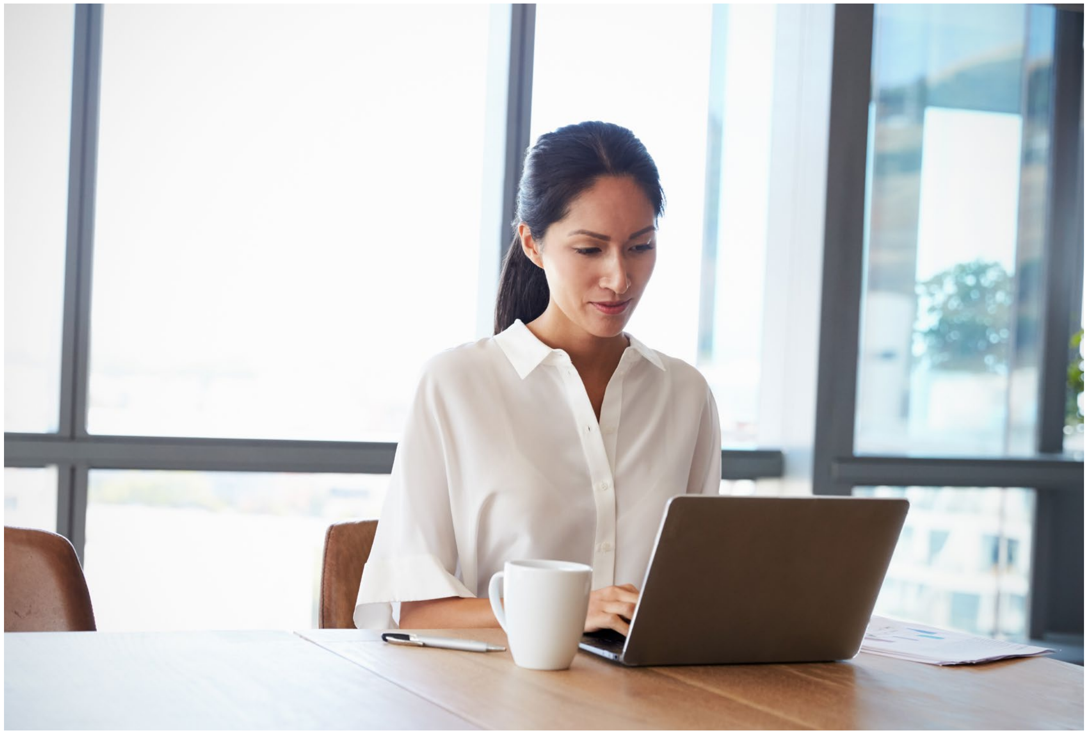
KPMG

Addressing top-of-mind credit card issuer challenges

Q4 2023

Content



Risk and regulatory

The financial industry faces dramatic shifts in risk and regulatory measures. **Late fees** cost American cardholders around $12 billion each year, according to the Consumer Financial Protection Bureau (CFPB). The agency proposed a rule[1] in February 2023 that would amend Regulation Z to "better ensure" credit card late fees are "reasonable and proportional" to late payments. Legal challenges to the proposed CFPB rule late fees on small business lending data could impact its final timeline.

The Federal Reserve Board (FRB) issued proposed amendments[2] to the **interchange fee cap** in Regulation II (Debit Interchange Fees and Routing), which potentially impacts debit card issuers' revenues. The Board of Governors discussed the rule in October 2023 and noted changes in fraudulent activity and transaction-processing costs. The final rule is set for June 30, 2025, but faces opposition from the American Bankers Association.

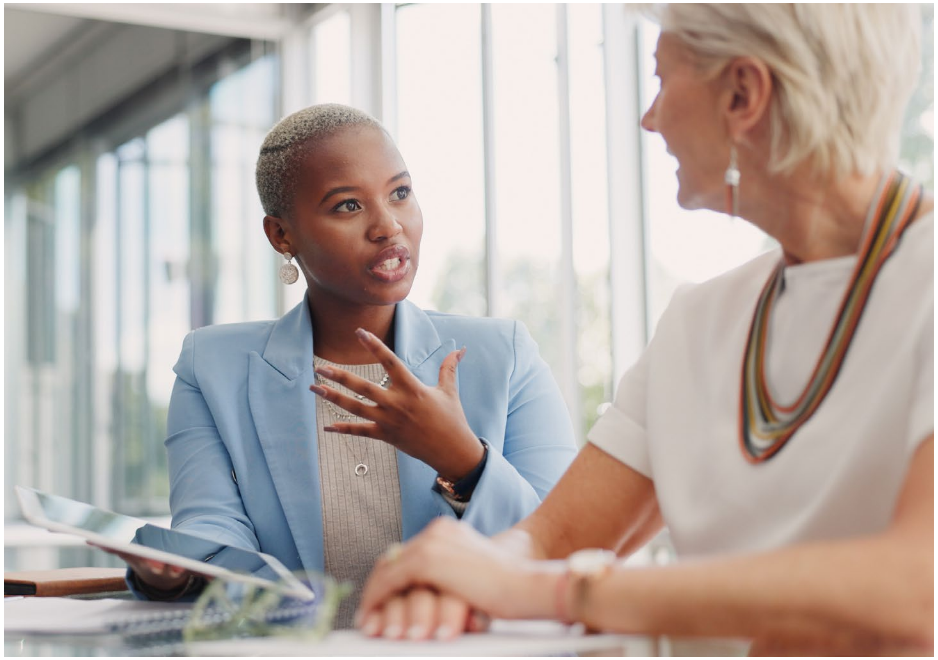
In line with global privacy regulations such as the EU's General Data Protection Regulation (GDPR) and the California Consumer Privacy Act (CCPA), the CFPB has proposed a rule[3] to implement "open banking" that would require depository and nondepository entities to share **consumer financial data** with both consumers and authorized third-parties, establishing privacy protections and access standards. This was issued on October 19, 2023, and the CFPB is currently taking comments, which are due no later than December 29, 2023.

Potential actions:

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

Thought leadership:

- CFPB Proposal for Late Fees
- FRB Proposal for Interchange Fees
- CFPB Proposed Data Rule



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

Credit

The credit industry has recently experienced significant growth, with credit card balances reaching $1.08 trillion in the fourth quarter of 2023. The $154 billion spike year over year is the largest since 1999. Delinquencies have returned to prepandemic levels, and continue to rise, particularly among those with auto loans or student loans. Household savings account balances are declining as credit card and other household debt balances rise, with student loans increasing to $1.6 trillion in the third quarter.

The consumer of credit card balances and loans may face cash constraints and is more likely to default on payments. This can result in higher credit delinquency rates and, ultimately, losses as student loan payments resume, and customers experience a "payment shock."

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

Potential actions:

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

Thought leadership:

- CECL Pulse Check Q4 2023
- Credit Markets Update Q3 2023

Accounting

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

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

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

FASB is currently redeliberating the transition guidance and evaluating stakeholders' comments. A final standard could potentially be issued in the second half of 2024, depending on how FASB deliberations take place.

Potential actions:

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

Thought leadership:

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

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