CREDIT CARD LENDING

Core Analysis Procedures

Examiners are to consider these procedures but are not expected to perform every procedure at every institution. Examiners should complete only the procedures relevant for the institution's activities, business model, risk profile, and complexity. If needed, based on other identified risks, examiners can complete additional procedures not included below. References to laws, regulations, supervisory guidance, and other resources are not all-inclusive.

References

- *Interagency Guidelines Establishing Standards for Safety and Soundness (FRB: 12 CFR 208, Appendix D-1; FDIC: 12 CFR 364, Appendix A)*
- *Supervisory Guidance on Model Risk Management (FDIC: FIL-22-2017)*
- *Guidance on Model Risk Management (FRB: SR 11-7)*
- *Interagency Guidance on Credit Card Lending (FDIC: FIL-2-2003; FRB: SR 03-1)*
- *Uniform Retail Credit Classification and Account Management Policy (FRB: SR 00-8; FDIC:* FIL 40-2000*)*
- *FDIC: Credit Card Activities Manual*

Considerations and Background

This reference module applies to credit card banks and banks where credit card receivables are not primary loan products. Credit card banks deal with large volumes of accounts, have highly automated systems, and rely on credit scoring models. Consequently, credit card banks generally employ more specialized policies and procedures. FDIC Examiners should use the Credit Card Activities Manual as their primary reference tool when assessing a credit card bank.

This module addresses many of the same issues found in credit card banks and is designed to assess the asset quality aspects of credit card operations. The FDIC Credit Card Activities Manual includes further guidance regarding capital, earnings, interest rate risk, and liquidity.

The analysis of operating policies and procedures is fundamental to the examination of credit card banks and credit card operations. Credit card lending is characterized by a high volume of accounts, homogenous loan pools, and small-dollar balances; therefore, the review of individual accounts is not practical. Instead, examination procedures should focus on evaluating policies, procedures, and internal controls in conjunction with performing other selected functions. The goal is not confined to identifying current portfolio problems. The process should include consideration of potential problems that may result from ineffective policies, unfavorable trends, lending concentrations, ineffective underwriting or predictive models, or non-adherence to policies.

Proper account management and loss allowance principals are relevant to all institutions that offer credit card programs. The risk profile of the institution, the strength of internal controls (including internal audit and risk management), the quality of management reporting, and the adequacy of charge-off policies and loss allowance methodologies should be factored into the assessment of the overall adequacy of these account management practices. Scrutiny of, and risk management expectations for, certain practices (such as negative amortization of over-limit accounts) should be greater for higher risk portfolios and portfolio segments, including subprime portfolios. Refer to the January 2003 Interagency Guidance on Credit Card Lending for further discussion.

Findings and Conclusions
Document findings and conclusions here, and include a summary of these findings and conclusions in the appropriate Primary or Supplemental modules.

Preliminary Review
1. Review documents that may identify issues relating to credit card lending, such as: • **Prior examination reports and workpapers** • **Examination planning memoranda and file correspondence** • **Loan review reports** • **Internal and external audit reports** • **Loan committee minutes** • **Documentation of action taken by management to address prior recommendations**
2. Review UBPR data to determine the volume of credit card activity. UBPR ratios provide an overview of the financial condition of an institution and may help examiners determine the nature of the credit card operations.[1]
3. Review applicable state and federal laws and the bank's charter to identify restrictive provisions that may affect operations.[2]
4. Determine whether management plans to offer new products, enter new markets, or grow the credit card portfolio and consider their effect on the bank's financial condition.
5. Determine whether the institution is engaged in, or plans to engage in, subprime credit card lending. If subprime lending exists or is planned, complete the Subprime Lending ED Module in conjunction with this credit card activities review.[3]

[1] Examiners should use caution when comparing the peer group data of banks with large credit card operations to commercial financial institutions. Comparative data may not be relevant due to the unique aspects of credit card bank operations. Even comparisons with peers may be misleading because some credit card securitizers achieve off balance sheet treatment of their securitizations while others do not.

