III. IDENTIFYING INVOLVEMENT IN CREDIT CARD ACTIVITIES

Banks are important participants in credit card systems and networks. Involvement could include:

- Directly issuing the accounts and holding the receivables.
- Directly issuing the accounts and **securitizing** the receivables.
- Purchasing credit card receivables and/or relationships.
- Renting their rights to offer credit card products under the Associations' logos to a third party in return for a fee (otherwise known as Rent-a-BINs).
- Servicing credit card portfolios, including collections and customer service.
- Providing payment **processing** and **lockbox** services.
- Providing **clearance** and **settlement** of cardholder transaction data as well as funds for the transactions.
- Serving as an **acquiring bank**.
- Serving as an **agent bank**.
- Or a combination these or other functions.

The terminology used to describe the manner in which a bank is involved in credit card activities can vary widely and continues to transform. Nonetheless, credit card lending typically has wide-spread impacts on many components of the bank, including, but not limited to, the Allowance for Loan and Lease Losses (ALLL), capital, funding, earnings, and rate sensitivity. That coupled with the dynamics of the credit card market requires the bank to carefully and attentively manage every aspect of the credit card lending process. The following sections are intended to assist the examiner in determining whether and how the bank is involved in credit card activities and include brief overviews of the activities.

CREDIT CARD SPECIALTY BANKS (CCSBs)

By definition, CCSBs focus on one type of lending – credit card lending. According to the March 2005 update of A User's Guide for the Uniform Bank Performance Report (UBPR), a bank must exhibit two features to be considered a CCSB. Their (Credit Card Loans plus Securitized and Sold Credit Card Loans) divided by (Total Loans plus Securitized and Sold Credit Cards) must exceed 50 percent. In addition, their (Total Loans plus Securitized and Sold Credit Card Loans) divided by (Total Assets plus Securitized and Sold Credit Card Loans) must exceed 50 percent.

CCSBs are one of four broad groups within the UBPR's peer group structure and are subdivided into three groups based on asset size, using 90 day average assets from Call Report schedule RC-K. CCSB peer group numbers are 201, 202, and 203 and have asset sizes of greater than $3 billion, between $1 billion and $3 billion, and less than $1 billion, respectively. Risks for these types of banks center on credit risk from the card portfolio. If securitizations are involved, the liquidity, capital, strategic, reputation, and operational risks are further impacted.

Due to the dynamic environment of the credit card industry and the participation of many banks in credit card activities in some material degree or another, this manual covers not only CCSBs but many other types of credit card operations.

RENT-A-BINS

Association members include issuing members and acquiring members. Issuing members contract with the cardholders to issue products. In other words, they sign the cardholders. Acquiring members, however, partake in the acquisition of merchants to accept credit cards as payment for good and services and also partake in the acquisition of cardholder transactions. When a bank is contracting with the Associations, it identifies which business it will conduct. Banks often specialize on one side or the other (issuer or acquirer), but can do both. Based on the type of business that will be conducted, the Associations assign one or more Bank Identification Numbers (BINs) (Visa) or Interbank Card Association (ICA) (MasterCard) numbers to member banks to identify the business purpose(s). The number is reflected as the first several digits of the account number and is used for many purposes such as issuing, processing, settling, and reporting. For simplicity, these numbers will be referred to as BINs in this manual. Members which are licensed BINs may allow other entities to conduct various credit card related activities through the member's BIN. These arrangements are typically referred to as Rent-a-BINs.

There are essentially two types of Rent-a-BINs: an issuing Rent-a-BIN and an acquiring Rent-a-BIN. A credit card issuing Rent-a-BIN is an arrangement whereby a bank "rents" its right to offer credit card products and other services under the applicable Association's logo to a third party in return for a fee. The arrangement essentially entails the bank lending its name and regulated-entity status to a credit card program operated by the third party (which may or may not be affiliated with the bank). Issuing Rent-a-BIN arrangements can take on a variety of structures. For example, some banks have arrangements with several third parties for different credit card programs, and contracts for certain portfolio services (customer service, processing, and so forth) could be with the BIN-renter or other third parties. Further, the bank might perform certain services. Under an issuing Rent-a-BIN arrangement, the bank generally transfers all or a majority of the credit card receivables off its books; however, the bank sometimes retains some or a majority of the receivables. The bank retains ownership of the card accounts and/or relationships. A contract typically governs the relationship between the bank and the BIN-renter, including specifying the responsibilities of each party. Legal, compliance, reputation, and counter-party risks are the crux of the bank's risks for issuing Rent-a-BIN arrangements. However, there are a number of other potentially significant risks, such as funding and credit risk, which can impact the bank and largely tie to the financial wherewithal and practices of the third parties involved. Additional information on issuing Rent-a-BINs is found in Chapter XIV.

An acquiring Rent-a-BIN is an arrangement whereby an acquiring bank allows an **Independent Sales Organization (ISO)** or **Member Service Providers (MSP)** to utilize (or rent) the bank's BIN number to acquire and settle merchant credit card transactions in return for a fee. Risks associated with acquiring Rent-a-BIN activities center on risk from losses (in this case **charge-backs**), counter-party risks, and legal, compliance, and reputation risks, among other risks. Acquiring Rent-a-BINs are discussed in the Merchant Processing chapter.

