IX. PORTFOLIO MANAGEMENT

Portfolio management covers the full spectrum of overseeing and administering the credit card programs, portfolios, and accounts. It encompasses risk management, account management, portfolio reporting and monitoring, and many other activities. Inappropriate portfolio management practices can create sizable risk for the bank, including credit risk, reputation risk, liquidity risk, and other risks. Portfolio management is challenging because the goal is to offer the customer efficient services and responses while internally controlling costs, appropriately managing risks and revenues, and achieving corporate and regulatory compliance.

RISK MANAGEMENT

Risk management is considered the broadest of the portfolio management terms and involves the overall monitoring and managing of the quality and risks of the credit card portfolio. It includes, but is not limited to, evaluating underwriting standards and modifying those standards as needed to maintain an acceptable risk level in the portfolio. Account management, portfolio reporting and monitoring, consumer complaints, fraud, and other functions are also essential subsets of risk management. In all, risk management should address research, development, testing, and product roll out, to monitoring on-going performance of the products, to post-mortem analysis.

Aspects of the risk management function, such as the level of technology as well as the degree of sophistication and number of staff needed, normally depend on the size and complexity of the credit card activities and of the bank itself. Independence from those who make day-to-day marketing, underwriting, and account management decisions provides an important control. Risk management is sometimes performed by a separate risk management department. In other cases, the board might assign it to other functional areas such as loan review and/or credit administration. Regardless of where responsibility is assigned, examiners should look for evidence that management has implemented sound practices that identify risk, establish controls, and provide monitoring. In general, risk management is involved in many functions, including:

- Developing and implementing marketing initiatives to ensure that such initiatives do not create an unacceptable risk level in the portfolio.
- Confirming proper underwriting and marketing decisions.
- Assessing the integrity of scoring systems.
- Reviewing policies and procedures, including proposed revisions thereto, for adequacy, and assessing the impact of those policies and procedures on the card portfolio.
- Determining the quality of the credit card portfolio.
- Analyzing the success of specific products and marketing initiatives by assessing delinquencies and losses for each product or roll-out.
- Developing new, and assessing existing, account management strategies.
- Monitoring performance of the collections, fraud, and recovery functions, including recommending changes regarding management, staffing, or practices.

Common tools used for risk management include data warehouses, portfolio management software, credit scoring, ACS, and risk models. Data warehousing capabilities allow the storage and retrieval of pertinent data. ACS are discussed in the Scoring and Modeling chapter, but to reiterate, are decision-tree strategies used to formulate account management approaches. They bring consumer behavior and other attributes into play.

Risk management's purposes with regard to marketing and underwriting is to determine the characteristics of the responders and analyze the results of marketing programs to ascertain if they were successful in attracting the targeted populations. As a result of this process, management can adjust underwriting standards to maintain an acceptable risk level in the card portfolio. Marketing and underwriting are discussed in the Marketing and Acquisition chapter as well as the Underwriting and Loan Approval Process chapter. The remainder of this chapter largely focuses on risk management's role in the on-going servicing and monitoring of the card programs, portfolios, and accounts subsequent to marketing and underwriting. As such, account management and portfolio reporting and tracking are two key subjects of this chapter. Other risk management functions, such as loss allowances, are discussed in later chapters.

ACCOUNT MANAGEMENT GUIDANCE

Examinations have disclosed a wide array of risk management, account management, and loss allowance practices, many of which have been inappropriate and have substantially elevated banks' risk profiles. In response, the FDIC jointly issued the *Account Management and Loss Allowance Guidance for Credit Card Lending* (Account Management Guidance, or AMG) on January 8, 2003. The AMG is generally applicable to all FDIC-supervised institutions that offer credit card programs as well as to similar institutions supervised by other regulatory agencies. It generally applies regardless of where the receivables reside.

The AMG specifically speaks to credit line management, over-limit practices, minimum payments and **negative amortization**, workout and forbearance practices, and income and loss allowance practices. Regulatory scrutiny and risk management expectations for certain practices will be greater for higher-risk portfolios and portfolio segments, including those that are subprime. Less than full compliance with the AMG should generally be criticized. However, the Agencies do recognize that limited exceptions to the AMG may be warranted in well-managed programs. In those cases, examiners should expect that exceptions are addressed in the bank's policies and procedures, the volume of accounts granted exceptions is small and well-controlled, and management is closely monitoring the performance of those accounts.

An assessment of the overall adequacy of account management practices factors in the bank's risk profile, strength of internal controls, quality of management reporting, and adequacy of charge-off and loss allowance policies. The following sections of this chapter discuss key account management practices, including those addressed by the AMG. Subsequent sections discuss reporting and tracking associated with those functions.