[2] Some credit card banks operate under restrictive laws or charters that may affect, directly or indirectly, lending and deposit functions and potential earnings.

[3] Some banks may enter agreements in which denied applications are forwarded to other lenders for a fee. These arrangements can subject the bank to reputational risk and should be reviewed closely.

6. Review correspondence and reports the institution received from credit card networks/agencies (i.e. VISA, MasterCard).

Policy Considerations

7. Review the credit card policy. Policy guidelines typically address:

- **Screening of account applicants**
- **Standards for approving accounts, assessing borrowers' ability to repay, and determining the size of credit lines**
- **Standards for reassessing borrowers' ability to repay and approving increases to existing credit lines**
- **Standards for approving the issuance of additional cards (multiple credit lines) to customers**
- **Minimum documentation standards**
- **Due diligence procedures for engaging (and monitoring) third parties**
- **Standards for reporting, approving, and managing policy exceptions**
- **Internal controls to prevent and detect fraud, such as:**
  - **Frequent review of delinquent and high risk accounts**
  - **Delinquency notification and collection procedures**
  - **Criteria for freezing accounts and charging off balances**
  - **Criteria for curing and re-aging delinquent accounts**
  - **Reissuance of expired cards to obligors with unsatisfactory credit histories**
  - **Approval of over-limits and overrides**
  - **Cardholder information security**

Audit

8. Review the adequacy of the audit function regarding credit card operations. Determine whether audits:

- **Identify contraventions of internal policy, Association (i.e. VISA and MasterCard) regulations, and written contracts**
- **Include reviews of the accuracy and integrity of the institution's management information systems for reporting past due credit card loans**
- **Include reviews of computer-driven models**
- **Independently test automated procedures, (for example, a sample of automatically re-aged accounts may be independently reviewed to test the integrity of automated systems)**
- **Include reviews of service performance and relationship documentation of outside vendors (such as telemarketing, data processing, and direct mail firms)**
- **Considers predictive models and oversight thereof**

- **Include a review of credit card processing operations[4]**

9. Determine whether management reviews and appropriately responds to audit findings regarding credit card operations.

Credit Line Management

10. Assess management's consideration of borrowers' repayment capacity before significantly increasing existing credit lines. Determine whether:

- **Assigned credit lines are managed conservatively using proven credit criteria**
- **Management considers the entire relationship prior to issuing additional cards, including store-specific private label cards and affinity relationship cards**

11. Determine whether management appropriately tests, analyzes, and supports account management practices (including credit-line management and pricing criteria) prior to implementing the practices. Generally, management will periodically review its practices and initiate changes when appropriate.

Over-Limit Practices

12. Evaluate account management practices designed to control authorizations and provide for timely repayment of over-limit amounts. Determine whether:

- **The institution's over-limit opt-in policy is appropriate**
- **Over-limit practices are prudent for all credit card accounts, especially subprime accounts**
- **Over-limit tolerances are liberal or if repayment requirements are adequate and do not magnify high-risk exposures to the lending institution**
- **Deficient reporting and loss allowance methodologies are understating the credit risk**
- **Over-limit practices are carefully managed and focus on reasonable control and timely repayment of amounts that exceed established credit limits**
- **Management information systems are sufficient to enable management to identify, measure, manage, and control the unique risks associated with over-limit accounts**
- **Over-limit authorizations on open-end accounts, particularly those that are subprime, are restricted and subject to appropriate policies and controls**
- **Controls are in place to prevent over-limit transactions when a customer does not participate in an over-limit option**

[4] The Product Control File, which governs credit card processing, frequently gives rise to a number of internal control weaknesses. A lack of segregation of duties and access controls are common weaknesses. Management should be aware of the risks and have an audit staff with the expertise to evaluate procedures and suggest controls for the risk.

