lending. Because credit card debt is generally unsecured, repayment depends primarily on a borrower's willingness and capacity to repay. The highly competitive environment for credit card lending provides consumers with ample opportunity to hold several credit cards from different issuers and to pay only minimum monthly payments on outstanding balances. In such an environment, borrowers may become overextended and unable to repay, particularly in times of an economic downturn or a personal catastrophic event.

Regulation Z prohibits a card issuer from opening a credit card account for a consumer under an open-end (not home-secured) consumer credit plan, or increasing any credit limit applicable to such account, unless the card issuer considers the consumer's ability to make the required minimum periodic payments under the terms of the account, based on the consumer's income or assets and current obligations.[8]

Product pricing may vary widely and include both fixed- and variable-rate structures. Issuers may offer low introductory rates to consumers to entice them to transfer balances to a new credit card. Introductory rate offers may be as low as zero percent, although transfer fees may apply. At the end of the introductory period, the variable rate is likely to increase.[9] For more information on interest rate limitations and requirements imposed by the CARD Act, refer to the "Truth in Lending Act" booklet of the *Comptroller's Handbook*.

In addition to credit risk posed by individual borrowers, credit risk exists in the overall credit card portfolio. Relaxed underwriting standards, aggressive solicitation programs, inadequate account management, and a general deterioration of economic conditions can increase credit risk. Changes in product mix and the degree to which the portfolio has concentrations, geographic or otherwise, can also affect a portfolio's risk profile.

Banks control credit risk through coordinated strategic and marketing plans. Banks should have comprehensive policies and procedures that include strong front-end controls over underwriting standards, well-defined account management processes, strong back-end controls for effective collection programs, and robust monitoring and reporting management information systems (MIS).

Examiners assess credit risk by evaluating portfolio performance, profitability, and borrower characteristics by business lines, products, and markets. They consider changes in underwriting standards, account acquisition channels, credit scoring systems, and marketing plans.

[8] Refer to 12 CFR 1026.51.

[9] For information on Regulation Z requirements pertaining to introductory rates, refer to 12 CFR 1026.55(b)(1).

Operational Risk

A bank's success in credit card lending depends in part on achieving economies of scale. Credit card operations are highly automated, service large volumes of transactions, and require strong operational controls. Aggressive growth has the potential to stretch operational capacity and can cause problems in handling customer accounts and in processing payments.

Fraud is a continuing problem associated with credit card programs. The very nature of the product—an easily obtainable unsecured line of credit that is basically managed by the customer—makes it an ideal mechanism for fraud. A bank's technology platform can pose significant operational risk to an issuer. Platforms that are outdated or difficult to use or reprogram expose banks to higher servicing costs and higher potential for errors when they require manual workarounds or manual intervention.

With most requirements under TILA pertaining to credit cards, a creditor that fails to comply generally may be held liable to the consumer for actual damages and legal costs.[10] In addition, a creditor may be held liable for twice the amount of the finance charge involved, subject to certain limits. Effective controls and efficient processes should be in place to manage litigation exposure in credit card lending. Operational risk exists not only in account originations and servicing, but also in collections, whether or not a bank uses external vendors or attorneys in collection practices. There are many detailed legal requirements around the preparation and filing of collection documentation, and each issuer should have processes in place, or ensure that its vendors have processes in place, to ensure compliance with those requirements.

To control operational risk, a bank should maintain effective internal controls, internal and third-party audits, third-party relationship management practices, business continuity planning, and MIS. Bank management should consider the volume of accounts managed (both on the books and securitized), the capabilities of systems and technologies in relation to current and prospective volume, contingency preparedness, and exposures through the payment system. If a bank employs vendors in any part of its operations, the bank should have strong third-party relationship management practices. OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance," provides guidance to banks for assessing and managing risks associated with third-party relationships.

Examiners assess operational risk by evaluating the adequacy of systems and controls governing credit card application processing, account management, and collections.

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[10] TILA exempts a creditor from civil liability for a violation if the creditor shows by a preponderance of the evidence that the violation was not intentional and results from a bona fide error, notwithstanding the maintenance of procedures designed to avoid such an error. Refer to 15 USC 1640(c). Further, failing to comply with the advertising provisions in 15 USC 1661–1665b does not expose a creditor to civil liability for actual damages or legal costs.

Liquidity Risk

Banks use a variety of funding techniques to support credit card portfolios. Techniques employed by individual banks introduce different types of liquidity risk. For example, a credit card bank that is self-funded through securitizations (refer to the "Glossary" section of this booklet) has different liquidity risk considerations than a credit card bank that is funded by its retail parent's commercial paper. Moreover, large banks with access to a full array of funding sources to support credit card operations have different liquidity risk considerations than smaller institutions with potentially less diverse funding sources.

Liquidity risk is present in a bank's obligation to fund unused credit card commitments. For example, more consumers use their cards at certain times, such as around holidays, so banks should be aware of seasonal demands.

Credit card portfolios composed of higher-risk assets and having unusual portfolio volatility may be difficult to securitize or sell. Failure to adequately underwrite or collect loans may trigger early amortization of a securitization, which could cause liquidity problems, increase costs, or limit access to funding markets in the future. For more information on early amortization of securitizations, refer to the "Asset Securitization" booklet of the *Comptroller's Handbook*.

Banks may control liquidity risk through a strong balance sheet management process, a diversified funding base, a comprehensive liquidity contingency plan, and laddered securitization maturities, if appropriate.

To assess liquidity risk, examiners consider

- reliability of funding mechanisms.
- dependence of the credit card operation on securitization of assets.
- volume of unfunded commitments.
- attrition of credit card accounts.
- stability of affinity and cobranded card relationships.
- ability to fund seasonal increases in demand.

Strategic Risk

Strategic risk in credit card lending can arise when business decisions adversely affect the quantity or quality of products and services offered, program operating controls, management supervision, or technology. Bank management's knowledge of economic dynamics and industry market conditions can help limit strategic risk. For example, banks may be exposed to strategic risk if they inadequately plan for marketing of preapproved credit card solicitation programs. To mitigate the risk, bank management should fully test new markets, analyze results, and refine solicitation offers to limit the booking of new credit card accounts that do not perform as anticipated.

Failure to sufficiently test new markets and strategies before full rollout can present significant strategic risk to a bank. For example, an issuer that wants to change the composition of its portfolio to be more heavily weighted toward a certain demographic or customer base may minimize strategic risk by testing the new strategy in a pilot phase. Similarly, to effectively manage the risk of enabling credit cards with EMV (Europay, MasterCard, and Visa) integrated circuit card credit card technology (IC cards or chip cards), bank management should provide for adequate testing and thoroughly consider the costs and benefits of the new technology before introducing it. Bank management should pay particular attention to changes in the credit card marketplace, such as the increased use of chip cards or MasterCard and Visa implementing a fraud liability shift for point-of-sale transactions that provides incentives for banks and merchants in the United States to shift from a signature-based model to a chip and PIN-based model.

Examiners assess strategic risk by determining whether bank management has evaluated the feasibility and profitability of each new credit card product and service before it is offered. Examiners determine whether the bank's pricing, growth, and acquisition strategies realistically consider economic and market factors. In particular, examiners evaluate whether a proper balance exists between the bank's willingness to accept risk and its supporting resources and controls.

Reputation Risk

A bank's credit card operation can create reputation risk in a variety of ways. For example, poor servicing of existing accounts, such as failing to appropriately resolve consumer issues or process payments in a timely manner, can result in the loss of existing relationships. Issuing banks that employ outside vendors to perform solicitation, servicing, collection, or other functions should effectively monitor and control the products and services provided by the third parties. Reputation risk also may exist when a bank offers cobranded or affinity credit cards, because consumers may associate the quality of the bank's partner's products and services with the bank.

Certain credit card practices can also increase reputation risk. To illustrate, common industry practices, such as punitive and penalty pricing for defaults on accounts, are perceived as unfriendly to the consumer. Several major issuers have received negative publicity for having employed these practices.

To assess reputation risk, examiners consider

- volume and number of credit card accounts under management or administration.
- merger and acquisition plans and opportunities.
- potential or planned entrance into new credit card products, marketing strategies, or technologies (including new delivery channels).
- the market's or public's perception of the bank's financial stability.
- past performance in offering new credit card products and services and in conducting due diligence.

- ability to prevent violations of laws and regulations and minimize impact from any violations that do occur.
- volume of customer complaints and the ability to address them.
- management's willingness and ability to adjust strategies based on regulatory changes, market disruptions, or market or public perception.
- quality and integrity of MIS and the development of expanded or newly integrated systems.

Interest Rate Risk

Interest income and fee income derived from credit card portfolios are sensitive to changes in interest rates. Complex, illiquid hedging strategies or products have their own risks that may exacerbate interest rate risk. The availability of a wide variety of rate structures for credit card products provides flexibility in managing such risk. Banks should manage interest rate risk on a consolidated basis for their credit card portfolios, as well as within individual product lines.

When assessing interest rate risk, examiners should consider the CARD Act's limits on rate increases,[11] as well as the variety of pricing programs and the impact of competition on rates. Intense competition on pricing to meet market demands can compress margins. Examiners should also consider the source(s) and cost of funding the credit card portfolio.

Compliance Risk

The evaluation of compliance risk should consider the numerous laws that affect aspects of credit card lending. These compliance laws include: the Bank Secrecy Act of 1970 (BSA) and consumer laws and regulations, including TILA, the Fair Credit Reporting Act of 1970 (FCRA), the Fair Debt Collection Practices Act of 1977 (FDCPA), the CARD Act, the Equal Credit Opportunity Act (ECOA), the Servicemembers Civil Relief Act of 2003 (SCRA), and laws prohibiting UDAP and UDAAP.[12] Bank management should ensure that staff and third-party service providers involved in marketing, credit scoring, processing applications, and collection activity comply fully with these laws and regulations. The examiner should determine whether the bank's credit card lending activities treat customers fairly and fulfill the bank's contractual obligations with the customer.

Examiners must understand the BSA risks surrounding the institution and its third-party relationships. Secured credit cards may pose a higher risk of money laundering or terrorist financing, and examiners should assess the potential risks from the following: (1) placement (introducing cash into the financial system by some means); (2) layering (undertaking complex financial transactions to camouflage the illegal source); and (3) integration

[11] Refer to 12 CFR 1026.55.

[12] See footnote 2.

(generating wealth from the placement of the illicit funds). Examiners must also understand each credit card program as it relates to the BSA.

Refer to the Federal Financial Institutions Examination Council's *FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual* and the "Fair Credit Reporting," "Fair Lending," "Truth in Lending Act," and other *Consumer Compliance* series booklets of the *Comptroller's Handbook* for the primary compliance-related examination information on credit card lending.

Risk Management

Each bank should identify, measure, monitor, and control risk by implementing an effective risk management system appropriate for the size and complexity of its operations. When examiners assess the effectiveness of a bank's risk management system, they consider the bank's policies, processes, personnel, and control systems. Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for an expanded discussion of risk management.

Management

Credit card lending is a highly automated, high-volume activity that distributes sophisticated products to consumers. A bank's credit card operation should have the management and organizational structure, expertise, staffing levels, information systems, training programs, and general and specialty audit processes to be effective in this environment. Accountability and responsibility should be clearly defined at every level.

A bank's strategy for credit card activities should identify, in broad terms, the level of risk the bank is willing to accept for various products in its portfolio. The plan should reflect realistic goals and objectives based on reasonable data and assumptions. The bank's appetite for risk often involves balancing its underwriting and the pricing structure to achieve desired results. For example, a bank may ease its credit standards, and price for that risk through higher interest rates, projecting increased profits in spite of the higher losses that may be associated with those accounts. Examiners should assess the adequacy of the bank's total strategy.

All banks should implement sound fundamental business principles that identify risk, establish controls, ensure compliance with applicable laws and regulations, and provide for monitoring systems for lending activities. Monitoring systems should also provide a mechanism to identify, investigate, and report suspicious activities. Because credit card lending includes numerous activities that pose significant risks, the bank should have effective policies and strong internal controls governing each operational area. Effective policies and internal controls enable the bank to adhere to its established strategic objectives and to institutionalize effective risk management practices. Policies also can help ensure that the bank benefits through efficiencies gained from standard operating procedures.

Risk Management Control Systems

Control systems identify, measure, and monitor risks. These systems include models, loan review, quality control, audit, and MIS. The structure and function of each system can vary depending on the size and complexity of the bank's credit card operations. Technology, level of sophistication, and staffing levels may also be different. Examiners must determine how and where each function is performed and assess its effectiveness.

The bank's audit and loan review functions should conduct periodic reviews of the bank's credit card program. Credit card audit programs should be comprehensive, covering the life of the account and the product overall, including marketing, origination, account management and servicing, loss mitigation, fraud prevention, and collection. Procedures should include regular testing of the credit underwriting function for compliance with policy guidelines and applicable laws, regulations, and regulatory guidance, as well as a review of all significant policies for prudence and staff adherence to policy. Further, the bank's audit function should test controls designed to identify and report suspicious activity.[13]

A strong credit risk management function is crucial to the ongoing success and profitability of the credit card program. The risk management function is responsible for evaluating credit standards, monitoring the quality of the portfolio, and making changes to the underwriting standards as necessary to maintain the appropriate level of risk in the portfolio. An effective risk management function promotes early and accurate identification of existing and potential problems, identifies the need for policy revisions, and provides bank management with the information it needs to respond promptly to changes.

The risk management process should address the entire cycle of credit card lending, from strategic development, testing, and product rollout to long-term performance of the portfolio. OCC Bulletin 2004-20, "Risk Management of New, Expanded, or Modified Bank Products and Services: Risk Management Process," provides OCC guidance for national banks. Examiners should review this issuance when evaluating a national bank management's process for introducing new credit card products.[14]

The risk management function should include responsibility for performing product analyses to serve as the basis for underwriting, marketing, compliance, and portfolio management decisions. The function should ensure that marketing initiatives appropriately reflect acceptable levels of risk. Risk management should help manage and maintain all scoring systems, analyze portfolio delinquencies and losses, and identify reasons for adverse changes or trends. It should also monitor portfolio performance, including the performance of specific products, marketing initiatives, and vintages (refer to the "Glossary" section of this booklet).

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[13] Refer to 12 CFR 21.21 and the *FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual* (December 2, 2014).

[14] For FSAs, refer to the Office of Thrift Supervision's *OTS Examination Handbook*, section 760, "New Activities and Services."

The bank should have effective MIS in place to perform its risk management functions effectively. For example, MIS should be able to provide sufficient information to evaluate and measure the impact of actions taken and identify unusual or suspicious activity. Bank management should receive reports derived from MIS data outlining portfolio dimensions, composition, and performance. Reports should include portfolio risk levels, trends, concentrations, and earnings.[15] These reports should be prepared for each product type, affinity group, or other portfolio segment that may be significant due to strategic importance, performance related concerns or new products.

Information Technology

Credit card lending is highly dependent on technology. From the time of the loan application through the remaining life of the loan, information technology (IT) plays a key role in operations, risk management, and regulatory reporting. IT and the IT infrastructure allow bankers to leverage resources and increase both operational and financial efficiency. Additionally, high-volume credit card lenders should have a strong IT culture because of the high level of MIS and reporting for management and regulatory requirements.

Assessment of IT systems within credit card lenders should include an assessment of the capability of the IT systems to support the operational, risk management, and risk control functions of a credit card operation. The assessment also should consider continuity planning for IT as well as overall resiliency of business processes. IT systems should be compatible and able to process the high volume of data generated during the life of a credit card.

Scoring Models

Most banks use credit scorecards to some degree in their credit card operations. Credit scorecards, also referred to as models, are risk-ranking tools that attempt to differentiate between accounts that will exhibit "good" behavior and those that will not.[16] The scores generated indicate the relative level of risk in either ascending or descending order, depending on the convention used by the model developer. Credit scoring also is used to control risk in acquisition and underwriting, account management, and collection processes.

The use of models also can pose risk to the bank—specifically, the risk that the bank will suffer losses because the bank's lending strategies are based on poor or failed models. OCC Bulletins 1997-24, "Credit Scoring Models: Examination Guidance," and 2011-12, "Sound Practices for Model Risk Management: Supervisory Guidance on Model Risk Management," and appendix H of this booklet, "Credit Scoring and Development of Scoring Models," provide additional useful information.

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[15] Refer also to the "Loan Portfolio Management" booklet of the *Comptroller's Handbook* for further discussion of MIS reports.

[16] The definition of a "bad" account varies but typically involves some level of delinquency, usually more than 60 or 90 days past due.

In simple terms, scoring employs mathematical techniques to predict future behavior based on past performance. Predictive horizons range from six months to two years. The assumption is that the behaviors of the scored population going forward will not change markedly from those of the population used to develop the model. The ability of models to differentiate risk deteriorates with time, however, as a result of shifts in consumer behavior, economic conditions, and bank and industry product terms and marketing.

The majority of scoring models rely on statistical regression techniques (linear, logistic, or neural network), but banks occasionally use nonempirical "expert" models. Expert models are designed using subjective and judgmental factors such as age; therefore, usage is limited because Regulation B (which implements the ECOA) contains specific requirements for use of an applicant's age in scoring models.[17] Risk models are programmed to generate adverse action reason codes.

Models are categorized as either generic or custom. Generic, off-the-shelf scorecards are also known as pooled data models because the developer uses information obtained from multiple lenders or credit repositories or bureaus to create the model. Generic scorecards are most often used when the bank lacks a sufficient number of approved and denied applications or depth of account history to provide the requisite development sample to build a custom scorecard (i.e., the bank does not have enough data to generate statistically valid conclusions). Some pooled data models are developed specifically for credit cards.

Proprietary or custom scorecards are bank- or product-specific models developed using the bank's own data and customer experience. These scorecards may be developed in-house, if the bank has the modeling expertise on staff, or scorecards may be developed by modeling vendors.

Scoring systems do not normally consist of a single model. Recognizing that there are differences in available information and behavior patterns, the modeler attempts to segment the group into similarly situated subpopulations. The modeler can then develop individual scorecards for each distinct subpopulation that use the variables most predictive of risk for that particular group, thereby increasing accuracy and precision. For example, a credit card application might consist of seven models: a "thin file" scorecard for applicants with little or no previous credit history; three "derog" or "subprime" models for those with prior delinquencies; and three "prime" scorecards for those with more substantial credit histories who have been paying on time. The definition of the subpopulations and the determination of how many to use are key components of the model development process.

Banks' use of risk models in the underwriting process varies. Banks may

- use scoring models exclusively to approve or reject loan applications.
- rely heavily on scoring, using automated underwriting systems to approve high scores and reject low scores, but divert borderline scores to underwriters for further review (also called "gray zone" strategies).

[17] Refer to 12 CFR 1002.6. Banks should ensure that credit scoring models comply with all applicable fair lending laws, regulations, and guidance, including other provisions of Regulation B, such as 12 CFR 1002.4.

- use scores as one among many inputs in a judgmental underwriting process.
- use scores to route applications between senior and junior underwriters or for some other queuing strategy.

Most large retail credit operations fall into the second category above, while smaller banks with low volume tend to fall into the third category. The types of scores generated by risk models include the following:

- **Credit bureau risk scores:** The most widely used of all the scores, bureau scores use only information on file at the three major credit bureaus; loan-specific information and general economic conditions are not included in these models. For the most part, bureau scorecards (e.g., FICO, formerly known as Fair Isaac Corporation, and VantageScore) have been developed by vendors, although a few large banks have collected enough data over time to develop their own internal bureau scores. For example, FICO developed and maintains several bureau scorecards (e.g., Classic FICO, FICO8, FICO NextGen) that are used to underwrite and manage mortgage, credit card, and auto loan portfolios. Although the models that each bureau uses are somewhat different, they all consist of the same number of sub-scorecards and assign a three-digit number ranging from 300 to 850, which quantifies the relative ranking of consumers according to general credit quality. The higher the customer score, the lower the credit risk. Each bureau has a name for its own scoring system: "BEACON" at Equifax, "EMPIRICA" at TransUnion, and "FICO" at Experian. In March 2006, the three bureaus launched a new scoring model called VantageScore to compete with FICO in selling scorecards to banks. VantageScore also rank orders consumers using scores from 300 to 850.

  Credit bureau scores consider five general groups of predictive variables:
  - Previous performance, including the severity and frequency of poor performance and how recently the poor performance occurred.
  - Current level and use of nonmortgage debt.
  - Amount of time that credit has been in use.
  - Pursuit of new credit and inquiries.[18]
  - Types of credit available.

- **Application scores:** As the name suggests, application scores incorporate information from the loan application as well as various credit bureau data, possibly including the bureau score. In some cases, the model may also consider information related to the transaction being financed. The score may be used to determine pricing, as well to decide approval or denial.

Once the accounts are booked, the bank uses additional models to help manage the portfolio. Banks can use scores for monitoring portfolio risk, implementing account management initiatives, targeting cross-selling opportunities, and prioritizing collection activities. These scores may include the following:

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[18] Multiple inquiries in a short period of time are usually eliminated, or "de-duped," so that the consumer is not penalized for rate shopping. In addition, non-consumer-originated promotional inquiries are excluded.

- **Behavioral scores:** These models generate scores based on customer performance on the bank's loans (e.g., payment and delinquency patterns). Whereas traditional behavior scorecards were confined to internal, or "on us," borrower performance, many models now include bureau scores or certain bureau report characteristics in the scores. Transactional behavior models, such as those used for fraud identification, can rescore credit card accounts after individual transactions. Some collection departments use specialized behavior models based on the performance of delinquent borrowers.
- **Bankruptcy scores:** These are designed to identify customers posing a higher risk of bankruptcy based on the attributes of borrowers who have declared bankruptcy. Bankruptcy scores usually are used in conjunction with conventional credit risk models.

Banks may also use non-credit-risk models in the account acquisition, underwriting, and account management processes. These models include the following:

- **Marketing:** Target marketing initiatives to meet preferences or perceived needs.
- **Response:** Target prospects most likely to respond to an offer.
- **Revenue:** Project the level of revenue a customer will generate for the life of the loan.
- **Attrition:** Identify accounts likely to prepay or voluntarily close.
- **Fraud:** Identify potentially fraudulent applications or credit card transactions.

Bankers sometimes combine multiple scorecards. This practice is also known as model layering or matrixing, through which the bank benefits from combining the risk selection capabilities of the various models used. Matrixing lets the bank adjust the cutoff on a cell-by-cell, stair-step basis, allowing for "swap sets." This enables the bank to approve the best of the customers, who may or may not have been approved based on a fixed cutoff score. Effective use of matrixing encourages a bank to develop a "joint delinquency table" (which can be converted to a "joint odds" table) from the combination of multiple scorecards.

The "swap set" concept is illustrated in table 1, in which the application scores are on the vertical axis and the bureau scores are on the horizontal axis, with the risk decreasing as scores increase. The percentages in the body of the table represent the frequency with which an account was ever delinquent within a defined time period.

Table 1: Joint Delinquency Matrix, Delinquency Rates

	Less than 600	600–649	650–699	700–749	750 or higher	Average delinquency rate by custom score segment
Less than 180	20%	14%	14%	11%	8%	13.4%
180–199	13%	11%	10%	6%	7%	9.4%
200–219	11%	10%	7%	5%	5%	7.6%
220–239	10%	7%	5%	4%	5%	6.2%
240 or higher	8%	3%	3%	2%	1%	3.4%
Average delinquency rate by bureau score segment	12.4%	9.0%	7.8%	5.6%	5.2%	

Assume, for simplicity, that the delinquency chart is based on the performance of 2,500 borrowers evenly distributed over the 25 cells (i.e., 100 borrowers in each cell).
If the bank's tolerance for risk is associated with a delinquency rate of roughly 6 percent, a cutoff score of 200 using only the custom scorecard would achieve that objective (the delinquency rate based on a custom score greater than 200 would be 5.7 percent) based on a portfolio of 1,500 borrowers. The bank could lower the average delinquency rate to 5.1 percent—an 11.6 percent reduction in the delinquency rate—without decreasing volume by overlaying the bureau score and swapping out poor performers (i.e., bureau scores below 650) with custom scores greater than 200 and swapping in better performers (i.e., bureau scores greater than 700) with custom scores less than 200.

Banks also layer credit scores with nonrisk scores (e.g., risk, revenue, and response models may be used together for a pre-approved credit card solicitation). This practice presents difficulty in that the purposes of the models used may conflict. Although management tries to control credit risk by using the risk score, revenue and response scores generally increase for higher-risk borrowers (reflecting higher potential for revenue generation in terms of pricing and fees and greater propensity to respond to credit offers). This may result in adverse selection (e.g., higher-risk borrowers are more likely to respond). The odds associated with the risk score can be adversely affected as fewer "good risk" prospects respond relative to the level of "bad risk" prospects. Management's planning should reflect a solid understanding of the risks associated with the use of these types of strategies.

Model Documentation

Bank policy should address requirements for maintaining model documentation. Acceptable forms of documentation may include the following:

- **Model inventory:** Summary listing of all models in use, their application(s), and the dates developed, implemented, and last validated.
- **Individual models:** Model documentation that is understandable and sufficiently detailed to allow for precise replication should the need arise.

- **Chronology log:** Listing by date of all significant internal and external events relevant to the credit function (score implementation, product changes, cutoff score changes, major marketing initiatives, economic or competitive shifts, etc.).

Models purchased from vendors should come with comprehensive manuals describing development, as well as ongoing maintenance and validation requirements.

Model Management and Tracking

Banks using scoring systems should have the management expertise and processes in place to evaluate the models, ensure their appropriate use, monitor and assess their performance on an ongoing basis, and ensure proper validation. This oversight also should extend to any scoring-based strategies employed. OCC Bulletins 1997-24, "Credit Scoring Models: Examination Guidance," and 2011-12, "Sound Practices for Model Risk Management: Supervisory Guidance on Model Risk Management," provide guidance for scorecard management.

Any time a credit decision is made that is contrary to that indicated by the customer score, it is known as a scoring override. Requests that meet or exceed the score cutoff but that are denied are known as high-side overrides.[19] Requests that fail the cutoff but are approved are known as low-side overrides. Not only are these policy exceptions, but excessive levels of overrides may diminish the effectiveness of the scoring models and may be indicative of illegal discrimination on a prohibited basis (causing a violation of Regulation B).[20] Furthermore, approved loans that fail to meet the score cutoff often perform worse than loans above the cutoff. Bank management should evaluate low-side overrides by comparing them with the bad rate at the lowest score band above the cutoff; the highest-scoring overrides just under the cutoff should theoretically outperform the marginal passes in the next-highest score band.

Override tracking is an important control. Bank management should track override performance by reason, channel, analyst approving credit, and score band, and monitor the volume, the reason codes, and the quality of the override segment. It is important to know why some applicants with low scores are approved and others with high scores are denied. Override volume and quality may support the need for underwriting criteria or score cutoff changes. Table 2 shows an example of override tracking.

[19] A high-side override can occur when the bank considers variables or characteristics that were excluded from the model.

[20] Under Regulation B, the prohibited bases are race, color, religion, national origin, sex, marital status, age, the fact that all or a part of the applicant's income derives from any public assistance program, or the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act or any state law on which an exemption has been granted by the CFPB. Refer to 12 CFR 1002.2(z).

Table 2: Example of Override Tracking

Scorecard Overrides						
Score range	**Number of overrides approved**	**Percentage of overrides approved**	**Number of overrides denied**	**Percentage of overrides denied**	**Percentage of bad loans (volume)**	**Percentage of bad loans (dollars)**
800 or higher	50	100%	0	0%	1%	1%
750–799	100	95%	5	5%	1%	2%
700–749	200	93%	15	7%	2%	4%
675–699	300	88%	40	12%	3%	6%
650–674	400	89%	50	11%	5%	9%
625–649	60	15%	350	85%	8%	15%
600–624	10	9%	100	91%	11%	20%
Less than 600	2	4%	50	96%	100%	100%

Bank management should track low-side overrides by number as well as by dollar balances. Generally, banks establish low-side and high-side override limits.

Scorecard-tracking MIS are crucial for effective scorecard management and provide valuable information for risk management and marketing. Bank management generally monitors model performance to determine how much the bank's customer population has changed, to analyze and adjust cutoffs, and to determine when it is time to redevelop a model. Reporting frequency varies from monthly to quarterly, depending on volume and the level of risk involved.

Scorecard MIS comprise two broad categories: front-end population stability reports and back-end performance reports. Front-end or stability reports measure score distribution changes in the customer and essentially determine whether the customer population is changing. This is important because if the population changes significantly, it triggers the need for additional model analysis and, possibly, model adjustment (e.g., recalibration, alignment, or weighting) or redevelopment.

Key front-end modeling reports include the following:

- **Application distribution reports:** Track approvals and denials and high- and low-side overrides by score band, provide feedback on application volumes and the success of marketing programs, and serve as an early warning of shifts in the risk profile.
- **Population stability reports:** Identify changes in the population by comparing score distributions of the developmental sample with current production.
- **Characteristic analysis reports:** Triggered when population stability changes, these reports compare the base population with actual results for individual attributes. Bank management should track every attribute individually. Vendors often provide developmental sample population factors in scorecard manuals. If not, banks can form a benchmark population from the first use of sample population and track population stability over time.

- **Scoring accuracy reports:** Present the volume of scoring errors sorted by those deemed significant versus minor. Significant errors may represent miscalculated scores resulting in decisions on overrides that are inconsistent with the cutoff; minor errors are mistakes that if corrected would not alter the credit decision.

Back-end quality reports compare actual versus expected results, and essentially determine whether scorecards still differentiate risk sufficiently. Bank-end reports serve the dual purpose of measuring model efficacy and evaluating overall portfolio quality.

Key back-end reports include the following:

- **Vintage tables and charts:** Measure the performance and trends of accounts originated each month or quarter. These generally are the most fundamental and indispensable model and portfolio management tools.
- **Delinquency distributions reports (DDR):** Compare scores with subsequent performance and show whether scorecards continue to accurately rank-order risk. DDRs present coincident delinquencies and actual delinquencies at a point in time.
- **Maximum delinquency distributions reports (MDDR):** Identical to DDRs, except that MDDRs show "ever delinquent" statistics, which include delinquent loans that were cured, repaid, or charged off. Delinquencies are presented using the same "bad rate" definition used in the model development.
- **Benchmarking:** The post-implementation vintage tables or charts and delinquency distributions should be benchmarked against the performance distributions generated from the development sample to determine whether the models are performing as expected. The distributions and tables based on the development data should reflect the bank's best guess of expected outcomes. Moreover, trends in the benchmarking analysis would be evaluated to differentiate between random, but temporary, deviations in performance (which may require minor changes in strategies) from permanent, systematic deviations (which may require recalibration or redevelopment of the models).
- **Chronology logs:** Identify internal and external changes that are expected to affect model performance and the credit function so that a model can be properly evaluated in the future. For example, a chronology log records important external macroeconomic indicators, such as recession or changes in the unemployment rate, and internal changes such as changes in cutoffs, collection strategies, or override policies.
- **Early-warning analysis:** Uses benchmark performance over shorter time horizons than those used in the development of the model. Although the performance window from many scoring models is 24 to 36 months, waiting up to three years to generate a valid back-end analysis may be an unsafe or unsound practice. For that reason, early-warning performance benchmarks based on the performance of the model development sample over shorter performance horizons (e.g., 12, 15, and 18 months) should be constructed and used to project the performance of the current portfolio over the next 24 to 36 months.

Scorecard tracking reports should be comprehensive and consistent with the purpose of the model and should use a level of rigor reflecting the importance of the model in the decision process. Statistically valid tests should be used in lieu of judgment-based evaluation of charts.

Vendors and credit repositories periodically publish scorecard odds for generic models. Although the data can be informative and useful when implementing a new model, the data are often outdated and differ significantly from individual bank results. Such pooled-data odds are generally not an appropriate substitute for basic scorecard tracking by banks that depend on the models. Banks should perform formal revalidations using a discrete sample of applications and should regularly compute model separation measurements (e.g., Kolmogorov-Smirnov, or K-S, scores, chi-squared test).

It is important for bank management to understand (1) which models are deployed; (2) how the models are used; (3) what control systems are in place to manage and monitor model performance; (4) how cutoffs and strategies are developed; (5) how risk/reward tradeoffs are made; and (6) how bank management analyzes portfolio and vintage performance and uses that information to alter or improve targeting, underwriting criteria, cutoffs, and other scoring strategies. In short, bank management should determine whether the bank's models and related risk management processes ensure that risk remains within approved tolerances.

Marketing and Underwriting of New Accounts

The competition in the credit card industry, combined with the relative saturation of the market, makes new account acquisition a key component of a successful credit card program. Marketing for new accounts has evolved from a relatively simple process of offering credit cards to existing bank customers through "take-one" applications in branches to active marketing and solicitation via diverse media channels across a large, often nationwide, market. More specifically, account acquisition is most often accomplished through three distinct methods: prescreened solicitations (typically using direct mail); approval of completed applications; and portfolio acquisitions from third parties. Each method should include sound underwriting practices to achieve and maintain desired portfolio quality.

Marketing is expensive and carries risk. Even successful marketing programs can leave the bank with a new population of customers with higher risk profiles than the bank initially sought. A bank's marketing program typically depends on its size, strategy, and growth plans, appetite for risk, and distribution network. The bank's risk management function should be responsible for ensuring that marketing initiatives reflect the levels of risk acceptable to management. The bank's marketing activities should be guided by a detailed, realistic marketing plan that is consistent with the overall goals and objectives of its strategic plan and in compliance with applicable laws and regulations.[21] Policies and procedures should ensure that functional areas of the bank (e.g., credit risk management, operations, systems, legal, and compliance) are appropriately involved in all aspects of the marketing

[21] For example, marketing materials are subject to the advertising and solicitation requirements in Regulation Z. Refer to 12 CFR 1026.16 and 1026.60. Also, banks should ensure that marketing programs comply with the ECOA and all other applicable fair lending laws; section 5 of the FTC Act, which prohibits unfair and deceptive acts or practices; and section 1036 of the Consumer Financial Protection Act (CFPA), which prohibits unfair, deceptive, and abusive acts or practices.

process. Other important components of a successful marketing program include experienced and competent management and staff, reliable projections and market analyses, and complete and accurate MIS reports that track performance by product and initiative (such as a specific promotional or balance transfer program).

Prescreened Solicitations

In a prescreened solicitation program, a credit card issuer generally uses a list of potential customers to whom it will make firm offers of credit. Compilation of the list of names is typically a joint effort involving the bank's marketing and risk management functions or credit divisions. Marketing is usually responsible for identifying the targeted population, creating the products the bank offers, and controlling marketing costs. The risk management function's main responsibilities generally include establishing the prescreening credit criteria, establishing credit lines, ensuring compliance with appropriate consumer and fair lending laws and regulations, and monitoring the success of the program after the accounts are booked. The area in the bank responsible for the finances of the credit card program may play a key role in projecting the impact that credit and marketing decisions will have on the profitability of new accounts obtained through prescreened solicitations.
Before proceeding with any prescreened solicitation program, the bank should ensure that it has the systems necessary to capture and monitor needed data once accounts are booked. For example, systems may need to capture credit bureau scores, number of respondents, and reasons an applicant's credit score may decline after approval.

Credit card issuers usually plan prescreened campaigns throughout the year to obtain new accounts. They may either purchase a list of names from a list vendor or from the credit bureaus, or they may identify a segment of the bank's customers. The bank then provides these lists of names, along with written instructions of its prescreened criteria, to the credit bureaus to start the prescreening process. Banks generally specify two types of criteria: exclusion and credit.

Exclusion criteria are applied to eliminate prospects that the bank does not want to consider in the mailing. These prospects are not scored. People with seriously derogatory credit histories are examples of excluded prospects.

Credit criteria are then used to subdivide the remaining prospects into different groups. Issuers commonly incorporate credit bureau scores into these levels of credit criteria to create marketing initiatives targeting prospects whose score ranges suggest a higher probability of good performance rates. The different criteria levels allow the bank to market to individuals with the overall risk profile it desires and to offer variations in the product and pricing based on risk. Prospects usually are segmented into categories such as A, B, C, D, etc., with the A category comprising the lowest-risk consumers. Prospects that do not qualify for level A are considered for level B, those that do not qualify for level B are considered for level C, etc. The last level includes consumers who do not qualify for the higher levels but passed the general exclusion criteria.

Banks also establish criteria for credit line assignments. Some banks assign the credit line up front and disclose it to the consumer as part of the prescreened offer.

Another common approach is for banks to offer the consumer a credit limit up to a certain amount. The bank does not assign the credit line until after the consumer responds to the solicitation. The criteria that each bank uses vary, but may be based on a combination of disclosed income, credit bureau score, and criteria level.

Certain practices in connection with this type of "up to" marketing present high compliance and reputation risks. As a result, banks should not engage in practices that could be considered unfair, deceptive, or abusive, including the following:

- Targeting consumers who have limited or poor credit histories with solicitations for a credit card with a maximum, or "up to," credit limit that is far greater than most of these applicants are likely to receive.
- Providing most applicants with a "default credit line" (the lowest credit line available) that is significantly lower than the maximum amount advertised, while failing to disclose fully and prominently in the promotional materials the default credit line and the possibility that the consumer will receive it.
- Advertising possible uses of the card when the initial available credit line may be so limited that the advertised possible uses are essentially illusory.

Banks should also consider providing and disclosing a readily exercisable mechanism for consumers to cancel the card at little or no cost when they learn the actual credit limit granted.[22]

Prescreened solicitation campaigns often include a promotional rate to attract customers and to induce new and existing customers to transfer balances from other credit cards. A typical promotional rate solicitation involves representations that an applicant or current cardholder may, for a limited time, receive a reduced APR on certain credit card charges or transactions. The reduced APR generally is in effect for only a specified period of time.[23]

Once the credit bureau prescreens the list of prospects against the bank's criteria, the bank has the opportunity to review the breakdown by criteria level. The information the bank receives at this point does not have identifying information about the consumers, such as names and addresses. This is done to avoid triggering provisions of the FCRA. Therefore, the bank can still eliminate prospects if it wants to reduce the size of its overall mailing or the number of consumers solicited within a certain criteria level.

The *Consumer Compliance* series of *Comptroller's Handbook* booklets; the *OTS Examination Handbook*, section 1300, "Fair Credit Reporting Act," and related "Program";

[22] Card issuers cannot impose a fee on consumers who close their accounts. Refer to 12 CFR 1026.52(b)(2)(i)(B)(3).

