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Hot Topics in Credit Card Regulation and Finance

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Consumer Finance
MONTHLY BREAKFAST BRIEFING

Agenda

- Introduction to the Credit Card Regulatory Landscape
  - What requirements apply to credit cards and how do they differ from requirements applicable to other consumer credit products?
- Recent Trends in Enforcement and Consumer Litigation
  - What are the common pitfalls that lead to regulatory liability for credit card products?
- Transaction and Product Structuring Considerations
  - How does the discontinuance of LIBOR affect credit card securitizations differently than other financings?

REGULATORY LANDSCAPE

Regulatory Landscape—Scoping Considerations

- Regulatory requirements and key issues vary based on several factors
  - Major network vs. store credit card
  - Target market
    - Credit characteristics—prime vs. sub-prime; secured cards
    - Consumer-purpose vs. business-purpose
  - Vanilla open-end credit vs. multi-feature plan
  - Add-on products/services (credit and non-credit)
  - Physical card vs. virtual card

Regulatory Landscape—Compliance Obligations, in General

- Federal Consumer Financial Laws and Banking Laws

AML/KYC/OFAC	FCRA	MLA
ECOA	FDCPA	TILA/CARD Act
EFTA	GLBA	UDAAP

- Applicable State Laws
  - Bank vs. non-bank issuers
- Industry Governance and Self-Regulatory Obligations
  - Network Rules
  - PCI-DSS Standards

Regulatory Landscape—Heightened Risks—TILA/CARD Act

- Among federal laws, TILA imposes the most comprehensive set of requirements that are unique to credit cards.
- Significant day-to-day compliance considerations, including:
  - Disclosure requirements: Marketing, Origination, and Servicing
  - “Ability to Pay” underwriting standards
  - Fee restrictions
  - Payment processing and credit refund requirements
  - Dispute resolutions procedures

Regulatory Landscape—Heightened Risks—UDAAP

- UDAAP risk may be heightened by product terms and/or delivery methods.
- Product Terms
  - Promotional credit
  - Credit-related add-on products (*e.g.*, debt cancellation, credit monitoring, etc.)
  - Non-credit add-on products and services (*e.g.*, rewards programs, warranties)
- Delivery Methods—Heightened risk primarily driven by solicitation and/or payment acceptance by third parties.

Regulatory Landscape—Heightened Risks—Fraud/ID Theft/InfoSec

- Credit card programs are a common target for scammers, hackers, etc., in part because of a tempting combination of revolving credit lines and large volumes of personal data.
- Specific regulatory requirements:
  - FCRA/ID Theft Red Flags requirements
  - GLBA Safeguarding Rule
  - State information security requirements and data breach notification laws

Regulatory Landscape—
Heightened Risks—OFAC Screening

- Heightened OFAC risk due to ongoing extension of credit to cardholders
- Screening at account-opening may be insufficient and screening on a per-transaction basis is likely impractical
- Best practice = periodic portfolio screening as a component of a comprehensive OFAC compliance program

Regulatory Landscape—Heightened Risks—Charged-Off Accounts

- Sellers and purchasers of charged-off accounts face additional issues
- OCC Bulletin 2014-37 describes regulatory expectations for sales of charged-off consumer debt
  - Internal policies and procedures and purchaser oversight
  - Provide accurate and comprehensive account information
  - Exclude certain accounts and/or limiting collection activities
- CFPB and OCC enforcement actions against sellers and FTC actions against purchasers

ENFORCEMENT AND LITIGATION TRENDS

Enforcement and Litigation Trends—Promotional Credit Programs

- Deferred Interest
  - Marketing, Disclosures, and Consumer Understanding
  - Payment application
- Balance Transfer Programs
  - Solicitation UDAAPs
  - Interaction with grace periods

Enforcement and Litigation Trends—Credit-Related Add-On Products

- Deceptive sales practices
  - Misleading disclosures regarding eligibility, costs, and/or benefits
  - Misleading sign-up practices, such enrolling consumers who merely requested additional information
- Barriers to receiving full benefits of add-on products once enrolled
- Barriers to cancelling add-on products once enrolled
- Billing for services not actually provided (*e.g.*, credit monitoring)

Enforcement and Litigation Trends—Non-Credit Add-On Products and Services

- Deceptive sales practices, including misleading disclosures regarding eligibility, costs, and/or benefits
- Consumer confusion between rewards programs and credit programs (e.g., consumers believing that they were only applying for participation in a rewards program being issued a store credit card)
- Barriers to receiving full benefits once enrolled