Minimum Payment/Negative Amortization

The institution is required to disclose to the customer a minimum payment warning and a separate warning that the balance will never be paid off if the minimum payments result in negative amortization.

13. Determine whether there has been a general easing of minimum payment requirements by considering whether:

- **Prepayment formulas have the effect of further delaying principal payments**
- **Liberal repayment programs increase credit risk and mask portfolio quality**
- **Minimum payments consistently fall short of covering all finance charges and fees assessed during the billing cycle (which results in larger outstanding balances, i.e., negative amortization)**
- **The lender is recording uncollected income by capitalizing unpaid finance charges and fees into the account balance owed by the customer**
- **The risks of negative amortization are magnified by subprime accounts, especially when the condition is prolonged by recurring over-limit fees and other charges intended to increase recorded income for the lender rather than enhance the borrowers' access to credit**
- **Management requires minimum payments that will amortize the current balance over a reasonable period, consistent with the unsecured, consumer-oriented nature of the underlying debt and the borrower's documented creditworthiness**
- **Prolonged negative amortization, inappropriate fees, or other practices that inordinately protract consumer debt, disguise portfolio performance and quality, or raise safety and soundness concerns**

Fraud

14. Evaluate management's strategies for controlling fraud, such as emphasizing application reviews to prevent fraudulent accounts, or using algorithms to identify fraudulent transactions. Common controls include:

- **Application fraud practices such as name and address verification, duplicate application detection, social security number verification, etc.**
- **Card controls such as holograms, enriched magnetic strip information, chip technology**
- **Adequate staffing and training of fraud detection department**
- **Computer programs that identify suspicious activity**
- **Procedures to prevent interception and activation of issued cards**
- **Procedures for handling returned cards, statements, PINs, checks, and lost and stolen cards**
- **Procedures for freezing accounts or controlling over limit balances when payments are returned due to insufficient funds**
- **Investigation and documentation of suspected fraud**
- **Freezing accounts with suspicious activity**
- **Procedures for filing Suspicious Activity Reports (SAR)**
- **Procedures for appropriately accessing and altering customer information**
- **Procedures for managing card holder payments, account balance records, and chargebacks**
- **Account authorization procedures**

15. Determine whether management receives adequate fraud monitoring reports, such as: • **Out-of-pattern or sequence-of-purchase reports that identify suspicious transactions that do not fit a cardholder's purchasing patterns** • **Suspicious-purchasing-activity reports that identify purchases, such as electronics or jewelry, which may correlate with fraudulent activity**
16. Review consumer complaint correspondence from cardholders on file with the institution or primary federal regulator for irregularities or patterns of activity. Consider the credit card fraud warning signs outlined in Section 9.1, Bank Fraud and Insider Abuse, of the FDIC's RMS Manual of Examination Policies**.**
Account Solicitation
17. Assess whether the institution's marketing activities are consistent with its business or strategic plan and risk tolerance.
18. Review management's approach to account solicitations, such as using mass mailings, telemarketing, internet advertising, or counter displays, and preapproved or non-preapproved accounts.
19. Determine the extent to which outside contractors are used in marketing programs; mass mailing and telemarketing operations are frequently outsourced. ***Refer to Third Party Risks Reference ED Module.***
20. Review management's product and marketing programs, including program goals and product pricing.
21. Determine how management identifies target markets and evaluates expected performance. • **Consider the analytical procedures used to project results for a particular market solicitation. Procedures often include response rates, usage rates, credit score distributions, and future delinquency and loss rates.** • **Determine how management supports projections before proceeding with a full-scale solicitation program (test marketing).**