[23] Such promotional offers are subject to limitations and disclosure requirements in Regulation Z. Refer to 12 CFR 1026.16 and 1026.60.

and other related issuances describe FCRA and relevant provisions of the Fair and Accurate Credit Transactions Act of 2003 (FACT Act). These resources also provide information on a bank's ability to deny credit to consumers targeted in a preapproved solicitation campaign. With few exceptions, once the bank receives the list with prospect names and other identifying information, the bank should make a firm offer of credit to each consumer on the list. As a result, the bank should ensure that the list is based on the criteria that it submitted to the credit bureaus and list processors. For example, the bank should complete audits to ensure that the credit bureaus applied the correct credit criteria (i.e., the criteria the bank originally submitted, which may differ from its current criteria). The bank should complete this audit after the credit bureau prescreening, but before taking delivery of the names.

Many banks use a third-party list processor throughout the prescreening process. The list processor performs various steps, such as eliminating duplicate names and existing cardholders and verifying addresses. The bank may also use scoring models to help identify consumers who would be more likely to respond and to provide more income to the bank by revolving their balances. Identifying more likely responders has become a very important aspect of prescreening campaigns, since industry reports show that response rates have declined from around 5 percent to less than 1 percent in recent years.

After the bank receives the prospect names, it solicits the consumers by direct mail, telemarketing, social media, or a combination of these and other solicitation efforts. The bank or a third party then processes the consumer responses. Some banks then obtain updated credit bureau information on all responders. This may lead to a favorable or unfavorable change in credit score, not necessarily because a consumer's behavior has recently changed, but because the bank now has a more complete profile of the borrower. Once the bank books the new accounts, its risk management function should analyze the results and characteristics of the responders to determine whether the bank was successful in attracting the types of consumers it intended to target.

Results of previous prescreened solicitations provide valuable information for future programs. One method the risk management function may use to analyze results is to complete a vintage analysis. Bank management may organize vintages by solicitation campaign or by quarterly or annual periods. At a minimum, most vintage reports include delinquency and credit loss information. A more comprehensive vintage report would include bankruptcy, activation, utilization, and attrition information. Vintage reports are an effective way to compare the performance of various segments of the portfolio, based on the origination period and acquisition method. The reports also can be used to compare actual with projected performance to enable the risk management function to determine the reason for significant differences.

A bank's risk management function typically helps establish credit criteria and performance projections before the prescreened solicitation campaign is executed. Risk management also should promptly and thoroughly analyze the results of major prescreened solicitation programs. The risk management function should first review the results of prescreened solicitation campaigns within a relatively short time, such as three months, to determine the quality and quantity of responders. Shortly thereafter, risk management should review activation rates, balances, and delinquencies. For the next six months to a year, risk management should review the financial results of each major prescreened solicitation campaign and compare these results to the initial forecasts.

An effective account acquisition program usually includes testing changes in credit standards and marketing practices before full rollout of the campaign. A bank's testing program should have defined objectives and requirements for analysis, review, and decision making. A bank may perform a wide variety of tests to evaluate variables, such as changes in criteria, cutoff scores, and pricing and product type.

For example, assume a bank plans to solicit 1,000 names for a prescreened offering. One test may allow 50 of those solicited to have two 60-day delinquencies on credit reports within the previous 12 months, even though this population normally would be excluded from offers. These 50 are the test group. The remaining 950 solicited consumers are the control group. Bank management then monitors the test group's performance in relation to the control group until management can reach a reasonable conclusion about the effect of the change in delinquency standards. The time period for tests may vary, depending on the credit standard or borrower characteristic management is testing. It may take up to 18 months before a bank can make a valid conclusion regarding changes to credit criteria.

Applications

Banks market credit card applications in various ways, including via the Internet, direct mail, telemarketing, magazine inserts, and countertop "take-one" applications. Most banks use an automated application processing system to process applications. Typically, information from applications filed electronically goes directly to an issuer's application system, while an analyst may manually process an application mailed to the bank. The bank automatically obtains a credit bureau report in connection with processing an application. The bank should have a system in place to ensure that data from the applications are entered correctly.

In recent years, major issuers relied primarily on automated scoring systems to decision credit card applications, with a small segment of applications referred to judgmental underwriting. Judgmental underwriting involves undertaking a manual review using the bank's underwriting policy and established guidelines that define the quality of new accounts. When credit scoring is used to grant credit, quality is controlled by setting the cutoff score based on the desired loss rate. Because of the volume of applications and the desire for rapid decision making, most large issuers use scoring. When judgmental underwriting is included in making the credit decision, it should be tightly controlled to ensure that underwriters or analysts consistently follow policy and comply with applicable consumer protection and fair lending laws and regulations. The bank controls the quality of new accounts by establishing well-understood controls and credit guidelines in its policy and performing routine quality control reviews.

The CARD Act introduced an additional legal requirement to the underwriting process: A card issuer must consider a consumer's ability to make the required minimum periodic payments under the terms of an account.[24] Specifically, issuers must determine an applicant's ability to pay based on an assessment of the applicant's current or reasonably expected income or assets and his or her current debt obligations. The card issuer may limit its consideration of a consumer's current or reasonably expected income or assets to the consumer's independently verifiable income or assets. To meet the ability-to-pay requirement, issuers should have access to information regarding the applicant's income or assets and current obligations at the time of application. This information may be available in several ways: The applicant may provide it at application; the issuer may have access to recent information (e.g., within 12 months) through other established bank products, as well as from third parties (such as data aggregators) or affiliates, subject to applicable information-sharing rules; or the information may be estimated through an income estimator model that is "empirically derived, demonstrably and statistically sound."[25]

The underwriting process varies among issuers. The proportion of scored versus judgmentally decided applications is not always the same. Most issuers choose to assess ability to pay as the last step in the approval process, but issuers do not have to wait until the end of the process to do so. Whatever the bank's underwriting structure, however, bank management should have established and implemented well-defined guidelines for the credit approval process to mitigate consumer compliance, BSA, and credit risk.

Portfolio Acquisitions

Investors acquire credit card portfolios for many reasons. They may want to expand an already established credit card business quickly, realize improved economies of scale, diversify product lines or niches and geographic markets, or increase profits. A seller, on the other hand, may wish to reinvest in other investments, recapitalize its business, or increase liquidity. Whatever the reason, there are markets for credit card portfolios, and the premiums can be lucrative.

Banks should have procedures, systems, and controls in place to govern portfolio acquisitions. Procedures provide consistent analysis throughout the acquisition process and reduce the risk that a critical item or aspect of the transaction will be overlooked. The procedures should incorporate detailed instructions regarding such areas as prospective portfolio reviews, due diligence, and final analysis.

Further, the due diligence review should include an assessment of the selling institution's customer identification program (CIP) and BSA, anti-money laundering (AML), and Office of Foreign Assets Control (OFAC) procedures to determine whether the selling institution's activities are consistent with the acquiring bank's procedures. Also, credits that are inconsistent with the acquiring bank's risk management should be identified and removed from the portfolio acquisition. If the portfolio contains subprime credit cards, the bank should refer to the guidance in OCC Bulletin 1999-10, "Subprime Lending Activities: Interagency Guidance," and OCC Bulletin 1999-15, "Subprime Lending: Risks and Rewards." Although

[24] Refer to 12 CFR 1026.51.

[25] Refer to 12 CFR 1026, supplement I, comment 51(a)(1)(i)-5.

OCC Bulletin 1999-15 does not apply to FSAs, it describes prudent practices that FSAs may wish to consider when managing a portfolio containing subprime credit cards.

Examiners should test a sample of new accounts to determine the level of adherence to the bank's policies and the quality of accounts coming into the bank. Sampling techniques are discussed in detail in appendix A, "Transaction Testing." (Refer to the "Purchased Credit Card Relationships" section of this booklet and appendix J for a discussion of intangible assets resulting from credit card portfolio acquisitions.)

Account Management

Account management is the loan administration piece of credit card lending and describes the treatment of booked accounts. As with account acquisitions, account management should include heavy involvement from risk management or risk policy, marketing, operations, compliance, customer service, customer retention, and payment processing.

The guidance issued in OCC Bulletin 2003-1, "Credit Card Lending: Account Management and Loss Allowance Guidance," covers such areas as credit line management, over-limit practices, minimum payment and negative amortization, workout and forbearance practices, income recognition and loss allowance practices, and policy exceptions. Although the "Introduction" section of this booklet discusses account management in general terms, examiners should refer to OCC Bulletin 2003-1 during the examination process. Examiners should also review the steps in the "Examination Procedures" section of this booklet, as well as the steps in appendix A, "Transaction Testing."

The account management process begins with monitoring at the levels of portfolio, portfolio segment (e.g., product, vintage, credit risk, marketing channel), and account. Bank management relies on MIS and tools, such as behavioral and credit bureau scoring, to identify positive and negative trends. Analyses of those trends and the reasons behind them provide bank management with a basis for strategies to enhance performance and maximize profitability. These strategies often involve credit decisions. The analysis should also cover the types of activities in which customers engage and should include a determination whether the activities are consistent with similarly situated customers. Bank management should develop the eligibility requirements and treatment characteristics as carefully as it does the underwriting criteria for the product.

Account management strategies can be used on an individual account basis, or for entire portfolios or selected segments of portfolios. The strategies can be manual or automated. Regardless of the strategies employed, banks should develop and implement policies and procedures that adequately monitor and control the assumed risk and that provide for consistent treatment of similar customers. In community and midsize banks, account management processes are typically not as formal and automated as they are in larger banks. Examiners should assess whether account management processes are commensurate with the size of the retail function and complexity of the products.

Some banks use a one-size-fits-all approach to account management, in which there is one option and the customer either meets the criteria or does not. Other banks deliver a range of options based on each customer's creditworthiness and needs. The latter approach requires extensive use of technology and system support, but can expand the account management options that the bank uses and prove to be more profitable in the long run.

Just as with initial product design, bank management should test account management initiatives before full implementation, as described in OCC Bulletins 2003-1, "Credit Card Lending: Account Management and Loss Allowance Guidance," and 2004-20, "Risk Management of New, Expanded, or Modified Bank Products and Services: Risk Management Process."[26] Banks often use a "champion/challenger" technique to test account management initiatives, in which the existing practice is deemed the champion and one or more modifications applied to smaller portions of the portfolio are tested and deemed the challengers. After observing performance over a period, usually several months, the account treatment that was changed in or applied to a well-performing challenger may be applied to a larger population or may even replace the champion. Conversely, poorly performing strategies are either modified or discontinued. Ongoing and thorough analyses are critical to reaping the benefits of multiple strategy scenarios. For the strategies to be meaningful, it is important that the strategy populations be isolated from other account management strategies. Otherwise, it may be impossible to determine factors contributing to the outcome with any degree of reliability.

Some of the more common account management activities are described in the following sections.

Line Increases and Decreases

Generally, lines are increased for account holders who have demonstrated the financial capacity to perform on a new, higher credit limit. It is important to note that line increases must be supported with information documenting a cardholder's ability to pay. Refer to 12 CFR 1026.51 and the "Truth in Lending Act" booklet of the *Comptroller's Handbook* for information on ability-to-pay requirements and guidance. Conversely, lines may be decreased for account holders showing negative financial trends, based either on performance on the bank's credit card account or credit bureau information. Current account line decrease programs generally do not reduce line amounts below outstanding balances. In addition, Regulation Z requires the issuer to provide advance notice of the decrease before an over-the-limit fee or a penalty rate can be imposed solely due to the consumer exceeding a newly decreased credit limit. Refer to 12 CFR 1026.9(c)(2)(vi).

Applying line decreases to current accounts is a difficult issue. Credit line assignments have been a major competition point for many years, and customers may view them as a status symbol or indication of value to the bank. As banks strive to better control unfunded commitment exposure, however, they may reduce credit card limits to better reflect an account holder's typical line usage and financial resources.

[26] Refer to footnote 12.

A bank may also suspend or freeze a line at the cardholder's current balance. This account management activity is typically applied when a borrower experiences financial difficulties and is used in conjunction with a temporary or long-term workout program. These programs are discussed in the "Collections" section of this booklet.

Over-Limit Authorizations

Banks generally maintain guidelines to determine whether accounts are authorized for transactions that exceed customer credit lines and to determine how much excess is allowed. For example, credit card accounts of the most creditworthy individuals may be approved to allow those customers to exceed their credit limits by 20 percent to 30 percent.

Over-limit approvals should be granted for only a bank's most creditworthy account holders.[27] Assigned credit limits should accurately reflect the dollars a bank is willing to risk with a given customer (based on his or her financial capacity and condition). Over-limit approvals are underwriting exceptions and should be identified, tracked, and reported as such. Further, over-limit practices should be carefully managed and focus on reasonable control and timely repayment of amounts that exceed established credit limits. Alternatively, the credit card account holder agreement may require that over-limits be cured when billed; in this case, if the cardholder remits only the minimum payment required (usually calculated as 1 percent of the principal, along with finance charges, and fees), then the account is considered delinquent. Banks should ensure that consumers have clear and full notice of the consequences of an over-limit.[28] In addition, an issuer should not assess a fee or charge for an over-limit transaction unless the consumer affirmatively consents (or opts in) to the card issuer's payment of over-limit transactions. Regulation Z contains additional requirements for over-limit authorizations and fees.[29]

If accounts routinely exceed credit limits, then the bank's board or management should be concerned either with the initial line assignment or with the risk management process. In addition to chronic over-limit accounts, over-limit approvals for accounts that previously exhibited high and generally unused line assignments could signal credit problems. Management should assess the bank's over-limit policies and their impact on an ongoing basis.

[27] Bank management should maintain policies that ensure consistent treatment of similarly situated customers in these over-limit authorization decisions (and other account decisions discussed in this booklet, e.g., approvals and line increases) to avoid infringing fair lending laws and regulations. These include section 5 of the FTC Act, which prohibits unfair or deceptive acts or practices, and section 1036 of the CFPA, which prohibits unfair, deceptive, or abusive acts or practices.

[28] The notice in the original credit card agreement might not be sufficient to prevent a card issuer's treatment of over-limits from being considered an unfair, deceptive, or abusive practice in some cases.

[29] Refer to 12 CFR 1026.56 for these requirements.

Repricing of Accounts and Other Changes to Credit Terms

Credit card issuers may increase a cardholder's APR to address credit risks that arise when the cardholder fails to make timely payments on the account; this is referred to as penalty pricing. If the cardholder makes timely payments for six consecutive months at the higher rate, however, Regulation Z requires that the APR be returned to the rate charged before the increase. Refer to 12 CFR 1026.54 and the "Truth in Lending Act" booklet of the *Comptroller's Handbook* for disclosure and other requirements related to penalty pricing.

Account Closures

Banks should have a policy governing when an account should be closed. Policies and procedures should also require reporting of suspicious activities, including suspected identity theft, when appropriate. Although account closure typically occurs as a result of collection and loss mitigation activity, bank management should also consider circumstances under which current accounts should be closed to control risk, contingent liabilities, and cost. Examples of appropriate line closures include accounts of deceased customers, accounts of bankrupt customers, accounts that have been inactive for a specified time, and accounts that show significant financial deterioration over a relatively short time. Policies and procedures should recognize that there are fee and interest restrictions for accounts, for example, in cases of bankruptcy or a deceased customer. Further, the policies and procedures should ensure timely settlement with the executor or administrator of a deceased customer's account.

Cross-Selling Initiatives

Banks generally develop marketing strategies designed to target various components of their retail credit portfolios with additional loan or service offers. If developed properly, such activities often serve to reinforce the relationship with the consumer. To avoid practices that may be unfair, deceptive, or abusive, however, the bank should ensure that the customers have not opted out of receiving solicitations; that those customers that are solicited have the financial resources to support the additional product or service; and that fee-based services actually add value. The bank should also ensure that all cross-selling initiatives comply with all applicable fair lending laws and regulations. Otherwise, the bank may create customer ill will and violate the law by soliciting customers with inappropriate offers or an unmanageable payment burden.

Retention Strategies

The competitive environment is rife with substitute offers and refinancing opportunities. Consequently, larger banks have found it beneficial to develop techniques for identifying profitable customers who may be targeted by competing offers and to contact those customers proactively to offer them more attractive or enhanced products that typically include reduced interest rates, higher credit lines, convenience checks, or upgrades to associated products or services. Banks that do not engage in proactive offer activities generally develop reactive profitability and performance qualification guidelines for alternative products or a refinancing should a customer call to close an account.

As with other account management activities, bank management should track the volume of retention calls (in and out), the "save" rate, and the ongoing performance of those accounts. This information can be used to assess the profitability of retention initiatives and to adjust policy.

Other Account Management Tools

Some banks offer "payment holidays," or skip-a-pay programs, in which customers are given the option to skip a payment for a billing cycle. This practice has evolved in response to competition. Although these programs generally may be profitable to the bank because interest continues to accrue during the billing cycle, they can be detrimental because they lengthen the repayment term and impair risk analyses that rely on regular payment streams.

"Pay-aheads" occur when a customer makes a payment that exceeds the minimum amount due and the bank keeps track of the excess payment and reduces future payments accordingly. Pay-aheads can pose increased risk because they do not require a minimum payment every month. When banks require customers to make monthly payments, the banks are able to monitor portfolio quality through more accurate delinquency reporting. Banks should limit the use of pay-aheads to accounts with low risk characteristics. Banks that accept pay-aheads on credit card accounts must refer to 12 CFR 1026.53, which sets forth the requirements for the allocation of the excess payment amounts.

Match-pay programs are yet another type of account management tool. In this program, frequently used in collections, the bank offers to match all or a part of the payment being made by the borrower. The bank's portion of the payment should be limited to an amount that results in a principal reduction only and should not be so large as to cover finance charges and fees.

Finally, convenience checks present risks that a bank can minimize by offering the product only to customers exhibiting low credit risk and low line utilization. Frequently, these checks come with a low, promotional interest rate to induce customers to use them. Bank management should make certain that controls and reporting are in place to monitor this process adequately. For example, convenience checks should have a short-term expiration date, usually 30 or 45 days. The expiration date limits the risk of a cardholder using the checks at some date in the distant future when he or she is experiencing a financial hardship.

Bank management should ensure that use of these tools is covered by policy, closely monitored, and periodically assessed to ensure that the tools are not used to mask delinquencies. Bank management should ensure that sufficient account management MIS are in place to depict the condition of the portfolio accurately and completely. Reports and analyses should identify and explain trends and anomalies. From these reports, management should be able to discern the level of success of strategies in place and the strategies' impact on performance. Examiners should evaluate how bank management uses account management reports to adjust policies and strategies, as well as the timeliness of management responses to identified concerns.

Examiners should test various account management strategies through a sampling of accounts. Information on sample types and sizes is included in appendix A, "Transaction Testing."

Securitized Assets

Asset securitization began with structured financing of mortgage loan pools in the 1970s. The market continued to evolve with the securitization of auto loans and credit card receivables in the mid-1980s. From that time until the recession that began in 2008, banks and other financial services providers significantly increased their use of asset securitization to fund receivable growth, manage their balance sheets, and generate fee income. Although the recession essentially brought a halt to the securitization market, issuers slowly have reentered the market. The "Asset Securitization" booklet of the *Comptroller's Handbook* discusses in detail the processes for credit card securitizations and provides procedures for examiners who are reviewing this area.

Collections

As with other loan portfolios, issuers experience credit and fraud (operational) losses in credit card portfolios. Reasons for the losses include changes in underwriting standards, mass marketing of cards in a saturated market, economic downturns that may influence a consumer's ability to repay due to unemployment or reduced income, consumer bankruptcy, information breaches, and identity theft. Collection systems and controls historically have not kept pace with new account generation, and examiners should focus on this area.

Credit Losses

An effective collection process is a key component of controlling and minimizing credit losses. It should be effectively managed at each operational level. The problems associated with an inadequately managed collection function include

- reduced earnings caused by increased loan losses and reduced recoveries.
- inaccurate or late communications of performance concerns to senior management and the board of directors.
- inaccurate reporting of past-due and charged-off loans, and possibly imprudent management strategic decisions for the loan portfolio.
- improper use of re-aging (that is, changing the delinquency status of an account), fixed payment and other workout programs, settlement agreements, or other collection-related practices.
- insufficient allowance for loan and lease losses (ALLL) caused by weak MIS, inaccurate past-due figures, and the improper use of re-aging, fixed payment programs, etc.
- inadequate audit trail for collection and recovery activities.
- poorly trained employees, resulting in loss of productivity, collections, and recoveries.
- violations of law and regulations, potentially including fair lending issues.

The collection function is challenging to manage properly because of the size and complexity of the typical credit card issuing business and the labor-intensive nature of collections. Consequently, the use of specialized, state-of-the-art technology is increasingly appropriate to optimize productivity and control overhead costs. Bank management should use current technology and current and historical information at its disposal to formulate a strategy for optimizing its collection efforts. In general, the strategy should direct the collection department's efforts to those accounts with the greatest risk of loss and the greatest potential for collection.

Collection departments may be structured in several ways. The most common approaches are "cradle-to-grave" and back-end/front-end segmentation. In the cradle-to-grave approach, a collector works with an account from the earliest stage of delinquency through all of the succeeding stages, or delinquency buckets. This approach is most often used in community banks in which the collection staff is small. In the back-end/front-end segmentation approach, some collectors specifically handle early-stage (front-end) delinquency accounts while others handle later-stage (back-end) accounts. Larger banks often use this approach.

Some banks have chosen to outsource the collection function to an external service provider, rather than staff an internal department. Because the service provider is collecting the bank's accounts, however, there is increased compliance and reputation risk with this type of activity. If a bank chooses this approach, it should have strong third-party relationship management processes in place to ensure that the service provider is adhering to all legal and regulatory requirements and treating the bank's customers appropriately.[30]

Collection departments vary significantly in structure and approach. They have at least one challenge in common, however: the need to closely supervise collection staff. Collection supervisors should have both collection experience and good management skills. Bank management should require that collection department supervisors regularly review collectors' performance in areas such as number of contacts made, time per contact, and promises to pay versus dollars received. Such supervisors should also monitor customer complaints regarding collection and individual collectors' calls, as well as the documentation for those calls, to ensure that collectors treat customers fairly and comply with internal policies and debt collection statutes and regulations.

Examiners should understand how bank management determines the optimum level of accounts per collector, a crucial factor in preventing and controlling charge-offs. A single collector can be responsible for hundreds of accounts. A collector's assigned workload can vary widely depending on the type of account (bank card or retail) and the technology used. In addition, front-end (early delinquency) collectors typically handle significantly more accounts than back-end (severe delinquency) collectors.

Collection strategies determine the specific accounts on which collectors work, the timing of collection activities, and the manner of the contact (e.g., phone calls, collection letters, or legal letters). In many banks, collection strategies rely on behavioral scoring models that

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[30] Refer to OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance" (October 30, 2013), which sets forth regulatory guidance for third-party relationships.

predict the likelihood of collection. Some banks also use champion/challenger collection strategies. Using such information, bank management can effectively direct collection efforts with an emphasis on dollars at risk. Bank management should maintain close control over collection strategies because, in some cases, a seemingly minor change can significantly affect the dollars collected. Examiners should review the bank's collection strategy process and reports generated and discuss them with management.

Examiners must have a general understanding of the technologies employed by collection departments to evaluate a collection department's effectiveness. Examiners also should review the bank's collection training program. Nearly all well-managed collection operations have formal classroom and on-the-job training programs, which include instruction on new processes, procedures, or regulatory requirements for new and existing employees.

Management of an account increasingly includes practices such as re-aging, fixed payment, settlement, and Consumer Credit Counseling Service programs. OCC Bulletins 2000-20, "Uniform Retail Credit Classification and Account Management Policy: Policy Implementation," and 2003-1, "Credit Card Lending: Account Management and Loss Allowance Guidance," provide guidance on the use of these collection tools. Although the following sections describe these tools, examiners should refer to these issuances for specific details.

Re-Aging

The credit card industry often uses a tool called re-aging, which involves changing the delinquency status of an account. The term applies to both forward and backward changes, and re-aging often occurs in both the customer service and collection areas. For example, a payment on an account subsequently returned for not sufficient funds (NSF) could result in re-aging the account into a more severe delinquency status, whereas a delinquent account could be brought current if certain payment requirements are met. This discussion focuses on instances of collection re-aging in which delinquent accounts are brought current rather than on one-time customer service actions (e.g., correcting bank errors, cases involving a borrower who does not have history of becoming delinquent).

The practice of bringing a delinquent account current originated to acknowledge and assist customers who corrected previous, usually one-time, cash flow problems. To prevent the accounts from showing as perpetually delinquent, the bank re-ages them to show them as current. The practice evolved with some issuers inappropriately using re-aging to mask longer-term or frequent delinquency of troubled borrowers.

Consistent with OCC Bulletin 2000-20, "Uniform Retail Credit Classification and Account Management Policy: Policy Implementation," banks that re-age open-end accounts should establish a reasonable written policy and adhere to it. For example, a policy may provide that the borrower make at least three consecutive minimum monthly payments or the equivalent amount before the account can be re-aged to current. Three consecutive payments, rather than a single lump-sum payment, may be better evidence of the customer's ongoing willingness and sustained ability to pay. In addition, the policy may provide that an account should have been on the books for at least nine months to be eligible for re-aging and that the number of re-agings on an account should be limited to one in 12 months and two in five years. Examiners should

- carefully review the analysis that supports the bank's decision to re-age accounts and the bank's re-aging parameters.
- understand the re-aging program in place and review available MIS reports.
- assess the bank's re-aging practices, including bank management's supervision of the activity.
- sample a number of re-aged accounts to ensure that management practices mirror policy.

Examiners also should consider the bank's policies and practices in light of OCC Bulletin 2000-20. Sampling techniques for re-aged accounts are included in appendix A of this booklet.

Because of potential risks associated with re-aging, the practice should be governed by appropriate policies and procedures. The bank's re-aging policy should address the following:

- Approval and reporting requirements.
- Age of the account before it is eligible for re-aging.
- Status of the account while re-aging: closed, blocked, or open.
- Consideration of the borrower's overall capacity to repay (factors such as income, length of employment, and other debts) in the re-aging decision.

An improperly managed re-aging program can lead to pools of problem receivables. It also can understate delinquency and charge-off figures, as well as impede accurate analysis of the adequacy of the ALLL. Therefore, reports for the re-aging program should be accurate. Bank management should review regular reports showing both the number and dollar amount of newly re-aged accounts (current month) and those re-aged within the last 12 months. According to OCC Bulletin 2000-20, bank management should monitor cumulative historical data that show the performance of loans that have been re-aged, extended, deferred, renewed, or rewritten and/or placed in a workout program. Without this information, management generally cannot determine the effectiveness of re-aging practices. For example, if the bank ultimately charges off a large percentage of re-aged accounts within a 12-month time frame, management should determine whether the outcome (dollars collected before charge-off versus collection costs) justifies the practice.

Fixed Payment Programs

Another practice often used in the collection arena is the fixed payment program. Such programs are targeted to borrowers with prolonged or severe credit problems in an attempt to both work with the borrower and to encourage continued repayment. These programs can be either "temporary" (up to 12 months, after which the account returns to its original terms) or "permanent" (whereby the account is closed and the balance fully amortized over a term that generally should not exceed 60 months). Guidance on the terms of temporary programs and programs lasting longer than 12 months are addressed by OCC Bulletin 2003-1, "Credit Card Lending: Account Management and Loss Allowance Guidance."

Although most banks offer one or more fixed payment or other workout programs, program characteristics can vary. Programs typically consist of a fixed payment amount over a specified period of time and often include a reduction in interest rate. Examiners must be aware that concessions such as reductions in interest rates and delayed payment schedule adjustments may be troubled debt restructurings (TDR) as defined in Financial Accounting Standards Board Statement 15, "Accounting by Debtors and Creditors for Troubled Debt Restructurings," as amended by ASC 310-10, "Accounting by Creditors for Impairment of a Loan." A TDR is a restructuring in which a bank, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider.

As would be done for loans and other extensions of credit, estimates of losses on credit card receivables should reflect consideration of all significant factors that affect the collectability of the portfolio as of the evaluation date. Examiners should refer to OCC Bulletin 2006-47, "Allowance for Loan and Lease Losses: Guidance and Frequently Asked Questions on the ALLL," and the call report instructions.

Loss rates associated with fixed payment programs are generally higher than those of the total portfolio because of the borrowers' financial problems. The bank should have policies that specify the terms and conditions of fixed payment programs, such as qualifications for entering the program and how long an account can stay in the program (consistent with OCC Bulletin 2003-1). Bank management should institute strong controls and ongoing monitoring and perform regular analyses of the programs to determine whether they ultimately benefit or harm the bank.

The examiner should assess the prudence of the fixed payment programs in place and the dollars involved. This assessment should include a sampling of accounts to ensure consistency with OCC Bulletin 2003-1. Banks generally re-age accounts to current on receipt of payments equivalent to three contractual payments at the newly agreed rate and amount. Examiners should review the bank's programs to determine whether consumers are just moved from one temporary program to another and whether enrollment in a program results in an inappropriate adjustment to the delinquency buckets. As with the review of re-aged accounts, sampling techniques for fixed payment programs are also included in appendix A, "Transaction Testing." As part of transaction testing, examiners should determine whether account files document whether a consumer's difficulty is temporary or permanent. If the difficulty is temporary, file documentation should support the temporary nature of the hardship and whether a temporary fixed payment program was appropriate. For example, in a temporary workout situation system, notes for the file might document that the borrower was out of work with a medical problem and returned to work in two months without further loss of income. In this case, a temporary payment program might be appropriate. If the borrower sustained a longer-term issue that resulted in a diminished ability to repay, however, a permanent workout may be appropriate.

There are several common issues examiners encounter when reviewing workout programs. Collectors may not adequately assess and/or document the severity of the cardholder's financial difficulty. If borrowers are routinely placed in temporary hardship programs when their financial problems are of a permanent nature, it may mask the true condition of the portfolio. High default rates in workout programs may call into question the assessment of the severity or long-term nature of a cardholder's financial difficulty. In this case, examiners should question the effectiveness of collection practices around workout programs and, if appropriate, criticize the practices. In addition, some bank policies allow borrowers to move from one workout program to another, often when a borrower does not perform or "breaks" the workout, without adequate analysis supporting this transition. In general, cardholders should be placed in the workout program with payment terms appropriate to their hardship. The total length of time a borrower is in a workout program, on a combined basis, generally should not exceed 60 months.[31]

Settlement Programs

Settlement programs are another type of workout program in which the bank agrees to accept less than the full balance due from a borrower in full satisfaction of the debt. As with any other workout program, collectors should determine the borrower's ability to repay under the settlement terms.

When there is a settlement agreement, the portion of the balance that will not be paid by the borrower should generally be charged off when the agreement is reached. If a bank's technology does not allow for charge-off of a partial balance, the partial balance should be fully reserved in the bank's ALLL. On receipt of the final settlement payment or if the borrower misses a payment under the agreement, the remaining balance should be charged off in full within 30 days.

Consumer Credit Counseling

As part of their collection efforts, many banks also work with consumer credit counseling (CCC) programs. CCC organizations are typically independent third parties that help consumers work through their financial difficulties.

A consumer's acceptance into a CCC program is often based on a counselor's determination that the consumer's financial situation is salvageable. If accepted, the consumer generally agrees to cancel all credit cards and other open unsecured lines of credit, develop and adhere to a budget (with counselor guidance), and make debt payments as agreed. The consumer credit counselor then notifies creditors that the consumer has been accepted into the program and negotiates reduced payment terms with each creditor. Terms vary by creditor, with some requiring the full payment amount and others reducing interest and principal payments significantly in an attempt to stop the account from going to loss. As with the fixed payment programs, bank management should evaluate these accounts to determine whether they meet

[31] Refer to OCC Bulletin 2003-1, "Credit Card Lending: Account Management and Loss Allowance Guidance." Exceptions should be clearly documented and should be supported by compelling evidence that less conservative terms and conditions are warranted.

the standards for a TDR. If so, the bank should employ proper accounting practices. Refer to the “Fixed Payment Programs” section of this booklet for further information and existing OCC instructions.

After acceptance into a CCC program, consumers generally then make their payments directly to the CCC organization, which pays the creditors. CCC programs can run for up to 60 months and are considered “permanent” workout programs under OCC Bulletin 2003-1.

After receiving confirmation of a consumer’s acceptance into the CCC program and the typical three consecutive payments (or the lump-sum equivalent) under the plan, a creditor normally re-ages the consumer’s account to a current status, if the account is otherwise delinquent. At this point, the creditor generally waives any late and over-limit fees and ceases all collection efforts, as long as the account complies with the renegotiated terms. If an account goes delinquent again for any significant period of time, it usually reverts to the original contract terms, collection efforts commence, and it is dropped from the CCC program.

Banks should have a policy regarding CCC accounts and appropriate systems to properly account for related transactions with the CCC organization. Banks typically assign an individual or specific group to supervise and monitor its CCC accounts. The bank should ensure that all CCC accounts are properly identified to enable accurate reporting of CCC delinquencies and charge-offs and should incorporate CCC information into the appropriate loan risk grades and into ALLL calculations. The bank should have a process to identify CCC accounts that qualify as TDRs to ensure that the ALLL for these accounts is determined in accordance with ASC 310-10, “Accounting by Creditors for Impairment of a Loan.”

MIS for Collections

The collection area typically generates many MIS reports to help manage the risks associated with this activity. Regular MIS reports for each collection program are an important aid in proper supervision. Executive management should regularly review key MIS collection reports. Management should be able to identify and quantify all collection program specifics, such as the number of re-agings on an account. OCC Bulletin 2000-20, “Uniform Retail Credit Classification and Account Management Policy: Policy Implementation,” states that, to be effective, MIS should also monitor and track the volume and performance of loans that have been re-aged, extended, deferred, renewed, or rewritten and/or placed in a workout program. MIS provide the mechanism to assess consistency with OCC Bulletin 2007-45, “Identity Theft Red Flags and Address Discrepancies: Final Rulemaking,” and to assess compliance with rules implementing sections 114 and 315 of the FACT Act (15 USC 1681m(e) and 15 USC 1681c(h), respectively), 12 CFR 41, and any other applicable laws and regulations. Further, MIS should provide management with the ability to identify and report suspicious activities. If a program is not working effectively, management should take steps to discontinue or modify it. Examiners should evaluate the bank’s MIS for pertinent information and accuracy and may need to criticize any absence of appropriate tracking and monitoring.

One report, called the “rollover,” or “roll-rate” report, is particularly important. Through this report, bank management can review the number and dollar volume of accounts that move from current to 30 days delinquent, 30 to 60 days delinquent, etc. This information aids management in projecting accurately the charge-off rates as far as six months into the future and informs decisions regarding collection staffing levels.

Delinquency and charge-off reports serve as valuable tools in evaluating collection effectiveness. Bank management should review these reports for the entire portfolio as well as on a program-by-program basis. Many credit card operations report delinquencies using two formats: end-of-month (EOM) and sum-of-cycle (SOC). EOM delinquencies are used for call report purposes and reflect outstanding delinquencies at month-end as a percentage of outstanding receivables. SOC reports compute delinquencies for each billing cycle, then aggregate these cycles to determine delinquency for the total portfolio. Unlike EOM reports, SOC reports ignore the “cleaning up” of delinquencies between the end of the cycle date and the end of the month.

Bank management may find reports that analyze delinquencies and charge-offs on a “lagged” basis useful, especially if a portfolio has experienced significant growth. Such analyses calculate current delinquency and charge-off figures as a percentage of receivables outstanding six or 12 months prior. A “block” or “status code” report provides valuable information for reviewing the composition of the portfolio (e.g., the number and dollar amounts of fixed-payment, bankruptcy, fraud, deceased, and canceled accounts). Other reports should include actual versus budgeted performance, impact of changes in collection strategies, and performance of behavioral or other scoring models.

Delinquency, Classification, and Charge-Off Policies

Bank management should regularly review the quality of the portfolio through a variety of means, including past due, charge-off, and profitability reports. Management should be able to quickly identify trends in the portfolio and react appropriately.

Guidance on account classification and charge-off practices is provided by OCC Bulletin 2000-20, “Uniform Retail Credit Classification and Account Management Policy: Policy Implementation,” which, in general, advises that credit card accounts be charged off when they become 180 days delinquent. Accounts that are placed in long-term amortizing workout programs should be charged off at 120 days. The bulletin also addresses accounts that are affected by bankruptcy, fraud, and death, and examiners should review this issuance closely when assessing a bank’s collection activities.

All accounts that are 90 to 180 days delinquent should be classified as substandard. Examiners are not precluded from classifying additional portfolio segments as substandard, however, if a review of credit information and loss performance indicates that such classification is warranted. For example, a subprime program in which the roll-to-loss rate from 30 days delinquent is between 30 percent and 50 percent may indicate a need to classify these assets substandard rather than waiting until they are 90 days delinquent, when the roll-to-loss rate is 90 percent. Likewise, it may be appropriate to charge off these accounts sooner than 180 days if roll-rate information suggests that almost 100 percent of the accounts roll to loss earlier in the cycle.

Recoveries

Recoveries represent collection activities conducted after an account is charged off. The rate of recovery depends on many factors, including

- previous collection efforts.
- depth and experience of staff.
- adequacy of systems and controls.
- use of technology.

Recovery activities are generally conducted internally and then out-placed to collection agencies after several months. When out-placing accounts, the bank should maintain strict controls and appropriate systems to evaluate each agency's performance. Collection agencies receive a percentage of the dollars collected, typically between 30 percent and 60 percent. The amount varies based on whether the agency is the primary collector (the first to work the accounts) or the secondary or tertiary collector. Fees are lowest for the primary agency and highest for the tertiary agency. A bank should periodically rotate out-placed accounts among agencies to ensure that the accounts are actively and appropriately worked.

When banks select agencies to which they out-place accounts, the banks should perform due diligence to ensure that an agency is, among other things, properly licensed, bonded, and insured. Banks also should have systems to monitor the agencies on an ongoing basis to ensure that the agencies operate prudently. Bank management should follow the guidance in OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance," when working with outside parties to collect accounts.

Consumer Debt Sales

As providers of consumer credit, banks lend money to be repaid with interest. Banks underwrite the loans and price them according to the risk associated with the type of lending and the customers' creditworthiness. A percentage of the loans that banks make goes unpaid. Under guidelines set out in OCC Bulletin 2000-20, "Uniform Retail Credit Classification and Account Management Policy: Policy Implementation," banks should charge off open-end credit at 180 days past due. Even though the bank has charged off the loan, the borrower generally continues to have an obligation to repay the debt. At that point, the bank faces a business decision on how to recover the loss or whether to pursue collection at all.