Disclosure Issues Relating to Regulatory Enforcement Actions

- For a financing transaction, securitization or portfolio sale, lenders/investors/purchasers will want to conduct due diligence on regulatory actions and investigations.
- Confidential supervisory information, including MOUs, MRAs and other examination findings that are not made public cannot be disclosed by bank without regulatory approval.
  - May handle with an indemnification, repurchase obligation and/or covenant to comply with results of the examination; Inability to provide disclosure, may affect pricing

“True Lender” and Madden Risk

- “True Lender” and Madden Risk (reduced for performing credit cards vs. other consumer loans, but still present)
  - Arises in bank partner programs and in connection with sales of existing portfolios
  - Risk typically mitigated by several factors:
    - Bank named creditor on cardholder agreements and maintains account relationship (Krispin);
    - Bank typically remains involved with accounts through servicing;
    - Some bank partner programs try to further mitigate true creditor risk by having the bank retain an interest in the receivables or acquire a participation interest in sold receivables.

Enforcement and Litigation Trends—Other Issues

- Enforceability of arbitration provisions
- Debt collection practices
- Credit reporting practices

TRANSACTION AND PRODUCT CONSIDERATIONS

LIBOR Impact on Credit Card Securitizations

- As in many areas of the financial markets, credit card issuers are beginning to prepare for the transition away from LIBOR.
- Credit card issuers face a unique challenge because nearly all credit card master trusts rely on the grandfathering provision of the FDIC safe harbor for purposes of isolating the securitized receivables from the insolvency of the bank sponsor.
  - FDIC safe harbor requires the master trust to continue to meet the requirements of FAS 140, the accounting rules that were in effect before 2010.
  - FAS 140 required the issuer to meet the requirements of a "qualifying special purpose entity", including limitations on permitted activities.

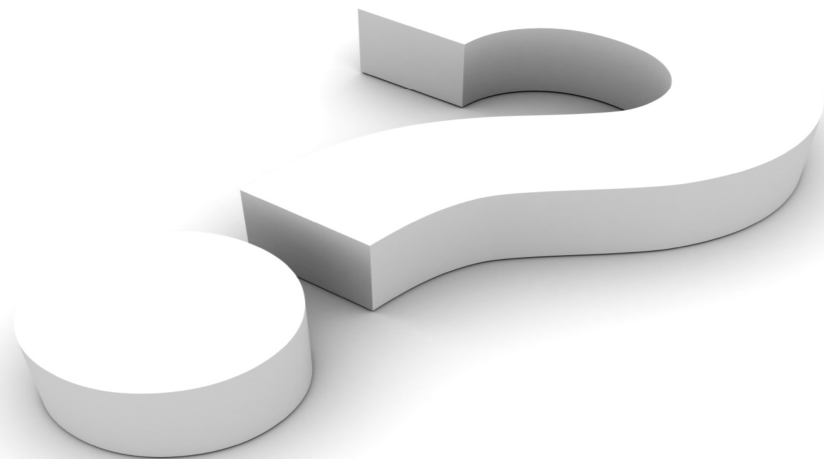
LIBOR Impact on Credit Card Securitizations

- How does a LIBOR fall-back provision implicate the old accounting rule?
- Typically trustees have been unwilling to determine the fall-back rate for term transactions, so sponsors will need to exercise some "discretion" in determining the fallback rate or otherwise put a procedure in place for determining the rate.
- Restrictions on permitted activities for "Qualifying SPEs" included:
  - "permitted activities (1) are significantly limited, (2) were entirely specified in the legal documents that established the SPE …"
  - Some credit card banks worry that exercising discretion on behalf of the issuer to change interest rates violates the above
  - External accountants are no longer willing to opine on FAS 140 compliance, so this will be an issue for internal accounting groups

LIBOR Impact on Credit Card Securitizations

- The subject of LIBOR fall-back provisions and related FAS 140 concerns have been the subject of many industry calls in recent months and discussions are ongoing.
- Some issuers seem to be getting comfortable with the FAS 140 analysis, and one issuer has recently filed a registration statement with the following provision:
  - "if… [Sponsor](or one of its affiliates) determines that LIBOR has been discontinued or is permanently no longer being published, the issuance trust will use a substitute or successor base rate that [Sponsor](or one of its affiliates) has determined, in its sole discretion after consulting any source it deems to be reasonable, is (a) the industry-accepted substitute or successor base rate or (b) if there is no such industry-accepted substitute or successor base rate, a substitute or successor base rate that is most comparable to LIBOR.
  - Other issuers exploring more automated reset provisions or continuing to analyze.

QUESTIONS?



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