22. Determine whether management monitors solicitation results and incorporates findings into future solicitations. This monitoring is generally done for each major account segment.	
23. Determine whether management monitors and responds to adverse selection trends. Adverse selection occurs when a disproportionate number of higher-risk applicants respond to an offer, which results in a higher than projected volume of riskier accounts in the solicitation response pool.	
24. Review affinity and co-branding relationships, and determine whether the institution adequately controls the approval and acceptance of accounts.[5]	
25. Review new product offerings. Key concerns with new product offerings include: • **The amount of historical and test sample data used to analyze the product or solicitation,** • **The speed at which the new product is introduced, and** • **The size of solicitations.**	
26. Determine whether management had any problems due to the wording of solicitations or applications. Imprecise offer terms can lead to asset quality and earnings problems. Problems often result from: • **No expiration date on the offer** • **Wording that fails to give management discretion in setting credit limits** • **Insufficient applicant information requirements**	
27. Review balance-transfer policies and monitoring practices. Balance transfers generally result in higher exposure and can distort ratios due to the immediate booking of relatively large balances.	
28. Review teaser-rate practices. Without adequate monitoring and controls, teaser rates may disguise a borrower's repayment capacity or contribute high attrition when teaser rates expire.	

[5] Co-branding is a third party relationship that exists between a broad base of cardholders and a jointly sponsored credit card. The bank and usually a retail merchant are the sponsors, and the cards may include features such as cash rebates or discounts on merchandise. The relationships often require the bank to fund a significant portion of marketing programs that are administered by the co-branding partner.

Predictive Models
Credit card banks may use predictive models to limit risks and maximize profitability. Credit-scoring models are generally used during the application process. Behavioral models are often used during the management of existing accounts. Both models use a credit scorecard. The scorecard is a table of characteristics, attributes, and scores that help a credit grantor to predict account behaviors and risks.
29. Identify the types of predictive models used and determine whether the models are generic, custom, or vendor-supplied. If the bank is using a custom model, determine whether the reliability of the model was tested using out-of-sample data before implementation. This can be accomplished by using test accounts or applying a subset of the portfolio that has characteristics different from the original values used to create the model.
30. Review integrated credit-risk assessments and behavioral scoring models used in identifying and selecting prospective customers. Information derived from these models can help management identify, quantify, and minimize credit risk and fraud loss.
31. Determine how management uses models to make decisions and whether each model's use is consistent with its intended purpose.
32. Determine whether management fully understands and effectively implements any predictive models used.
33. Determine whether management reviews models for accuracy and makes adjustments when risk tolerances or business strategies change.
Credit Scoring
34. Assess the nature and extent that credit scores are used in the underwriting process.
35. Review cut-off scores and odds charts to assess the level of risk being taken.

36. Determine the degree of reliance placed on credit bureau validation tables.[6]
37. Assess the institution's model calibration procedures.
38. Determine whether recent calibrations are well documented and have been properly executed.
39. Determine whether management uses a single or dual score model. A single score model will use credit bureau scores. A dual score matrix will calculate a score based on the combination of a custom score, usually based on credit application data, and the credit bureau score. For complex operations, management generally uses the more sophisticated dual scoring model.
Behavioral Scoring System
40. Determine whether management implemented a behavior scoring system to manage existing accounts. The score is derived from a cardholder's payment and card-use behavior with the card-issuing bank. A cardholder's historical performance with a particular institution is typically the best indicator of future performance with that institution. Behavior scores are frequently supplemented with credit bureau scores to enhance their predictive value.
41. Determine whether management periodically refines existing or considers new predictive models. • **Determine whether a "champions and challengers" system is in place. Such a system involves ongoing portfolio analysis and identification of predictive characteristics. Based on this analysis, existing models are revised and enhanced. The revised challenger model is then compared with the existing champion model. If the challenger model is more predictive, it is typically adopted.** • **Determine whether management adopted or is considering using new predictive models. New models include revenue, revolving, bankruptcy, and payment predictors.**
Model Governance
42. Assess the adequacy of policies providing oversight commensurate with the overall reliance on models.

[6] These charts are only a starting point. With historical account data, management generally develops its own odds chart. Given sufficient quantity and quality of historical information, a customized odds chart should be more predictive than credit bureau data. This process is referred to as calibrating.