The majority of debt that banks charge off and sell to debt buyers is credit card debt, but banks also sell to debt buyers other delinquent debts, such as auto, home equity, mortgage, and student loans. Most debt-sale arrangements involve banks selling debt outright to debt buyers. Banks may price debt based on a small percentage of the outstanding contractual account balances. Typically, debt buyers obtain the right to collect the full amount of the debts. Debt buyers may collect the debts or employ a network of agents to do so. Notably, some banks and debt buyers agree to contractual “forward-flow” arrangements, in which the banks continue to sell accounts to the debt buyers on an ongoing basis. This section focuses specifically on debt sales. Many of the principles, however, also apply when a bank hires a third party to collect debt on its behalf.

When a bank sells consumer debt, the bank should have policies, procedures, and practices that help ensure that any third party purchasing the bank’s consumer debt for its own collection treats customers fairly and consistently, in accordance with the bank’s expectations and applicable law. Increased risk most often arises from poor planning and inferior performance or service on the part of the debt buyer, and this may result in legal costs or loss of business for the bank. Selling debt to a debt buyer can significantly increase a bank’s risk profile, particularly in the areas of operational, reputation, compliance, and strategic risks.

- **Operational risk:** Inadequate systems and controls can place the bank at risk for selling debt with inaccurate information regarding the characteristics of accounts.
- **Reputation risk:** When banks sell consumer debt to debt buyers that engage in practices perceived to be unfair or detrimental to customers, banks can lose community support and business.
- **Compliance risk:** This risk exists when banks do not appropriately assess current and ongoing debt buyer collection practices for compliance with laws, fair treatment of customers, or the bank’s policies and procedures.
- **Strategic risk.** Decisions to sell debt to debt buyers should be carefully analyzed by examiners to assess consistency with the bank’s strategic goals and whether capable management and staff are in place to perform due diligence and carry out debt sales.

Examiners are encouraged to refer to OCC Bulletin 2014-37, “Consumer Debt Sales: Risk Management Guidance,” for guidance as they review bank debt sales activities. Likewise, examiners should refer to OCC Bulletin 2013-29, “Third-Party Relationships: Risk Management Guidance,” which sets forth guidance for effectively managing risks associated with vendors and third-party service providers, including third-party service providers collecting debt on behalf of the bank (debt placement relationships). Additionally, examiners should complete a careful review of these sales to assess that they are consistent with generally accepted accounting principles (GAAP).

Federal statutes applicable to debt sales include the following:

- **FDCPA:** This applies to debts incurred primarily for the consumer’s personal, family, or household purposes. Under the FDCPA, “debt collector” is defined broadly to encompass debt buyers working on behalf of original creditors, including banks.
- **FCRA:** The FCRA, which is implemented by Regulation V, regulates the collection, dissemination, and use of consumer information, including consumer credit information.
- **Gramm–Leach–Bliley Act (GLBA):** Certain provisions of the GLBA and Regulation P, which implements the GLBA, require banks to provide consumers with privacy notices at the time consumer relationships are established and annually thereafter. In addition, this law imposes limitations on banks’ sharing of nonpublic personal information with debt buyers.

- **ECOA:** The ECOA and its implementing regulation, Regulation B, prohibit discrimination in any aspect of a credit transaction on a “prohibited basis.” The prohibition against discrimination in any aspect of a credit transaction on a prohibited basis includes collection procedures.
- **FTC Act:** Section 5 of the FTC Act prohibits UDAP in or affecting commerce. Public policy may also be considered in determining if acts or practices are unfair.
- **Dodd–Frank Act:** Section 1036(a)(1) of the Dodd–Frank Act, 12 USC 5536(a), prohibits a covered entity from engaging in UDAAP.

Fraud Control

Fraud is a continuing problem with credit card programs. By its very nature, the product is an easily obtainable, unsecured line of credit managed by the consumer, making it an ideal mechanism for fraud. The bank card associations, issuers, and acquirers, the U.S. Postal Service, and other entities have strengthened systems and controls to reduce fraudulent activities. Despite significant advances in detection, however, fraud—specifically identity theft—continues to be a major issue in the credit card industry.

Bank management should have appropriate systems and controls in place to control fraud losses. Systems and controls should include procedures for reporting suspicious activity. The proper training of bank employees regarding fraud systems and controls, fraud recognition and handling, and accurate MIS reporting are important for maintaining fraud losses at or below industry averages. Training programs for this area should include the “Identity Theft Red Flags and Address Discrepancies” rules implementing sections 114 and 315 of the FACT Act, 12 CFR 41, as well as identification and reporting of suspicious activities.

Fraud can be orchestrated in many ways. Lost or stolen cards and nonreceipt of issued cards represent a large percentage of all fraud reported. In recent years, however, thousands of consumers have been affected when their card account numbers were illegally obtained from retailers’ sales records and then used for unauthorized purchases. Banks must implement a comprehensive written information security program designed to ensure the security and confidentiality of customer information.[32] A bank should make the OCC aware as soon as possible when it becomes aware of a security breach involving sensitive customer information. Examiners should assess the adequacy of the bank’s assessment of the security breach, the magnitude of the event, and the appropriateness of its response, including its plans to notify customers.

Bank card associations track fraud according to type, and most issuers follow this or a similar format in reporting fraud in their internal MIS reports. Reporting specific information on types of fraud allows a bank to better identify its points of greatest risk. If a bank does not distinguish fraud losses by type, examiners should discuss the benefits of such reporting with bank management.

[32] Refer to 15 USC 6801 and 6805(b) of the GLBA and 12 CFR 30, appendix B.

Card issuers should review their average fraud losses to determine whether their staff identifies fraudulent activities in a timely manner. If an issuer has inadequate systems and controls to identify fraud, fraudulent activity is likely to continue for longer periods and result in higher losses.

Card issuers have pursued the following activities to deter and reduce fraud:

- Sorting mail outside the facility where the mail was initiated.
- Instituting call-to-activate requirements for new cards and reissued cards.
- Implementing pattern recognition programs and systems.
- Developing neural networks (an extension of risk scoring techniques used in part to identify fraudulent transactions) or expert systems.
- Extending the time after which cards are reissued from two years to three years to reduce the number of cards in the delivery system.
- Designating a special customer service group to handle reports of lost or stolen cards.
- Increasing the level of payment review to include all checks over a certain dollar amount, regardless of whether there is a payment coupon.
- Introducing EMV (Europay MasterCard Visa) standard payment cards (referred to as chip-and-PIN or chip-and-signature cards) to reduce fraud at the point of sale.

Most large issuers maintain a dedicated fraud staff that supervises the many actions that occur when a cardholder notifies the issuer or the issuer becomes aware that fraud has occurred. These activities include

- preparing a lost or stolen card report from the cardholder and advising the cardholder to destroy additional cards. The report may include the account number, name, fraud type, address, number of transactions, dollar amount of fraud, charge-off month and date, description of fraudulent activity, corrective action taken, if any, name of preparer, and name of manager signing off on the report.
- blocking the account and placing it on an exception file with its own unique block codes, depending on its processor.
- preparing a request to issue new cards to the cardholder. This may include reviewing activity in the blocked account and transferring legitimate transactions to a replacement account.
- setting up a file for investigation of fraud accounts. This may include requesting draft copies of fraudulent items and challenging the cardholder’s claims that items are fraudulent, if those claims are suspect.
- reviewing and initiating appropriate steps to charge back items to other parties responsible for chargebacks. This may include preparing fraud notifications to applicable card networks (e.g., Visa or MasterCard), investigating and documenting fraudulent cards, and prosecuting culprits, if possible.
- investigating and resolving address or other types of discrepancies.
- filing suspicious activity reports, if required.

Issuers should have adequate systems and controls in place to recognize fraudulent activities in a timely manner, to block accounts when appropriate, to prevent future authorizations, and to file the proper reports. The timing of the block date is important, as the vast majority of fraud losses occur on or before the block date, and losses incurred after the block date usually have significantly lower transaction sizes.

According to OCC Bulletin 2000-20, fraudulent loans should be classified as loss and charged off no later than 90 days after discovery or when the account is 180 days delinquent, whichever is sooner. Losses resulting from fraud committed by someone other than the cardholder should be charged to other noninterest expense. Losses resulting from fraud committed by the cardholder should be charged to the ALLL.

Purchased Credit Card Relationships

Purchased credit card relationships (PCCR) are intangible assets created when a bank purchases a credit card portfolio at a premium from a third party. Generally, when a performing credit card portfolio is purchased, a large part of the premium (the purchase price over the par value of the credit card receivables acquired) is related to the PCCR. The PCCR represents the right to conduct ongoing credit card business dealings with the cardholders. Such relationships arise when the reporting bank purchases existing credit card receivables and has the right to provide credit card services to those customers. PCCRs may also be acquired when the reporting bank purchases an entire depository institution. The PCCR represents the value of the profit coming from the established card relationships acquired, typically discounted at the acquiring institution’s cost of capital. This intangible is amortized over its expected life. For more information on PCCRs, refer to appendix J of this booklet.

Not every credit card portfolio that is purchased results in a PCCR. The cost of acquiring a credit card portfolio can vary widely, and a bank may even purchase a portfolio at a discount. The purchase price can be determined by a variety of factors that, in the aggregate, reflect the expected cash flows of the portfolio. Some of the main factors considered are the yield, attrition rates, portfolio performance, funding rates, and processing costs.

Most credit card portfolio purchasers maintain automated models that bank management can load with its best estimates of how the purchased portfolio will perform. The card portfolio data are typically obtained directly from the sellers (or their investment bankers) and are used to determine the initial bid on the portfolio. If the bank is selected to perform a due diligence examination (because it offered one of the highest bids), it then modifies the model with enhanced data obtained during the due diligence review. The model generally creates cash flow data, income statements, balance sheets, equity flows, and other information that permits the purchaser to determine an appropriate value for the portfolio, usually based on an internal earnings hurdle rate (the minimum acceptable rate of return on a capital investment project). Models typically include discounted cash flow models, discounted capital flow models, and return-on-asset models. (Refer to appendix J for a detailed discussion on the analysis of PCCRs.)

Allowance for Loan and Lease Losses

The methods used to establish and maintain the ALLL in credit card portfolios varies among banks. Examiners must review the bank's method to determine whether it is reasonable, adequately documented, and consistent with OCC Bulletin 2006-47, "Allowance for Loan and Lease Losses: Guidance and Frequently Asked Questions on the ALLL." Examiners must recognize that no method can determine the appropriate reserve level with absolute precision; instead, reasonable and supportable estimates must be made by bank management based on careful analysis of the portfolio. For more information on reviewing the adequacy of and the methodology for determining the appropriate level for the ALLL and examination procedures, refer to the "Allowance for Loan and Lease Losses" booklet of the *Comptroller's Handbook*.

Examiners must determine whether the bank's methodology for determining its ALLL adequately estimates losses in the portfolio. OCC Bulletin 2006-47 defines "estimated credit losses" as "an estimate of the current amount of loans that it is probable the bank will be unable to collect given facts and circumstances as of the evaluation date." Estimated losses for pools of homogeneous loans, such as credit card portfolios, are governed by ASC 450-20, "Loss Contingencies" (formerly Statements of Financial Accounting Standards (SFAS) 5). In general, for credit card portfolios, the bank should have a supportable and well-documented analysis that segments the portfolio and computes loss histories for each segment, applies adjustments for internal and external qualitative factors, and results in an ALLL balance that is prudent and appropriate (i.e., sufficient to absorb estimated credit losses).

For estimated credit losses on accrued interest and fees that are reported as part of the respective loan balances on the bank's balance sheet, the associated ALLL should be evaluated under ASC 450-20.

One method commonly used to estimate losses in credit card portfolios is the roll-rate analysis. When using this method, bank management should segment the portfolio into appropriate product types. Further segmentation is possible when defining characteristics are present that apply to additional homogeneous pools within the credit card portfolio. Bank management should then track the rates at which loans roll through the delinquency buckets to determine estimated losses based on performance history. For example, management may track how many loans roll from current to 30 days delinquent, then how many of the 30-day delinquent loans roll to 60 days delinquent, and so on. Management then may assess broader economic factors to estimate how external influences may affect portfolio performance. This is a simplistic example of estimating losses using the roll-rate process. Many large banks use some form of roll-rate analysis, often with granular segmentation of the various portfolios. Environmental factors are likely to affect domestic portfolios differently than international portfolios.

Whatever the method, the ALLL analysis should be commensurate with the size and complexity of the credit card portfolio and provide sufficient support to the portion of the bank's allowance that is allocated to credit cards. Generally, institutions should use at least an "annualized" or 12-month average net charge-off rate when estimating credit losses.

Reserving for Rebate Programs

With the fierce competition to provide credit cards, issuers have become increasingly aggressive in account acquisition. The sheer number and various types of issuers—such as nonbank card issuers, Competitive Equality Banking Act (CEBA) credit card banks, and cobranding partners—have intensified marketing to the consumer. Most issuers, either directly or through a partnership arrangement, now offer some type of rebate or rewards program to cardholders. Rebates may be in the form of cash; free gas, hotel stays, or airline tickets; monies toward car purchases; and other items.

The cobranding partnership contract is very important in determining the issuer's costs, marketing requirements, and liabilities, if any. In most arrangements, the partner has contingent liability based on a rebate formula involving cardholder purchase dollar volume. In some cases, however, the contract could be negotiated to impose on the issuer some of the contingent liability on the rebate program. The bank should factor contract terms, particularly covering liability, into pricing the partnership relationship. If the issuer has contingent liability, it should reserve for the liability, as described in this section.[33]

Most major issuers now offer general purpose cards (including affinity and cobranded cards) that contain rebate features. In these cases, the contingent liability pertaining to the rebate redemption rests with the issuer. Because of this, the issuer should reserve for this future redemption liability, and examiners must determine the rebate reserve's adequacy, as well as the reasonableness of the reserve method.

If the issuer has contingent liability on any rebate program, examiners should approach the analysis in a manner similar to evaluating the adequacy of the ALLL. The issuer should have an accounting policy that governs the rebate reserve method.[34] If there is no policy, examiners should discuss the need for a policy with bank management. The policy should address issues such as

- general ledger account under which the reserve will be located.
- account under which the expense will be located.
- how monthly accruals will be determined.
- maintenance of subsidiary ledgers.
- how often formal analysis of the reserve will be prepared.
- management sign-off to attest to reserve adequacy.
- management sign-off to change the reserve methodology.
- handling of redemptions.
- handling of over- and under-reserve levels.
- if outside vendors are used in the redemption process, interface of databases in connection with points accounting, redemption transactions, etc.

[33] Refer to OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance."

[34] Information on accounting for rebates can be found in guidance issued by Emerging Issues Task Force (EITF).

In analyzing the adequacy of a rebate reserve, examiners should review the method and determine how long the program has existed and whether rebate reserve levels differ as the program ages. Examiners should also determine whether there have been any significant modifications regarding rebates or rebate reserve methodology. The type of product the issuer or retailer promotes has a material impact on the type of reserve method that bank management uses. For example, the rebate reserve method for a program that allows for the accumulation of points toward a purchase may be different from a program that annually rebates 5 percent of net purchase sales in cash. Also, many programs have rebate limitations during specific time periods. If no limitations are apparent, examiners should discuss this with bank management and evaluate what, if any, risk the absence of limitations poses to the issuer's financial condition.

Outside vendors may be used to provide a variety of services for rebate programs, including accounting and redemption. Examiners should assess what outside parties are involved in the rebate operation, how information is passed between systems, and how payments are transacted.

In addition, examiners should be mindful of the operational and reputation risks associated with rebates and rewards programs. If a cardholder can choose from multiple rewards on a single card, these risks may grow significantly. Banks should have strong controls in place to ensure that cardholders actually receive the rebates or rewards they signed up for, that cardholders receive proper disclosures, and that rewards are correctly calculated.

Profit Analysis

Credit card operations offer banks substantial opportunities for profit because credit card portfolios can generate returns on assets that far exceed those of other product lines. Profit margins on credit card accounts can be overstated, however, and examiners should perform a thorough analysis of a credit card operation's financial statements to draw accurate conclusions. Moreover, profitability can vary, as it is influenced by cyclical trends in the consumer retail area and the economy in general.

Examiners should begin their analysis with a review of the credit card operation's strategic plan. Strategic goals can vary among issuers. For instance, credit card operations owned by retailers may be concerned primarily with increasing incremental sales of the retailer. The card operations may lower their credit standards to put more of the retailer's cards in circulation. Although this increases sales for the retailer, lower standards may reduce the profitability of the credit card operation because it could lead to higher credit losses.

The credit card operation should have a system to measure overall profitability, including direct and indirect costs. The operation should have detailed budgets that are compared against actual results, with significant variances investigated. The bank should periodically estimate the impact of potential economic changes, competition, and legislative issues on the portfolio. Lastly, bank management should prepare pro forma financial statements on major new product rollouts or modifications of significant terms on existing product lines to identify potential effects on income streams.

The credit card operation should prepare profit analyses for the total portfolio and for each individual portfolio or program. In addition, it is increasingly appropriate for operations to manage profit levels at the individual account level. As profit margins continue to narrow and account retention becomes increasingly important, assessing account-level profitability becomes more important. Account-level data can help bank management focus its retention efforts by determining such things as accounts on which to waive annual membership fees.

Most major issuers have separate finance areas to supervise the accounting of income and expenses. These areas should have in place appropriate MIS reports that detail income and expenses for executive management summary reports. Good MIS are crucial to ensuring that management has an accurate profitability picture. The finance area generally is responsible for coordinating and preparing the budget and strategic goals, as well as generating any reports to the parent company; payment card networks, such as Visa, MasterCard, or American Express; and regulatory agencies.

Profitability among credit card operations varies widely based on a number of factors, such as management competence, risk appetite, products offered, affinity or cobranding relationships, and the method used to report various costs. Bank management should have strong accounting and reporting systems in place to supervise the business effectively. (Refer to appendix I of this booklet, “Profit Analysis,” for examples of ways to examine the profitability of credit card operations.)

There are several common measures of the overall profitability of a credit card portfolio. These include return on average assets (ROAA), return on equity (ROE), and income per billed account. ROE measures help determine the market’s perception of the bank’s financial performance. They can, however, vary significantly depending on securitization volumes and capital leverage. Consequently, the use of ROE as the sole measure to gauge financial performance for credit card operations should be scrutinized by examiners.

Examiners must know the sources of a credit card operation’s income and expenses to analyze its profitability. Some of the basic components of income in a credit card operation are finance charges, annual and service fees, and interchange fees. Some credit card operations receive service fees and residual income from securitized portfolios. Interest rates vary widely depending on products, borrowers’ risk profiles, competition, and state usury laws. The annual and service fee component of income generally includes fees assessed to the customer for use of the card. Annual fees vary and generally are tailored to the perceived value of the card and associated enhancements, such as travel insurance or check cashing privileges. Service fees are generally fees imposed on transactions such as cash advances, late payments, and over-limit transactions. An interchange fee is a fee to the issuer that is extracted from the discount fee paid by a merchant who accepts a credit card transaction.

For most credit card operations, one basic component of expenses, the cost for account acquisition, continues to rise, particularly for accounts associated with rewards programs. The value of the reward “bonus” required to lure a new creditworthy account holder continues to rise significantly and, along with it, the cost of that bonus. Other expenses for most credit card operations include credit processing, card issuance, authorizations, collections, loan-loss provisions, cardholder servicing and promotion, cardholder billing, payment processing, and fraud investigations. Other possible expenses include payments to affinity and cobranding partners and reserves for rebate programs, where applicable.

Credit card operations tend to be one of the costlier areas of a bank. The small size of individual accounts and the high transactional volume create higher costs per account. There are also costs associated with data processing, whether conducted in-house or contracted out to a third party.

Cost of funds is a major expense item that can compose up to half of an issuer's total expense distribution. Cost of funds can vary depending on the funding sources used by the bank, as well as the bank's condition and reputation in the market. Many large credit card issuers use securitization as a source of funding. Examiners should discuss trends in funding costs and composition with the bank and investigate unusual variances.

In reviewing income and expense categories, it is helpful to compare the bank's performance against peer data. Examiners should inquire whether the bank has recent industry cost studies. Notably, bank card associations periodically provide their members with cost studies and other industry data.

Ancillary Products: Debt Cancellation Contracts and Debt Suspension Agreements

Under a debt cancellation contract (DCC) or debt suspension agreement (DSA), a lender agrees to cancel, or temporarily suspend, all or part of a consumer's repayment obligation upon the occurrence of a specified event. Historically, these occurrences have been limited to events that negatively affect a consumer's life, such as death of a spouse, disability, or unemployment. Over the last several years, the industry has expanded the array of events that could trigger activation under these agreements to include other life events, such as birth of a child, purchase of a home, divorce, enrollment in college, etc. Not only has the coverage of these agreements expanded, but more banks are offering them.

The OCC issued 12 CFR 37, "Debt Cancellation Contracts and Debt Suspension Agreements" (Part 37), to establish rules governing these products and ensure that national banks offer them in a safe and sound manner and with appropriate consumer protections. The regulation codified the OCC's longstanding position that DCCs and DSAs are permissible banking products and are not governed by the OCC's consumer protection regulations regarding insurance sales or by state contract law. National banks are governed by this regulation. FSAs are not governed by this regulation, although, as a prudential matter, they should consider following the guiding principles contained in Part 37.

The following practices relevant to DCCs and DSAs sold in connection with credit card accounts are prohibited under the regulation:

- Tying credit approval or terms to a customer's purchase of a DCC or DSA with the bank.
- Engaging in misleading advertisements or practices.

- Retaining a right to modify a DCC or DSA unilaterally, unless the modification benefits the customer or the customer is notified of the proposed change and has a reasonable opportunity to cancel without penalty.

National banks that offer DCCs and DCAs in connection with credit card accounts are subject to the following limitations under the regulation:

- A national bank may offer a DCC or DSA that does not provide for a refund only if the bank also offers that customer a bona fide option to purchase a comparable contract that provides for a refund.
- A national bank may offer the customer the option to pay the fee in a single payment, provided the bank also offers the customer a bona fide option of paying the fee for that contract in monthly or other periodic payments.

The regulation establishes a number of disclosure requirements as well. These requirements are structured to accommodate the methods that national banks typically use to market DCCs and DSAs, by permitting the use of oral or written short-form disclosures in certain circumstances. Such circumstances include telephone solicitations and "take one" applications, where full disclosure of the terms most relevant to a customer's decision to purchase is not practicable. National banks must follow short-form disclosures with written long-form disclosures.

These disclosures must[35]

- inform the customer that the DCC or DSA is optional.
- explain that a DCC or DSA, if activated, does not cancel the debt, but only suspends requirements to make payments.
- disclose the amount of fees charged.
- make customers aware of the option to make a single payment or periodic installments.
- disclose the bank's refund policy if the fee is paid in a single payment and added to the amount borrowed.
- tell customers whether they are barred from using their credit line if the DCC or DSA is activated.
- disclose whether the customer has the right to cancel the DCC or DSA.
- explain eligibility requirements, conditions, and exclusions that might affect a customer's ability to purchase or obtain benefits under the contract.

Sample short- and long-form disclosures are included as appendixes to Part 37. The sample forms are not mandatory, and national banks that make disclosures in a form substantially similar to those provided are deemed to satisfy the disclosure requirements. Regulation Z contains disclosure rules applicable to debt cancellation and debt suspension coverage, at 12 CFR 1026.4(b)(10) and 12 CFR 1026.4(d)(3). Both national banks and FSAs should carefully review Regulation Z requirements in this area.

[35] Some of the information is required only for long-form disclosures, which must be made in writing before the customer completes the purchase of the contract. Refer to Part 37, appendixes A and B, for further details.

Part 37 requires that a national bank, in most cases, obtain a consumer's written acknowledgment of his or her receipt of the required disclosures, as well as an affirmative election to purchase the DCC or DSA, before completing the sale. Like the disclosure requirements, these provisions are tailored to accommodate the use of various sales methods, such as by telephone, where immediate receipt of a written acknowledgment is not practicable. The disclosures, acknowledgment, and affirmative election option must be conspicuous, simple, direct, readily understandable, and designed to call attention to their significance.

The Consumer Financial Protection Bureau (CFPB) also monitors DCC and DSA products to ensure that they are not unfair, deceptive, or abusive. Examiners and bankers both should be aware of any changes to regulations that may be developed and implemented by the CFPB related to DCC or DSA products. The CFPB's Regulation Z contains disclosure rules applicable to debt cancellation and debt suspension coverage at 12 CFR 1026.4(b)(10) and 12 CFR 1026.4(d)(3). Both national banks and FSAs should carefully review Regulation Z requirements in this area

Finally, under 12 CFR 37.8, "Safety and Soundness Requirements," national banks offering DCCs or DSAs must appropriately manage the risk associated with these products in a safe and sound manner. National banks must also establish and maintain effective risk management and control processes over its DCCs and DSAs. In addition, national banks should assess the adequacy of their internal controls and risk mitigation activities in light of the nature and scope of their DCC and DSA programs.

Accordingly, national banks should have

- policies and procedures in place for each DCC and DSA program that promote compliance with the regulation's requirements.
- appropriate MIS reports in place to monitor and administer the programs. Such reports should include information about
  - enrollment and volume trends (e.g., number and balances of accounts enrolled in the program and cancellation rates, segmented by consumer versus bank closure).
  - application and activation volumes and trends, such as
    - average claim processing time by type.
    - benefit application, approval, decline, and fallout rate.
    - number and account balances of accounts in benefit status.
    - average duration of benefit period by type and aging of active benefits (time to benefit exhaustion).
    - delinquency status of accounts in active benefit status, by type.
    - performance of accounts subsequent to benefit denial, fallout, or benefit exhaustion).
  - profitability (e.g., fee income generated; average APR of enrolled and activated accounts; costs by type, including retroactive adjustments).

If the national bank securitizes assets, its MIS reports should be broken down by receivable ownership (e.g., bank, trust, trust series) and aggregated for the managed portfolio overall.

These reports should be used to evaluate program performance (current performance and trends, operational issues, etc.) and pricing; to establish adequate interest and fee reserves; to set the amount of the trust's remittances (if any); and to analyze the ALLL.

Although they are not subject to 12 CFR 37.8, FSAs should, as a matter of safety and soundness, have appropriate risk management processes if they offer DCCs or DSAs.

Examiners should review the national bank's MIS reports to ensure that bank management performs appropriate account analyses. These analyses should include a review of the performance of the accounts by the type of benefit claimed, such as unemployment or disability. Bank management should review whether accounts with benefits claimed performed differently than the rest of the portfolio and incorporate the findings of this analysis into the ALLL methodology. Examiners should confirm bank management's analysis by reviewing a sample of accounts that came off benefit status in the previous six months and assessing the performance on those accounts.

Examiners should ensure that the accounting for DCCs and DSAs is in accordance with GAAP. With regard to DCCs and DSAs, the service that banks provide is the continuing contractual obligation to either cancel or suspend the customer's minimum payment obligation in the event of activation. Banks provide this service each month the contract is in effect, and customers typically pay a monthly fee for the service. Therefore, banks earn the fee each month and may appropriately recognize the fee as revenue. If a bank charges a one-time fee, the bank should defer that fee and recognize revenue over the term of the contract.

In some instances, customers have the right to rescind their coverage within a specified period following the charging of the fee to the customer's account. Banks should not recognize revenue for amounts that may be rescinded until after the rescission period has ended.

A bank's estimate of the amount of probable loss related to DCCs or DSAs is a contingent loss. ASC 450-20 (formerly SFAS 5) governs the accounting for contingent losses. Under ASC 450-20, companies must recognize estimated losses from loss contingencies if the losses are probable and reasonably estimable. Thus, according to the accounting standards for both DCCs and DSAs, a bank should estimate the amount of contingent loss inherent in its contract population. Depending on the particular terms of the DCCs or DSAs, the estimated amount of loss is either the amount that the bank will have to remit or the contractual amount that the bank will not receive from the customer.

Accounting for benefits claimed through DCCs is similar to accounting for loan losses and charge-offs. Each period, the bank should estimate the amount of probable losses related to benefits under the DCCs and recognize that amount of loss in the ALLL. Once benefits are claimed and the related receivables are cancelled, the bank should recognize the cancellation of the receivable as a charge-off to the allowance.

Examination Procedures

This booklet contains supplemental procedures for examining specialized activities or specific products or services that warrant extra attention beyond the core assessment contained in the "Community Bank Supervision," "Large Bank Supervision," and "Federal Branches and Agencies Supervision" booklets of the *Comptroller's Handbook*. Examiners determine which supplemental procedures to use, if any, during examination planning or after drawing preliminary conclusions during the core assessment. Examiners can tailor the examination request items found in appendix B, "Suggested Request Items for Credit Card Lending Activities," to assist in their examinations.

Scope

These procedures are designed to help examiners tailor the examination to each bank and determine the scope of the credit card lending examination. This determination should consider work performed by internal and external auditors and other independent risk control functions and by other examiners on related areas. Examiners need to perform only those objectives and steps that are relevant to the scope of the examination as determined by the following objective. Seldom will every objective or step of the supplemental procedures be necessary.

Objective: To determine the scope of the examination of credit card lending and identify examination objectives and activities necessary to meet the needs of the supervisory strategy for the bank.

1. Review the following sources of information and note any previously identified problems related to credit card lending that require follow-up:

   - Supervisory strategy
   - EIC's scope memorandum
   - OCC's information system
   - Previous reports of examination and work papers
   - Internal and external audit reports and work papers
   - Bank management's responses to previous reports of examination and audit reports
   - Customer complaints and litigation

2. Obtain the results of such reports as the "Domestic Credit Card Data" (maintained by Large Bank Supervision) and Canary.

3. Using the Financial Institution Data Retrieval System (FINDRS), obtain and review relevant credit card-related call report data. Such data may include balances, unfunded commitments, losses, recoveries, early- and late-stage delinquencies, and nonaccrual. FINDRS also includes data on the volume of capitalized fees in total reported balances, as well as information on reserves for capitalized fees and finance charges included in the ALLL or separate valuation allowance.

4. Obtain and review policies, procedures, and reports bank management uses to supervise credit card lending, including internal risk assessments.

5. In discussions with bank management, determine whether there have been any significant changes (for example, in policies, processes, personnel, control systems, products, volumes, markets, and geographies) since the prior credit card lending examination.

6. Based on an analysis of information obtained in the previous steps, as well as input from the EIC, determine the scope and objectives of the credit card lending examination.

7. In preparing for the credit card examination, create a request letter as directed by the EIC (refer to appendix B, "Suggested Request Items for Credit Card Lending Activities").

8. Select from the following primary and supplemental examination procedures the necessary steps to meet examination objectives and the supervisory strategy.

Procedures

These procedures are grouped by functional and product-specific areas. They guide examiners' assessments of the quantity, aggregate level, and direction of credit, operational, strategic, and reputation risk, and the quality of risk management. The primary examination procedures are "Management," "Risk Management and Control Functions," "Information Technology," "Marketing and Product Development," "Underwriting," "Account Management," and "Collections," and apply to all credit card lending activities. These functional areas also contain supplemental procedures. In addition, based on the bank's activities, supplemental procedures should be used, including "Profit Analysis," "ALLL," "Purchased Credit Card Relationships," "Third-Party or Private-Label Partner Management," "Debt Suspension and Cancellation Programs," "Reserving for Rebate Programs," "Program Availability and Eligibility Standards," "Credit Terms and Methods of Payment," "Credit Reporting," and "Compliance with Consumer Protection Laws and Regulations."

The scope of credit card lending supervisory activities depends on the examiner's knowledge of those activities, the amount of total and product exposure, and the amount of risk posed to the bank's earnings and capital. The primary procedures provide the steps used for completing a comprehensive credit card lending examination in smaller or less complex operations, and serve as the base credit card lending procedures for larger or more complex operations. While reviewing credit card activities, examiners should remain alert for lending practices and product terms that could indicate noncompliance with consumer laws and regulations, including potentially discriminatory, unfair, deceptive, abusive, or predatory practices.

The scope of the review may be expanded as necessary when the bank offers new or significantly changed products, when a particular concern exists, or in larger, more complex operations. In these situations, examiners should select the appropriate supplemental examination procedures in this booklet to augment the primary procedures. The supplemental procedures are grouped by functional and product-specific areas. Examiners are also encouraged to refer to other *Comptroller's Handbook* booklets, including "Allowance for Loan and Lease Losses," "Concentrations of Credit," "Internal and External Audits," "Internal Control," "Loan Portfolio Management," and "Rating Credit Risk." In addition, examiners may refer to appropriate booklets in the *Consumer Compliance* series of the *Comptroller's Handbook*, as well as other resources, including the *FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual*.

Fully document findings, conclusions, and recommendations in a memorandum for review and approval by the loan portfolio management examiner or the EIC. Reach a conclusion with respect to the quality of risk management, the quantity of risk, and the aggregate level and direction of risk, and include all necessary support. To accomplish these objectives, do the following:

- Provide special mention and classified asset totals to the loan portfolio management examiner or the EIC. In addition to the delinquency-based classifications outlined in OCC Bulletin 2000-20, "Uniform Retail Credit Classification and Account Management

Policy: Policy Implementation," consider bankruptcies, workout programs, and any other segments that meet the special mention and classified definitions.
- Provide conclusions to the examiner responsible for assessing earnings and capital adequacy.
- If the bank securitizes assets, provide conclusions and supporting information about credit quality to the examiner assigned to review securitizations.
- If legal violations are noted, prepare write-ups for inclusion in the report of examination.
- Prepare a recommended supervisory strategy.
- Document findings in OCC systems as appropriate.

Management

Conclusion: Based on the responses to procedures, the quality of risk management for the bank's management activities is (strong, satisfactory, or weak).

Objective: To assess the effectiveness of the overall oversight (including management oversight, expertise, and staffing) of credit card products currently offered and planned to be offered, given the bank's size and complexity.

Primary Examination Procedures

1. Based on the information provided and reviewed when setting the scope of the exam, determine the adequacy and timeliness of bank management's response to previous supervisory activities and any findings or issues requiring follow-up.

2. As provided when setting the scope of the exam, review relevant reports issued by internal and external audit, quality assurance, loan review, risk management, and compliance management since the prior supervisory activity. Determine the adequacy and timeliness of bank management's responses to the issues identified and any findings or issues requiring follow-up. Request work papers, if warranted.

3. Review the minutes of credit card lending-related committee meetings conducted since the prior supervisory activity.

4. Determine the level of compliance with or divergence from strategic business plans through risk assessments and impact analysis. (**Note:** Significant deviation from plans may lead to a change in the quantity and quality of products, services, controls, management supervision, and technology. Management should have a clear and demonstrable understanding of the anticipated impact of the strategic changes on the financial condition of the operation.)

5. Review staffing levels and expertise relative to origination volume, servicing size, or complexity of operations. (**Note:** Insufficient staffing levels, experience, and operational efficiency can lead to high error rates and may pose significant risk to the bank.)

6. Assess the nature and number of customer complaints relative to the amount of production and servicing. Determine whether the bank has accurately assessed the reasons for such complaints and instituted appropriate steps to provide relief to existing customers and prevent further events from occurring.

7. Review the key risk limits for each of the major functional areas. (**Note:** Absence of meaningful risk limits usually indicates that the bank does not understand the nature of the risk and is vulnerable to unknowingly accepting excessive risk, such as credit, operational, or interest rate risk.)

8. Assess the depth and timing of MIS reporting. (**Note:** Insufficient and lagging reporting efforts may suggest a high level of management and oversight risk. Management is not able to effectively integrate appropriate risk management processes without a clear knowledge of account management, profitability, and product expectations.)

9. Review the functional organization dynamics and assess the separation of duties among the primary operating functions (scoring and modeling, marketing, underwriting, and account management). (**Note:** Insufficient functional independence may lead to conflicts of interest and expose the bank to various risks, such as credit, operational, and liquidity risk.)

10. Review the volume of credit card originations, portfolio size and turnover rate, and the dollar amount of the servicing portfolio. (**Note:** Significant changes may cause concerns, such as management's desire to accelerate earnings or an absence of appropriate management oversight.)

Supplemental Examination Procedures

1. Discuss the bank's planning process with management and determine whether the process is formal or informal. The applicability of the following steps depends on the size and complexity of the bank and the process the bank currently has in place.

2. Determine whether the credit card lending component of the strategic plan is realistic and prudent given the current competitive, economic, and legal environments and the bank's capacity and level of expertise.

   - Assess the bank's strategy and any supporting documents.
   - Determine whether the bank's objectives are consistent with its strategic plan
   - Determine whether marketing plans and budgets are consistent with the bank's overall retail credit objectives and strategic plan.
   - Review the competitive analysis (bank-prepared) and available industry information.
   - Review the analysis of economic, legal, and other external factors.
   - Review the assumptions used to develop the strategic plan and assess the reasonableness of the assumptions.

- Review the organizational structure and management expertise in key positions and determine whether they are adequate to execute the strategic plan (incorporating conclusions regarding capacity).
- Determine whether the internal control questionnaire (ICQ) should be completed.

3. Determine whether the bank's retail credit strategy establishes realistic risk tolerances.

- Determine whether the plan incorporates risk parameters for growth, credit quality, concentrations, income, and capital.
- Determine how the limits were established (e.g., assumptions used).
- Assess the limits for reasonableness.
- Discuss with management the key risks and obstacles (strengths, weaknesses, opportunities, and challenges) to achieving the plan.

4. Review and assess the adequacy of the bank's policies, procedures, and practices. Specifically,

- determine whether credit card lending policies were approved by the board of directors at inception and included in annual policy reviews thereafter.
- identify significant changes in underwriting criteria and terms, how credit scoring models are used, account management activities (including credit line management programs), and collection practices and policies. Specifically,
  – determine the effect of those changes on the portfolio and its performance.
  – determine whether underwriting policies provide appropriate guidance on assessing whether the borrower's capacity to repay the loan is based on a consideration of the borrower's income, financial resources, and debt service obligations as required under Regulation Z.
- If the bank uses credit scoring models (e.g., bureau, pooled, or custom),
  – determine how the bank ensures that the models in use are appropriate for the target population and product offering.
  – assess the reasonableness of the process used to establish cutoffs and determine whether bank management changed the cutoffs between examinations and, if so, the implications for portfolio quality and performance.
  – determine whether the policy provides for model monitoring and validation.
  – if the model includes applicant age as a predictive variable, determine whether the model meets the requirements of Regulation B, which implements the ECOA.
  – determine whether any other variables in the model implicate the nondiscrimination requirements of Regulation B.
- Determine how bank management communicates policies and changes to policy to staff, trains staff to implement changes, and assesses the adequacy of the process.
- Evaluate the bank's process for establishing policy exception criteria and limits, and for monitoring and approving underwriting policy exceptions (e.g., underwriting standards, score overrides, and collateral documentation).
- Determine the control processes in place to track and monitor policy adherence and compliance with laws and regulations (e.g., quality assurance, MIS reports, loan review, and audit), and assess the adequacy of those processes.