For both types of Rent-a-BINs, the bank retains its contract(s) with the Association(s), and as such, accountability (including financial responsibility) for activities conducted with its BINs, and hence, many of the risks. Since American Express and Discover only recently expanded their access to banks, little is known about any such branded Rent-a-BIN activities.

ACQUIRING BANK

An acquiring bank, also known as a merchant bank, contracts with (or acquires) merchants, either directly with the merchant or indirectly through **agents** or other entities, for the settlement of card transactions. Many banks serve as acquiring banks for local merchants. The acquiring bank generally owns the BIN and provides **backroom operations**. It also carries the risk of charge-backs, which can be significant, if the merchant is unable or unwilling to honor the financial liability. Other risks include transaction, liquidity, compliance, strategic, and reputation risks. Information on acquiring banks is housed in the Merchant Processing chapter.

AGENT

A definition of agent is not universally set. However, agent banks contract with merchants on behalf of an acquiring bank and are usually community banks that do not directly offer merchant processing services. Depending on each applicable contract, an agent bank may or may not retain liability for charge-backs. In addition to sourcing merchants, agents can also source cardholders or provide other services, such as back-room processing or servicing loyalty programs. The Merchant Processing chapter contains additional information on agent banks.

CEBA CREDIT CARD BANKS

A **CEBA bank** is a type of national bank charter which affects the bank's lending and deposit functions. Requirements are set forth in an amendment to the Bank Holding Company Act (BHCA), the Competitive Equality Banking Act (CEBA) Act of 1987, hence the name CEBA bank. To qualify, the bank must:

- Engage only in credit card activities.
- Not accept demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties.
- Not accept any savings or time deposits of less than $100M unless they are used as collateral for secured credit card loans.
- Maintain only one office that accepts deposits.
- Not engage in the business of making commercial loans.

Some states have bank statutes with similar restrictions.

SECURITIZING BANK

Some banks (including some CCSBs) securitize credit card receivables. Securitization is the process by which the financial assets (in this case credit card receivables) are transformed into securities. It is a complex process, and examiners should refer to the Risk Management Credit Card Securitization Manual. That manual discusses the risks associated with securitizations, which primarily include credit, liquidity, capital, reputation, operational, and strategic risks. Banks can also be indirectly involved in securitizations, for instance if the holder of the credit card receivables under a Rent-a-BIN arrangement is using securitization(s) as a funding mechanism.

OTHER

Some banks may not meet the formal definition of CCSB but still operate large credit card departments. If the bank holds a large portfolio of receivables it can be susceptible to credit risk, and consequently, to earnings, liquidity, capital, and other risks. And, it is subject to legal, compliance, and reputation risks. Other banks, such as small community banks, might have small credit card programs that are primarily targeted to their local customer base. While the credit risk from such portfolios may not be significant in comparison to the bank's other lending operations, legal, compliance, or reputation risks may be higher. Some banks purchase credit card portfolios, thereby potentially increasing the credit risk on their books. Banks can be involved in credit card activities in a variety and combination of fashions, and examiners are tasked with identifying the type of credit card activities conducted by or impacting the bank as well as the level of risk that those activities pose.

RESOURCES

Several resources, including Call Reports, UBPRs, and bank web-sites, are available to help examiners determine whether a bank is involved in credit card activities. Examiners may also inquire about such activities as part of banker outreach and pre-examination contacts.

Call Reports contain several schedules with credit card specific line items. Some schedules and their contents include:

- RC-C – credit card loans to individuals as well as outstanding credit card fees and finance charges included those loans.
- RC-F – retained interests in accrued interest receivable related to securitized credit cards; **credit-enhancing interest-only** (IO) strips related to securitized credit cards.
- RC-K – quarterly average of credit card loans to individuals.
- RC-L – unused commitments for credit card lines, merchant credit card sales volume including sales for which the bank is the acquiring bank and sales for which the bank is the agent bank with risk.
- RC- N – past due credit card loans to individuals.
- RC-S – includes a column devoted to credit card receivables as well as a line item for outstanding credit card fees and finance charges.
- RI-B – **charge-offs** and **recoveries** on credit card loans; uncollectible credit card fees and finance charges reversed against income; separate **valuation allowance** for uncollectible credit card fees and finance charges; amount of allowance for loan and lease losses attributable to retail credit card fees and finance charges.

Examiners may also consult with their FDIC supervisors, Case Managers, and the Consumer Response Center, which is located in Kansas City, Missouri. The Consumer Response Center consolidates the processing of complaints and inquiries about FDIC-supervised institutions. However, complaints that it receives continue to most frequently be about credit cards. As part of the pre-examination planning process, the Consumer Response Center can provide a report summarizing consumer complaints about the bank[4]. Correspondence files may also house consumer complaints forwarded by the Consumer Response Center.

[4] Examiners should call 1-800-378-9581 to obtain examination pre-planning requests and other information from the Consumer Response Center. Consumers' complaint and inquiry calls should generally be made to the ASKFDIC line at 1-877-275-3342, which offers a wider range of business hours.