43. Determine whether management provides adequate controls over each model's use, based on the criticality and complexity of the model.[7]
44. If using credit scoring, determine whether management is validating scores regularly. Validation compares account quality rank of accepted applications to that predicted by the system. As long as the rank orderings remain substantially the same, the scoring system remains valid. To assess validation procedures: • **Evaluate the scope of the validation work performed.** • **Review reports summarizing validation findings and any additional workpapers necessary to understand findings. (For example, review the statistical techniques used to validate each model. Common statistical techniques used include K/S Test, Chi Square, Goodness of Fit Test, Divergence Statistics, and the Population Stability Test. Examiners generally do not need to know the details of these tests, just that they are generally acceptable validation tests or techniques.)** • **Evaluate management's response to the reports, including remediation plans and timeframes.** • **Determine whether staff or vendors performing the validation are qualified.** • **Determine whether high and low override controls exist and are detailed on exception reports. (Overrides can skew a statistical population and distort analysis.)** • **Assess override policies and practices.** • **Review the number, volume, and types of overrides.** • **Verify override reports are reviewed by management and that performance is adequately tracked.** • **Determine the impact of overrides on asset quality.**
45. Assess the adequacy of an internal audit or independent review process. The process generally tests model control practices and model validation procedures to ensure compliance with established policies and procedures.
Portfolio Analysis
46. Review customized credit card bank reports.[8]

[7] Data integrity is vital to model performance. Much of the information used in a model is electronically extracted or manually input from source systems; either approach provides opportunity for error.

[8] These reports provide various ratios and peer group data. However, even within the industry, peer group data may be distorted due to niche marketing, specialized card products, or extensive affiliate support.

47. Determine whether management adequately segments portfolios for delinquency, profitability, future marketing, allowance for loan and lease losses (ALLL) or allowance for credit losses (ACL)[9] for loan and lease calculations, and other purposes.[10]
48. Determine whether geographic, customer base, card type, or other concentrations exist. Identify the risks posed by the portfolio segments or concentrations and assess associated risks and mitigating factors.
49. Review how management uses portfolio information to identify developing trends, make strategic decisions, and detect potential problems. • **Determine how internal reports identify the number and volume of workout and re-aged credits (such as when a customer's delinquency status is changed by the institution without full collection of delinquent payments).** • **Evaluate the information that management reviews, such as asset quality ratios and vintage analysis (i.e., analysis of account performance of homogenous loans booked at a similar time using the same credit and pricing criteria).**
50. Determine whether cash advances are monitored and authorization procedures are in place and followed. (Cardholders with excessive debt may obtain cash advances to pay other debts.)
51. Review the level and trend of ratios, such as:[11] • **Average Balance of Delinquent Accounts (by 30-day time frames) to Average Balance of Non-Delinquent Accounts** • **Lagged Delinquency Rate and Nine-Month Net Charge-offs to Lag Rates** • **Net Charge-off Rate and Lagged Net Charge-off Rate** • **Re-aged Accounts and Partial Payment Plans to Total Active Accounts and to Average Total Loans** • **Total Past Due Loans to Gross Loans** • **Noncurrent Loans to Gross Loans**

[9] The ACL for loans and leases is the term used for those banks that adopted ASU 2016-13, replacing the ALLL used under the incurred loss methodology.

[10] Portfolios are commonly segmented based on geographic or demographic distribution, affinity relationship (cardholders belonging to a particular union, corporation, professional association, etc.), product type (premium or standard cards), credit bureau scores, or other segmentation basis.

[11] These ratios are discussed further in agency manuals: FDIC: Refer to the Credit Card Activities Manual, FRB: Refer to Commercial Bank Examination Manual, Section 2130.1.