- Determine if the bank has the control processes in place to track and monitor model performance and has developed policies and procedures for calibrating or redeveloping their models when the models fail to perform as expected.
- If the bank uses third-party vendors, including brokers and dealers, for services such as loan origination or collection, determine
  - if their use is consistent with OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance."
  - if the third-party vendors comply with all applicable laws and regulations
  - how the bank communicates its policies to those entities, and the adequacy of that process.
  - how the bank monitors and reports third-party vendor policy adherence and performance, and the adequacy of that process.

Document findings and draw conclusions from the review of the bank's credit card lending policies. Examiner conclusions on the quality of credit card lending underwriting policy standards should be used to complete the appropriate Credit Underwriting Assessment in Examiner View. (Updated June 16, 2016)

5. Assess the adequacy of the bank's process for tracking performance against the plan.

- Determine the process to track actual performance against the plan.
- Assess the adequacy of the process, including
  - timeliness, accuracy, and detail of reports.
  - frequency of reports.
  - report distribution, including whether results are provided to senior management and the board.
- Assess the bank's process for revising the plan and supporting operating or product plans to reflect current information and trends.

6. Determine whether bank management adequately considers the economic cycle in the planning process.

- If the bank does not incorporate such information, determine whether planning is appropriate given the bank's circumstances (e.g., size and complexity of operation, market).
- Determine which department develops the scenarios (e.g., finance, marketing, or risk management) and obtain copies of the best, worst, and most likely scenarios.
- Review the assumptions used, the reasonableness of the assumptions, and the frequency of analyses.
- Determine whether the bank uses stress testing. If the bank does not have such a process, discuss with management how the portfolio would withstand an economic downturn. For example, how would account performance be affected in a downturn, and are standards strong enough to mitigate risk of loss?
- Determine how bank management uses this information in the planning process.

7. Determine whether the bank has sufficient management expertise and whether bank management is held accountable for executing the portions of the strategic plan that focus on the bank's credit card operations.

    - Using the organization chart, discuss the backgrounds and responsibilities of key managers with senior management. Confirm understanding of those roles with the key managers.
    - Obtain the criteria for key management compensation programs and position evaluations or performance elements. Determine whether they include appropriate qualitative (risk) considerations in addition to quantitative (growth or marketing) goals, and whether the goals are consistent with the bank's plan. In addition, review key managers' performance-based compensation for the most recent evaluation period to assess whether managers are held accountable for meeting agreed strategic and portfolio objectives.
    - Incorporate the results from the other examination objectives in reaching conclusions regarding bank management.

8. Determine whether the bank's operational capacity, infrastructure, and MIS are sufficient to support and execute the bank's credit card operations.

    - Determine whether key operations and systems managers are adequately involved in the planning process.
    - Discuss capacity planning with bank management (e.g., facilities, systems, staffing, and training).
    - If available, obtain and review the most recent capacity studies for staffing (including underwriting, collection, and control functions), facilities, systems, and technology. Assess adequacy and identify the implications for plan execution. Assess bank management's response to study findings and the potential impact on current plans.
    - Review the retail organizational structure and note any significant changes in senior management or staffing levels, including turnover trends for significant functional areas.
    - Review the compensation plans in place for the various functional areas (e.g., sales and originations, collections), assess the reasonableness of those plans, and determine whether adherence to compliance responsibilities is included.
    - Incorporate the results from the other examiners assigned to the review; determine whether those results reveal any capacity, infrastructure, or MIS issues or problems.

9. Determine whether bank management has a process for establishing specific performance goals for items such as loan growth, policy overrides, credit performance, and profitability for the retail credit card portfolio as a whole and segmented by product. Determine whether management effectively tracks actual performance against these goals.

10. Evaluate the expected performance of the credit card portfolio and the individual products through analysis of management reports, portfolio segmentation, and discussions with bank management. Specifically, review

- score distributions and trends for accounts over time, evaluating scores at application (e.g., application score and bureau score), refreshed bureau scores, and behavior scores.
- delinquencies and losses by credit score range for each major scoring model, and whether there has been any deterioration of the good-to-bad odds.
- trend in advance rates and the effect on performance and loss severity.
- loan growth sources (e.g., branch; region; loan officer; product channels, such as direct, indirect, telemarketing, direct mail, or Internet; and purchased portfolios) and differences in performance by source.
- levels and trends of policy and documentation exceptions, and the performance of accounts with exceptions versus the performance of the portfolio overall.
- volumes and trends of first and early payment defaults.
- volumes and trends of account and balance attrition.
- management's loss forecasts.

11. Determine whether bank management has appropriately considered and supported loan-loss allowance and capital needs in the plan.

Risk Management and Control Functions

Conclusion: Based on the responses to procedures, the quantity of risk is (low, moderate, or high), and the quality of risk management is (strong, satisfactory, or weak) for the bank's risk management and control activities.

Objective: To evaluate the adequacy of the bank's processes for identifying, measuring, monitoring, and controlling risk by reviewing the effectiveness of risk management and other control functions.

Note: If the bank uses affiliates or third-party vendors for loan acquisition, servicing, control, or other key functions, refer to the supplemental examination procedures in the "Third-Party or Private-Label Partner Management" section of this booklet.

Primary Examination Procedures

1. Assess the structure,[36] management, and staffing of each of the control functions, including risk management, loan review, internal and external audit, quality assurance, and compliance review.

   Note: Compliance is clearly a significant risk for credit card lending. Although consumer compliance examiners generally assess the quality of the compliance review function, safety and soundness examiners should understand compliance-related roles, responsibilities, and coverage, as well as how compliance controls fit into the overall control plan.

[36] Depending on the bank, risk management functions may be managed from different areas in the bank (e.g., from the line of business or from the corporate offices).

2. Ascertain the roles, responsibilities, and reporting lines of the various control functions through discussions with senior management.

    - Review the organization chart for each function, and evaluate the quality and depth of staffing (including number of positions) based on the assigned role and the size and complexity of the operation.
        - Review the experience levels of senior managers and staff.
        - Determine whether employees are capable of evaluating line-of-business activities.
        - Review management and staff turnover levels.
    - Discuss the structure and staffing plans, including known or anticipated gaps or vacancies, with senior management.
    - Review compensation plans to determine whether performance measurements are appropriately targeted to risk identification and control objectives.
    - Determine whether organizational reporting lines create the necessary level of independence.
      Note: If the management and staff of a control function lack the knowledge or capability to adequately review all or parts of retail operations, bank management may need to consult or hire appropriate outside expertise.

3. Discuss with senior managers how they ensure that significant risks are appropriately monitored by at least one control function and how they assess the effectiveness of each function.

4. Determine whether the risk management function appropriately monitors, analyzes, and controls the bank's credit card risks.

    - Determine risk management's recurring responsibilities and major projects, including status of projects, and assess the adequacy of those activities in light of the bank's retail credit risk profile, the products offered, and the complexity of the operation.
    - Determine whether credit risk decisions involve all key functional areas, including risk management, marketing, finance, operations, compliance, legal, and information technology, either formally or informally.
    - Determine whether risk management is involved in tactical credit decisions, such as credit program approvals, program renewals, new products, marketing campaigns, and annual financial planning.
    - Obtain descriptions of key management reports to determine the types and purposes of reports produced, report distribution, and frequency of preparation.
    - Obtain a sample of recent ad hoc or special studies or board reports produced by risk management to determine the types of analyses performed, the reasonableness of the scopes and methodologies used, and the accuracy of the conclusions drawn, including the adequacy of the support provided.
    - Determine what technologies and risk tools are deployed and risk management's role in the management of those tools, including data warehouse, portfolio management software, credit scoring and adaptive control systems, and risk models.

- Determine whether market, competitive, legislative, and other external factors are considered in the risk management process.

5. Determine whether bank management considers consumer complaints and complaint resolution in the risk management process. If not previously completed, obtain copies of complaints reported to the OCC's Customer Assistance Group and bank consumer complaint logs (discuss with the compliance examiner whether the CFPB complaint database should also be consulted). Evaluate the information for significant issues and trends. **Note:** Complaints serve as a valuable early warning indicator for compliance, credit, and operational issues, including potentially discriminatory, unfair, deceptive, abusive, and predatory practices.

6. Determine whether changes to practices and products, including new credit card products and practices, are fully tested, analyzed, and supported before implementation. **Note:** Refer to the supplemental examination procedures in the "Marketing and Product Development" section of this booklet for testing guidelines.

7. Test the effectiveness of the bank's risk management process for existing and new products, marketing and collection initiatives, and changes to risk tolerance (e.g., initiating or changing credit criteria or adopting new scoring systems and technologies). Select at least one significant new product, account management practice (e.g., line increase, pricing, payment holiday), or collection initiative (e.g., workout program, rewrite) and track it through all phases of the management process.

   - **Planning.** If tracking a new credit card product, for example, determine how the bank developed new underwriting standards (e.g., how it analyzed the applicability of the underwriting criteria and marketing strategies then in use and the basis of any projections), and how it derived new criteria or strategies (e.g., identify key drivers).
   - **Execution.** Evaluate the adequacy of the process employed to ensure that new criteria and changes were implemented as intended. **Note:** This component is generally performed by some combination of the information technology, product management, quality control, audit, and loan operations.
   - **Measurement.** Ascertain how adherence to standards is measured and how bank management measures impact using back-end monitoring and analysis. Determine the key measurements that bank management uses to analyze the effectiveness of its decisions (e.g., responder analyses, first or early payment default, vintage reporting for delinquencies and losses, activation and booking, utilization, risk-adjusted margin, profit and loss), and the adequacy of back-testing analyses (comparison with targets, identification and analysis of anomalies).
   - **Adjustment.** Determine how feedback results (lessons learned, opportunities identified) are incorporated into the process as course corrections or adjustments. Assess the process for making adjustments as problems or unexpected performance results are identified and whether the process is both timely and appropriate.

8. Determine whether the bank has the data warehousing capabilities (i.e., the capacity to store and retrieve pertinent data) to support necessary monitoring, analytical, and forecasting activities.

9. Evaluate executive management's monthly and quarterly report packages. Specifically,

   - determine whether the reports accurately and completely describe the state of the bank's credit card lending.
   - evaluate whether reports adequately measure credit risk (e.g., score distributions and vintage reports), identify trends, describe significant variances, and present issues. **Note:** Reports should allow bank management to assess whether retail operations remain consistent with strategic objectives and within established risk, return, and credit performance tolerances.
   - determine whether reports clearly evidence analysis of performance results and trends rather than merely depicting data.
   - Determine whether there is any litigation, either filed or anticipated, associated with the bank's credit card lending activities, and assess the allegations, the expected cost, or other implications.

Note: Allegations in litigation, like complaints, may serve as an indicator of compliance, credit, or operational issues.

Supplemental Examination Procedures

Credit Scoring Models

Note: For more information, refer to OCC Bulletins 1997-24, "Credit Scoring Models: Examination Guidance," and 2011-12, "Sound Practices for Model Risk Management: Supervisory Guidance on Model Risk Management."

1. Assess the scorecard management process and determine the department or personnel responsible for scorecard and model development or procurement, implementation, monitoring, and validation.

   - Obtain a model inventory to determine the models in use. The inventory should include the following:
     - Name of the model.
     - Model description.
     - Type (custom, generic, behavioral).
     - Date developed.
     - Source (name of the vendor or in-house modeler).
     - Purpose (e.g., application, response, attrition, pricing, profitability).
     - Date last validated and next scheduled validation date.
     - Models under development, if any.
     - Management contact for each model.

- Determine whether scorecards are used for purposes consistent with the development process and populations. If not (e.g., scorecards are applied to a different product or new geographic area), assess the ramifications and acceptability.
- Review the most recent independent validation reports for key risk models, and discuss the conclusions with risk management.
- Discuss how bank management uses the models to target prospects, underwrite applications, and manage the portfolio.
- Determine how bank management measures the ongoing performance and robustness of models (e.g., good/bad separation, bad rate analysis, and maximum delinquency or "ever bad" distribution reports).
- Review scorecard tracking reports to assess how the models are performing. Select tracking reports for key models, determine whether model performance is stable or deteriorating, and assess how bank management compensates for deteriorating efficacy. Benchmark key performance measures against their values derived from the development sample.
- Determine how cutoffs are established, reviewed, and adjusted. Review the most recent cutoff analysis for key risk models.
- Determine the bank's score override policy, assess the adequacy of associated tracking, and review override volume and performance. Determine whether bank management segments low-side overrides by reason and whether it tracks delinquencies or defaults by reason and override score bands, and assess the performance and trends.
- Review chronology logs to determine changes in the credit criteria or risk profile and to explain shifts in the portfolio, including in volume and performance.

2. Select at least one key credit risk scoring model and fully assess the adequacy of the model management process.

    - Review the original model documentation or scorecard manual, and assess bank management's adherence to the modeler's recommended scorecard maintenance routine.
    - Compare the population characteristics and the developmental sample performance odds with the bank's current experience.
    - Review model performance reports and assess the adequacy of bank management's response to the issues or trends identified. Reports reviewed may include applicant distribution, population stability, characteristic analysis (if indicated by a population shift), override tracking, and vintage delinquency and loss distribution reports.
    - Review early-warning analyses for early indications of deteriorating model performance, such as a rise in early delinquencies relative to what would be expected from the time frame of delinquencies in the development data.

Loan Review

3. Assess the adequacy of the loan review process for credit card lending. Determine whether

- loan review's scope includes providing a risk assessment of the quality of risk management and quantity of risk.
- the scope includes appropriate testing for policy exception tracking and controls and adherence to key credit policies and procedures.
- the scope includes appropriate reviews to assess compliance with applicable laws and regulations and consistency with guidance, including an assessment of whether any lending practices are discriminatory, unfair, deceptive, abusive, or predatory.
- the scope includes a review of the accuracy and adequacy of MIS reporting.
- the frequency of reviews is acceptable based on the significance of the risks involved.
- staffing levels and experience are commensurate with the complexity and risk in the retail lending area.
- loan review is independent from the production process.
- loan review possesses sufficient authority and influence to correct deficiencies or curb noncompliant practices.

4. Review recent loan review reports. Determine whether

   - reports are issued in a timely manner following completion of the on-site work.
   - reports provide meaningful conclusions and accurately identify concerns.
   - significant issues require management's written response.
   - management initiates timely and appropriate corrective action.
   - the issues that are identified and the status of corrective actions are tracked and reported to senior management and escalated to executive management if uncorrected or of high significance.

   Note: Weaknesses identified by examiners, but not identified by the loan review, may be evidence of deficiencies in loan review processes or staffing.

Quality Control

5. Assess the adequacy of the bank's quality control process for its credit card lending operation. Determine whether:

   - the process assesses ongoing consistency with key credit and operational policies and procedures and compliance with applicable laws and regulations for all primary areas, including
     – loan origination.
     – account management programs.
     – fraud.
     – customer service.
     – collections.
     Note: Quality control processes should be established for all direct lending activities and any third-party loan servicing and origination arrangements.
   - quality control tests the integrity and accuracy of MIS data.
   - the frequency of reviews is properly geared to the significance of the risk.

- the testing or sample sizes are appropriate.
- the quality control function has sufficient authority and influence to correct deficiencies or curb noncompliant practices.

6. Review a sample of quality control ongoing testing worksheets and periodic summary reports (e.g., monthly summaries of testing conclusions). Determine whether

   - the reporting process allows for timely feedback to bank management.
   - worksheets and summary reports accurately identify concerns.
   - significant issues require management's written response.
   - management initiates timely and appropriate corrective action.
   - the issues that are identified and the status of corrective actions are tracked and reported to senior management and escalated to executive management if uncorrected or of high significance.

   Note: Weaknesses identified by examiners, but not identified by the quality control function, may be evidence of deficiencies in quality control processes or staffing.

7. If the quality control function is not independent from the loan production process, determine whether internal audit or loan review tests quality control to ensure that bank management can rely on those findings.

8. If reviews and testing by quality control do not include significant risk areas, communicate findings to the EIC to determine whether it is appropriate to complete transactional testing in areas not covered by quality control. (**Note**: Examiner transaction testing provides a check-the-checker control and helps examiners determine the strength of the quality control function.)

Internal Audit

9. Assess the adequacy of internal audit. Determine whether

   - the scope includes appropriate testing for adherence to key credit and operational policies and procedures and compliance with applicable laws and regulations and for consistency with regulatory guidance.
   - the frequency of reviews is properly geared to the significance of the risks.
   - internal audit is independent.
   - internal audit has sufficient authority and influence to correct deficiencies or curb noncompliant practices.

   Note: For more information, refer to the "Internal and External Audits" booklet of the *Comptroller's Handbook.*

10. Review recent internal audit reports. Determine whether

- reports are issued in a timely manner following completion of the on-site work.

- reports accurately identify concerns.
- significant issues require bank management's written response.
- management initiates timely and appropriate corrective action.
- issues that are identified and the status of corrective actions are tracked and reported to senior management.
  Note: Weaknesses identified by examiners, but not identified by internal audit, may be evidence of deficiencies in internal audit processes or staffing.

MIS

11. Determine whether there is an adequate process in place to reconcile major balance sheet categories and general ledger entries on a daily basis.

12. Assess the adequacy of MIS and reports with respect to providing bank management with the necessary information to monitor and manage all aspects of credit card lending. Include identification of, and reporting of, suspicious activities, if appropriate. Determine whether

    - adequate processes exist to ensure data integrity and report accuracy and that balances and trends included in bank management's retail credit reports reconcile with the bank's general ledger and the call report.
    - various department reports are consistent; for example, the reports show the same numbers for the same categories and time periods regardless of the unit generating the report.
    - descriptions of key management reports are maintained and updated.
    - reports are produced to track volume and performance by product, channel, and marketing initiative, and to support any test with implications for credit quality or performance (e.g., pricing, open-end line assignment or adjustment, advance rates). This reporting process should be fully developed and implemented before the bank offers new products or initiates tests in order to accurately monitor new product performance from inception.
    - MIS and reports are available to clearly track volumes, performance, and trends for all types of forbearance or workout programs and settlements, as well as activities such as re-aging, extensions, deferrals, renewals, and rewrites.
    - reports are clearly labeled and dated.

13. Evaluate the condition and risk profile of the credit card portfolio and individual products by reviewing historical trends and current levels of key performance indicators. Such indicators include, but are not limited to, loan balances, utilization, delinquencies, losses, recoveries, and profitability. Focus primarily on dollar balance percentages, but also consider percentages of numbers of accounts. Review performance indicators for:

    - portfolio segments, acquisition channels, and acquired portfolios.
    - third-party originators, including brokers and dealers.
    - internal performance indicator hurdles and metrics. Compare actual performance indicators with internally established objectives.

- comparison with industry and peers, using available information sources (e.g., American Bankers Association, Argus, Consumer Bankers Association, Risk Management Association, Visa's Issuer Risk Key Indicators (IRKI), and rating agency and securitization research). Compare industry indicators with bank performance.

In addition to coincident analysis,[37] consider performing vintage analysis,[38] especially if underwriting criteria, loan terms, or economic conditions have changed, and lagged analysis[39] if the portfolio exhibits significant growth. If available and well maintained, the bank's chronology log[40] may prove useful in determining the causes of variances.

Information Technology

Conclusion: Based on the responses to procedures, the quality of risk management for the bank's credit card information technology activities is (strong, satisfactory, or weak).

Objective: Assess the adequacy of the credit card lending's IT structure, operating environment, and control practices.

Note: These procedures are intended to provide an overview of IT in the credit card function. The procedures are not all-inclusive and should be adjusted accordingly. Refer to the *FFIEC Information Technology Examination Handbook* as needed.

Primary Examination Procedures

1. Determine whether the bank adopted new Internet-based systems for credit card origination, processing, pricing, or delivery, or enhanced existing usage of such systems.

2. Assess the level of remote access for independent agents and information walls to assure third-party confidentiality.

3. Review the number and nature of outsourcing relationships. Vendors can be problematic for a bank to manage given the technical challenges of connecting to each third party and the potential for increased electronic threats.

[37] Coincident analysis relies on end-of-period reported performance, (e.g., delinquencies or losses in relation to total outstandings of the same date).

[38] Vintage analysis groups loans by origination time period (e.g., quarter) for analysis purposes. Performance trends are tracked for each vintage and compared to other vintages for performance relative to similar time on book.

[39] Lagged analysis minimizes the effect of growth by using the current balance of the item of interest as the numerator (e.g., loans past due 30 days or more), and the outstanding balance of the portfolio being measured for some earlier date as the denominator. This earlier date is usually at least six months before the date of the information used in the numerator.

[40] The chronology log is a sequential record of internal and external events relevant to the credit function.

4. Determine whether the bank uses a third party to process credit card applications and the safeguards possessed to ensure the security of the customers' personal information.

5. Assess the level of access controls over customer information from internal as well as external threats.

6. Review the bank's incident response process to system problems. Rapid identification and mediation are imperative to recovery and monitoring for future events.

7. Determine whether the bank has properly segregated IT duties. Failure to appropriately segregate IT duties from the production process can expose the bank to fraud schemes and, ultimately, affect its earnings and capital.

8. Determine the existence, testing, and updating of the business continuity processes. Examine the assumptions, change control processes, data synchronization procedures, crisis management methodologies, and incident response times for level of continuity.

Supplemental Examination Procedures

1. Review internal and external IT audit comments and reports that address the technology supporting the credit card business.

   Note: IT-related audit comments and reports may be issued by a specialized IT audit group or integrated with general internal or external audit comments and reports.

2. Review internal IT risk assessments of the technology systems that support credit card activities.

3. Obtain and review technology management reports to assess performance trends of key credit card lending systems.

4. Obtain and review a list of recent credit card IT projects, e.g., new systems, enhancements, and upgrades.

5. Review meeting minutes from the board of directors or designated committee overseeing credit card activities.

   Note: The IT examiner should coordinate this review with the credit card lending EIC.

6. After review of the above information and discussion with the credit card lending EIC, determine the scope of the IT examination.

7. Determine whether key credit card systems are operated internally or by a third-party vendor. If the credit card system is managed by a third party, review the service contract and assess the effectiveness of the bank's third-party relationship management program. Refer to OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management

Guidance," and the "Outsourcing Technology Services" booklet of the *FFIEC Information Technology Examination Handbook.*

8. Assess the effectiveness of the IT control environment managed by the bank's IT department, with emphasis on

   - IT management.
   - IT audit.
   - systems development life cycle.
   - data input, access, processing, and change controls.
   - data and system validation.
   - network performance monitoring.
   - information security.
   - business continuation and disaster recovery planning and testing.
   - user access controls.
   - systems administrator practices.
   - level and quality of IT technical staff.

9. Assess access control and change management policies and procedures for internally developed and off-the-shelf software used by the credit card function.

10. Discuss any IT-related issues and concerns with the credit card EIC and bank management.

11. Compile IT conclusions and matters requiring attention (MRA) and communicate to the credit card EIC.

Marketing and Product Development

Conclusion: Based on the responses to procedures, the quality of risk management for the bank's marketing and credit card product development activities is (strong, satisfactory, or weak).

Objective: To determine whether the bank's credit card marketing activities are consistent with the bank's business plans, strategic plans, and risk tolerance objectives, and whether appropriate controls and systems are in place before the bank rolls out new credit card products or new-product marketing initiatives. Risk management guidance pertaining to new, expanded, or modified bank products is set forth in OCC Bulletin 2004-20, "Risk Management of New, Expanded, or Modified Bank Products and Services: Risk Management Process."[41]

Primary Examination Procedures

1. Assess the structure and expertise of the marketing function, focusing on bank management, key personnel, and staffing adequacy.

[41] Refer to footnote 12.

2. Review the bank's credit card marketing plan and assess it for reasonableness given the bank's strategic plan and objectives, level of expertise, capacity (operational and financial resources), market area, and competition.

    - Determine whether the bank has based its plan on internally or externally prepared market, economic, or profitability studies. If so, obtain and review copies of those studies.
    - Review the process for developing and implementing marketing plans, with particular attention to whether the appropriate functional areas (e.g., risk management, finance, operations, information technology, legal, and compliance) are involved throughout the process.
    - Assess the appropriateness of the data and assumptions used to develop marketing plans, in part through the review of MIS reports that track actual performance against marketing plans.
    - Discuss with bank management the controls in place to monitor marketing plans and activities.
      Note: Before the implementation of any marketing initiative, including the rollout of a new product or change to an existing product, bank management should review all marketing materials, consumer disclosures, product features, and terms to identify and address potential discriminatory, unfair, deceptive, abusive, or predatory lending practices.[42]
    - Discuss with bank management any significant changes made to or planned for the bank's account acquisition, account management, and cross-selling strategies, including changes in channels and the use of third-party vendors.

3. Assess new credit card product development. Specifically,

    - discuss with bank management the new-product development process.
    - determine whether there are written guidelines for what constitutes a new product.
    - review new-product proposals and plans approved since the last examination.
    - determine whether the appropriate functional areas (e.g., risk management, finance, operations, information technology, legal, and compliance) are involved throughout the development process to ensure that associated risks are identified and controlled. In addition, determine whether these functional areas remain involved during the implementation phase.
    - evaluate systems planning to determine whether MIS and reporting needs are adequately researched and developed before new products are rolled out. Specifically, determine whether the systems and reports are adequate to supervise and administer new products.
    - evaluate the adequacy of the review and approval processes for new products.
    - determine whether bank management, including appropriate legal and compliance personnel, reviews marketing materials during the product development and

[42] For more information, refer to the "Fair Lending" booklet of the *Comptroller's Handbook* and to OCC Advisory Letter 2002-3, "Guidance on Unfair or Deceptive Acts or Practices."

implementation phases to avoid deceptive or misleading advertising, terms, and disclosures.
- determine whether the planning process adequately identifies and addresses the risks, operational needs, and systems support associated with different solicitation methods and channels, including direct applications, preapproved offers, indirect (broker or dealer), loan-by-phone, and the Internet.

Supplemental Examination Procedures

1. Evaluate the adequacy of the bank's test process for new credit card products, associated marketing campaigns, and other significant initiatives. Review the process to determine whether testing

    - is a required step for any new products or significant marketing and account management initiatives.
    - is properly approved. Senior management should approve the testing plan, and it should determine that the proposed test is consistent with the bank's strategic plan and meets strategic objectives.
    - requires clear descriptions of test objectives and methods (e.g., assumptions, test size, selection criteria, and duration), as well as key performance measurements and targets.
    - includes a strong test and control discipline. The test should include a clean holdout group and test groups that are not subject to any significant account management or cross-selling initiatives for the duration of the test. **Note:** Strict test group design enables bank management to draw more accurate performance conclusions.
    - is accorded an adequate period of time, sufficient to determine probable performance and to work through any operational or other issues. When the new credit card (or associated marketing) or other initiative involves a significant departure from existing bank products or practices, the test duration should probably be longer. **Note:** Tests generally should run for at least six months, or up to nine or 12 months per industry practice. The time frame may vary depending on the product or practice being tested.
    - is supported by appropriate MIS and reporting before implementation.
    - includes a thorough and well-supported postmortem analysis in which results are presented to and approved by senior management and the board before full rollout.

2. For affinity and cobranding programs, perform the following steps:

    - Determine whether any of the programs
        – diverge from the bank's underwriting standards.
        – offer preferential pricing.
        – offer features not available to other bank customers.
    - If a program does any of the above,
        – evaluate the appropriateness of program differences; and
        – determine the overall impact on the portfolio quality and discuss your findings with bank management. Use transaction testing, as appropriate, to determine this impact.

- Review the terms of contracts with affinity groups or business partners to determine whether bank management has agreed to any inordinate or large concessions or assumed any contingent liability.
- If bank management granted any inordinate or large concessions or assumed any contingent liability, investigate the reasons, particularly if the bank has only one or a few partners.
- Determine whether the issuer reviews the financial condition of its partners, and whether any partner's financial condition may be questionable.

3. Determine whether bank management assesses how underwriting standards for the new products may affect credit risk and the bank's risk profile.

4. Evaluate cross-selling strategies, including the criteria used to select accounts.

5. If the bank maintains a data warehouse, determine how it is used for marketing purposes and if it is capable of aggregating customer loan relationships.

6. Determine the adequacy and effectiveness of the bank's controls with respect to information sharing, for both affiliates and unrelated third parties.

7. Prepare profiles for each of the products offered. Address

   - product description, including any unique characteristics and a general overview of terms (including pricing), target market (credit quality and geographic), and distribution channels.
   - changes in the product characteristics since the last examination.
   - volume and trends summary, discussing growth to date and planned growth.

8. Select at least one new product introduced since the prior supervisory activity to assess the bank's planning process. Specifically, review

   - planning documents and the final approved proposal.
   - tests and analysis conducted, including performance compared with expectations.
   - MIS tracking reports.
   - available risk management, quality assurance, and audit reviews.
   - any subsequent product modifications and the basis or documented support for those changes.
   - management review and approval documentation.
   - information presented to executive management, management committee, board committee, or the board of directors (depending on the risk profile of the bank).

9. Develop conclusions about whether marketing activities are consistent with the bank's business plans, strategic plans, and risk tolerance objectives, and whether the activities comply with applicable laws and regulations. Determine whether appropriate controls and systems are in place before new products or marketing initiatives are rolled out.

Underwriting

Conclusion: Based on the responses to procedures, the quality of risk management for the bank's credit card underwriting activities is (strong, satisfactory, or weak).

Objective: To assess the quality of the bank's new credit card loans and any changes from past underwriting; determine the adequacy of and adherence to credit card lending policies and procedures; determine compliance with applicable laws and regulations; and gain a thorough understanding of the processes employed in account origination.

Primary Examination Procedures

1. Ascertain and evaluate the types of credit card products the bank offers, and evaluate the reasonableness of the following:

    - Loan products offered and planned to be offered.
    - Underwriting standards and terms, including the bank's evaluation of consumers' ability to pay as required by Regulation Z (12 CFR 1026. 51).
    - Degree of innovation (e.g., new terms, products, and markets).
    - Markets served and economic conditions.
    - Competitive environment.
    - Volume and proportion of loan portfolio (managed and on book), by product.
    - Level of participation in high-risk or subprime lending.
    - Types of marketing and account acquisition channels.
    - Historical and planned growth.
    - Securitization activities.

    Note: When evaluating lending activities, examiners should remain alert for practices and product terms that could indicate potentially discriminatory, unfair, deceptive, abusive, or predatory practices.

2. Review new-account metrics to determine the composition and quality of accounts being booked and the adequacy of MIS to track new-loan volume. Compare the quality of recent bookings with the quality of accounts booked in the past. Metrics evaluated by product should include

    - application volume and approval and booking rates.
    - distribution of credit scores, if used, by category of application: those submitted, approved, and booked.
    - price tiers and fees.
    - average line amount.
    - initial utilization or draw rate.
    - geographic distribution.
    - override volume.
    - credit policy exceptions.

3. Obtain an overview of the origination process and the steps involved. When describing the process in the work papers, document the following:

   - Aspects of the underwriting process that are automated versus manual.
   - Use of credit scoring models (e.g., types of models, history of model use, monitoring, and validation).
   - Differences in the underwriting processes arising from the application channel (e.g., direct mail, telemarketing, "take-one" applications in branches, Internet) and from card types (e.g., affinity, cobranded, private-label, corporate or commercial, and secured).
   - Differences for unsolicited versus prescreened applications.

4. Determine how bank management evaluates underwriter performance: by monitoring new-loan and subsequent-performance MIS reports for or focused on the underwriter; by transaction testing completed for each underwriter by the manager and the quality assurance and loan review departments; or by another method.

5. If the bank uses credit scoring in the underwriting process, assess the mix of automated and judgmentally approved loans. Also, refer to the "Credit Scoring" steps in the supplemental examination procedures in the "Risk Management and Control Functions" section of this booklet.

   Document findings and draw conclusions from the review of the bank's credit card lending policies. Examiner conclusions on the quality of credit card lending underwriting standards should be used to complete the appropriate Credit Underwriting Assessment in Examiner View. (Updated June 16, 2016)

Supplemental Examination Procedures

1. For banks that lend in multiple geographic areas or states, confirm that bank management performs periodic bureau preference analyses to determine optimal credit bureaus for different states or localities.

2. Obtain a copy of or access to the bank's credit card lending policies and procedures. Assess the adequacy and soundness of the policies and procedures, focusing on the main criteria used in the decision-making process and, if applicable, the verification processes used to confirm application and transaction information. Evaluate

   - permissible types of accounts.
   - lending authority and limits, and the exception approval process.
   - limits on concentrations of credit (e.g., product, geographic, broker, dealer, and score band).
   - credit underwriting criteria, including measurements of the borrower's capacity to repay the loan (e.g., debt-to-income ratio or net disposable income calculations) and treatment of derogatory credit bureau items.
   - credit scorecard cutoffs and tolerances for overrides.

- borrower credit grade definitions (e.g., A, B, and C).
- pricing considerations.
- exception and override processes, criteria, and tracking.

3. Determine whether the bank's and/or third-party vendor's policies and procedures provide adequate guidance to avoid discriminatory, unfair, deceptive, abusive, and predatory lending practices, and whether these policies and procedures are consistent with OCC guidance.

   If weaknesses or concerns are identified, consult the bank's EIC or compliance examiner.

   Note: For more information, refer to the "Fair Lending" booklet of the *Comptroller's Handbook* and OCC Advisory Letter 2002-3, "Guidance on Unfair or Deceptive Acts or Practices."

4. Assess the adequacy of the process for changing the underwriting standards applicable to the bank's credit card portfolio. Review all changes in standards since the last examination and determine their effect on the quality of the loan portfolio.

   - Review analyses and documentation supporting recent changes to underwriting criteria and score cutoffs.
   - Discuss reasons for changes (if not readily apparent) with bank management and determine whether there has been a shift in the credit risk appetite.
   - Determine whether all affected functional areas provide input to underwriting changes.
   - Verify that bank management maintains a chronology of significant changes to underwriting standards.

   If applicable, document findings of any significant changes to the bank's credit card lending policies. Draw conclusions on the quality of credit card lending underwriting standards resulting from changes to complete the appropriate Credit Underwriting Assessment in Examiner View. (Updated June 16, 2016)

5. Evaluate limits on, and tracking and reporting of, credit policy exceptions and scorecard overrides. Determine whether

   - volumes are consistent with policy limits, and whether those limits are reasonable.
   - management tracks the volume and trends of policy exceptions (by type) and of overrides (separately and by reason code).
   - management tracks the performance (i.e., delinquencies and losses) of these accounts over time, by type, and compares the performance with that of the overall portfolio.
   - as warranted, management responds appropriately to the levels of overrides and exceptions, adjusting underwriting policies and exception limits or providing additional underwriter training accordingly.

- management appropriately identifies the effects of the levels of exceptions and overrides and the performance of affected accounts on the quantity and direction of credit risk.

6. Select and analyze appropriate credit card product samples to determine credit quality; to verify adherence to bank underwriting policies; to assess the adequacy of analysis and decision documentation; to ensure compliance with laws and regulations; to determine that MIS reports accurately capture exception information; and to determine whether practices exist that are inconsistent with bank policy or that are not adequately depicted in existing management reports. For each significant product type, perform the following steps:

   - Sample recently approved accounts to assess adherence to underwriting policy and applicable laws and regulations. If the bank uses credit scoring, select two samples: one sample from accounts not automatically approved (e.g., judgmental decision involved even if credit scoring is used as a tool) and one sample from accounts automatically approved. Ensure that your sample includes accounts originated from each significant marketing channel and, if warranted, consider expanding the sample to test specific channels more thoroughly.
   - Sample recently approved accounts that represent exceptions to underwriting policy to determine whether credit decisions are consistent, whether the analysis and other support for them are adequate, and whether the exceptions are approved on a prohibited basis.
   - Use the bank's credit files, account origination systems, and MIS reports to create a worksheet to summarize information for the sample. The worksheet should be tailored to fit the product and the bank's underwriting criteria but should generally include the following information:
     – **Account data:** Name, account number, origination date, account balance, credit line amount, current status, employment information, time at residence.
     – **Underwriting terms:** Credit score (bureau, pooled, or custom), debt-to-income ratio, interest rate.
     – **Underwriting policy exceptions and score overrides:** Indicate whether bank or examiner identified.

     If prepared properly, the worksheet facilitates examiner analysis and provides a sound foundation for reaching conclusions about the adequacy of the bank's policy and its adherence to that policy.

   Document findings to support quality of credit card lending underwriting practices and direction of underwriting practices for selected loans in the Credit Underwriting Assessment using the appropriate version of National Credit Tool 2, unless use of the tool is properly waived. (Updated June 16, 2016)

7. Based on the results of the testing and the severity of the concerns identified, determine whether the samples should be expanded. Refer to appendix A, "Transaction Testing," for additional sample suggestions.

8. Document conclusions of quality of credit card underwriting practices and direction of underwriting practices in the appropriate Credit Underwriting Assessment in Examiner View. (Updated June 16, 2016)

9. Develop conclusions with respect to the quality of the bank's new loans, any changes from past underwriting, the adequacy of and adherence to credit card lending policies and procedures, compliance with applicable laws and regulations, the processes employed in account origination, MIS for monitoring new-loan volume, and implications for the risk profile of the loan portfolio. Clearly document all findings.

Account Management

Conclusion: Based on the responses to procedures, the quality of risk management for the bank's credit card account management activities is (strong, satisfactory, or weak).

Objective: To assess the effectiveness of activities and strategies used to enhance performance and increase profitability of existing, nondelinquent accounts or portfolios, and determine the implications for the quality of the portfolio and the quantity and direction of risk.

Primary Examination Procedures

1. Determine whether bank systems are capable of aggregating the entire loan relationship by customer (multiple loan accounts by product and in total) for the purpose of customer-level account management. If so, determine the extent to which the bank uses that capability.

2. Determine whether the bank uses credit scoring for nondelinquent account management. If so, identify the type of scoring used (e.g., refreshed bureau, behavior, and bankruptcy scores), the frequency of obtaining updated scores, and how the scores are used in the account management process.

3. If the bank does not use scoring, determine how bank management reviews the bank's account base for changes in credit quality (e.g., bureau warning screens) or to identify marketing opportunities. Determine whether the process is reasonable, including any actions taken based on the reviews.

4. Review and assess the adequacy of written policies and procedures, including disclosure requirements, governing account management activities. Account management activities may include:

   - line increase and decrease programs.
   - line suspension, lines that convert to amortization, and closure programs.

- graduation programs.[43]
- balance transfer and convenience check offers.
- customer service re-ages, extensions, and deferrals.
- retention programs. **Note:** Retention programs are critical to relationship management and attrition. Be alert to whether the programs are proactive or reactive and how bank management measures performance.