52. Consider factors that may indicate possible deterioration in asset quality, such as:

- **Rapid portfolio growth due to lower underwriting standards**
- **Low minimum payment requirements or extended payment cycles, which may result in negative amortization or less creditworthy accounts**
- **A high ratio of total accounts being charged-off to the total number of accounts, or an increasing average balance for accounts**
- **Low payment rates combined with increasing average balances, which may indicate borrowers are having trouble servicing their debt**
- **The ratio of income-earned-not-collected to total loans is high compared to the ratio of total-past-due-loans to gross loans, which may indicate frequent re-agings, inadequate collection procedures, or failure to promptly charge-off credit card receivables**
- **The average age of accounts may indicate that loss rates will rise for unseasoned accounts (typically, loss rates are low for new offerings and peak after 18-24 months)**

53. Evaluate management practices on cure programs, such as re-agings, loan extensions, deferrals, fixed payments, and debt forgiveness.

- **Determine whether cure programs address the issues discussed in the** FFIEC Uniform Retail Credit Classification and Account Management Policy**.**
- **Determine whether management monitors and analyzes the performance of each program (for example, do programs achieve objectives for reducing delinquency ratios or improving borrowers' subsequent performance).**
- **Assess the current and potential impact of such programs on reported performance and profitability, including ALLL or ACL for loans and leases, as applicable, implications.**
- **Determine whether third parties purchase loans or fund loan payments to cure loan delinquencies and, if so, assess the effect.**

54. Determine whether management developed contingent strategies to deal with rising delinquency levels. Strategies may include:

- **Reviewing accounts more frequently**
- **Decreasing the size of credit lines**
- **Freezing or closing accounts**
- **Increasing collection efforts**

55. Assess management's compliance with credit card policies and procedures by reviewing a sample of credit card loans originated since the prior examination.

56. Determine the level of classifications:

- **Ascertain the accuracy and integrity of the institution's system for reporting past due status. Review a sample of loans to determine accuracy of past due status.**
- **Determine whether and how the institution's classification and charge-off procedures reflect consideration of the FFIEC Uniform Retail Credit Classification and Account Management Policy.**

Workout and Forbearance Practices

If the bank does not have strong reporting, internal controls, and independent review procedures regarding workout and forbearance practices, examiners should consider asking the bank to run queries to test the bank's practices.

57. The following queries may be used to test bank practices:

- **Identify accounts that were past due as of MM/DD/YY, and current as of MM/DD/YY (usually 60 days after the first date). Do not include charged-off accounts.**
- **Identify accounts since MM/DD/YY that were ever greater than 90 contractual days delinquent, current the following month or billing cycle, and have not been charged-off.**
- **Identify accounts that were ever greater than 120 contractual days delinquent since MM/DD/YY, and have not been charged-off to date.**
- **Identify accounts in MM/DD/YY with late fees assessed and later reversed.**
- **Identify accounts with an NSF payment in MM/YY (one month or longer period).**
- **Identify accounts that were re-aged between MM/YY and MM/YY (one month or longer period).**
- **Identify accounts that have been re-aged more than once.**
- **Identify accounts booked between MM/DD/YY and MM/DD/YY (choose a period appropriate for the bank) with no up-front FICO scores or a FICO score less than 660.**
- **Identify accounts booked between MM/DD/YY and MM/DD/YY with application scores below the bank's application cutoff scores (i.e. low side overrides).**
- **Identify accounts with credit-line increases in MM/YY. Include the account balance, delinquency status, credit line limit, and scores (i.e. FICO, behavior, credit line scores–if used to qualify for the line increases) prior to the credit line increase. Also, provide the new credit line limit.**
- **Identify accounts placed in a workout program between MM/DD/YY and MM/DD/YY.**
- **Identify accounts booked in MM/YY that never made a payment.**

58. Determine whether management is properly managing workout programs. Consider:

- **Evaluating the adequacy of MIS reports used to monitor program performance**
- **Reviewing for liberal repayment terms, extended amortizations, high charge-off rates, moving accounts from one workout program to another, or multiple re-agings**
- **Assessing temporary hardship programs that help borrowers overcome temporary financial difficulties[12]**

[12] Temporary hardship programs longer than 12-month duration, including renewals are considered workout programs; less than 12-months are not considered workout programs.

- **Assess repayment terms for accounts in workout programs[13]**
- **Determine whether workout programs are designed to maximize principal reduction[14]**

59. Determine whether the institution appropriately negotiates settlement agreements with borrowers who are unable to service their unsecured open-end credit.

60. Assess the institutions' charge-off practices with regard to settlements. Determine whether debt forgiven in a settlement arrangement is reported as charge-off on Call Reports.

Income Recognition

61. Determine whether management appropriately evaluates the collectability of accrued interest and fees on credit card accounts.

62. Determine whether the institution employs appropriate methods to ensure income is accurately measured.

63. Determine whether management accounts for the owned portion of accrued interest and fees, including related estimated losses, separately from the retained interest in accrued interest and fees from credit card receivables that have been securitized.

Allowance for Credit Losses on Loans and Leases

Use procedures 64-68 to assess the ACL for loans and leases methodology for institutions that have adopted ASU 2016-013, and use procedures 64a-68a to assess the ALLL methodology for institutions that have not adopted ASU 2016-013.

64. Determine whether the policy for the ACL for loans and leases is appropriate, and the supporting methodology is documented and reasonable. Roll-rate analysis (migration of an account from one billing cycle to the next), generally performed for each portfolio segment, has been the industry standard. However, some banks use other methods, such as:

- **Delinquency analysis using a set percentage of loans over 60 days delinquent**

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[13] Reduced minimum payment requirements in combination with continued charging of fees and finance charges may result in extended repayment periods well beyond reasonable periods.

[14] Workout programs generally strive to have borrowers repay credit card debt within 60 months, with exceptions clearly documented and supported by evidence that less conservative terms and conditions are warranted.

• **Exposure analysis that projects net charge-off rates to each 30 day period of delinquency** • **Charge-off projections based on vintage analysis** • **Historical rolling average analysis based on charge-off rates for a specific time period** • **Analysis based on external economic forecasting services**
65. Review the ACL for loans and leases methodology for reasonableness. Several variables, such as aggregating seasoned and unseasoned portfolios, can significantly distort the calculation of required allowance allocations.
66. Determine whether the ACL for loan and lease methodology is comprehensive and consider factors such as:[15] • **Contingent liabilities (risks associated with undisbursed funds, unless unconditionally cancelable)** • **Bankrupt and deceased cardholders (such losses are often not identified by roll rate analysis)** • **Economic conditions and reasonable and supportable forecasts (unemployment and bankruptcy rates significantly affect asset quality)** • **Number and volume of workout and re-aged credits (consider over-limit portfolio segments)** • **Workout programs (particularly when repayment periods are liberal)**
67. Determine whether fraud losses are charged to the ACL for loans and leases or included in ACL for loans and leases calculations per the instructions for the Call Reports.
68. Determine whether, after a loan is charged off, management properly reports any subsequent collections on the loan.[16]
64.a. Determine whether the ALLL policy is adequate, and the supporting methodology is documented and reasonable. Roll-rate analysis (migration of an account from one billing cycle to the next), generally

[15] A prudent practice is to segregate workout and re-aged credits from the rest of the portfolio because the accounts typically have higher charge-off rates.

[16] Per Call Report Instructions, institutions must ensure that the total amount credited to the ACL for loans and leases as recoveries on a loan (which may include amounts representing principal, interest, and fees) is limited to the amount previously charged off against the ACL on loans and leases on that loan (which may have been limited to principal). Any amounts collected in excess of this limit should be recognized as income. To include any excess as a recovery, understates an institution's net charge-off experience, which is an important indicator of the credit quality and performance of an institution's portfolio. (Refer to the ACL definition in the Call Report glossary for more information.)