5. Determine the adequacy of bank management's administration of account management programs. Specifically,

   - review the adequacy of the program or strategy approval process and assess whether applicable functional areas are appropriately represented (e.g., risk management, marketing, customer service, compliance, information technology, and finance).
   - assess whether the analyses performed to support new and existing strategies are adequate and appropriately consider all possible effects of the proposed actions (e.g., the effects on credit performance, attrition and adverse retention, earnings, and compliance and reputation risks). In addition, determine whether analyses properly consider the impact of overlapping or repeat account management strategies.
   - determine whether the bank performs adequate testing before full implementation of strategies that have the potential for significant impact on credit performance and earnings. Testing is particularly important for line management initiatives (e.g., balance transfer offers) and, per industry practice, is conducted for a minimum of six months, but preferably for 12 months.
   - assess whether the bank has developed and implemented appropriate MIS reports before initiating testing and implementing strategies and whether bank management regularly monitors and analyzes actual versus expected results.
   - assess the adequacy and timeliness of bank management's response to poorly performing strategies, as well as the actions taken when strategies perform significantly better than expected.
   - Assess the reasonableness of the bank's account management strategies, evaluating the scope and frequency of each strategy employed, the inclusion and exclusion criteria, the various strategy components and outcomes, and adherence to the approved strategies and written policies and procedures.

Supplemental Examination Procedures

1. Review the policies that govern imposing and waiving late, over-limit, extension, annual, and other fees. Determine whether the policies are reasonable and whether the effect on portfolio performance is adequately monitored, analyzed, and addressed.

2. If the issuer previously increased interest rates on accounts based on the credit risk of the consumer, market risk, or other factors, determine that the issuer has developed and

[43] In open-end credit, graduation programs reward sustained successful performance of high-risk borrowers by moving them from a subprime type of account (typically higher-priced, with a lower credit limit, and often secured) to a more mainstream product.

implemented policies and processes to periodically evaluate whether the increased rate remains appropriate. Accounts should be reviewed at least every six months to determine if the circumstances causing the earlier rate increase remain or if a rate reduction is required. If appropriate, select a sample of affected accounts and perform transaction testing to determine the level of consistency with policy.

3. Based on the significance of the bank's use of account management activities, determine whether account sampling is warranted. If so, refer to the sampling procedures in procedure 14 of this section and in appendix A, "Transaction Testing," of this booklet.

4. Develop conclusions with respect to the effectiveness of activities and strategies used to enhance performance and profitability of existing, nondelinquent accounts or portfolios, and any implications for the quality of the portfolio and the quantity and direction of risk. Clearly document all findings.

5. Evaluate the adequacy of the bank's transaction authorization process. Assess transaction limits (i.e., dollar amount, frequency, and cash versus purchase allocations) and criteria used to "block" accounts (prohibit additional transactions). In addition,

   - ascertain the types of transactions (e.g., small-dollar transactions, recurring transactions, and delayed postings, such as charges for rental cars) that are likely to circumvent the bank's authorization process and determine how the bank manages that risk.
   - determine how the bank handles payments returned for NSF and the adequacy of the bank's policies for large payment holds.

6. Determine whether the bank allows borrowers to exceed their credit limits. If so,

   - determine the amount and reasonableness of the over-limit authorization buffers, if any.
   - assess the bank's over-limit strategies, focusing on how the eligibility criteria are developed, whether the strategies are appropriately tested, the adequacy of the initial and ongoing analyses supporting the strategies, and the management approval process for the program.
   - assess the adequacy of over-limit MIS reporting and whether it provides accurate data reflecting over-limit volume, trends, and the subsequent performance of over-limit accounts.
   - review the requirements of the account terms and conditions for curing over-limits and determine whether the bank enforces these requirements. Assess the adequacy of the bank's process.
   - assess the bank's performance in light of the over-limit provisions of OCC Bulletin 2003-1, "Credit Card Lending: Account Management and Loss Allowance Guidance." Refer to appendix D, "Account Management and Loss Allowance Guidance Checklist," of this booklet.

- determine that the bank charges an over-limit fee only when a consumer has proactively opted in for authorized over-limit transactions.[44]

7. Review internal reports on over-limit activity. If the volume is significant or if negative trends are evident, discuss with bank management.

8. Assess the system in place to monitor for and identify suspicious or unusual activity. Also, assess the adequacy of processes to investigate and report suspicious activity in a timely manner.

9. Conduct transaction testing to verify the initial conclusions on the prudence of the bank's account management strategies. Determine whether the accounts reviewed are performing consistent with program assumptions and expectations and whether the action resulted in a change in credit risk. In addition, determine whether accounts conform to initial criteria, whether MIS reports accurately capture tracking information, and whether bank management has adequately identified and controlled the impact of repeat and competing strategies.

   Note: When selecting the initiative to sample, consider the size of the population affected, the amount of the change, or the initiative with the greatest performance variance from program projections. Place emphasis on the older initiatives with characteristics similar to current initiatives to gain the longest subsequent performance period.

   - Sample accounts from at least one of the significant automated line-increase and line-decrease initiatives since the prior supervisory activity.
   - Sample accounts that exceed approved credit limits by a certain threshold (e.g., accounts 10 percent or more over limit) as of the last statement or billing date. Determine why the accounts are over limit (e.g., authorization, NSF, or other issues); whether the bank charges over-limit fees only on the accounts of consumers who have opted in to over-limit fees (this does not apply to commercial credit card accounts); when the bank imposes or suspends over-limit fees; how the minimum payment is calculated; and whether practices are consistent with the disclosures in the cardholder agreement. In addition, determine whether negative amortization exists and, if so, the extent thereof.
   - Sample accounts that received manual line increases or decreases, or other significant changes, and assess whether the policies were consistently applied and whether the analyses and decisions were well documented.
   - Select one other account management program offered by the bank and sample accounts that participated in that program. Determine that accounts met all eligibility criteria when accounts were initially selected for the program, at the time of the promotional mailing, and at the time the cardholder accepted the offer to participate.

[44] Refer to 12 CFR 1026.56.

Collections

Conclusion: Based on the responses to procedures, the quality of risk management for the bank's collection activities is (strong, satisfactory, or weak).

Objective: To evaluate the effectiveness of the credit card collection function, including the collection strategies and programs employed; to better assess the quality of the portfolio, the quality of risk management with respect to the collection function, and the quantity and direction of credit risk.

Primary Examination Procedures

1. Assess the structure, management, and staffing of the collection department.

    - review the organization chart for the department and evaluate the quality and depth of the staff based on the size and complexity of the operation.
    - discuss with senior management staffing plans for each major collection activity (e.g., early-stage, late-stage, fraud monitoring, and third-party management of both collection and credit counseling agencies), including how plans fit with department and bank objectives (e.g., growth and credit performance projections).
    - review the experience levels of senior managers and supervisors.
    - assess the adequacy of the bank's training program for collectors through discussions with bank management.
    - assess the appropriateness and administration of the bank's incentive pay program for collectors. Pay particular attention to possible negative ramifications of the plan, such as the potential to encourage protracted repayment plans, aggressive curing of accounts, or individual rather than team efforts. Determine whether the plan limits the total incentive pay that a collector can receive.
    - determine whether the board or senior management reviewed and approved the incentive pay program before implementation.

2. Assess the adequacy of the bank's written collection policies and procedures. Determine whether they cover all significant collection activities and are consistent with OCC Bulletin 2000-20, "Uniform Retail Credit Classification and Account Management Policy: Policy Implementation," and OCC Bulletin 2003-1 "Credit Card Lending: Account Management and Loss Allowance Guidance." Refer to the checklists in appendixes C and D of this booklet.

    - Review the bank's credit card policies to determine if it allows the rebooking of accounts that are charged off for any reason other than bank error. If so, discuss this information with the EIC.
    - Determine whether the bank is considered a debt collector as defined by the FDCPA. If so, forward this information to the EIC or the compliance examiners to ensure appropriate review of the FDCPA at the next compliance examination.

- Identify where bank management has implemented automated decisions (e.g., charge-off, re-aging, and extensions) to be consistent with the above policy guidelines.

3. Evaluate the adequacy of the bank's classification, nonaccrual, and charge-off practices and whether the practices comply with the bank's written policies and procedures and are consistent with regulatory guidance. Specifically,

   - discuss practices with both bank management and line personnel. Identify any ways in which practices are inconsistent with policies and procedures. Ensure that examiners assisting with the collection review and conducting testing are aware of these inconsistencies.
   - identify instances in which management has implemented automated processes instead of manual processes to be consistent with policies. Review the system settings to verify that the parameters of the automated processes correspond to those described in the bank's credit card policies and allow compliance with regulatory requirements and consistency with guidance. If they do not, discuss the differences with management and request appropriate corrective action.
   - request management's summary of classified accounts. Determine whether the classification practices are consistent with OCC Bulletin 2000-20, "Uniform Retail Credit Classification and Account Management Policy: Policy Implementation." Generally, loans should be classified substandard at 90 days past due.
   - request management's summary of nonaccrual loans. If the bank does not place credit card loans on nonaccrual, determine whether the bank employs appropriate methods to ensure that income is not overstated (e.g., appropriate reserves are established for uncollectible fees and finance charges as part of the ALLL, or the estimated uncollectible income is charged directly against interest and fee income).
   - determine how accounts scheduled for charge-off are loaded into a charge-off queue or other system for loss. Specifically, determine whether losses are automatically or manually processed; what circumstances, if any, delay a charge-off; and when the bank recognizes losses (e.g., daily, weekly, or monthly).
   - request a report detailing accounts more than 180 days past due that have not been charged off. Review the report with bank management, and determine why those balances remain on the bank's books and whether there are system or policy issues that need to be corrected.

Supplemental Examination Procedures

1. Evaluate the adequacy of the bank's policies and practices for payment posting and assessing late fees.

   - Review the payment posting procedures and practices and determine whether payments are promptly posted.

- Determine the conditions under which late fees are imposed[45] and, if applicable, at what point the fees are suspended.
- Determine the bank's policy for collecting late fees (e.g., as part of the next regularly scheduled payment) and how unpaid late fees are accounted for, tracked, and collected.
- Determine whether the bank's process for evaluating the ramifications of changes in late-fee policies, including dollar amounts and grace periods, is adequate before broad implementation of the changes.
- Assess whether the available MIS and reports provide the information necessary to evaluate the effect of late fees. Specifically, assess whether the information is sufficient to allow management to determine whether the fees have the desired effect on performance (i.e., improving on-time payments), whether late fees result in negative amortization, and the extent to which late fees assessed are actually collected.
- Ensure that the bank has established adequate loss allowance for accrued but uncollectible interest and fees, including late fees, in either the allowance or a separate reserve.

2. Assess the appropriateness of bank management's collection strategies.

    - Through discussions with bank management, determine how it develops collection strategies, who is responsible, and how the success of the strategies is measured.
    - Determine what triggers strategy changes and who has authority to direct revisions.
    - Establish whether the bank uses scoring or any other predictive techniques to assist in the collection of accounts. If so, determine
        - the scores or techniques used, how they are used, and whether they are internally or externally developed.
        - when the scores or techniques were last validated, by whom, and the results of the validation.

3. If applicable, assess the adequacy of the bank's use of champion/challenger strategies.

    - Identify the person or group responsible for strategy development.
    - Determine that the development process begins with a clear identification of strategy objectives and relies on reasonable assumptions and complete and accurate MIS.
    - Determine that the bank's controls provide for proper testing (e.g., test size, time frame, and account population and characteristics) of challenger strategies before making decisions to expand challenger penetration or to replace the existing champion strategy.
    - Assess the monitoring process and determine whether the bank accumulates and analyzes appropriate data to measure strategy success.

[45] It is generally considered an unfair practice for a bank to assess a late fee when the only delinquency is attributable to the late fee assessed on an earlier installment, and the payment is otherwise a full payment for the applicable period and is paid on its due date or within an applicable grace period. Refer to OCC Bulletin 2014-42, "Credit Practices Rules: Interagency Guidance Regarding Unfair or Deceptive Credit Practices."

- Determine that the bank maintains adequate documentation of the various strategies.

4. Determine whether the bank uses cure programs such as re-aging, match pay, temporary forbearance, fixed payment plans, permanent internal or external workout programs (e.g., CCC), or settlement programs. If so,

   - assess the adequacy of the policies and procedures used to administer the programs, as well as consistency with OCC Bulletin 2000-20, "Uniform Retail Credit Classification and Account Management Policy: Policy Implementation," and OCC Bulletin 2003-1 "Credit Card Lending: Account Management and Loss Allowance Guidance," regarding limits, analysis, documentation, amortization periods, and allowance considerations.
   - review and evaluate any test and analysis summaries completed before the implementation of new cure programs.
   - determine whether the bank's programs appropriately address proper income recognition, and TDR designation, if appropriate, for restructured loans.
   - evaluate the MIS and reporting used to monitor and analyze the performance of each program. Compare performance with forecasts and bank objectives and tolerances. In addition to reports listed in procedure 10, determine whether bank management generates and reviews reports detailing
     – volume (balance and unit) trends for cure program accounts, by product, program, vintage, and in total.
     – loss performance, by product, program, vintage, and in total.
     – performance of the accounts 30, 90, 180, 270, 360, etc., days subsequent to the cure.
     – performance of accounts cured more than once, broken down by the number of times cured and tracked over time.
     – policy exceptions and the performance of those exceptions.
   - Compare the performance of accounts in cure programs with the performance of those in the general population.
   - Assess the current and potential impact of such programs on the bank's reported performance (asset quality) and profitability, including allowance and capital implications.

   Note: If bank management accepts external debt management plans, such as CCC, bank management should be able to monitor the performance of accounts by individual credit counseling agency.

5. Review and determine the effectiveness of the bank's "skip tracing" [46] practices and procedures to track delinquent customers.

[46] In the field of debt collection, the term "skip" traditionally referred to a person who disappeared to avoid paying debt. Today, "skip tracing" is thought of more broadly in the collection context as a process of locating consumers whose contact information is outdated or invalid, regardless of why the information is not accurate.

- Ascertain what portion of the portfolio lacks current and correct telephone numbers and mailing addresses.
- Evaluate the adequacy of the bank's process for obtaining missing contact information.
- Determine whether the bank has a process to exclude accounts without pertinent contact information from promotional initiatives and favorable account management treatment.
- If applicable, determine whether the bank appropriately monitors outside agencies used to skip-trace accounts.
- Determine whether skip accounts are flagged for accelerated charge-off if attempts to locate borrowers are unsuccessful.

6. Assess whether the bank's automated systems for collecting delinquent accounts are adequate and discuss these systems with bank management.

    - Determine which technologies and processes the bank uses to collect accounts (e.g., automated dialers, collection letters, statement messaging, videos and other media), how each is used, and the key reports generated to monitor performance. Determine whether the key reports provide sufficient data to allow bank management to make appropriate decisions.
    - If auto-dialing is used, determine how the system routes "no contact" accounts. These are accounts that collectors remove from the dialer because of a promise to pay or a payment arrangement (e.g., accounts subject to bankruptcy proceedings or those being handled by counsel in situations in which the borrower has protections against direct creditor contact).
    - Determine whether the systems generate a sufficient audit trail.
    - Determine whether managers, supervisors, and quality control staff have the ability to listen to collector phone calls on-line.
    - Evaluate the adequacy of the bank's contingency plans, and determine whether the plans are tested regularly.

7. Assess the quality, accuracy, and completeness of MIS reports and other analyses used to manage the collection process. Specifically,

    - evaluate the quality of MIS collection reports regularly provided to executive management and determine whether the reports provide adequate information, including comparisons with collection objectives and tolerances, for timely decision making.
    - determine the appropriateness and accuracy of key collection reports. Review specifically
        - vintage and coincident delinquency and loss reports.
        - roll-rate reports and migration-to-loss reports.
        - cure program reports, in total, by program, and by collector, including reports that track the volume (number and dollar) of accounts entering cure programs, accounts awaiting re-aging or extension, and the actual performance of accounts in the various programs.

- collector and strategy reports or special-handling-queue reports.
- productivity reports, including information such as call penetration, right party contact, promises made and kept, dollars collected, and staffing summaries.

Note: If not removed, NSF checks can affect several of the metrics above. Bank management should have a method to identify, or correct, the effects of NSF checks on the metrics.

- determine whether departments other than collections, such as customer service, can initiate collection activities, such as cure programs. If so, determine whether appropriate monitoring MIS are in place to monitor volumes and credit performance of accounts in collection activities initiated outside the collection department.

8. Determine what system(s) the bank uses to recover charged-off accounts and whether they interface with the bank's collection management system(s). If not, determine how the recovery unit gathers and uses information about prior collection activities.

9. Determine whether the bank uses outside collection agencies (including attorneys and attorney networks) to collect delinquent accounts or to recover losses. If so,

- assess the bank's due diligence process for selecting third-party collection agencies.[47]
- determine whether the bank's legal counsel and compliance officer have reviewed the contracts with, and practices of, third-party collection agencies.
- evaluate any forward-flow contracts to third-party collection agencies, including performance tolerances and termination requirements (important for remediation or severing the contract in case of poor performance). **Note:** Forward-flow contracts provide third-party collection agencies with a set number of accounts at a determined frequency and assist the bank in forecasting placements.
- determine the frequency and method, including reasons supporting the method, of rotating accounts between third-party collection and recovery agencies and in-house collections, i.e., assess the distinctions in effectiveness and cost between primary, secondary, and tertiary collectors.
- review productivity and cost reports for each third-party collection agency. Discuss with bank management how the bank monitors the success of third-party collection agencies and whether the bank uses the results of this monitoring to assign delinquent accounts to third-party collection agencies.
- evaluate the systems and controls used to supervise out-placed accounts, including active reconciliations of amounts collected and fees disbursed to each third-party collection agency.
- review MIS used to monitor the performance of third-party collection agencies.
- evaluate the adequacy and frequency of the bank's audits (on-site and off-site, if applicable) of third-party collection agencies.

Note: For more information on reviewing third-party relationships, refer to the supplemental examination procedures in the "Third-Party or Private-Label Partner Management" section of this booklet.

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[47] Refer to OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance."

10. Assess the bank's recovery performance using historical results and industry averages, by product, as guidelines.

    - Determine whether the bank periodically sells charged-off accounts. If so, determine the reasonableness of forecasts, the bank's cost-benefit analysis, and the bank's consistency with OCC Bulletin 2014-37, "Consumer Debt Sales: Risk Management Guidance."
    - Evaluate the bank's recoveries in light of prior-period losses.
    - Evaluate the accuracy of the recovery figures. If the bank charges accrued but uncollected interest and fees against income rather than the allowance, verify that recoveries are reported accordingly (i.e., include principal only). Refer to appendix D, "Account Management and Loss Allowance Guidance Checklist," of this booklet.
    - Assess the costs associated with the dollars recovered, and explore trends.

11. Assess the appropriateness of the bank's fraud policies and procedures.

    - Review the bank's definition of fraud losses and assess whether it is reasonable and appropriately distinguishes fraud from credit losses.
    - Assess consistency with OCC Bulletin 2000-20, "Uniform Retail Credit Classification and Account Management Policy: Policy Implementation," regarding charge-offs (for example, 90 days from discovery).
    - Confirm that fraud losses are recognized as operating expenses rather than charges to the ALLL.
    - Assess whether the bank's policies differentiate between account charges alleged to be fraudulent and undisputed charges. For example, for open-end credit, some banks may re-age the entire amount owed to current pending the outcome of a fraud investigation; that treatment, however, should not extend to undisputed amounts.
    - If an investigation negates a fraud allegation, verify that the bank returns the account to the previous delinquency status and immediately reinstates collection efforts.

    Note: When an account is reported as fraudulent, the reason should be given (for example, because account activity is alleged to be fraudulent, because it is confirmed to be fraudulent, or because the application is fraudulent). An account that has had an NSF check or that did not make the first payment should not automatically be identified as fraudulent.

12. Review the adequacy of MIS reports pertaining to fraud.

    - Determine whether the information is sufficient to monitor fraud and the effectiveness of fraud controls, including the appropriate filing of suspicious activity reports.
    - Assess the levels and trends of fraud losses compared with industry averages, and discuss any atypical findings with bank management. **Note:** Fraud losses often are depicted as fraud losses divided by sales.

- Assess the system in place to monitor for and identify suspicious or unusual activity. Also, assess the adequacy of the processes to investigate and report suspicious activity in a timely manner.

13. Assess the adequacy of internal and external audit, quality assurance, loan review, and risk management in the collection area, including scope, frequency, timing, report content, and independence.

    - Review relevant audit, quality assurance, loan review, and risk management reports.
    - Determine the adequacy and timeliness of bank management's responses to the issues identified and any findings or issues requiring follow-up. If warranted based on the significance of the issue or concerns about the adequacy of the response or action taken, test corrective action.

14. Conduct transaction testing to verify initial conclusions with respect to the bank's collection programs and activities. In addition to determining consistency with approved policies and procedures, determine whether the programs and activities result in an enduring positive change in credit risk or provide only temporary relief. Verify that MIS reports accurately capture the activities and the subsequent performance of the accounts. (For more information, refer to appendix A, "Transaction Testing.")

    - Sample accounts that were at least 60 days delinquent in the month preceding the examination and are now current to determine whether the customer cured the delinquency or whether the account was cured artificially (e.g., re-aging or extension). If the latter, determine whether the action was consistent with existing bank policy and with OCC Bulletin 2000-20, "Uniform Retail Credit Classification and Account Management Policy: Policy Implementation."
    - Sample accounts from each of the primary collection areas (e.g., early-stage, late-stage, skip, bankruptcy, estate, or deceased borrower accounts) to determine adherence to policy. The sample helps an examiner understand the collection process and strategies employed. **Note:** This sample is often best completed or supplemented by sitting with collectors as they work accounts. Monitoring taped or live collection calls is also an effective tool examiners can use to determine whether practices comply with policies and procedures.
    - Sample loans from each of the following areas to assess compliance with bank policies for the programs and the reasonableness of decisions: recent re-agings; temporary forbearance; internal and external workouts, such as CCC; and settlements. Decisions also should be compared with the bank's normal underwriting guidelines with respect to amortization period, debt or repayment limitations, and pricing.
    - Sample charged-off accounts and review all activities that occurred before charge-off to determine whether the bank employs practices that result in loss deferral.
    - Sample identified fraud accounts and review all activities to determine propriety of practices, adherence to policy, and timeliness of charge-off practices.

15. Develop conclusions with respect to the effectiveness of the collection function, including the collection strategies and programs employed, and the implications for the quality of the portfolio and the quantity and direction of credit risk.

16. Determine the delinquency level at which the bank temporarily suspends lines of credit and the level at which it permanently closes an account. Also,

    - determine whether scoring models or other methods contribute to decisions to permanently close lines of credit.
    - evaluate the circumstances under which a closed account can be reactivated, and verify that the collection department refers such accounts to the credit department for an underwriting decision.

17. Ascertain whether the bank's collection strategies include the use of penalty pricing. If so,

    - as required by the CARD Act (refer to 12 CFR 1026.55(b)(4)), ensure that penalty pricing is not triggered until the account becomes 60 days delinquent and that the account is returned to its lower, non-penalty-pricing level on receipt of six consecutive timely payments.
    - assess bank management's objectives in structuring its penalty pricing strategy and the quality of the supporting analysis. Be particularly alert to whether the analysis adequately considers the possible ramifications of the strategy, including reputation risk, negative retention, increased credit losses, and decreased interest income in the long term.
    - determine whether the strategy was properly tested using reasonable sample sizes and time frames, and that the initial performance assumptions were adequately validated before full rollout.
    - determine bank management's performance targets for the penalty pricing strategy, and review actual performance against those metrics.
    - evaluate the adequacy of the MIS and reporting used to monitor the performance of accounts during, and subsequent to, penalty pricing.
    - assess the timeliness and appropriateness of bank management's response to negative strategy results.

Profit Analysis

These supplemental examination procedures should be used when assessing the profitability of the bank's credit card lending activity.

Conclusion: Based on the responses to procedures, the quantity of risk is (low, moderate, or high) and the quality of risk management is (strong, satisfactory, or weak) for the profitability of the bank's credit card lending activities.

Objective: To assess the quantity, quality, and sustainability of credit card lending earnings.

Note: For banks that securitize assets, examiners should also review income statements for managed assets.

Supplemental Examination Procedures

1. Obtain and review copies of the income statement for the credit card portfolio and for each significant product. Ensure that the reports are “fully loaded,” i.e., that they include all pertinent income and expense items, including overhead and funding costs.

2. Ascertain the contribution of the credit card portfolio to corporate earnings and the expected contribution in the future.

   - Review executive management monthly or quarterly performance reports and portfolio-quality MIS packages.
   - Review historical trends, including changes in the product contributions.
   - Review financial projections and budget and plan variances.
   - Review significant income and expense components and measures, including noninterest income (fees and other add-ons), marketing expense, charge-offs, net interest margin, and risk-adjusted yield.
   - Evaluate the methodologies, assumptions, and documentary support for the bank’s planning and forecasting processes. Determine whether material changes are expected in any of the key income and expense components and measures.
   - Determine factors limiting bank management’s return on assets, return on managed assets, and return on equity and the actual returns as of the examination date.
     Note: Asset-based measures are typically more meaningful for comparison because banks allocate capital differently.

3. Verify that the bank appropriately recognizes uncollectible accrued interest and fees through the ALLL, through a separate interest and fee reserve or through cash income recognition.

4. Review the bank’s stress test and discuss potential earnings volatility through an economic cycle with bank management in order to assess sustainability. If the bank does not perform stress testing, discuss whether and how management prices loans to withstand economic downturns.

5. Determine whether the bank’s cost accounting system is capable of generating profit data by product, segment (including grade), channel, and account.

6. Assess the profitability of each product.

   - For each product, review profitability by credit score band, credit grade, sub-portfolio (e.g., unsecured or secured credit card), and vintage, as appropriate.
   - Compare actual results with projections and discuss variances with bank management.

7. Evaluate profitability by channel.

    - Through discussions with bank management responsible for third-party oversight, determine profitability generated through the various channels (e.g., third-party originators).
    - Compare the profitability of the loans generated by the various channels.

8. Determine the adequacy of the pricing method.

    - Review the pricing strategy, pricing method, and pricing model, if applicable.
    - Review the major assumptions used in the pricing method and assess reasonableness. Be alert to differences in assumptions by product and channel.
    - Determine whether pricing is driven by risk, capital, or some other allocation method or hurdle, and to what extent, if any, it is driven by the competition.
    - Determine whether the pricing method incorporates a realistic break-even analysis, and whether the analysis reflects the true costs of premature account closures (attrition) and reductions (prepayment).
    - Review the pricing matrix, by product.

9. Verify that all charges and fees were established by the bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding, or discussion with other banks or their officers. Determine that charges and fees were established by a decision-making process through which the bank considered the following factors:
    - The cost incurred by the bank in offering and providing the service.
    - The deterrence of misuse by customers of banking services.
    - The enhancement of the competitive position of the bank in accordance with the bank's business plan and marketing strategy.
    - The maintenance of the safety and soundness of the institution.

10. Assess the adequacy of planning, reporting, and analysis with respect to attrition and prepayment. Specifically, ascertain whether bank management identifies the volume and trends of accounts with high interest rates relative to accounts with market or low introductory rates to determine exposure and impact on earnings.

ALLL

These supplemental examination procedures should be used when assessing the portion of the ALLL applicable to the bank's credit card lending activity.

Conclusion: Based on the responses to procedures, the quantity of risk is (low, moderate, or high) and the quality of risk management is (strong, satisfactory, or weak) for the ALLL of the bank's credit card lending activities.

Objective: To assess the bank's ALLL methodology for its credit card lending activities.

Supplemental Examination Procedures

1. Determine whether the amount of the ALLL is appropriate and whether the method of calculating the allowance is sound. Assess whether bank management routinely analyzes the portfolio to identify instances when the performance of a product or some other business segment (e.g., workout programs) varies significantly from the performance of the portfolio overall and that such differences are adequately incorporated into the allowance analysis. Refer to the "Allowance for Loan and Lease Losses" booklet of the *Comptroller's Handbook*, and specifically consider

    - whether estimates and assumptions are documented and supported in a manner consistent with OCC Bulletin 2006-47, "Allowance for Loan and Lease Losses: Guidance and Frequently Asked Questions on the ALLL."
    - credit quality, including any changes to underwriting, account management, or collections that could affect future performance and credit losses.
    - historical credit performance and trends (e.g., delinquency roll rates and flow-to-loss) overall, by product, and by vintage within products.
    - level, trends, and performance of subprime and other higher-risk populations (e.g., over-limit accounts).
    - level, trends, and performance of cure or workout programs, including re-agings, extensions, deferrals, renewals, modifications, and rewrites.
    - levels and trends of bankruptcies and the performance of accounts in bankruptcy that remain on the bank's books (including accounts that have been reaffirmed and those that have not).
    - charge-off practices and consistency with OCC Bulletin 2000-20, "Uniform Retail Credit Classification and Account Management Policy: Policy Implementation."
    - whether bank management provides for accrued interest and fees deemed uncollectible in the allowance or in a separate reserve.
    - the effects of securitization activities, if applicable.
    - economic conditions and trends.
    - consistency with OCC Bulletin 2003-1, "Credit Card Lending: Account Management and Loss Allowance Guidance." Refer to appendix D, "Account Management and Loss Allowance Guidance Checklist," in this booklet.

Purchased Credit Card Relationships

These supplemental examination procedures should be used when a bank has significant exposure to PCCR activity.

Conclusion: Based on the responses to procedures, the quantity of risk is (low, moderate, or high) and the quality of risk management is (strong, satisfactory, or weak) for the bank's PCCR activity.

Objective: To assess the bank's purchased credit card relationships activity and to determine the implications for income as well as credit quality, program performance, and level of compliance.

Supplemental Examination Procedures

1. Determine whether the bank uses a pool-by-pool approach or an aggregate approach to determine impairment.

2. For portfolios with PCCRs, obtain and review the acquisition model(s) used in each purchase. Determine the type of model(s), such as discounted cash flow, capital flow, or return on assets, that bank management uses to acquire and value portfolios.

3. Determine how bank management uses the acquisition model(s).

4. Determine whether acquisition model(s) are well documented and periodically audited. If not, discuss with bank management and make recommendations.

5. For each model, determine whether the model was loaded with the final purchase contract terms.

    - If not, discuss with bank management why accurate final purchase contract terms should be included in the acquisition model(s) from which the true inherent discount rate can be determined.
    - Determine whether the premium booked in the final acquisition model matches the premium used in the bank's PCCR valuation and amortization model. Determine whether there is support for each component of the premium, if applicable.

6. If the model(s) are something other than a discounted cash flow model, evaluate the way bank management computed the inherent discount rate at the time of portfolio acquisition.

    - If no inherent discount rate was computed or a rate was used that is inconsistent with the inherent variability in the cash flows, assess the impact this may have on impairment testing.
    - Discuss with bank management why the correct inherent rate should be maintained to conduct valuations correctly.

7. For each model, obtain and review the most recent valuation model used for the required quarterly review. If the models are not discounted cash flow models, as required by the call report instructions, discuss with bank management the possible need to recalculate valuations.

8. Determine whether the discount factor used in each model equals or exceeds the inherent discount factor used at the portfolio's acquisition.

- If not, discuss the requirements detailed in the call report instructions.
- Discuss with bank management the possible need to recompute the impairment tests using the appropriate discount factors.

9. For each model, review the main drivers to ensure their reasonableness. Compare the drivers against the actual statistics for the prior period or prior year to determine reasonableness. If the drivers used in the quarterly valuation model(s) do not fairly represent recent trends, discuss with bank management to determine whether adjustments are required.

10. Review the amortization schedules for each model and perform the following procedures:

    - Determine whether the estimated useful life of the PCCR corresponds to the estimated life of the credit card relationships acquired. If the amortization exceeds 10 years, determine whether any adjustments are necessary.
    - Determine whether PCCRs are amortized using an accelerated amortization method.
        - If so, determine what the method is, and how it corresponds to the value of the acquired asset (e.g., 110 percent, 125 percent, 150 percent, 200 percent).
        - If a straight-line amortization method is used, determine whether any adjustments are necessary based on performance of the card portfolio.

11. The Basel III final rule changed the treatment of PCCRs for regulatory capital purposes. When fully implemented on January 1, 2018, all PCCRs must be deducted from common equity tier 1 capital. The rules provide a transition period, however, during which some PCCRs are not required to be deducted from common equity tier 1 capital.

    Examiners should refer to the call report instructions and capital policy for the specific percentages to be deducted each year during the transition period. Refer to 12 CFR 3.300(b)(1)(ii). Before full implementation on January 1, 2018, the following procedures apply:

    - Determine whether the discount factors used in the model(s) are appropriate. If not, determine what possible range of rates would be more acceptable and determine whether fair market values must be recomputed.
    - Determine the percentage of PCCRs that must be deducted from common equity tier 1 capital in accordance with 12 CFR 3.300(b)(1)(ii), table 3. During the transition period, PCCRs not required to be deducted from common equity tier 1 capital are assigned a risk weight of 100 percent.

    Beginning January 1, 2018, the following procedures apply:

    - Determine whether the discount factors used in the model(s) are appropriate. If not determine what possible range of rates would be more acceptable, and determine whether fair market values must be recomputed.
    - All PCCRs must be deducted from common equity tier 1 capital.

Third-Party or Private-Label Partner Management

These supplemental examination procedures should be used when a bank has significant exposure to third-party or private-label partner activity.

Conclusion: Based on the responses to procedures, the quantity of risk is (low, moderate, or high) and the quality of risk management (strong, satisfactory, or weak) for the bank's third-party management activities is.

Objective: To determine the extent of third-party involvement in credit card lending activities and evaluate the effectiveness of bank management's third-party oversight and risk management processes.

Supplemental Examination Procedures

Note 1: Many of these vendor-management-related procedures can be applied to the review of the relationship between the bank and its private-label partners. Examiners should select appropriate procedures to evaluate these relationships.

Note 2: These procedures apply to any arrangements with third parties to provide credit card-related services to customers on the bank's behalf. Banks may fully outsource loan originations (using telemarketers, for example), collection activities (using collection agencies or attorneys), or the offering of products in the bank's name.

Note 3: The terms "third party," "vendor," and "service provider" are used interchangeably throughout the following procedures. "Third-party relationship management" is the term used to describe the bank's process for overseeing these parties. For more information, refer to OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance," and OCC Bulletin 2002-16, "Bank Use of Foreign-Based Third-Party Service Providers: Risk Management Guidance."

1. Determine the adequacy of the bank's third-party relationship management program.

   - Assess the adequacy of the third-party relationship management policy, and determine whether analysis, documentation, and reporting requirements are clearly addressed.
   - Determine whether bank management has designated an individual to be responsible for the program and has delegated the authority necessary for effective administration of the program to that individual.
   - Review the bank's process for identifying and maintaining a complete list of third-party vendors used by the bank.
   - Review the bank's criteria for designating "critical" service providers according to the dollar amount of the contract, the importance of the service provided, and the potential risk involved in the activity.

Note: Although the third-party relationship management program should address all third-party relationships, the bank should have a more rigorous process to manage those third-party relationships deemed critical.

- Review the bank's due diligence process for selecting and monitoring third-party vendors and assess whether the process
  - provides for comprehensive, well-documented reviews by qualified staff.
  - identifies any potential conflicts of interest with bank directors, officers, staff, and their related interests.
  - addresses compliance with all applicable laws and regulations, including safety and soundness regulations and laws prohibiting lending discrimination and unfair or deceptive practices.

2. Identify service providers that provide critical credit card services on the bank's behalf, particularly those that provide loan origination, servicing, or both. Determine the bank's relationship manager for each of those service providers.
3. Verify that bank management has sufficient expertise in the outsourced activities to effectively monitor the vendor's performance and accurately identify and manage the risks involved.

4. Determine whether bank management has adequate controls, including policies and procedures and monitoring controls, to avoid becoming involved with a third party engaged in discriminatory, unfair, deceptive, abusive, or predatory lending practices. If weaknesses or concerns are identified, consult the bank's EIC or compliance examiner.

   Note: For more information, refer to the "Fair Lending" booklet of the *Comptroller's Handbook* and OCC Advisory Letter 2002-3, "Guidance on Unfair or Deceptive Acts or Practices."

5. Assess the adequacy of contract management, focusing on the process for ensuring that clauses necessary to effectively manage the vendor are included.

   - Ensure that the bank has a current contract on file for all third-party relationships and that the bank monitors key dates (e.g., maturity, renewal, and adjustment periods).
   - Review a sample of contracts with critical service providers to assess how the contracts address
     - the scope of the arrangement, including the frequency, content, and format of services provided by each party.
     - outsourcing notifications or approvals if the service provider proposes to subcontract a service to another party.
     - all costs and compensation, including any incentives.
     - performance standards, including when standards can be adjusted, and the consequences of failing to meet those standards.
     - reporting and MIS requirements.
     - data ownership and access.
     - appropriate privacy and confidentiality restrictions.

- requirements for compliance with all applicable laws and regulations, including safety and soundness regulations and laws prohibiting lending discrimination and unfair or deceptive practices.
- Third-party control functions such as quality assurance and audit, including the submission of audit results to the bank.
- expectations and responsibilities for business resumption and contingency plans.
- responsibility for consumer complaint resolution and associated reporting to the bank.
- any requirements for the third party to submit financial statements to the bank.
- appropriate dispute resolution, liability, recourse, penalty, indemnification, and termination clauses.
- authority for the bank to perform on-site reviews of third parties. **Note:** Third-party performance of services is also subject to OCC examination oversight, if warranted, in accordance with the Bank Service Company Act, 12 USC 1867(c) and 12 USC 1464(d)(7)(D).

- Determine whether the bank's monitoring of third-party relationships' adherence to their contracts (especially to financial terms and performance standards) is adequate in frequency and scope.
- Determine whether issues identified through the monitoring process are appropriately resolved in a timely manner.

6. Assess the adequacy of the monitoring process for critical third-party relationships.

- Using the sample of critical third-party relationships reviewed in procedure 5, assess whether the bank's oversight incorporates, at a minimum,
  - reports evidencing the third party's performance relative to service-level agreements and other contract provisions.
  - customer complaints and resolutions for the services and products outsourced.
  - third parties' financial statements and audit reports.
  - compliance with applicable laws and regulations.
- Evaluate whether the process results in an accurate determination of whether contractual terms and conditions are being met and whether any revisions to service-level agreements or other terms are needed.
- Verify whether bank management documents and follows up on performance, operational, or compliance problems and whether the documentation and follow-ups are timely and effective.
- Determine whether third-party relationship manager or other bank staff periodically meets with its vendors to discuss performance and operational issues.
- Determine whether third-party relationship management administers call monitoring, mystery shopper, customer callback, or customer satisfaction programs, if appropriate.
- Assess the adequacy of the bank's process for determining when on-site reviews are warranted, the scope of those reviews, and reporting of results.
- Determine whether bank management evaluates the third party's ongoing ability to perform the contracted functions in a satisfactory manner based on performance and financial condition.