performed for each portfolio segment, is the industry standard. However, some banks use other methods, such as: • **Delinquency analysis using a set percentage of loans over 60 days delinquent** • **Exposure analysis that projects net charge-off rates to each 30 day period of delinquency** • **Charge-off projections based on vintage analysis** • **Historical rolling average analysis based on charge-off rates for the last six months** • **Analysis based on external economic forecasting services**
65.a. Review ALLL calculation techniques for reasonableness. Several variables, such as aggregating seasoned and unseasoned portfolios, can significantly distort the calculation of required allowance allocations.
66.a. Determine whether ALLL calculations are comprehensive and consider factors such as:[17] • **Contingent liabilities (risks associated with undisbursed funds)** • **Bankrupt and deceased cardholders (such losses are often not identified by roll rate analysis)** • **Economic conditions (unemployment and bankruptcy rates significantly affect asset quality)** • **Number and volume of workout and re-aged credits (consider over-limit portfolio segments)** • **Workout programs (particularly when repayment periods are liberal)**
67.a. Determine whether fraud losses are charged to the ALLL or included in ALLL calculations per the instructions for the Consolidated Report of Condition and Income.
68.a. Determine whether, after a loan is charged off, the institution properly reports any subsequent collections on the loan.[18]
Asset Securitization

[17] An effective practice is to segregate workout and re-aged credits from the rest of the portfolio because the accounts typically have higher charge-off rates.

[18] Per the Call Report Instructions, institutions must ensure that the total amount credited to the ALLL as recoveries on a loan (which may include amounts representing principal, interest, and fees) is limited to the amount previously charged off against the ALLL on that loan (which may have been limited to principal). Any amounts collected in excess of this limit should be recognized as income. To include any excess as a recovery, understates an institution's net charge-off experience, which is an important indicator of the credit quality and performance of an institution's portfolio. (Refer to the ALLL definition in the Call Report glossary for more information.)

FDIC: Refer to the [Credit Card Securitization Manual] ***when examining credit card banks that securitize credit card receivables. FRB: Refer to the*** [Commercial Bank Examination Manual]***, Section 2130, Consumer Credit.***
69. Determine whether delinquency and loss rates are similar for the owned portfolio and the securitized portfolio. (Slightly higher delinquency and net charge-off ratios on securitized assets may be prevalent if the bank is experiencing high growth and possesses a significant portion of unseasoned accounts.) • **If the delinquency and loss rates deviate significantly, determine whether management is selectively prioritizing credit card receivables (by either high credit quality or superior past credit history) and segregating them for asset securitization. Ratios that are generally similar for managed and owned portfolios include the noncurrent loans to gross loans ratio and the total past due loans to gross loans ratio.**
70. Assess the on- and off-balance sheet effects of asset securitization.[19]
Third Parties
71. Determine whether any credit card related activities are outsourced. If so, complete the Third Parties section of the Subprime Lending ED Modules or the Third Party Risk ED Module.[20] • **Determine whether third party contracts provide the bank with sufficient access to financial and operating information to assess the performance of the third party.** • **Determine whether management monitors the financial and operating performance of major third party vendors.**
72. Determine whether the institution shares a BIN (bank identification number) with a third party. Sharing of BINs can create financial liability. As such, an institution sharing a BIN generally has a process to identify, monitor, and control the risks associated with BIN sharing.[21]
End of Core Analysis.

[19] Analyzing the performance of securitized assets is important because the level of a credit card bank's earnings and capital are largely dependent upon the quality of its average total assets under management and not merely the owned credit card portfolio.

[20] Third parties may include brokers, marketing firms, collection or servicing firms, correspondents, affinity partners, and information systems firms.

[21] Certain VISA and MasterCard members are assigned BINs (represented by a series of numbers on the credit card) for clearing and settlement of their credit card activities. Members that are licensed specific BINs may allow other members to deposit and receive transactions through those BINs. However, the BIN licensee (holder of the BIN) has primary responsibility for transactions processed through its BIN. In addition, users of a BIN other than the BIN licensee (BIN holder) may share responsibility for transactions processed under that BIN in the event that the licensee fails to meet its membership obligations.