7. For third-party account originators,

   - assess the adequacy of the process used to qualify third-party account originators.
   - assess the adequacy of the reports and tracking mechanisms in place to monitor performance (e.g., volume of applications submitted, approved, and booked, quality, exceptions, and performance) and relationship profitability, including performance and profitability compared with projections.
   - assess the adequacy of the process used to monitor compliance with the bank's lending policies and applicable laws and regulations, as well as its consistency with regulatory guidance.
   - verify that bank management maintains a watch list for problematic originators and that actions taken (including termination of the relationship, if warranted) are appropriate and timely.

8. Assess the adequacy of the content, accuracy, and distribution of third-party relationship management program reports.

9. Determine whether the bank has any loans to a third-party service provider in connection with its credit card lending activity and whether any conflicts of interest exist.

10. Determine whether any insiders have relationships with the third parties used by the bank and whether any potential conflicts of interest exist (e.g., an insider has ownership interests, officer or board positions, or loans to or from the third party).

11. Determine whether the bank is involved in any significant third-party relationships with deficiencies in management expertise or controls that may result in the failure to adequately identify and manage the associated risk. If so, consult the EIC and the supervisory office and determine whether it is appropriate to require that the activity be suspended pending satisfactory corrective action.

Debt Suspension and Cancellation Programs

These supplemental examination procedures should be used when a bank has significant exposure to debt suspension and cancellation activity.

Conclusion: Based on the responses to procedures, the quantity of risk is (low, moderate, or high) and the quality of risk management is (strong, satisfactory, or weak) for the bank's debt suspension and cancellation activities.

Objective: To assess the bank's debt suspension and cancellation programs and determine the implications for income, as well as for credit quality, program performance, and level of compliance.

Note: These procedures should be completed if debt suspension and cancellation products have significantly penetrated the credit card portfolio or have shown substantial growth or plans for growth. The procedures also reference 12 CFR 37, which is applicable only to national banks. Although 12 CFR 37 does not apply to FSAs, FSAs that offer DSAs and DCCs should have strong controls and risk management processes in place.

Supplemental Examination Procedures

1. Determine whether the bank offers any type of debt suspension and cancellation products.

2. Determine program features and assess the adequacy of those features, the accuracy of their description in the marketing, and the disclosures of terms and conditions provided to bank customers.

3. In national banks, determine whether marketing and promotional materials comply with 12 CFR 37.6(e).
4. Assess the adequacy of the policies, procedures, and practices in place for each product or program. Test consistency with bank guidance and compliance with 12 CFR 37 in national banks by reviewing a sample of at least 30 approved and 30 denied claims.

5. Assess compliance with 12 CFR 37 in national banks. Determine that the national bank

    - does not extend credit or alter the terms or conditions of credit conditioned upon the customer entering into a DCC or DSA (12 CFR 37.3(a)).
    - does not engage in any practice or use any advertisement that could mislead or otherwise cause a reasonable person to reach an erroneous belief with respect to information that must be disclosed under the rule (12 CFR 37.3(b)).
    - does not offer DCCs or DSAs that give the bank the right to unilaterally modify the contract or agreement unless (1) the modification is favorable to the consumer without additional charge or (2) the customer is notified of the proposed change and given a reasonable opportunity to cancel the contract without penalty before the change becomes effective (12 CFR 37.3(c)(1)).
    - does not provide customers a no-refund DCC or DSA unless it also offers a comparable product that provides for a refund of any unearned fees paid for the contract if the contract is terminated (12 CFR 37.4(a)).
    - obtains a customer’s written acknowledgement to purchase a contract and written acknowledgement that the customer received the long-form disclosures (12 CFR 37.7(a)).

    In addition,

    - if the national bank sells a contract over the telephone, confirm that the bank
        - maintains sufficient documentation to show that the customer received the short-form disclosures and affirmatively elected to purchase a contract or agreement (12 CFR 37.7(b)(1)).
        - mails the affirmative written election and written acknowledgement together with the long-form disclosures to the customer within three business days after the telephone solicitation and maintains sufficient documentation to show it made

    reasonable efforts to obtain the documents from the customer (12 CFR 37.7(b)(2)).
  - permits the customer to cancel the purchase of the contract or agreement without penalty within 30 days after the bank has mailed the long-form disclosures to the customer (12 CFR 37.7(b)(3)).
- if the bank or vendor sells a contract over the telephone, review the telemarketing scripts or listen to calls to assess compliance with 12 CFR 37.
- if a contract is solicited through written materials, such as inserts or "take-one" applications, and the national bank provides only the short-form disclosures, confirm that the bank
  - mails the acknowledgement of receipt of disclosures, together with the long-form disclosures, to the customer within three business days, beginning on the first business day after the customer contacts the bank or otherwise responds to the solicitation (12 CFR 37.7(c)).
  - does not obligate the customer to pay for the contract until after the bank receives the customer's written acknowledgment of receipt of disclosures, unless the bank
    - maintains sufficient documentation to show that it provided the acknowledgement of receipt of disclosures to the customer (12 CFR 37.7(c)(1)).
    - maintains sufficient documentation to show it made reasonable efforts to obtain from the customer a written acknowledgement of receipt of the long-form disclosures (12 CFR 37.7(c)(2)).
    - permits the customer to cancel the purchase of the contract or agreement without penalty within 30 days after the bank has mailed the long-form disclosures to the customer (12 CFR 37.7(c)(3)).

6. Select a sample of accounts in which the borrower terminated DCCs and DSAs to determine that the national bank

   - refunded to the customer any unearned fees paid unless the contract provided otherwise (12 CFR 37.4(a)).
   - calculated the amount of refund using a method at least as favorable to the customer as the actuarial method (12 CFR 37.4(b)).

7. Through discussions with lending officers and a review of the national bank's training program, determine whether personnel provide and are trained to provide

   - short-form disclosures orally at the time the bank first solicits the purchase of a contract (12 CFR 37.6(c)(1)).
   - long-form disclosures in writing before the customer completes the purchase of the contract (12 CFR 37.6(c)(2)).
   - long-form disclosures in writing to the customer if the initial solicitation is in person (12 CFR 37.6(c)(2)).
   - short-form disclosures orally to the customer and to mail long-form disclosures, with a copy of the contract, if appropriate, to the customer within three business days after a telephone solicitation (12 CFR 37.6(c)(3)).

- long-form disclosures that are mailed to the customer within three business days, beginning on the first business day after a customer responds to a mail insert or "take-one" application (12 CFR 37.6(c)(4)).
- disclosures, if provided through electronic media, that are consistent with the Electronic Signatures in Global and National Commerce Act of 2000 (15 USC 7001 *et seq*.) requirements (12 CFR 37.6(c)(5)).

8. Ensure that the national bank complies with the disclosure requirements of 12 CFR 37, "Debt Cancellation Contracts and Debt Suspension Agreements," by completing appendix E, "Debt Suspension Agreement and Debt Cancellation Contract Forms and Disclosure Worksheet," of this booklet.

9. Assess the quality of the MIS used to monitor and administer DSAs and DCCs. At a minimum, the bank's monthly reports should be sufficient to accurately ascertain
   - enrollment volume and trends, including
     – number and account balances of accounts enrolled in the program.
     – cancellation rate, segmented by customer versus bank closure.
   - application and activation volume and trends, including
     – average claim processing time, by type.
     – benefit application, approval, decline, and fallout[48] rates.
     – number and account balances of accounts in benefit status.
     – average duration of benefit period by type and aging of active benefits (time to benefit exhaustion).
     – delinquency status of accounts in active benefit status, by type.
     – performance of accounts subsequent to benefit denial, fallout, and benefit exhaustion.
   - profitability, including
     – fee income generated.
     – average APR of enrolled and activated accounts.
     – costs, including retroactive adjustments, of active benefits, by type.

   Note: If the bank securitizes assets, the above information should be broken down by receivable ownership (bank, trust, trust series, etc.), and aggregated for the managed portfolio overall. The information should be used to evaluate program performance (current and trends, operational issues, etc.) and pricing, to establish adequate debt waiver interest and fee reserves, to set the amount of a trust's remittance (if any), and to analyze the ALLL.

10. Evaluate the quality and frequency of the analyses performed.

    - Determine whether bank management analyzes the performance of accounts and whether the analysis includes the performance of accounts, by type of benefit claimed (e.g., unemployment, medical) for the following types of accounts:
      – Accounts with denied claims.

[48] Fallout refers to failure to satisfactorily complete the claim.

  - Accounts with claims that are not completed after initial notification to the bank.
  - Accounts for which benefits have expired.
- Determine whether the accounts above perform differently from the rest of the portfolio. If so, assess whether the performance difference is appropriately incorporated into the allowance analysis.
- Confirm the bank's analysis by reviewing a sample of accounts that came off benefits six months ago. Determine the current payment status of those accounts.

11. Determine whether the bank administers DSA and DCC programs in-house or if they are outsourced to an affiliate or third party. If they are outsourced, review the governing contract, costs, and the controls in place to monitor performance and compliance with all applicable laws and regulations.

12. Evaluate the accounting and profitability of each program by

    - assessing the bank's accounting for income and expenses.
    - ensuring that the bank maintains an adequate reserve for claims, if applicable.
    - assessing the significance of debt waiver income to the bank's total income, and evaluating income sustainability in view of program volume, claims experience, and cancellation rates, at a minimum.
    - if the program is offered for accounts that are securitized, determining the bank's responsibility for income sharing and claims payments and reviewing the supporting accounting entries. Confirm that trust reimbursements are accurate and timely.

13. Complete appendix F, "Debt Suspension and Cancellation Product Information Worksheet," of this booklet, and retain a copy in the examination work papers.

Reserving for Rebate Programs

These supplemental examination procedures should be used when a bank has significant exposure to rebate activity.

Conclusion: Based on the responses to procedures, the quantity of risk is (low, moderate, or high) and the quality of risk management is (strong, satisfactory, or weak) for the bank's rebate activities.

Objective: To assess the bank's reserving for rebate programs and determine the implications for income, as well as for program performance.

Supplemental Examination Procedures

1. Determine whether the issuer has any liability on any rebate program that it offers and how that liability is calculated. If the issuer has no rebate liability, obtain an analysis as to why there is no liability for the issuer. Document your findings in the work papers.

2. If the issuer is reserving for future redemption liability, review the general ledger account activity and supporting analysis and assess the appropriateness of the reserve level based on redemption activity.

3. Determine, based on the reviews of the financial condition of the issuer's partners, whether any partner's financial condition may be questionable.

4. Review each product that has a rebate and for each program determine

   - the outstanding rebate reserve.
   - the redemption volume in recent months.
   - the process by which the customer redeems the rebates.
   - whether outside vendors are used.
5. Determine whether the contract limits the issuer's liability for certain items, such as rising airline ticket costs.

6. If the issuer pre-purchases rewards (e.g., airline points), assess whether the accounting for these purchases is consistent with GAAP.

7. In conjunction with the examiner performing the profitability analysis, determine the profitability for each product that offers a rebate and compare the results with the profitability of products that do not offer rebates.

Program Availability and Eligibility Standards

Conclusion: Based on the responses to procedures, the quantity of risks is (low, moderate, or high) and the quality of risk management is (strong, satisfactory, or weak) for the bank's activities to determine program availability and eligibility standards.

Objective: To evaluate the policies and procedures that bank management has established setting forth program availability and eligibility criteria that a consumer must meet to obtain a credit card.

Supplemental Examination Procedures

1. Determine whether bank management has established policies and procedures that set forth the availability and eligibility standards that a consumer must meet to obtain a credit card.

   - Review the policies and procedures that have been established to ascertain whether eligibility standards (e.g., relationship history, deposit history, incidence of default or bankruptcy) are set forth.

2. Determine whether the bank gathers sufficient information to determine that a consumer meets the bank's eligibility standards, and whether the bank satisfies the requirement in 12 CFR 1026.51 to evaluate a consumer's ability to pay, before approving the consumer

for a credit card. This information can be provided by the consumer on an application or collected from internal or external information sources.

3. Determine whether the bank's policies and procedures clearly identify each credit card product.

    - Review the bank's marketing materials to evaluate whether all available credit card products are adequately described.
    - Obtain a list of all available products to evaluate and compare with the bank's policies and procedures. Product features to evaluate include
        - whether product features are clearly identified by the bank.
        - whether the bank has clearly identified the eligibility and credit criteria that the consumer must meet to be approved for the loan.

Credit Terms and Methods of Payment

Conclusion: Based on the responses to procedures, the quantity of risk is (low, moderate, or high) and the quality of risk management is (strong, satisfactory, or weak) for the bank's credit terms and repayment activities.

Objective: To determine whether the bank has made approval of credit cards conditional on the consumer agreeing to repay the credit line by means of preauthorized electronic fund transfers.

Supplemental Examination Procedures

1. Has the bank conditioned the credit card on the consumer's repayment by preauthorized electronic fund transfers? Refer to 12 CFR 1005.10(e), which generally prohibits making an extension of credit to a consumer conditional on the consumer's repayment by preauthorized electronic fund transfers.

2. Does the product offer a reduced APR or other cost-related incentive to induce the consumer to accept an automatic repayment feature? If so, are other reasonable loan repayment options offered by the bank for the credit card?

3. Determine whether the bank requires consumers participating in automatic repayment by preauthorized electronic fund transfers to maintain a specified minimum balance in the consumer's account.

Credit Reporting

Conclusion: Based on the responses to procedures, the quantity of risk is (low, moderate, or high) and the quality of risk management is (strong, satisfactory, or weak) for the bank's credit reporting activities.

Objective: To assess whether the bank reports payment information to credit bureaus and/or consumer reporting agencies (CRA). If the bank reports payment or other consumer information to credit bureaus and/or CRAs, assess the bank's program for reporting consumer performance regarding credit card accounts.

Supplemental Examination Procedures

Note: Creditors are not legally required to report to CRAs or to consumer credit bureaus. If a creditor does report consumer information to a CRA or credit bureau, however, then the creditor must comply with the timing and accuracy requirements of the FCRA, implemented by 12 CFR 1022, "Fair Credit Reporting" (Regulation V). Reporting this information may improve the credit score of a consumer making timely payments.

1. Determine whether the bank maintains policies and procedures for reporting consumer information to credit bureaus.

2. Determine whether the bank reports consumer payment information to credit bureaus and/or CRAs.

Refer to OCC Bulletin 2008-28, "Fair Credit Reporting Act (FCRA): Additions to FCRA Examination Procedures," and the attached "Interagency FCRA Examination Procedures" (including module 4, "Duties of Users of Consumer Reports and Furnishers of Consumer Report Information," and appendix A, "Examination Procedures").

Also refer to OCC Bulletin 2009-23, "Fair Credit Reporting: Accuracy and Integrity of Consumer Report Information and Direct Consumer Dispute Regulations and Guidelines: Final Rules and Guidelines Together With Advance Notice of Proposed Rulemaking." Examiners may also refer to the *OTS Examination Handbook*, section 1300, "Fair Credit Reporting Act," and related "Program."

The final rules and guidelines,[49] as well as the related advance notice of proposed rulemaking, which were published in the *Federal Register* on July 1, 2009, implement section 312 of the FACT Act.

Compliance with Consumer Protection Laws and Regulations

Conclusion: Based on the responses to procedures, the quantity of risk is (low, moderate, or high) and the quality of risk management is (strong, satisfactory, or weak) for the bank's compliance activities.

Objective: To evaluate whether the credit card and the manner in which it is offered or marketed complies with all applicable consumer protection statutes and regulations. Applicable laws vary, depending on the characteristics of the specific product and may include TILA,

[49] These have since been transferred to 12 CFR 1022.

including the CARD Act; the ECOA; EFTA; sections 1031 and 1036 of Dodd–Frank Act; and section 5 of the FTC Act.

Supplemental Examination Procedures

Note: Depending on the focus of any particular review, the examiner undertaking reviews for compliance with consumer protection laws should further consult the relevant *Consumer Compliance* series booklet of the *Comptroller's Handbook* for more information and complete examination procedures. While the procedures in the "Credit Card Lending" booklet include some consumer compliance requirements, they are not intended to be comprehensive.

1. Verify that the bank has sufficient policies, procedures, and staff to comply with consumer protection laws and regulations that concern credit cards, and verify that related bank activities are executed in conformity with board-approved strategies and processes and comply with legislative and regulatory requirements.

    - Determine how policies and changes are communicated to staff and assess the adequacy of the process.
    - Evaluate the bank's process for establishing policy exception criteria and limits and for monitoring and approving underwriting policy exceptions (e.g., underwriting standards, loan terms).
    - Determine the control processes in place to track and monitor policy adherence (e.g., quality assurance, MIS reports, and audit) and assess the adequacy of those processes.

2. Determine whether marketing activities are consistent with relevant consumer protection laws and related policies and procedures.

    - Review the process for developing and implementing marketing plans, with particular attention to whether the relevant functional areas (e.g., compliance) are involved throughout the process.
    - Develop conclusions about whether marketing activities comply with consumer protection laws and regulations and are consistent with related policies and procedures, and assess whether appropriate controls and systems are in place before new credit card products or marketing initiatives are rolled out.

Conclusions

Conclusion: The aggregate level of risk is (low, moderate, or high). The direction of risk is (increasing, stable, or decreasing).

Objective: To determine, document, and communicate overall findings and conclusions regarding the examination of credit card lending.

1. Determine preliminary examination findings and conclusions and discuss with the EIC, including

   - quantity of associated risks (as noted in the “Introduction” section of this booklet). Interest rate, liquidity, and compliance assessments should be coordinated with examiners assigned to review those risks.
   - quality of risk management.
   - aggregate level and direction of associated risks.
   - overall risk in credit card lending.
   - Credit Underwriting Assessment findings and conclusions, if applicable. (Updated June 16, 2016)
   - matters requiring attention, violations, and other concerns.

<table>
<tr><th colspan="5">Summary of Risks Associated With Credit Card Lending</th></tr>
<tr><th>Risk category</th><th>Quantity of risk
(Low, moderate, high)</th><th>Quality of risk management
(Weak, satisfactory, strong)</th><th>Aggregate level of risk
(Low, moderate, high)</th><th>Direction of risk
(Increasing, stable, decreasing)</th></tr>
<tr><td>Credit</td><td></td><td></td><td></td><td></td></tr>
<tr><td>Interest rate</td><td></td><td></td><td></td><td></td></tr>
<tr><td>Liquidity</td><td></td><td></td><td></td><td></td></tr>
<tr><td>Operational</td><td></td><td></td><td></td><td></td></tr>
<tr><td>Compliance</td><td></td><td></td><td></td><td></td></tr>
<tr><td>Strategic</td><td colspan="2" rowspan="2"></td><td></td><td></td></tr>
<tr><td>Reputation</td><td></td><td></td></tr>
</table>

2. If substantive safety and soundness concerns remain unresolved that may have a material adverse effect on the bank, further expand the scope of the examination by completing verification procedures.

3. Discuss examination findings with bank management, including violations, recommendations, and conclusions about risks and risk management practices. If necessary, obtain commitments for corrective action.

4. Compose conclusion comments, highlighting any issues that should be included in the report of examination. If necessary, compose a matters requiring attention (MRA) comment.

5. Complete the applicable Credit Underwriting Assessment in Examiner View for credit card lending, if included in the examination scope. (Updated June 16, 2016)

6. Update the OCC's information system and any applicable report of examination schedules or tables.

7. Write a memorandum specifically setting out what the OCC should do in the future to effectively supervise credit card lending in the bank, including time periods, staffing, and workdays required.

8. Update, organize, and reference work papers in accordance with OCC policy.

9. Ensure any paper or electronic media that contain sensitive bank or customer information are appropriately disposed of or secured.

Internal Control Questionnaire

An ICQ helps an examiner assess a bank's internal controls for an area. ICQs typically address standard controls that provide day-to-day protection of bank assets and financial records. The examiner decides the extent to which it is necessary to complete or update ICQs during examination planning or after reviewing the findings and conclusions of the core assessment.

Policies

1. Has the board committee or the board of directors (depending on the risk profile of the bank), consistent with its duties and responsibilities, adopted written policies that establish

   a. procedures for reviewing credit card applications?
   b. standards for determining credit lines?
   c. minimum standards for documentation?
   d. standards for collection procedures?
   e. third-party relationship management?

2. Are policies reviewed at least annually to determine whether they are compatible with changing market conditions and the bank's strategic plan?

Underwriting and Scoring Models

3. Does audit or internal loan review test compliance with underwriting standards?

4. Are underwriting standards periodically reviewed and revised?

5. If credit scoring models are used,

   a. are credit limits determined by cutoff scores?
   b. are models periodically (e.g., quarterly or annually) revalidated for accuracy and stability?
   c. are there written internal procedures governing overrides?

6. Are data from the application tested for input accuracy to the account processing system? If so, what is the sample size and frequency of the test?

7. Are line of credit increases reviewed periodically by an independent person to determine compliance with bank policy and procedures?

8. Does an independent person periodically review credit lines for appropriateness of amount?

9. Are procedures in effect to review credit lines when the bank becomes aware of a change in financial status or creditworthiness of a cardholder?

10. Is an exception report produced and reviewed by bank management that tracks change in customer account status due to credit card re-agings, temporary and permanent hardship programs, settlement agreements, or other factors?

11. Does the bank prepare reports that document the daily balance of issued cards to the reported total of new and reissued cards?

12. Does the bank have procedures covering the establishment of employee accounts?

13. Are employee accounts periodically reviewed?

14. Has the bank established a policy on cash advances to employees?

15. Is the information on fraud claims reviewed to determine whether

    a. a bank employee could have been involved?
    b. a breakdown in the bank's control over issued cards is indicated?
    c. the card information could have been extracted before the card left the bank?

16. Are signatures on sales drafts compared with signatures on notifications when the owners of cards disclaim knowledge of sales or claim that cards were lost?

17. Is an officer required to sign off at the conclusion of a fraud investigation?

18. Does the credit card operation prepare a budget by

    a. function (e.g., collections, application processing)?
    b. program (e.g., secured card, private-label)?
    c. overall operation?

19. Are actual results compared to budget at least monthly?

20. Are significant trends and deviations adequately explained in the financial review process?

Risk Management

21. Does bank management develop and maintain written underwriting and account management policies?

22. Does bank management monitor adherence to those policies?

23. Does bank management ascertain the quality of the portfolio and assign risk ratings?

24. Does bank management periodically review policies and procedures to ensure that they remain appropriate and consistent with the bank's risk management objectives and to assess their impact on portfolio quality?

25. Does bank management ensure the integrity of scoring systems and other models in use?

26. Does bank management have appropriate policies and processes in place to manage and monitor third-party vendors?

27. Do asset securitizations receive appropriate approval?

28. Are collection programs for securitized loans appropriate?

29. Does bank management have a plan to ensure adequate funding for maturing securitizations?

Conclusion

30. Does the foregoing information confirm that there is an appropriate basis for evaluating the bank's internal controls over its credit card operations, and further, that there are no significant additional internal auditing procedures, accounting controls, administrative controls, or other circumstances that impair any controls or mitigate any weaknesses indicated above? (Explain negative answers briefly, and indicate conclusions as to their effect on specific examination or verification procedures.)

31. Based on the answers to the foregoing questions, internal control for credit card lending is considered________ (strong, satisfactory, or weak).

Verification Procedures

Verification procedures are used to verify the existence of assets and liabilities, or to test the reliability of financial records. Examiners generally do not perform verification procedures as part of a typical examination. Rather, verification procedures are performed when safety and soundness concerns are identified that are not mitigated by the bank's risk management systems and internal controls.

1. Test the additions of the trial balances and the reconciliation of the trial balances to the general ledger. Include loan commitments and other contingent liabilities.

2. After selecting loans from the trial balance by using an appropriate sampling technique (refer to the "Sampling Methodologies" booklet of the *Comptroller's Handbook* for information on sampling techniques),

   - prepare and mail confirmation forms to borrowers. (Loans serviced by other institutions, either whole loans or participations, are usually confirmed only with the servicing institution. Loans serviced for other institutions, either whole loans or participations, should be confirmed with the buying institution and the borrower. Confirmation forms should include borrower's name, loan number, credit line, interest rate, and current loan balance).
   - after a reasonable time, mail second requests.
   - follow up on any unanswered requests for verification or exceptions and resolve differences.
   - examine credit agreements for completeness and compare credit agreement date, original line amount, and terms with trial balance.
   - check whether required officer approvals are documented on the loan system.
   - check whether the credit agreement is signed, appears to be genuine, and is negotiable.

3. Review accounts with accrued interest by

   - reviewing and testing procedures for accounting for accrued interest and for handling adjustments.
   - scanning accrued interest for any unusual entries and following up on any unusual items by tracing them to initial and supporting records.

4. Using a list of nonaccruing loans, check loan accrual records to determine that interest income is not being recorded.

5. Obtain or prepare a schedule showing the monthly interest income amounts and the loan balance at the end of each month since the last examination, and

   - calculate yield.
   - investigate any significant fluctuations or trends.

Appendixes

Appendix A: Transaction Testing

Overview

Examiners should perform testing procedures to verify a bank's compliance with its own policies and procedures and with laws and regulations, as well as its consistency with guidance. Examiners also use testing to assess the bank's risk selection, the adequacy and accuracy of its MIS, and the adequacy and accuracy of its loan accounting and servicing. Testing procedures usually should be performed to some degree in all credit card examinations.

These procedures recommend judgmental sample sizes. The sample size and targeted portfolio segment may be modified to fit the circumstances. The sample selected should be sufficient in size to reach a supportable conclusion. Increase the sample size if questions arise and more evidence is needed to support the conclusion.

Examiners may want to consider using a statistical sampling process for reaching conclusions on an entire portfolio. Performing statistically valid transaction testing on portfolios of homogeneous retail accounts is extremely effective. The benefits of statistical sampling allow examiners to quantify the results of transaction testing and state with confidence that the results are reliable. For more information, consult the "Sampling Methodologies" booklet of the *Comptroller's Handbook*.

Examiners conducting testing should be alert for potential discriminatory, unfair, deceptive, abusive, or predatory lending practices (e.g., providing misleading disclosures). If weaknesses are found or other concerns arise, consult the bank's EIC or compliance examiner.

Note: For more information, refer to the "Fair Lending" booklet of the *Comptroller's Handbook* and OCC Advisory Letter 2002-3, "Guidance on Unfair or Deceptive Acts or Practices."

Suggested Transaction Testing Samples

Note: Sample sizes are suggestions only. The sample selected should be sufficient in size to reach a supportable conclusion. Expand the sample size if issues are found or if more evidence is needed to support a conclusion. Please refer to the "Sampling Methodologies" booklet of the *Comptroller's Handbook*.

Underwriting

Objective: Determine the quality of new accounts and risk selection. Determine adherence to lending policy, underwriting standards, and pricing standards.

Sample size – 30	Accounts booked in last 90 days. • Include coverage of all significant product types. • Include all or target certain acquisition channels. • Include different price points.

Sample size – 10 from **each** significant third-party origination channel	Accounts approved and booked in last 90 days. • Include all significant third-party loan originators.

Sample size – 30	Accounts declined in last 90 days. • Include coverage of all significant product types. • Include all or target certain acquisition channels. • Focus on applications not automatically denied if credit scoring is used.

Lending Policy Exceptions

Objective: Evaluate the quality and appropriateness of exceptions to lending policy.

Sample size – 30	Accounts booked in last 90 days. • Include all exception codes. • Include coverage of all significant product types. • Include accounts with exceptions from all significant third-party loan originators. • If exception coding is deficient, filter new accounts for exceptions to criteria for debt-to-income, credit history, etc., and select sample from results.

Overrides

Objective: Evaluate the quality and appropriateness of low-score overrides.

Sample size – 30	Accounts booked in last 90 days. • Select accounts that scored below cutoff and were approved. • Include all score-override reason codes. • Include accounts in all score bands below the cutoff.

Line Increases

Objective: Evaluate the change in credit risk and appropriateness of line increases.

Sample size – 30	Accounts with **automatic** line increases in last 180 days. • Select accounts from different products. • Select accounts from a full range of risk scores, but select proportionately more accounts with lower scores. • Include accounts with line utilization greater than 75 percent. • Test for consistency with credit criteria. • Evaluate the size of the line increase relative to creditworthiness. • Consider how much credit risk is added to the portfolio.

Sample size – 30	Accounts with **manual** line increases in last 90 days. • Select accounts from different products. • Include accounts with line utilization greater than 75 percent. • Include accounts in over-limit status. • Test for consistency with credit criteria. • Evaluate the size of the line increase relative to creditworthiness. • Consider how much credit risk is added to the portfolio.

Over-Limits

Objective: Evaluate the quality of accounts in over-limit status.

Sample size – 30	Accounts with balances that equal or exceed the assigned credit limit by a certain threshold (such as 20 percent or more) as of last statement cycle date. • Verify why accounts are over credit limits and if there are any authorization issues, NSF, or other issues involved. • Verify when over-credit-limit (OCL) fees are imposed and when OCL fees are suspended. • Verify how the minimum payment is calculated. • Evaluate sample for accounts with negative amortization. • Determine length of time accounts have been in OCL status.

Collection Activities

Objective: Evaluate appropriateness of collection activities and consistency with OCC Bulletin 2000-20, "Uniform Retail Classification and Account Management Policy: Policy Implementation." **Note:** Refer also to the checklist in appendix C of this booklet.

Re-Aging

Sample size – 30	Accounts that received automated collection (non-customer-service) re-aging in past three months. • Check consistency with OCC Bulletin 2000-20 and bank policies.

Sample size – 30	Accounts that received manual collection (non-customer-service) re-aging in the past three months. • Check consistency with OCC Bulletin 2000-20 and bank policies.

Sample size – 30	Accounts that received customer service re-aging for more than one delinquency cycle (i.e., accounts greater than 30 days past due when re-aged) in the past three months. • Check consistency with OCC Bulletin 2000-20 and bank policies.

Workout and Forbearance Programs

Sample size – 30 per program	Accounts in 1) external workout programs (such as CCC) and 2) internal permanent workout programs. • Include any program with payment amount, interest, or fee modification. • Verify how the minimum payment is calculated. • Select 50 percent of the sample from accounts that entered the program in the last quarter. • Evaluate the reasonableness of forbearance programs, e.g., qualifying criteria, interest rate, payment amount, and repayment period. • Verify that the account balance will amortize in no more than 60 months and that exceptions are limited, reported, and tracked • Verify compliance with internal policies and procedures. • Determine the length of time in temporary hardship program, if any. • Be alert to the movement of accounts from one program to another.

Sample size – 30 per program	Accounts in temporary hardship programs as of the examination date. • Evaluate the reasonableness of forbearance programs, e.g., qualifying criteria, interest rate, payment amount, and repayment period. • Determine that borrower hardship is documented and supportable as temporary. • Verify compliance with internal policies and procedures. • Verify how the minimum payment is calculated. • Be alert to the movement of accounts from one program to another.

Deceased Borrower Accounts

Sample Size – 30	Accounts coded as deceased 90–120 days before examination date • Verify compliance with internal policies and procedures. • Ensure charge-off within 60 days of notification or 180 days delinquent, whichever is shorter. • Policies and procedures should ensure timely settlement with executor or administrator of deceased's account and recognize there are fee and interest restrictions.[50]

Bankruptcy

Sample size – 30 per loan type	Accounts coded as bankrupt as of examination date. • Include borrowers in chapter 7 and chapter 13. • Assess for consistency with OCC Bulletin 2000-20 and bank policies such that charge-off generally occurs within 60 days of notification of bankruptcy filing or 180 days delinquent, whichever is shorter.

Settlement

Sample size – 30	Accounts with settlement agreements in the past three months. • Verify compliance with internal policies and procedures. • Evaluate reasonableness of the repayment period. • Determine appropriateness of loan allowance and charge-offs.

Was Past Due, Now Current

Sample size – 30	Accounts that were 90 days or more past due as of three billing cycles ago, but current as of next billing cycle. • Include accounts with NSF check payments, if possible. • Check compliance with FFIEC and bank policies. • Determine how the account returned to current status and the appropriateness of the method of return. • Assess the accuracy of the loan accounting system and delinquency reporting. • Consider the impact of any irregularities on roll rates and loan-loss method.

Exceptions to Charge-Off Policy

Sample size – 30	Accounts more than 180 days past due as of examination date. • Include accounts from each product type. • Verify consistency with OCC Bulletin 2000-20 and bank policies. • Evaluate whether exceptions to bank policy are appropriate.

[50] Refer to 12 CFR 1026.11(c).

Charge-Off Postmortem

Sample size – 30	Recently charged-off accounts. • Include accounts from each product type. • Verify consistency with OCC Bulletin 2000-20 and bank policies. • Review borrower, payment, and collection histories to determine whether actions taken pre-charge-off were reasonable or if the practices deferred loss recognition. • Evaluate whether exceptions to bank policy are appropriate.

Fraud

Objective: Assess adherence to policy, determine propriety of practices, and determine timeliness of charge-off policies.

Sample size – 30	Accounts identified as fraud, in part or total. • Determine whether accounts identified as fraud are being investigated. • Verify compliance with bank's policy and procedures, including what is considered fraud. • Determine whether fraud losses are properly identified as fraud losses rather than credit losses. • Determine compliance with charge-off time frames. • Assess adequacy of processes to investigate and report suspicious activity in a timely manner.

DSA and DCC Programs

Objective: Verify how product is managed.

Sample size – 30	Accounts with DCCs. • Include accounts in both pending and activated status. • Assess adequacy of account management processes, e.g., activation, accounting, re-aging, MIS. • Verify compliance with bank's policy and procedures. • Verify compliance with 12 CFR 37 in national banks.

Sample size – 30	Accounts with debt suspension agreements. • Include accounts in both pending and activated status. • Assess adequacy of account management processes, e.g., activation, accounting, re-aging, MIS. • Verify compliance with bank's policy and procedures. • Verify compliance with 12 CFR 37 in national banks.

Minimum Payment

Objective: Verify how the minimum payment is computed.

Sample size – 30	Accounts for each product type. • Include accounts in over-limit status, those in temporary hardship and workout programs, and those with the credit protection feature. • Verify that product control file settings are consistent with bank's policy and are appropriate.

Appendix B: Suggested Request Items for Credit Card Lending Activities

Please provide the following information for credit card lending operations as of the close of business (DATE), unless otherwise indicated. Information in an electronic format is preferred. If submitting hard copies, please prominently mark any information or documentation that is to be returned to the bank.

Our intent is to request information that can be easily obtained. If you find that the information is not readily available or requires significant effort on your part to prepare, please contact us before compiling the data.

Please note that this list is not all-inclusive, and that we may request additional items during the course of our examination.

General

1. Summary of each credit card product offered, and a brief description of characteristics and terms. Include descriptions of debt suspension and debt cancellation programs offered, if any. Also, include marketing or acquisition channels used (e.g., direct, Internet, mail, and third-party originators), where applicable.

2. Descriptions of any new or expanded products or marketing initiatives since the last examination and any upcoming plans, including information on any prescreening programs.

3. Descriptions of any third-party relationships applicable to credit card products, including but not limited to loan generation, servicing, and collection.

4. Descriptions of any credit card portfolios acquired since the last examination, including due diligence reports.

Management and Supervision

Note: During the supervisory activity, examiners may request, review, and discuss individual managers' performance appraisals.

5. An organization chart(s) for the bank's, division's, and department's current structure. Include all key managers, the number of people in each department, and approved but unfilled positions.

6. A list of primary contacts, including contact numbers.

7. Job descriptions and brief resume or work experience summary for all key managers.

8. A list of board and relevant senior management committees that provide oversight, including a list of members and meeting schedules.

9. Minutes of board and relevant senior management committees for the most recent full year and year to date. Include any relevant reports provided to the committees.

10. Most recent strategic plan with details of any assumptions used to prepare the plan. Include marketing plans and forecasts.

11. Summaries of all incentive programs in effect.

12. A list of all key reports used by bank management to monitor the business, including frequency, distribution, and the person or unit responsible for report preparation.

13. Access to suspicious activity reports (SAR) filed with the Financial Crimes Enforcement Network (FinCEN) during the review period and the supporting documentation. Include copies of any filed SARs that were related to requests for information under section 314(a) or 314(b) of the USA Patriot Act of 2001.

14. Any analysis or documentation of any activity for which a SAR was considered but not filed, and for which the bank is actively considering filing a SAR.

15. Copies of reports used for identification of and monitoring for suspicious transactions.

16. If not already provided, copies of other reports that can pinpoint unusual transactions warranting further review.

17. A listing or summary of what board or management has determined are the bank’s critical vendors and service providers in the credit card area

Financial Performance

18. Financial and profitability performance indicators for the most recent year-end and year to date. Copies of balance sheets and income statements from the most recent year-end and for the year to date, including budget data for comparison purposes.

19. Most recent credit card budget, with details of any assumptions used to prepare. Include any year-to-date budget variances and plan revisions as of the examination date.

20. Profitability reports for each major credit card product as of the examination date and the most recent year-end.

21. A summary of any profitability models used and current rate and fee schedule for each product.

Control Systems (Risk Management, Loan Review, Quality Assurance, Audit)

22. Relevant reports issued by internal and external audit, quality assurance, compliance management, and loan review since the last examination. Include bank management's responses.

23. Access to policies and procedures for major functional areas, including underwriting, account management, collections, loan-loss reserves, and quality assurance.

24. A chronology log of significant policy changes and other events relevant to the credit card portfolio's performance.

25. Risk management reports and analyses used to monitor performance of the credit card portfolio and individual products.

26. Loan volume reports by number and dollar amount for the entire credit card portfolio and individual product.

27. Summary of monthly delinquency and net loss reports for the most recent year-end and year to date for the credit card portfolio and individual products. Also provide any vintage analysis, dynamic delinquency, and loss analysis completed to monitor the portfolio. Include other credit performance analyses you feel are pertinent.

28. An overview of the scorecards used, if any, and summary of any changes planned.

29. Most recent model validation reports for each scorecard used.

30. Model development documentation for each scorecard or model within the scope of the examination.

31. Risk score distributions and migration trends.

32. Most recent loss forecasts.

33. If third-party originators are used, MIS used to monitor quality of applicants and credit performance of loans sourced from each third party used.

34. Description of controls (e.g., financial and audit requirements) and performance reports used to monitor the quality of service of third parties, as well as due diligence criteria used to select third parties for credit card lending activities.

Underwriting

35. Risk management reports used to monitor and analyze applicant quality and trends. Include application-tracking trend reports for the most recent year-end and year to date.

Depending on the portfolio, information may include applications submitted, approved, booked, and denied, and underwriting criteria, such as credit score and debt-to-income distributions or measures.

36. Reports used to track productivity and compliance with policy.

37. Reports used to monitor underwriting policy exceptions and overrides. Please include any analyses of subsequent performance by type of exception.

Collections

38. An overview of how the bank achieves consistency with OCC Bulletin 2000-20, "Uniform Retail Classification and Account Management Policy: Policy Implementation."

39. Volume and trends for re-aging activities, if any, including subsequent performance monitoring.

40. Volume and trends of accounts in workout programs (e.g., CCC) or other forbearance programs, including subsequent performance monitoring.

41. Problem loan list with credit risk classifications and criteria for assigning these risk classifications.

42. Loan-loss postmortem reviews from the most recent year-end and for year to date.

43. MIS reports used to manage and measure the effectiveness of the collection area (e.g., roll rates, dollars collected, and promises to pay).

44. MIS reports detailing the number and dollars of first payment defaults. If available, include monthly reports for the past 12 months.

Allowance for Loan and Lease Losses

45. Most recent ALLL analysis for the credit card portfolio. Include a complete description of the method and assumptions used.

Other Areas of Interest

46. Consumer debt sales charged off as debt to third parties. Refer to OCC Bulletin 2014-37, "Consumer Debt Sales: Risk Management Guidance."

47. Consumer complaint logs since the last examination.

48. Description of litigation, either filed (by bank or customer) or anticipated, associated with the bank's credit card activities. Include expected costs or other implications.

49. If debt suspension or debt cancellation products are offered, MIS used to monitor product performance. Include information for product penetration, claims rates (approved and denied), reserve method and balances, and profitability.

Transaction Testing

Examiners will conduct transaction testing to verify compliance with the bank’s policies and procedures; assess risk selection; determine accuracy of MIS; verify compliance with the applicable policies, laws, and regulations; or determine the accuracy of loan accounting and servicing.

50. Please provide electronic files for each major product that will allow an examiner to select a sample to conduct the testing. The files should be provided in a format compatible with the National Credit Tool or in an Excel worksheet that includes relevant loan information, including

    - account number,
    - customer name,
    - booking date,
    - loan amount,
    - payment information,
    - current payment due,
    - last payment date,
    - loan term,
    - interest rate,
    - delinquency status,
    - risk score, and
    - repayment capacity measure.

    Areas to be tested include the following:

    - Accounts approved in the last 60 days (since DATE). If credit scoring is used, provide two files, one for accounts not automatically approved and one for accounts automatically approved.
    - Accounts approved in the last 60 days (since DATE) that would have been denied except for an override or exception to policy.
    - Accounts that were 60 days or more past due as of (DATE), but current as of (DATE).
    - Accounts charged off in (MONTH).

Appendix C: Uniform Retail Credit Classification and Account Management Policy Checklist (RCCP Checklist)

Applicability: The retail credit classification and account management policy (policy) applies to the following:

- Open- and closed-end credit extended to individuals for household, family, and other personal expenditures, including consumer loans and credit cards.
- Loans to individuals secured by their personal residence, including first mortgage, home equity, and home improvement loans.

Note regarding minimum policy guidelines:

- The policy does not preclude examiners from classifying individual loans or entire portfolios regardless of delinquency status, or from criticizing account management practices that are deficient or improperly managed. If underwriting standards, risk management, or account management standards are weak and present unreasonable credit risk, deviation from the minimum classification guidelines outlined in the policy may be prudent.
- Credit losses generally should be recognized when the bank becomes aware of the loss, but the charge-off should not exceed the time frames stated in the policy.

Retail Credit Classification and Account Management Policy Checklist			
	Yes/no	**Doc. ref.**	**Comments**
Substandard classification 1. Does the bank consider open accounts 90 cumulative days past due to be substandard? 2. In cases in which the bank can clearly demonstrate that repayment of an account by a borrower in bankruptcy is likely to occur, is the account appropriately classified as substandard until the borrower re-establishes the ability and willingness to repay for a period of at least six months?			
Loss classification Are secured accounts written down to the value of the collateral, less cost to sell, **if** repossession of collateral is assured and in process?			

Retail Credit Classification and Account Management Policy Checklist			
	Yes/no	**Doc. ref.**	**Comments**
Bankruptcy 1. Are accounts in bankruptcy charged off within 60 days of receipt of notification of filing from the bankruptcy court or within the 120/180-day-past-due time frame (whichever is shorter)? 2. When an account's balance is not charged off, does the bank classify it as substandard until the borrower re-establishes the ability and willingness to repay for a period of at least six months?			
Fraudulent accounts Are fraudulent accounts classified as loss and charged off within 90 days of discovery or within the 120/180-day-past-due time frame (whichever is shorter)?			
Deceased borrower accounts Are accounts of deceased persons classified as loss and charged off when the loss is determined or within the 120/180-day-past-due time frame (whichever is shorter)?			
Other considerations for classification Under what conditions does the bank not classify an account as substandard or loss in accordance with the policy? **Note:** The policy permits nonclassification if the bank can document that the loan is well secured and in the process of collection, such that collection will occur regardless of delinquency status.			
Partial payments 1. Does the bank require that a payment be equivalent to 90 percent or greater of the contractual payment before counting the payment as a full payment? 2. As an alternative, does the bank aggregate payments and give credit for any partial payments received? 3. Are controls in place to prevent both methods above from being used simultaneously on the same credit?			

Retail Credit Classification and Account Management Policy Checklist			
	Yes/no	**Doc. ref.**	**Comments**
Re-aging, extensions, deferrals, renewals, and rewrites			
1. Are the above types of activities permitted only when the action is based on a renewed willingness and ability to repay the loan?			
2. Does documentation show that the bank communicated with the borrower, the borrower agreed to pay the loan in full, and the borrower has the ability to repay the loan?			
3. Do MIS separately identify the number of accounts and dollar amounts that have been re-aged, extended, deferred, renewed, or rewritten, including the number of times such actions have been taken?			
4. How does the bank monitor and track the volume and performance of loans that have been re-aged, extended, deferred, renewed, rewritten, or placed in a workout program? **Note:** The criteria above do not apply to customer-service-originated extensions or program extensions (such as holiday skip-a-pay). Examples of how the bank would determine and document a borrower's willingness and ability to repay could include such items as credit bureau score and data being obtained and reviewed, stated income being verified, and obtaining a "hardship" letter from the borrower.			

Retail Credit Classification and Account Management Policy Checklist			
	Yes/no	**Doc. ref.**	**Comments**
Open-end credit (re-aging) 1. Is a reasonable written policy in place and adhered to? 2. To be considered for re-aging, does the account exhibit the following: • Has the borrower demonstrated a renewed willingness and ability to repay the loan? • Has the account existed for at least nine months? • Has the borrower made at least three consecutive minimum monthly payments or the equivalent cumulative amount? • Does the bank prohibit the advancement of funds to make the minimum payment requirements? • Does the bank limit the number of re-agings to no more than once within any 12-month period? • Does the bank limit the frequency of re-agings to no more than twice within any five-year period? • For over-limit accounts that the bank re-ages, does the bank prohibit new credit from being extended until the balance falls below the pre-delinquency credit limit? 3. Consider the following questions regarding the bank's workout loan programs: • Does the bank require the receipt of at least three consecutive minimum monthly payments or the equivalent cumulative amount, as agreed under the workout or debt management program, before re-aging an account that enters a workout program (internal or third-party)? • Are re-agings for workout programs limited to once in a five-year period? • At a minimum, do MIS track the principal reductions and charge-off history of loans in workout programs by type of program?			

Appendix D: Account Management and Loss Allowance Guidance Checklist

Applicability: This checklist should be completed for all banks supervised by the OCC that offer credit card programs. The checklist should be used in conjunction with the related examination procedures.

Note: Negative responses may indicate that bank policies are not consistent with the guidance. In such cases, further review may be necessary to determine the appropriate corrective action.

Account Management and Loss Allowance Guidance Checklist			
	Yes/no	**Doc. ref.**	**Comments**
Credit line management 1. Does bank management test, analyze, and document line-assignment and line-increase criteria before broad implementation? 2. Does the bank offer customers multiple credit lines, such as bank card plus store-specific private-label cards and affinity relationship cards? If so, do the bank's MIS aggregate related exposures and does management analyze performance before offering additional credit lines? **Note:** Support for credit line management should include documentation and analysis of decision factors such as repayment history, risk scores, behavior scores, or other relevant criteria.			
Over-limit practices 1. Are policies and controls in place regarding over-limit authorizations? 2. Does bank management take appropriate actions to facilitate the timely repayment of the over-limit amounts (e.g., reduce or eliminate fees, raise the minimum payment, initiate workout programs)? 3. Do MIS enable management to identify, measure, monitor, and control the unique risks associated with over-limit accounts? MIS should include the following: • Over-limit volume, segmented by severity. • Credit performance. • Duration of over-limit.			

Account Management and Loss Allowance Guidance Checklist			
	Yes/no	**Doc. ref.**	**Comments**
Minimum payment and negative amortization 1. Do minimum payment requirements ensure that the principal balance will be amortized over a reasonable period of time, consistent with the risk profile of the borrower? 2. Do minimum payment requirements cover finance charges and recurring fees assessed during the billing cycle? **Note:** Liberal repayment programs can result in negative amortization (where outstanding balances continue to build). Prolonged negative amortization, inappropriate fees, and other practices can inordinately compound or protract consumer debt, mask portfolio performance and quality, and raise safety and soundness concerns. These practices should be criticized.			

Account Management and Loss Allowance Guidance Checklist			
	Yes/no	**Doc. ref.**	**Comments**
Workout and Forbearance Practices			
Note: An open-end credit card account is a workout when its credit is no longer available and its balance owed is placed on a fixed (dollar or percentage) repayment schedule in accordance with modified, concessionary terms and conditions. Temporary hardship programs are not considered workout programs unless the program exceeds 12 months, including renewals. **Repayment period** 1. Do all workout programs provide for repayment terms that have borrowers repay their existing debt within 60 months? 2. What exceptions are allowed to the 60-month time frame? Are such exceptions clearly documented and supported by compelling evidence that less conservative terms and conditions are warranted? **Settlements** 3. For credit card accounts subject to settlement arrangements, are controls in place for setting the amount (dollar or percentage) to be forgiven and the requirement for the borrower to pay the remaining balance in either a lump-sum payment or in a period not to exceed three months? 4. Is the amount of debt forgiven in a settlement arrangement classified as loss and charged off immediately? If this is not done, does the bank treat such amounts forgiven in settlement arrangements as specific allowances? **Note:** The creation of a specific allowance is reported as a charge-off in Schedule RI-B of the call report. 5. Upon receipt of the final settlement payment, are any deficiency balances charged off within 30 days?			

Account Management and Loss Allowance Guidance Checklist			
	Yes/no	**Doc. ref.**	**Comments**
Income Recognition and Loss Allowance Practices			
Accrued interest and fees 1. When determining appropriate loss allowances, does the bank evaluate the collectability of accrued interest and fees on credit card accounts? 2. If the bank does not place credit card accounts on nonaccrual, does it alternatively provide loss allowances for uncollectable fees and finance charges? 3. For banks that securitize credit card receivables, does management ensure that the owned portion of accrued interest and fees, including related estimated losses, are accounted for separately from the retained interest in accrued interest and fees from securitized accounts? **Loan-loss allowances** 4. Does bank management consider the loss inherent in both delinquent and nondelinquent loans? **Allowances for over-limit accounts** 5. Does the bank's allowance method address the additional risk associated with chronic over-limit accounts? **Note:** To be able to identify these incremental losses, it is necessary for the bank to be able to track the payment requirements and performance on over-limit accounts. **Allowances for workout programs** 6. Are accounts in workout programs segregated for performance measurement, impairment analysis, and monitoring purposes? (Multiple workout programs having different performance characteristics should be tracked separately.) 7. Is the allowance allocation on workout programs at least equal to the estimated loss in each program based on historical experience as adjusted for current conditions and trends? **Note:** Adjustments should take into account changes in economic conditions, volume and mix, terms and conditions of each program, and collections.			

Account Management and Loss Allowance Guidance Checklist			
	Yes/no	**Doc. ref.**	**Comments**
Recovery practices Does the bank ensure that the total amount credited to the ALLL as recoveries on a loan is limited to the amount previously charged off against the ALLL on that loan?			
Policy exceptions 1. Does the bank allow any exceptions to the FFIEC “Uniform Retail Credit Classification and Account Management Policy”? If so, what types of exceptions are allowed? 2. For exceptions granted, do the bank’s policies and procedures identify the types of exceptions allowed and the circumstances for permitting them? **3.** Is the performance of accounts granted exceptions to this policy tracked and monitored?			

Appendix E: Debt Suspension Agreement and Debt Cancellation Contract Forms and Disclosure Worksheet

This worksheet shows the required content of the disclosures that must be included in each DSA or DCC contract according to 12 CFR 37.6(a); also refer to OCC Bulletin 2002-40, "Debt Cancellation Contracts and Debt Suspension Agreements: Final Rule." This regulation and bulletin apply to national banks only.

Note: NA means not applicable.

Debt Suspension Agreement and Debt Cancellation Contract Forms and Disclosure Worksheet		
	Compliance: yes/no/NA	**Comments**
Appendix A to 12 CFR 37: short-form disclosures		
Product is optional Your purchase of [PRODUCT NAME] is optional. Whether or not you purchase [PRODUCT NAME] will not affect your application for credit or the terms of any existing credit agreement you have with the bank.		
Lump-sum payment of fee **Note:** Applicable if a bank offers the option to pay the fee in a single payment. You may choose to pay the fee in a single lump sum or in [monthly/quarterly] payments. Adding the lump sum of the fee to the amount you borrow will increase the cost of [PRODUCT NAME].		
Lump-sum payment of fee with no refund **Note:** Applicable if a bank offers the option to pay the fee in a single payment for a no-refund debt cancellation contract. You may choose [PRODUCT NAME] with or without a refund provision. Prices of refund and no-refund products are likely to differ.		
Refund of fee paid in lump sum **Note:** Applicable when the customer pays the fee in a single payment and the fee is added to the amount borrowed. *Choose one of the following:* (1) You may cancel [PRODUCT NAME] at any time and receive a refund; *or* (2) You may cancel [PRODUCT NAME] within _____ days and receive a full refund; *or* (3) If you cancel [PRODUCT NAME] you will not receive a refund.		

Debt Suspension Agreement and Debt Cancellation Contract Forms and Disclosure Worksheet		
	Compliance: yes/no/NA	**Comments**
Additional disclosures We will give you additional information before you are required to pay for [PRODUCT NAME]. *If applicable:* This information will include a copy of the contract containing the terms of [PRODUCT NAME].		
Eligibility requirements, conditions, and exclusions There are eligibility requirements, conditions, and exclusions that could prevent you from receiving benefits under [PRODUCT NAME]. *Either* 1) You should carefully read our additional information for a full explanation of the terms of [PRODUCT NAME]; *or* 2) You should carefully read the contract for a full explanation of the terms of [PRODUCT NAME].		
Appendix B to 12 CFR 37: long-form disclosures		
Product is optional Your purchase of [PRODUCT NAME] is optional. Whether or not you purchase [PRODUCT NAME] will not affect your application for credit or the terms of any existing credit agreement you have with the bank.		
Explanation of debt suspension agreement **Note:** Applicable if the contract has a debt suspension feature. If [PRODUCT NAME] is activated, your duty to pay the loan principal and interest to the bank is only suspended. You must fully repay the loan after the period of suspension has expired. *If applicable:* This includes interest accumulated during the period of suspension.		
Amount of fee *For open-end credit, either* (1) The monthly fee for [PRODUCT NAME] is based on your account balance each month multiplied by the unit-cost, which is ______; *or* (2) The formula used to compute the fee is _______.		
Lump-sum payment of fee **Note:** Applicable if a bank offers the option to pay the fee in a single payment. You may choose to pay the fee in a single lump sum or in [monthly/quarterly] payments. Adding the lump sum of the fee to the amount you borrow will increase the cost of [PRODUCT NAME].		

Debt Suspension Agreement and Debt Cancellation Contract Forms and Disclosure Worksheet		
	Compliance: yes/no/NA	**Comments**
Lump-sum payment of fee with no refund **Note:** Applicable if a bank offers the option to pay the fee in a single payment for a no-refund DCC. You have the option to purchase [PRODUCT NAME] that includes a refund of the unearned portion of the fee if you terminate the contract or prepay the loan in full before the scheduled termination date. Prices of refund and no-refund products may differ.		
Refund of fee paid in lump sum **Note:** Applicable when the customer pays the fee in a single payment and the fee is added to the amount borrowed. *Choose one of the following:* 1) You may cancel [PRODUCT NAME] at any time and receive a refund; *or* 2) You may cancel [PRODUCT NAME] within ____ days and receive a full refund; *or* 3) If you cancel [PRODUCT NAME] you will not receive a refund.		
Use of card or credit line restricted **Note:** Applicable if the contract restricts use of card or credit line when customer activates protection. If [PRODUCT NAME] is activated, you will be unable to incur additional charges on the credit card or use the credit line.		
Termination of product *Either* 1) You have no right to cancel [PRODUCT NAME]; *or* 2) You have the right to cancel [PRODUCT NAME] in the following circumstances: __________. ***and*** *Either* 1) The bank has no right to cancel [PRODUCT NAME]; *or* 2) The bank has the right to cancel [PRODUCT NAME] in the following circumstances: ___________.		

Debt Suspension Agreement and Debt Cancellation Contract Forms and Disclosure Worksheet		
	Compliance: yes/no/NA	**Comments**
Eligibility requirements, conditions, and exclusions There are eligibility requirements, conditions, and exclusions that could prevent you from receiving benefits under [PRODUCT NAME]. *Either* 1) The following is a summary of the eligibility requirements, conditions, and exclusions. [The bank provides a summary of any eligibility requirements, conditions, and exclusions.]; *or* 2) You may find a complete explanation of the eligibility requirements, conditions, and exclusions in paragraphs ______ of the [PRODUCT NAME] agreement.		
12 CFR 37.6(d): Form of disclosures		
Disclosures must be readily understandable Disclosure must be conspicuous, simple, direct, readily understandable, and designed to call attention to the nature and significance of the information provided.		
Disclosures must be meaningful Disclosures must be presented in a manner that engages the customer's attention. Examples of methods that could call attention to the nature and significance of the information provided include • a plain-language heading; • a typeface and type size that are easy to read; • wide margins and ample line spacing; • boldface or italics for key words; and • distinctive type style, and graphic devices, such as shading or sidebars, when the disclosures are combined with other information.		

Appendix F: Debt Suspension and Debt Cancellation Product Information Worksheet

Please answer the following questions for debt suspension and debt cancellation programs overall, and complete the attached worksheet for each debt suspension or debt cancellation product offered. Indicate whether responses are based on discussions with bank management or on an examination that included process review and verification.

For all debt suspension and debt cancellation products:

1. Must the account be current to activate benefits? If not, are there delinquency limits with respect to benefit activation?

2. If accounts are delinquent when benefits are approved, does the bank re-age the account to current, freeze it at the payment or delinquency status at the time the benefit event occurred, or freeze it at the delinquency status at the time of claim approval?

3. At what delinquency status does the bank terminate coverage (e.g., at 90 days past due)?

4. Does the bank stop premium assessments on accounts that are over-limit? If not, under what conditions does the bank "force" premium assessments on over-limit revolving accounts (i.e., book the premium even though it would be denied through the authorization process)?

5. Does the bank satisfactorily track and analyze the subsequent performance of the following populations for at least 12 months:

   - Accounts denied claims?
   - Accounts that failed to complete claims?
   - Accounts following benefit expiration?

6. If the default experience of the bank's credit card accounts is significantly worse than that of the population as a whole, is this information incorporated into the allowance analysis?

7. How does the bank compute the interest and fees associated with accounts in claims status? Specifically, since interest and fees for credit card accounts are generally suspended, how does the bank determine the associated interest and fees that would have been due on a month-to-month basis?

8. What is the bank's process for reserving for benefit claims? Is it sufficient to cover 1) the total of existing approved claims, 2) claims in process and reasonably expected to be approved, and 3) an estimate of claims not yet submitted by accounts in which an event has occurred?

9. If participating accounts are securitized and the bank is responsible for making payments to the trust, are the trust reimbursements accurate and made monthly?

10. Are the bank's MIS sufficient to generate the information needed to establish and maintain an adequate reserve?

11. Are the bank's MIS sufficient to monitor and manage the various debt suspension or cancellation products?

12. Is the bank's pricing based on a valid cost analysis (considering all associated costs)?

13. Does the bank periodically evaluate cost/benefit from the consumer's perspective? Is that analysis reasonable and reflected in the pricing?

14. Is flat-rate pricing, if any, appropriate for low-dollar loan amounts? Please explain.

15. How many written consumer complaints has the bank received regarding these products in the year to date and in the previous full year?

16. Is the bank planning to offer additional debt suspension or cancellation products or make significant changes to products (e.g., coverage, pricing) or marketing (e.g., channel, emphasis)? If so, please describe.

17. Determine whether the bank has liabilities recorded for these products, how they are determined, and whether the amounts appear reasonable.

Debt Suspension and Debt Cancellation Product Information Worksheet
Product name:
Offered since:
Retail credit product(s) covered:
Provider (bank, affiliate, third-party):
Administrator (bank, affiliate, third-party):
Responsible bank officer:

Note: Attach a copy of the product terms and conditions.

Benefits	**Unemployment**	**Disability**	**Leave of absence**	**Death**
Coverage: Specify maximum number of months, “not available” if not included, or yes/no for death				
Cost (e.g., statement balance x 0.0069)				
Individual				
Joint				
Benefit				
Interest and fees				
Principal				
Limits, if any (e.g., limited to number of months premiums were paid prior to event)				
Offered to self-employed customers?				
Penetration Number of accounts paying premiums Percent of portfolio				
Claims rate[a] (number of claims submitted divided by number of accounts paying premiums), year-to-date and prior year				
Approval rate (number of claims approved divided by number of claims initiated), year-to-date and prior year				
Denial rate (number of claims denied divided by number of claims initiated), year-to-date and prior year				
Fallout rate (number of incomplete claims divided by number of claims initiated), year-to-date and prior year				
Bank income generated from premiums: Year-to-date amount (percent) of total business line revenue of total business line pretax net income Prior year (percent) of total business line revenue of total business line pre-tax net income				
Cancellation policy, including refund policy				
Cancellation rate (number of cancellations divided by number of accounts paying premiums pre-cancellation), year-to-date and prior year				

[a] Approval, denial, and fallout rates should balance to claims rate.

Appendix G: Loss Forecasting Tools

Reliable forecasts of expected credit card charge-offs are critical for risk management, profitability, reserving, and capitalization. This supplement describes the three most common forecasting methods: roll-rate, historical, and vintage analyses. Some banks use combinations of all three methods for different credit card portfolios or forecasting purposes.

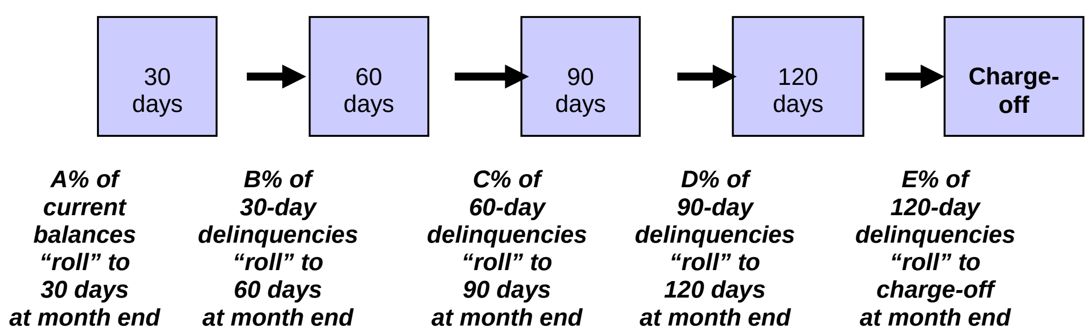
Roll-Rate

Roll and flow models are the most accurate short-term forecasting method. The name is derived from the practice of measuring the percentage of delinquent credit card accounts that migrate, or “roll,” from early- to late-stage delinquency buckets, or “flow” to charge-off. The most common method is the delinquency roll-rate model, in which dollars outstanding are stratified by delinquency status: current, 30-59 days past due, 60-89 days past due, and so on through charge-off. The rates at which these accounts roll through delinquency levels are then used to project losses for the current portfolio. Figure 1 describes how roll-rate analysis is used to track the migration of balances over a four-month period (120-day charge-off period).

Step 1: Calculate roll rates

In the example shown in table 3, the computation begins with the $725 million in accounts that were current in June 2014. From June 2014 to July 2014, $27 million in accounts migrated from current to 30 days delinquent, which equates to a roll rate of 3.73 percent ($27 ÷ $725). From July 2014 to August 2014, $10.6 million rolled to the next delinquency bucket, representing a 39.26 percent roll rate ($10.6 ÷ $27). Continuing along the diagonal (shaded boxes), loss rates increase in the latter stages of delinquency. To smooth out some fluctuations in the data, bank management often averages roll rates by quarter before making current portfolio forecasts and compares quarterly roll-rate results between quarters to analyze and adjust for seasonal effects.

Figure 1: Roll-Rate Schematic



Note: This example is a simplified depiction of dollar flow to illustrate the basic concept of roll rates. In reality, some balances cure (return to current), remain in the same delinquency bucket, or improve to a less severe delinquency status by the end of a period. For ease of calculation, roll-rate analysis assumes that all dollars at the end of a period flow from the prior-period bucket.

Step 2: Calculate loss factors by bucket.

To calculate the loss factor from the "current" bucket, multiply all average roll rates from the most recent quarterly average. In this example, the fourth-quarter average roll rates produce this factor: 3.42% x 42.58% x 67.12% x 72.12%, resulting in a 0.70 percent loss rate for accounts in the current bucket. To determine the loss rate for the 30-day accounts, multiply the most recent quarterly averages for the 60-, 90-, and 120-day buckets, resulting in a loss factor of 20.61 percent. Applying the same method results in a loss factor of 48.41 percent for the 60-day bucket and 72.12 percent for the 90-day bucket.

Table 3: Loss-Factor Calculation (Dollar Amounts in Millions)

Month	Current balance	30 days	Roll rate	60 days	Roll rate	90 days	Roll rate	120 days	Roll rate
June	$724.7	$26.1		$9.9		$6.7		$3.6	
July	$762.0	$27.0	3.73%	$10.9	41.77%	$7.1	71.27%	$4.7	70.36%
August	$788.6	$25.5	3.34%	$10.6	39.26%	$7.0	64.29%	$4.7	67.56%
September	$827.7	$29.4	3.73%	$12.1	47.82%	$7.9	74.88%	$5.5	78.74%
3Q average			**3.60%**		**42.95%**		**70.15%**		**72.22%**
October	$844.6	$31.1	3.76%	$12.8	43.53%	$8.5	70.53%	$5.9	75.58%
November	$896.3	$26.7	3.16%	$12.4	40.03%	$8.2	64.52%	$5.9	69.49%
December	$987.3	$30.0	3.35%	$11.8	44.18%	$8.2	66.31%	$5.8	71.29%
4Q average			**3.42%**		**42.58%**		**67.12%**		**72.12%**
Loss factors			**0.70%**		**20.61%**		**48.41%**		**72.12%**

Step 3: Apply loss factors to the current portfolio.

Step 3 is to forecast losses for the existing portfolio by applying the loss factors for each bucket (developed in step 2) to the current portfolio. In this example, the portfolio's expected loss rate over the next four months is 2.93 percent.

Table 4: Loss-Factor Application (Dollar Amounts in Millions)

December 31	Outstandings	Loss factor	Loss forecast
Current	$ 987.4	0.70%	$ 6.9
30 days	$ 30.2	20.61%	$ 6.2
60 days	$ 11.8	48.41%	$ 5.7
90 days	$ 8.2	72.12%	$ 5.9
120 days	$ 5.9	100.00%	$ 5.9
Total	$ **1,043.5**	**2.93%**	$ **30.6**

The major advantage of roll-rate analysis is its relative simplicity and considerable accuracy up to nine months. This method often segments portfolios by product, customer type, and other relevant groupings to increase precision and accuracy. Roll-rate reports are used extensively by collection managers to anticipate workload and staffing needs and to assess and adjust collection strategies.

The main limitation of roll-rate analysis is that the predictive power of delinquency roll rates declines after nine months. The focus on delinquency causes forecasts to lag behind underlying changes in portfolio quality, especially in the relatively large current bucket. Changes in portfolio quality occur because of factors such as underwriting and cutoff score adjustments, product mix changes, and shifts in economic conditions. Roll-rate analysis may underestimate loss exposure when these factors weaken portfolio quality. Finally, roll-rate analysis assumes that accounts migrate through an orderly succession of delinquency stages before charge-off. In fact, customers often migrate to charge-off status after sporadic payments or rush to that status by declaring bankruptcy.

Historical

Historical averaging is a rudimentary method for forecasting loss rates. Bank management tracks historical charge-offs, adjusts for recent loss trends, and adds some qualitative recognition of current economic conditions or changes in portfolio mix. This method is highly subjective and is used primarily by less sophisticated banks or for stable, conservatively underwritten products.

The historical method is sometimes used for allowance purposes and for monitoring general product or portfolio trends. The advantages of this method are its simplicity and modest data needs. Results can be reasonably accurate as long as underwriting standards remain relatively constant and economic and competitive conditions do not change markedly. The major limitation of the method is that forecasts will lag behind underlying changes in portfolio quality if competitive or economic conditions change. The method also introduces potential bias by allowing forecasters to rely on long-run averages when conditions deteriorate and short-run trends at the earliest signs of recovery, resulting in lower loss estimates. In addition, the method does not provide meaningful information on the effects of changes in product or customer mix, and it is difficult to apply any but the most basic stress tests.

Vintage

Vintage-based forecasting tracks delinquency and loss curves by time period, grouping accounts as different vintages according to time on book or by the marketing campaign during which they were initiated. The curves are predictive for future vintages as long as adjustments are made for changes in underwriting criteria, cutoffs, and economic conditions. The advantage of vintage-based forecasting is that it is usually more accurate than roll-rate forecasting for charge-offs beyond a one-year horizon. Bank management should adjust the loss expectations when new vintages are observed to deviate markedly from past curves, or if economic and market conditions change. The disadvantages of vintage-based forecasting are that it is more subjective and less accurate than the roll-rate method for short-term forecasting and that it relies on the assumption that new vintages will perform similarly to older vintages.

Appendix H: Credit Scoring and Development of Scoring Models

There are several statistical methods used to construct credit scoring models (e.g., multiple linear regression, logit and probit, discriminant analysis, general linear models). Each method has advantages; in practice, however, all of these methods generally produce a similar prediction of the relative credit quality of account holders by capturing the underlying correlation between their risk characteristics and delinquency behavior. These models use those factors correlating most strongly with good or bad performance. Scoring models used for underwriting should include data from rejected applications to correct for estimation bias that arises if only approved accounts are used. If rejected applicants are systematically excluded from a model's development, sample correlation between the applicants' characteristics and delinquency will reflect only the behavior of the relatively good segment of the population. When the model is applied to the general population, it will overestimate the relative quality of the accounts with characteristics similar to those that were rejected, increasing the likelihood that lower-quality applicants will be approved.

Scoring models are only as good as the data used to develop the models. These models predict the behavior of new applicants based on the performance of previous applicants. If the distribution of characteristics in the through-the-door population shifts (due, for example, to a change in marketing strategy that successfully attracts applicants outside the bank's current market), the model's ability to discriminate between "good' and "bad" accounts may deteriorate. Other elements affecting a model's ability to rank-order risk arise from using different sources to select sample applicants, using data from new market areas, and changing credit policy. Economic or regulatory changes also can affect the reliability of a model. For those reasons, a bank should continue to validate that the current population of applicants is similar to the population that was used to develop the model.

Models are rescored before system implementation to validate their ability to rank-order risk as designed. The validation process ensures that the demographic profiles of current applicants or the names selected for prescreening are similar to those used in the sample. The process also measures the divergence in performance between two populations (e.g., through-the-door applications compared with the development sample used to build the model) and sets credit scoring norms to account for slight shifts in the population credit score. The Chi-Squared goodness-of-fit measure test, the Kolmogorov-Smirnov measure of divergence test, and the Population Stability Index are the most common statistical validation tests used by banks to assess the accuracy, reliability and discriminatory power, and stability of a model, respectively. Validation tests are common and used to ensure that model results are accurate and effective in maintaining strong risk management practices.

Scoring models generally become less predictive over time because they are typically developed without explicitly capturing the time-sensitive impact of changing economic and market conditions. Applicant characteristics, such as income, job stability, and age, change, as do overall demographics. These changes result in significant shifts in the profile of the through-the-door applicants. Once a fundamental change in the profile occurs, the model is less able to identify potentially good and bad applicants. As these changes continue, the model loses its ability to rank-order risk. Thus, credit scoring models should be redeveloped as necessary.

After a scoring system is implemented, its developer provides bank management with a manual that details system maintenance requirements and recommended methods for supervising the system. Bank management should adhere closely to the manual's specifications, particularly those that provide guidance for periodically assessing the performance of the system. This often includes comparing actual results with system objectives.

For systems developed by outside vendors, examiners should review vendor guidelines in conjunction with bank management's system for periodically assessing the system and the frequency of such assessments. One quick way to evaluate the general performance of a system is to determine whether a direct correlation exists between credit scores and delinquency rates (that is, delinquency rates increase as risk increases). Another way is to review the management reports described in this appendix.

Types of Scoring Systems

Application Scoring

Systems that rely on data from credit applications augmented by credit bureau data are the most commonly used types of systems in credit scoring. Key items of application information (and credit bureau information, when available) are assigned point values. Typical application data include continued employment over a period of time, length of credit history, and rent or mortgage payments over a period of time. The characteristics that are assigned point values to predict the ability to repay a credit card loan are income, occupation, and outstanding credit balances. Banking references, credit references, reported delinquencies, recent credit bureau inquiries, and recently opened accounts are assigned point values that reflect a consumer's use of credit. The total of these point values (final score) reflects the relative likelihood that the consumer will repay as contracted.

Credit Bureau Risk Scoring

An application is sent to one of the credit bureaus for scoring based on the contents of the application and the payment history in the applicant's credit bureau report. The system statistically ranks current elements of a credit report to predict the customer's future payment behavior.

Banks purchase credit bureau scores for use in applicant screening, account acquisition, and account management strategies:

- **Applicant screening:** For approving or declining the credit card, establishing initial credit limits, and setting up a tiered pricing of credit cards accounts.
- **Account acquisition:** Used in solicitation programs, cross-selling opportunities of other products, and for acquiring portfolios from other institutions.

- **Account management:** For determining increases and decreases of credit limits and establishing authorizations, reissue, and collection parameters.

Credit bureau scores are designed to predict relative credit quality of a borrower based on a common set of credit bureau characteristics. A good account is one with no delinquencies or an isolated delinquency. A bad account exhibits seriously delinquent behavior or worse (i.e., bankruptcy, charge-off, or repossession).

More than 100 predictive variables are evaluated during the development or redevelopment cycle. Such variables include previous credit performance, current level of indebtedness, amount of time credit has been in use, pursuit of new credit, and types of credit available. Bank management should revalidate bureau scorecards as warranted. An integral part of the re-validation process involves assessing the variables and comparing the model's actual performance to its expected performance.

Scorecard vendors have risk scorecards in place at the major credit bureaus. The vendor uses the same process at each bureau to update and validate the scorecards. Generally, vendors evaluate the individual's performance at the time of revalidation and 24 months before revalidation. The earlier of these reports is used to generate the predictive information, and the later one is used to determine the performance of that account in the two years since the observation of the predictive information.

Credit Bureau Bankruptcy Scoring

Bankruptcy scorecards are used primarily to predict the likelihood that a customer will declare bankruptcy or become a collection problem. Credit bureaus derive their bankruptcy scorecards from information in a consumer's credit file containing credit histories from all reporting sources. Several bankruptcy scorecards are usually available at each credit bureau.

Credit Bureau Revenue Scoring

Revenue scores are designed to rank-order prospects by the amount of net revenue likely to be generated on a new bank card account in the first 12 months. Revenue scores are available through the credit bureaus. The scoring models are built using master file information on the amount of revenue generated on a bank card account in the previous 12-month performance period. The models consider factors such as high-balance-to-limit ratios, significant revolving balances, and multiple bank cards in use.

Behavioral or Performance Scoring

Behavioral scoring is a technique used to segment a portfolio of existing accounts based on the past behavior of the borrowers. Banks use behavioral scores for collection strategies, authorization requirements, credit line assignments, and renewal decisions. This scorecard predicts which accounts will become delinquent within the next six to 12 months. Behavioral scoring relies principally on credit line usage patterns (revolving credit) and payment patterns. Behavioral scoring models consider elements such as payment history, the number of times the payment has been greater than the minimum required, delinquency history, and use of the cash advance option. Credit bureau input may also be used.

Emerging neural net technology has enhanced the effectiveness of behavioral modeling. Neural nets are computer programs that can sort through huge amounts of data and spot patterns in a way that mimics human logic. This knowledge is then factored into subsequent decisions.

Collection Scoring

Scoring models that focus on collection activities include the following:

- **Collection scoring:** These systems show the likelihood that collection efforts will succeed. They help a bank allocate collection resources efficiently.
- **Payment projection scoring:** These systems identify the likelihood that a bank will receive a payment on a delinquent account within six months. The collection department can use this information to determine on which accounts it needs to focus.
- **Recovery scoring:** These systems identify the likelihood of recoveries after charge-off. The collection department can use these systems to minimize charge-off losses.

Adaptive Control

Banks can use behavioral scoring to examine alternative credit strategies. These strategies employ a technique called “adaptive control.” Adaptive control systems include software that allows bank management to develop and analyze various strategies that take into account the customer population and the economic environment. Adaptive control systems are credit portfolio management systems designed to reduce credit losses and increase promotional opportunities. New strategies (called challenger strategies) can be tested on a portion of the accounts while retaining the existing strategy (called the champion strategy). When a challenger strategy proves more effective than the existing champion, the bank replaces the champion strategy with the challenger. Continual testing of alternative strategies can help the bank achieve better profits and control losses in five areas:

- **Credit line management:** Current and delinquent accounts are reviewed for credit line and cash line increases and decreases at billing, based on several timing options.
- **Delinquent collections:** All accounts are checked for delinquency at billing time. Delinquent accounts are evaluated and actions are assigned to be taken throughout the next month. For example, computer-generated notices can be sent to account holders at varying intervals for 30 days; if the account remains delinquent, collectors can make phone calls every five days. Delinquent accounts are then reexamined for a change in account status. If there is no change, assigned actions proceed. If an account is no longer delinquent, actions are stopped. Accounts also can be reevaluated and assigned different actions (called dynamic reclassification).
- **Over-limit collections:** Accounts are examined for over-limit action at billing and posting. At billing, the bank may send a notice to an over-limit account holder. Additional action may be taken based on the over-limit strategy.

- **Authorizations:** Accounts are examined at billing and assigned an authorization strategy to be used by the authorization system throughout the month. The authorization system requests a decision on accounts in early delinquency or over-limit status.
- **Reissue:** Accounts are reviewed for reissuance at a certain time. This can be done several times a year and the bank may take an action such as mailing a letter regarding the status of a credit card or sending a new credit card.

Strategies for Selecting and Changing Cutoff Score

Three strategies may be used separately or together to select the cutoff score. The first strategy targets an approval or acquisition rate. The cutoff is set to result in a specified number of new accounts. Used separately, this may be the least desirable approach because it does not capture any projected performance of the accounts. The second strategy targets a credit loss rate. A cutoff score is selected that sets an acceptable level of losses. The third strategy targets the product’s profitability. A cutoff score can optimize expected profitability in terms of total profit center earnings, return on risk assets, or return on total assets.

The following are some of the most common reasons for changing a credit cutoff score:

- To approve previously declined accounts that are now believed to be potentially profitable.
- To decline previously approved accounts that are now observed to be unprofitable.
- To reduce losses or improve collections.
- To respond to increased or reduced competition in the marketplace.
- To comply with external requests (e.g., regulators or consumer groups) to ease or restrict credit availability.
- To compensate for aging or eroding scoring models.

Management Reports

Population stability report: This report measures changes in applicant score distribution over time. The report compares the current application population with the population on which the scoring system was developed. This comparison is made using a formula called the population stability index. The index measures the separation of the two distributions of scores. (The scoring manual provided by the system developer has instructions on how to interpret the variances.) For example, in a commonly used scorecard, a value under 0.100 indicates that the current population is similar to the original and no action is necessary. A value between 0.100 and 0.250 suggests that bank management should research the cause of the variance. A value over 0.250 suggests that substantial change has occurred in the population or the underwriting policies.

Characteristic analysis report: This report measures changes in applicants’ scores on individual characteristics over time. It is needed when the applicant population stability has changed and the bank wants to determine which characteristics are being affected. The report compares individual characteristics of the current applicants with those of the original population used in developing the scoring model. For example, checking and savings account references may be a better predictor of future behavior when the applicant has more history with the bank. This report can be used to identify the primary reasons for any shift in the applicant population from the development sample. Bank management should generate a report for each characteristic and review them individually and as a total.

Final score report: This report measures the approval rate and adherence to the scorecard. It shows the number of applicants at each score level and the number of applications accepted and rejected. The report also can be used to analyze the effect of factors outside the scorecard.

Delinquency distributions report: This report monitors portfolio quality by score ranges. Two types of reports may be used. One measures how well a scorecard is working, and the other measures current portfolio quality and changes in portfolio quality. The report compares accounts of different ages at equal stages in their account lives and reveals changes in the portfolio's behavior. Bank management should identify the causes for those changes. A vintage analysis table, which identifies accounts by year of origin, is used to compare a series of delinquency distributions reports and can be used to identify portfolio trends.

Portfolio chronology log: This log is an ongoing record of significant internal or external changes or events that could affect the performance of the accounts. The log helps to explain causes of behavior in various tracking reports. Some examples of events that should be recorded are new marketing programs, application form changes, new override policies, new collection strategies, changes in the debt-to-income ratio, or changes in income requirements.

Lender's override report: This type of report identifies the volume of high-side and low-side overrides by month and year to date, provides a comparison over time and against the bank's benchmark, and may include reasons for the overrides.

Income Estimators

The use of income estimator models (IE models), as with any type of model, invariably presents model risk, which is the potential for adverse consequences from decisions based on incorrect or misused model outputs and reports. Model risk can lead to financial loss, poor business and strategic decision making, or damage to a bank's reputation. Banks that use IE models should have effective model risk management programs consistent with supervisory guidance contained in OCC Bulletin 2011-12, "Sound Practices for Model Risk Management."

Banks continue to seek guidance from the OCC about acceptable uses for IE models when considering whether consumers are eligible for line increases on credit card accounts. The CARD Act requires card issuers to assess a consumer's ability to make the required minimum periodic payments under the terms of an account based on the consumer's income or assets and current obligations. The Commentary to the provisions of Regulation Z implementing the CARD Act further states: "A card issuer may consider … information obtained through any empirically derived, demonstrably and statistically sound model that reasonably estimates a consumer's income or assets."[51]

The ability of existing IE models to accurately estimate the income of a specific borrower may be limited and as a result may pose safety and soundness concerns. In some cases, to compensate for the inherent inaccuracy of the models, banks have asked if they can apply conservatism or use a confidence score threshold, e.g., if the IE model estimates a consumer's income to be $150,000 then the bank is 90 percent confident the borrower makes more than $75,000. In this example, the bank would underwrite and grant a credit line increase commensurate with a lower borrower income. Conservatism may impede proper model development and application, lead model users to discount model outputs, and potentially introduce unintended bias to underwriting decisions. Confidence scores may have limited effectiveness for safety and soundness purposes.

Even with skilled modeling and robust validation, IE model risk cannot be eliminated, so other tools, including monitoring of model performance, adjusting or revising the models over time, and establishing limits on model use should be used to manage model risk. Active management of model risk, in accordance with the OCC's supervisory guidance, can minimize potential safety and soundness concerns.

[51] Refer to 12 CFR 1026, supp. I., comment 51(a)(1)(i)-5(iv).

Appendix I: Profit Analysis

Table 5 is an example of a typical card issuer's income and expense statement. It may be used to monitor the earnings performance of the credit card operation.

Table 5: Total Portfolio Income and Expense Components (Managed Assets Basis)

Category	First-period income	Percentage of average receivables	Second-period income	Percentage of average receivables	Third-period income	Percentage of average receivables
Interest income						
Fees Annual membership fees Late fees Over-limit fees Cash advance fees Other fees **Total fees**						
Cost of funds						
Net interest margin						
Loan losses Credit Bankruptcy Deceased Recoveries Net losses (excl. fraud) Net provision **Total loan losses**						
Noninterest income Interchange Other income Less rebates **Net noninterest income**						
Noninterest expense Account acquisition and credit processing Over-limit and collections Servicing and promotion Card holder billing Fraud investigation Processing interchange Processing payments Card issuing Authorizations Card administration Outside services Processing Fraud Misc. expenses **Total noninterest expense**						
Pre-tax income before allocations expenses						
Corporate allocation						
Net pre-tax income						

Table 6 is an example of a tracking shell used to monitor the performance of individual card programs.

Table 6: Performance of Individual Portfolios (Managed Assets Basis)

	Pre-tax net income, first period	Percent of average receivables	Average receivables, first period	Pre-tax net income, second period	Percent of average receivables	Average receivables, second period
Classic						
Gold						
Affinity 1						
Affinity 2						
Affinity 3						
Affinity 4						
Affinity 5						
Cobrand 1						
Cobrand 2						
Cobrand 3						
Secured card						
Business card						
Other						
Total						

Note: If these typical income statements are used together, the total pre-tax net income for periods 1 and 2 should agree with the pre-tax net income reported in the gross portfolio income and expense components shell.

Impact of Introductory Teaser Rate on Income

Finance charge income (pricing) is a key determinant of the profitability of a credit card operation. In recent years, competition for account-holder growth has resulted in numerous marketing schemes involving introductory or teaser APR, which ultimately affect finance charge revenues. Lowering APRs can have a significant effect on profitability. For example, reducing the APR by 10 percent can result in a material decrease in the net margin, if all other factors remain constant.

The example in table 7 demonstrates the significant impact that pricing strategies can have on an issuer's financial statement. In the example, a 10 percent reduction in the APR, or price, results in a 47 percent compression of the net margin (from 4.3 percent to 2.3 percent). Even if the price reduction results in a 25 percent decrease in credit losses (from 3 percent to 2.25 percent), the net margin would still be 28 percent less than the original pricing strategy (from 4.3 percent to 3.05 percent). As a result, unless a bank adjusts the price for higher-risk customers, decreasing the price for low-risk customers or to obtain new customers dramatically affects net profit margins.

Table 7: Sample Income Statement

	Under original rate	Under new rate	Reduction	10% and 25% (cost of funds)	Reduction	Price reduction
Finance charge	19.8%	17.8%	–10%	17.8%	–10%	
Cost of funds	(7.0%)	(7.0%)	NA	(7.0%)	NA	
Net interest margin	12.8%	10.8%	–16%	10.8%	–16%	
Fee income	1.0%	1.0%	NA	1.0%	NA	
Charge-offs	(3.0%)	(3.0%)	NA	(2.25%)	–25%	
Noninterest expense	(6.5%)	(6.5%)	NA	(6.5%)	NA	
Net margin	4.3%	2.3%	–47%	3.05%	–28%	

Note: NA means not applicable.

Types of Users

The ratio of convenience users, or transactors (customers who accrue no finance charges because they pay in full each billing cycle), to revolvers (those who make less than full payments) plays a significant role in finance charge revenue. The greater the percentage of convenience users in the portfolio, the lower the yield. In addition, the bank must fund the convenience users’ receivables while, in many instances, only benefiting from interchange revenue. Depending on the product, purchase sales volume per account may never produce enough interchange revenue to break even on a convenience user account.

Appendix J: Purchased Credit Card Relationships

Since 1993, banks have been permitted to include PCCRs in regulatory capital computations. Pursuant to the Basel III final rule, beginning January 1, 2018, banks will be required to deduct PCCRs from common equity tier 1 capital. The Basel III final rule provides a transition period during which banks may include some PCCRs in regulatory capital. The information regarding regulatory capital treatment of PCCRs (in step 3) explains the treatment before January 1, 2018, after which date 100 percent of PCCRs must be deducted.

To qualify, as required by call report instructions, bank management must perform quarterly reviews on its PCCRs to determine whether they should be tested for impairment. The failure of bank management to accurately perform these tests could render the PCCRs ineligible for inclusion in regulatory capital computations before the final transition rule is in effect starting in 2018. To properly conduct a review of PCCRs for impairment and inclusion in regulatory capital computations, the examiner needs to review (for each portfolio that has a booked PCCR) the original acquisition model, the most recent discounted cash flow and fair market value models, and related supporting documentation and assumptions.

The FFIEC's "Instructions for Preparation of Consolidated Reports of Condition and Income" (call report instructions) require banks with PCCRs to perform a quarterly review to ensure that the intangible is adequately supported by the estimated future net cash flows from the acquired portfolio. If the review demonstrates that this is not the case, the PCCR should be tested for recoverability (impairment testing). An impaired PCCR means that the discounted amount of future net cash flows is below the book carrying value of the PCCR, thus requiring a writedown. Bank management must, at a minimum, perform the following to comply with FFIEC instructions:

1. Bank management must determine the inherent discount rate used in the acquisition of the portfolio. Because there are numerous methods management may have used to determine the purchase price of the portfolio, the OCC has established a common method to determine the inherent discount rate. The call report instructions state that the inherent discount rate is "based upon the estimated future net cash flows and the price paid at the time of purchase." Accordingly, to determine the inherent discount rate used in a portfolio purchase, the estimated future net cash flows of the portfolio are discounted at a rate that produces a net present value equal to the premium paid for the related PCCR for each portfolio. These should be true cash flows, excluding noncash items. If 10 percent of the portfolio is funded by equity capital in the acquisition model, similar leverage in the valuation model described in step 2 should result. Typically, these models run 10 years or less in estimated cash flows. On affinity and private-label portfolios that contain specific contract maturities (e.g., three, five, or seven years), the models should generally not exceed the contract maturity. The determination of the inherent discount rate should be performed for each portfolio for which there is a PCCR. The failure to accurately perform this step may result in a PCCR being declared ineligible for inclusion in regulatory capital computations.

2. Management should value the portfolio, on a quarterly basis, using a discount rate not less than the original discount rate inherent in the asset acquisition. Further, a discounted cash flow model should be used in the valuation. Using this valuation technique, the book value of the PCCR must not exceed the discounted amount of estimated future net cash flows. Management is currently permitted to use a pool-by-pool or an aggregate method to determine impairment. If, on an aggregate basis, impairment appears to exist, discuss with the EIC and management before requesting any writedown. This step should be performed for each portfolio for which there is a PCCR. The failure to accurately perform this step may result in a PCCR being declared ineligible for inclusion in regulatory capital computations.

   Typically, management uses a model that reduces the years of remaining cash flow periods as each quarter passes. For example, if management started with a 10-year model and six months have passed since the purchase, the valuation model would have nine and one-half years of cash flows remaining if the original portfolio cash flow expectations are still valid. In each model, management generally includes a termination value for the receivables remaining after the cash flow periods have been exhausted to simulate a portfolio sale. Examiners should look at what the terminal value is and make sure it is reasonable given the specific parameters of the program and the market.

   The assumptions used for these valuations should reflect recent trends of the portfolio. Many banks use the previous year's results as the drivers for the current year's models. Any significant variance from past actual experience should be questioned.

3. For regulatory capital computations, the following rules must be observed:

   a. Beginning January 1, 2015, all banks must deduct PCCRs from common equity tier 1 capital. Determine the amount of PCCRs that must be deducted in accordance with the transition provisions at 12 CFR 3.300(b)(1)(ii), table 3. PCCRs not required to be deducted must be assigned a risk weight of 100 percent.
   b. Beginning January 1, 2018, banks must deduct all PCCRs from common equity tier 1 capital.

   Management subsequently must determine the current fair market value of each intangible asset included in tier 1 capital at least quarterly. In doing so, management must "apply an appropriate market discount rate to the expected net cash flows of the intangible asset." In essence, the discount rate used in step 2 is replaced with a market discount rate.

4. The OCC's *Bank Accounting Advisory Series* (BAAS) states that PCCRs "should be amortized over [their] estimated useful lives … which will generally not exceed 10 years." The BAAS also recommends that banks use an amortization method that best reflects the pattern in which the economic benefit of the asset is consumed, which typically results in the use of an accelerated amortization method. If a usage pattern cannot be reliably determined, the straight-line method may be used. Many banks do not comply with this requirement and use a straight-line amortization method because it

reduces the earnings impact in the early years. The amortization schedules for each PCCR should be reviewed to ensure appropriateness as well as compliance with OCC guidelines. Preferably, the amortization schedule will approximate the revenue stream generated by the portfolio; e.g., if 20 percent of the revenue is recognized in the first year, it would be prudent to amortize 20 percent of the PCCR in that time frame.

There are numerous methods of performing valuations, some relatively aggressive and some conservative. For example, the valuation model should consider a termination value that could significantly increase the projected worth of the card portfolio and therefore support the booked PCCR.

Table 8: Example of Components in a Valuation Model

The following components often are disclosed or projected in an acquisition valuation model for actual and projected periods:

Total receivables	Net cost of funds
Average receivables	Losses: Charge-offs Recoveries
Amortization period (years)	
Percent of receivables capital funded	
Percent of premium capital funded	Net charge-offs
Accounts: Current Acquisitions Attrition rate Percent variable	Operating expenses: Recovery expense Collection expense Credit expense Customer service expense Development expense
Revenue: Finance charge Interchange Cash advance fee Annual fee Over-limit fee Late fee	Operations expenses: Systems expense Processing expense Conversion expense Other
	Total operating expense
Total fees	Termination value
Total revenue	Federal income tax
Funding: Portfolio cost of funds Funding of unamortized premium credits	Net income
	Discount rate
	Discount value
	Return on assets
	Return on equity

Appendix K: Glossary

Acquirer, acquiring member, or merchant bank: Bank, financial institution, or other payment card network member that maintains the merchant relationship and receives all credit card transactions. Sometimes referred to as the acquiring bank.

Adaptive control system: Credit portfolio management system designed to reduce credit losses and increase promotional opportunities. Adaptive control systems include software allowing bank management to develop and analyze various strategies that take into account customer behavior and economic environment. Refer to champion/challenger strategy.

Add-on: Additional service or credit product sold in connection with a credit account. Examples include travel clubs, disability insurance, credit life insurance, debt suspension agreements, debt cancellation contracts, and fraud alert programs.

Adverse selection: Disproportionately high response or acceptance rate to a marketing offer by high-risk customers in the targeted population. This situation generally occurs because the product or promotional design is flawed.

Affinity program: Credit card program issued by a bank in conjunction with such organizations as professional or trade groups, college alumni associations, or retiree associations. The issuing bank generally compensates the sponsoring organization on an ongoing basis in return for access to its membership.

Agent bank: Bank that, by agreement, participates in another bank's card program, usually by turning over its applicants for bank cards to the bank administering the card program and by acting as a depository for merchants.

Allowance for loan and lease losses (ALLL): Valuation reserve that is an estimate of uncollectible amounts (inherent losses) and that is used to reduce the book value of loans and leases to the amount expected to be collected. The allowance is established and maintained by charges against the bank's operating income, e.g., the provision expense.

Application scoring: Using a statistical model to objectively score credit applications and predict performance.

Attrition: All retail loan products undergo attrition, or the closing of accounts by either the customer or the bank, but the term is most commonly applied to credit card accounts.

Balance transfer: Transfer of an outstanding credit card balance from an account at one financial institution to an account at another institution. The receiving institution usually processes the transfer, but the consumer may make the transaction by using convenience checks written on the receiving institution.

Bank identification number (BIN)/Interbank Card Association (ICA): Series of numbers used to identify the settling banks for acquiring and issuing credit card transactions. These identifiers are a component of the customer account number embossed on credit cards.

Bank card association: Visa and MasterCard are examples of bank card associations. Only banks can be members, and only members can process transactions through an association's network. Non-members, however, may be able to process payments by renting membership rights from bank members. The associations specifically define membership rights, privileges, and obligations.

Bank cards: General purpose credit cards.

CEBA credit card bank: A special-purpose credit card bank excepted from the Bank Holding Company Act definition of "bank" by an exception established under the Competitive Equality Banking Act (CEBA) of 1987, which is codified at 12 USC 1841(c)(2)(F). Such banks may engage only in consumer credit card lending and may accept deposits only to secure those accounts or in amounts greater than $100,000. These banks typically have a nonbank holding company parent and often are affiliated with retailers. Although CEBA credit card banks often issue private-label cards, they may also issue general purpose credit cards.

Champion/challenger strategy: Banks often use a "champion/challenger" technique to test account management initiatives, in which the existing practice is deemed the champion, and one or more modifications applied to smaller portions of the portfolio are the challengers. After observing performance over a period, usually several months, a well-performing challenger may be applied to a larger population or may even replace the champion. Champion/challenger strategies are used extensively in the collection area for all types of retail loans and for ongoing account management functions for open-end credit.

Charge-back: Dispute procedure initiated by the card issuer after receiving an initial presentment from the acquirer. The issuer may determine that, for a given reason, the transaction was presented in violation of the rules or procedures and is eligible to be returned to the acquirer for possible remedy.

Chronology log: Chronological record of internal and external events relevant to the credit function.

Cobranded card program: Bank card program in which banks issue credit cards in conjunction with another company, usually bearing the logo of the other company. The program is generally associated with some type of partner rebate or other value-added incentive to the customer.

Coincident analysis: Analysis based on end-of-period delinquencies and losses in relation to total as of the same date. Distinguished from vintage, lagged, and other time series measures.

Consumer credit counseling (CCC): Nonprofit agencies that counsel overextended consumers and are funded by creditor "fair share" contributions (a negotiated percentage of the consumer's payment to the bank). CCC entities work with the consumers and their creditors to develop budget and debt repayment plans. Banks generally offer concessions to customers in CCC programs.

Consumer reporting agency: Any entity that, for monetary fees, dues, or on a cooperative nonprofit basis regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties, and that uses any means or facility of interstate commerce for the purpose of preparing or furnishing consumer reports.

Convenience user: Credit card holder who pays the outstanding balance in full by each payment due date. Also referred to as a transactor.

Corporate card program: Credit card program offered to companies, small businesses, and government entities to facilitate company travel (travel and entertainment cards) or procurement. Ultimate liability varies by contract, but companies often provide some type of guarantee in the event of cardholder abuse or nonpayment.

Credit bureau: Clearinghouse for information on the credit rating of individuals or businesses. The three largest credit bureaus in the United States are Equifax, Experian, and TransUnion.

Credit report: Report from a consumer reporting agency providing a customer's credit history. Credit reports are convenient and inexpensive, with larger users paying lower rates. A merged credit report obtains files from the three major credit bureaus.

Credit scoring: Statistical method for predicting creditworthiness of applicants and existing customers.

Cross-selling: Using one product or service as a base for selling additional products and services.

Debt burden ratio: Common measure of a consumer's ability to repay a debt. Also called debt-to-income or debt service ratio, it measures monthly debt obligations against monthly income.

Debt cancellation contract: Loan term or contractual arrangement modifying loan terms under which a bank agrees to cancel all or part of a customer's obligation to repay an extension of credit from that bank upon the occurrence of a specified event.

Debt service: Measure of a consumer's income in relation to committed debt payments.

Debt suspension agreement: Loan term or contractual arrangement modifying loan terms under which a bank agrees to suspend all or part of a customer's obligation to repay an extension of credit from that bank upon the occurrence of a specified event. The term "debt suspension agreement" does not include loan payment deferral arrangements in which the triggering event is the borrower's unilateral election to defer repayment or the bank's unilateral decision to allow a deferral of repayment.

Fee pyramiding: Occurs when fees result from imposition of other fees, for example, when posting a late payment fee on a credit card account causes the account to exceed its credit limit and to incur an over-limit fee. Regulation Z prohibits a bank from imposing more than one penalty fee based on a single event or transaction.

Five Cs of credit: Evaluation criteria typically used in a judgmental credit decision: character, capacity, capital, collateral, and conditions.

Fixed payment program: Also described as a "cure" or workout program. Includes CCC and in-bank programs designed to help customers work through some type of temporary or permanent financial impairment. Cure programs typically involve a reduced payment for a specified period of time and may also include interest rate concessions.

High-side override: Denied loan that meets or exceeds established credit score cutoff. To compute a bank's high-side override rate, divide the number of declines scoring at or above the cutoff score by the total number of applicants scoring at or above the cutoff.

Inherent losses: Amount of loss that meets the conditions of ASC 450-20 (formerly SFAS 5) for accrual of a loss contingency (i.e., a provision to the allowance). The term is synonymous with "estimated credit losses," which is used in the "Interagency Policy Statement on the Allowance for Loan and Lease Losses," originally issued on December 21, 1993.[52]

Interchange fee: Portion of discount fee (percentage of each transaction) paid by merchants on bank card transactions. Interchange fees are established by the bank card associations, based in part on the type of merchant and method of transmission from the merchant (i.e., online or off-line). The fee takes into account authorization costs, fraud and credit losses, and the average bank cost of funds.

Issuer: Institution (or agent) that issues a credit card to the cardholder. Sometimes referred to as issuing bank.

Lagged analysis: Analysis that minimizes effects of growth. Lagged analysis uses the current balance of the item of interest as the numerator (e.g., loans past due 30 days or more) and the outstanding balance of the portfolio being measured for some earlier time period (generally six months or one year ago) as the denominator.

Low-side override: Approved loan that fails to meet the scoring criteria. To compute the low-side override rate, the number of approvals scoring below the cutoff score is divided by the total number of applicants scoring below the cutoff.

[52] For more information, please refer to OCC Bulletin 2006-47, "Allowance for Loan and Lease Losses: Guidance and Frequently Asked Questions (FAQs) on the ALLL" (December 13, 2006).

Loss mitigation: Loan collection techniques used to reduce or eliminate the possible loss.

Managed assets: Total balance sheet assets plus all off-book securitized assets.

Merchant authorization: Issuance of a bank's approval of a credit card transaction in a specific amount. If a merchant complies with bank card association rules in obtaining an authorization, usually by telephone or authorization terminal, payment to the merchant is guaranteed.

Negative amortization: Increase in the capitalized loan balance that occurs when the loan payment is insufficient to cover the interest and fees due and payable for the payment period.

Open-to-buy: Difference between the outstanding balance and the credit limit on credit card accounts. The total amount of committed and as yet unfunded credit available to borrowers is a contingent liability.

Pay-ahead: Keeping track of excess payment amounts and reducing the next consecutive payment(s) accordingly. As a result, the consumer is not required by the bank to make payments until the amount of the overage has been extinguished. For example, if a consumer's minimum payment on the credit card account is $25 each month and the consumer remits $100, the next payment would not be due until the fourth subsequent month. Pay-aheads can pose increased risk because they do not require a minimum payment every month. When banks require customers to make monthly payments, the banks are able to monitor portfolio quality through more accurate delinquency reporting. Banks should limit the use of pay-aheads to accounts with low risk characteristics. Banks that accept pay-aheads on credit card accounts must refer to 12 CFR 1026.53, which sets forth the requirements for the allocation of the excess payment amounts.

Payment holiday (or skip-a-pay): Program that gives a financial institution's customers the option of skipping payments for a given month. Interest continues to accrue for the skipped time period. These programs are generally not considered prudent in credit card lending, and, if seen in practice, should be discontinued.

Penalty pricing: Increased finance charge imposed when a borrower fails to pay as agreed, based on performance criteria in the cardholder agreement. Penalty pricing is subject to the CARD Act and Regulation Z requirements and limitations.

Periodic rate: Finance charge expressed as a percentage that is applied to the outstanding balance of an open-end loan for a specified period of time, usually monthly.

Point of sale: Where a customer engages in a retail transaction.

Prescreen: To score or otherwise qualify a list of names or defined credit bureau population using credit bureau information. Under the FCRA, the issuer generally is required to make a firm offer of credit to the consumers it solicits for a credit card, or else, under the FCRA, it would not have a permissible purpose for obtaining the prescreened list (with limited exceptions).

Price point: Price tier into which banks segment retail portfolios. Price points show both rates and balances outstanding in each tier. Especially important when teaser rates are offered, price points enable banks to model past, present, and future revenue and the impact of shifts that result from pricing strategies. Some banks identify three tiers, such as low-rate teasers, medium-rate standard products, and high-yield loans; credit card issuers might analyze up to 50 price points.

Private-label credit card: Issued for use at a single retailer.

Procurement card program: Charge card program to facilitate corporate procurement. Balances on such cards are due in full each month or cycle.

Promise to pay: Used in collection departments to describe customers who have been contacted regarding their delinquent accounts and have committed to remitting payments. Once payment is received, it is reported under "promises kept."

Re-age: Returning a delinquent, open-end account to current status without collecting the total amount of principal, interest, and fees that are contractually due.

Reissue: Issuance of new bank cards to replace those that have expired or will expire for qualified cardholder accounts.

Revolvers: Credit card customers who pay less than the full outstanding balance on their accounts each month (so that the account "revolves").

Rewrite: Underwrite an existing loan by significantly changing its terms, including payment amounts, interest rates, amortization schedules, or final maturity.

Roll rate: Measure of the movement of accounts and balances from one payment status to another (e.g., percentage of accounts or dollars that were current last month rolling to 30 days past due this month).

Rollover: Carrying forward a portion of an outstanding balance on a credit card holder's account from month to month.

Secured credit card: Bank card secured at least in part by a deposit account held at the issuing bank or at a designated correspondent bank. The credit limit often is based on the amount of cash collateral provided.

Securitization: Process of creating an investment security backed by credit card receivables.
Settlement: Process by which acquirers and issuers exchange financial data and value resulting from sales transactions, cash advances, merchandise credits, etc.

Spread account: Most common form of securitization credit enhancement. A spread account carries reserves to absorb credit losses and generally equals two to three times the expected losses in the package of receivables or loans. The spread account is initially "seeded" (funded) by the selling bank. These advances usually are expensed to achieve treatment as sales under regulatory accounting procedures. Excess servicing income is deposited into this account each month until it is fully funded and the seed money is repaid to the selling bank. The securitization trustee controls the account.

Stress testing: Analysis that estimates the effect of economic changes or other changes on key performance measures (e.g., losses, delinquencies, and profitability). Key variables used in stress testing could include interest rates, score distributions, asset values, growth rates, and unemployment rates.

Sum-of-cycle reporting: Aggregates amounts based on their payment or billing cycle dates rather than the point-in-time reporting used in end-of-month (EOM) reporting. The benefit of this type of reporting is the ability to compare performance of accounts with different cycle dates on equal terms, e.g., total current versus delinquent accounts as of close of business on payment due date.

Teaser or introductory rate: Temporary interest rate offered by open-end credit lenders to consumers as an incentive to open accounts with the lenders. The teaser period generally lasts anywhere between six months and one year, and interest rates offered have been as low as zero percent. Customers' accounts revert to standard rate pricing after the introductory period. Card issuers must comply with the requirements of 12 CFR 1026.55(b)(1) when offering a temporary rate.

Third-party vendor or third-party service provider: Any third party that performs a function or provides a service on the bank's behalf. Although generally associated with outsourcing, equipment and supply providers are also considered third-party vendors.

Travel and entertainment card program: Charge cards with balances due in full each month (or cycle), issued to facilitate corporate travel and entertainment.

Vintage analysis: Grouping loans by origination time period (e.g., quarter) for analysis purposes. Performance trends are tracked for each vintage and compared with other vintages for similar time on book.

Appendix L: Abbreviations

ALLL	allowance for loan and lease losses
APR	annual percentage rate
ASC	Accounting Standards Codification
BAAS	Bank Accounting Advisory Series
BIN	bank identification number
CARD Act	Credit Card Accountability Responsibility and Disclosure Act
CCC	Consumer Credit Counseling
CEBA	Competitive Equality Banking Act
CFPB	Consumer Financial Protection Bureau
CFR	Code of Federal Regulations
CRA	credit reporting agency
DCC	debt cancellation contract
DDR	delinquency distributions report
DSA	debt suspension agreement
ECOA	Equal Credit Opportunity Act
EIC	examiner-in-charge
EITF	Emerging Issues Task Force
EMV	Europay, MasterCard, and Visa
EOM	end-of-month
FACT Act	Fair and Accurate Credit Transactions Act
FCRA	Fair Credit Reporting Act
FDCPA	Fair Debt Collection Practices Act
FFIEC	Federal Financial Institutions Examination Council
FICO	Fair Isaac Corporation
FinCEN	Financial Crimes Enforcement Network
FINDRS	Financial Institution Data Retrieval System
FMV	fair market valuation
FTC Act	Federal Trade Commission Act
GAAP	generally accepted accounting principles
ICA	Interbank Card Association
ICQ	internal control questionnaire
IE	income estimator
IRKI	Issuer Risk Key Indicators
MDDR	maximum delinquency distributions report
MIS	management information systems
NA	not applicable
NSF	not sufficient funds
OCL	over-credit-limit
OTS	Office of Thrift Supervision
PCCR	purchased credit card relationship
ROAA	return on average assets
ROE	return on equity
SAR	suspicious activity report
SCRA	Servicemembers Civil Relief Act

SFAS	Statements of Financial Accounting Standards
SOC	sum-of-cycle
T&E	travel and entertainment
TDR	troubled debt restructuring
UDAP	unfair or deceptive acts or practices
UDAAP	unfair, deceptive, or abusive acts or practices
USC	United States Code

References

Federal Consumer Protection Laws and Implementing Regulations Applicable to Credit Card Lending

Equal Credit Opportunity Act: 15 USC 1691 et seq.; 12 CFR 1002 (Regulation B)
Fair Credit Reporting Act: 15 USC 1681 et seq., as amended by the Fair and Accurate Credit Transactions Act of 2003; 12 CFR 1022 (Regulation V)
Fair Debt Collection Practices Act: 15 USC 1692 et seq.; 12 CFR 1006 (Regulation F).
Federal Trade Commission Act: 15 USC 45
Gramm–Leach–Bliley Act (privacy): 15 USC 6801 et seq.; 12 CFR 1016 (Regulation P)
Truth in Lending Act (TILA): 15 USC 1601 et seq., as amended by the Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act); 12 CFR 1026 (Regulation Z)

Other Laws and Regulations Applicable to Credit Card Lending

Statutes

National Banks

12 USC 24, "Corporate Powers of Associations"
12 USC 85, "Rate of Interest on Loans, Discounts and Purchases"
12 USC 484, "Limitation on Visitorial Powers"
12 USC 1867(c), "Bank Service Company Act"

Federal Savings Associations

12 USC 1464, "Federal Savings Associations"

Regulations

National Banks

12 CFR 3, subpart C (12 CFR 3.20–3.22), "Definition of Capital"
12 CFR 3, subpart D (12 CFR 3.30–3.63), "Risk-Weighted Assets–Standardized Approach"
12 CFR 3, subpart E (12 CFR 3.100–3.173), "Risk-Weighted Assets–Internal Ratings-Based and Advanced Measurement Approaches"
12 CFR 7.4000, "Visitorial Powers"
12 CFR 7.4001, "Charging Interest at Rates Permitted Competing Institutions; Charging Interest to Corporate Borrowers"
12 CFR 7.4002, "National Bank Charges"
12 CFR 7.4008, "Lending"
12 CFR 21.11, "Suspicious Activity Reports"
12 CFR 21.21, "Procedures for Monitoring Bank Secrecy Act (BSA) Compliance"

12 CFR 30, “Safety and Soundness Standards”
12 CFR 37, “Debt Cancellation Contracts and Debt Suspension Agreements”
12 CFR 41, subpart I, “Proper Disposal of Records Containing Consumer Information”
12 CFR 41, subpart J, “Identity Theft Red Flags”

Federal Savings Associations

12 CFR 3, subpart C (12 CFR 3.20–3.22), “Definition of Capital”
12 CFR 3, subpart D (12 CFR 3.30–3.63), “Risk-Weighted Assets–Standardized Approach”
12 CFR 3, subpart E (12 CFR 3.100–3.173), “Risk-Weighted Assets–Internal Ratings-Based and Advanced Measurement Approaches”
12 CFR 7.4010, “Applicability of State Law and Visitorial Powers to Federal Savings Associations and Subsidiaries”
12 CFR 21.21, “Procedures for Monitoring Bank Secrecy Act (BSA) Compliance”
12 CFR 30, “Safety and Soundness Standards”
12 CFR 41, subpart I, “Proper Disposal of Records Containing Consumer Information”
12 CFR 41, subpart J, “Identity Theft Red Flags”
12 CFR 128, “Nondiscrimination Requirements”
12 CFR 160, “Lending and Investment”
12 CFR 162, “Regulatory Reporting Standards”
12 CFR 163.176, “Interest-Rate-Risk-Management Procedures”
12 CFR 163.180, “Suspicious Activity Reports and other reports and statements”

Other Agencies

Statutes

12 USC 1818, “Termination of Status as Insured Depository Institution”
12 USC 5531, “Prohibiting Unfair, Deceptive, or Abusive Acts or Practices”
12 USC 5536, “Prohibited Acts”
31 USC 5311 et seq., “Bank Secrecy Act”

Regulations

12 CFR 1022, “Fair Credit Reporting” (Regulation V)
12 CFR 1026.11(c), “Timely Settlement of Estate Debts”
12 CFR 1026.56, “Requirements For Over-the-Limit Transactions”
17 CFR 229.1100, “Asset-Backed Securities” (Regulation AB)

Comptroller’s Handbook

Examination Process
“Bank Supervision Process”
“Community Bank Supervision”
“Federal Branches and Agencies Supervision”
“Large Bank Supervision”

“Sampling Methodologies”

Safety and Soundness, Asset Quality
“Allowance for Loan and Lease Losses”
“Concentrations of Credit”
“Loan Portfolio Management”
“Rating Credit Risk”
“Retail Lending Examination Procedures”

Safety and Soundness, Liquidity
“Asset Securitization”

Safety and Soundness, Management
“Internal and External Audits”
“Internal Control”

Safety and Soundness, Other Activities
“Merchant Processing”

Consumer Compliance
“Fair Credit Reporting”
“Fair Lending”
“Other Consumer Protection Laws and Regulations” (Fair Debt Collection Practices Act)
“Privacy of Consumer Financial Information”
“Servicemembers Civil Relief Act”
“Truth in Lending Act”

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Section 209, “Sampling” (November 2010)
Section 221, “Asset-Backed Securitization” (September 2003)
Section 340, “Internal Control” (October 2009)
Section 350, “External Audit” (July 2002)
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OCC Bulletin 1997-24, “Credit Scoring Models: Examination Guidance” (May 20, 1997)

OCC Bulletin 1999-10, "Subprime Lending: Interagency Guidance" (March 5, 1999)
OCC Bulletin 1999-15, "Subprime Lending: Risks and Rewards" (April 5, 1999) (not applicable to FSAs)
OCC Bulletin 2000-3, "Consumer Credit Reporting Practices: FFIEC Advisory Letter" (February 16, 2000)
OCC Bulletin 2000-20, "Uniform Retail Credit Classification and Account Management Policy: Policy Implementation" (June 20, 2000)
OCC Bulletin 2001-6, "Expanded Guidance for Subprime Lending Programs" (January 31, 2001)
OCC Bulletin 2002-16, "Bank Use of Foreign-Based Third-Party Service Providers: Risk Management Guidance" (May 15, 2002)
OCC Bulletin 2002-40, "Debt Cancellation Contracts and Debt Suspension Agreements: Final Rule," (October 16, 2002) (not applicable to FSAs)
OCC Bulletin 2003-1, "Credit Card Lending: Account Management and Loss Allowance Guidance" (January 8, 2003)
OCC Bulletin 2004-20, "Risk Management of New, Expanded, or Modified Bank Products and Services: Risk Management Process" (May 10, 2004) (national banks; for FSAs, refer to the *OTS Examination Handbook*, section 760)
OCC Bulletin 2006-34, "Gift Card Disclosures: Guidance on Disclosure and Marketing Issues" (August 14, 2006)
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Other

Financial Accounting Standards Board

ASC Topic 810, "Consolidations"
ASC Topic 860, "Transfers and Servicing"
ASC Subtopic 310-10, "Accounting by Creditors for Impairment of a Loan"
ASC Subtopic 450-20, "Loss Contingencies"
EITF 00-21, "Revenue Arrangements with Multiple Deliverables"
EITF 00-22, "Accounting for 'Points' and Certain Other Time-Based or Volume-Based Sales Incentive Offers and Offers for Free Products or Services to Be Delivered in the Future"
EITF 01-09, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)"

FFIEC

FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual (December 2, 2014)
FFIEC Information Technology Examination Handbook

OCC

An Examiner's Guide to Problem Bank Identification, Rehabilitation, and Resolution (January 2001)
Bank Accounting Advisory Series