ACCOUNT MANAGEMENT

Account management generally refers to any actions that the bank takes after a card account is originated and often in response to changes in cardholders' financial capacities. The changes can be brought about in several ways and may be for the better or for the worse. Account management encompasses the continual evaluation of accounts to identify and respond quickly to the changes in borrowers' financial conditions or behavioral patterns. The process is challenging because cardholders are not typically obligated to supply financial information after their accounts are opened.

Account management covers many activities and affects the amount and the length of time the bank makes credit available to the consumer. Adequately monitoring and managing account information necessitates effective strategies to handle the large volume of open-end credits and efficient information systems capable of generating reports needed to make on-going, timely credit decisions. Account management processes vary depending on the bank's size, level of automation, and staff expertise. They also vary depending on an account's status (for example, good standing versus a problem account) and on product type or cardholder attributes (for example, prime versus subprime accounts). But, no matter the program type or account status, regulators expect banks to have a means of identifying the current risk profile of portfolio(s).

Examiners' attention is warranted when banks substantially modify account management activities to accommodate affinity, co-brand, or other similar accounts. If account management practices for those types of programs diverge from the bank's typical practices, examiners normally call on management to readily support the reasonableness of such practices, including that such practices follow applicable regulatory guidance. Evidence should demonstrate that management's development and review of account management strategies includes all applicable functions, such as information technology, compliance, and finance.

The account management function can be handled with automated systems, manual systems, or a combination thereof. Most banks use automated systems which allow them to make decisions on a large number of accounts with minimal manual intervention, thereby reducing costs. Most automated systems use specific cardholder criteria established by management. For example, managers may identify borrowers within a range of credit scores that currently warrant a certain over-limit approval. Only those borrowers falling outside of the automated specifications would undergo potential manual intervention. For automated systems, examiners should evaluate management's practices for periodically validating scoring systems or other guidelines incorporated and verifying the accurateness of data entry. System settings that do not correspond to those described in the bank's policies and/or that do not provide for compliance with regulatory guidance illustrate circumstances warranting examiners' attention.

Non-automated systems require credit analysts to review the customer's risk profile and the bank's underwriting and policy guidelines for the decision-making process. While non-automated systems may be the only reasonable procedure available to many smaller banks, they can be costly. Non-automated systems call for control systems to ensure that analysts consistently follow policies and make informed decisions.

Supervisory review normally includes an assessment of the bank's account management techniques for identifying higher-risk accounts and adverse changes in account risk profiles. Identification of such matters assists management in implementing timely preventive and corrective actions. Effective account management generally includes:

- Periodically refreshing risk scores.
- Using behavior scoring and analysis to identify potential problem accounts.
- Assessing utilization rates.
- Assessing payment patterns, including borrowers who make only the minimum payments or who rely on the line to keep the account current.
- Monitoring collateral values.
- Obtaining updated collateral values when significant market factors indicate a potential decline in values or when the borrower's payment performance deteriorates, placing greater reliance on the collateral.

Concerns may appear when the frequency of these actions is not commensurate with risk in the portfolio. Further, any failures by management to fully test, analyze, and support its account management practices calls for elevated scrutiny during the examination.

Account management functions are often outsourced to third-parties. For example, customer service firms and collection firms are often used. The Third-Party Relationships chapter contains information on assessing third-party relationships.

Account management activities cover, but are not limited to, scoring, minimum payments, negative amortization, payment deferral programs, **pre-payment programs**, authorizations, over-limits, credit line management, renewals, collection activities, workout and forbearance programs, settlements, and re-aging.

Scoring

Failure to understand the current risk profile of cardholder accounts could lead to an artificially low level of identified credit risk which could translate into under-funded allowances and stress on liquidity, earnings, and capital. Issuers normally obtain a current risk profile on cardholder accounts by re-scoring accounts. Often, this is referred to as refreshing the credit score. In the past management typically obtained **refreshed credit scores** semi-annually or annually. However, quarterly and monthly refreshes are now common. By refreshing an account's credit score, management is able to identify apparent trends in the consumers' financial situation in the absence of updated consumers' financial information and potentially before any financial stress may be apparent based on the cardholder's internal performance. Within the bank's information systems and databases, both the original credit score and the refreshed credit score for each account are generally maintained to facilitate more effective risk management of the account and the portfolios. For example, the scores can be used in **migration analysis**.

More sophisticated institutions use behavior models in conjunction with credit scores. Similar to credit scores, behavior scores are refreshed on a regular basis. Due to expenses involved, smaller banks often do not use automated behavioral scoring systems. However, vendors continue to work to make these or similar systems more attainable for smaller institutions. Scoring models are discussed in the Scoring and Modeling chapter.

Minimum Payments and Negative Amortization

The amortization of principal balances is one of the key factors when determining whether a bank's credit card lending practices are safe and sound. As such, setting appropriate minimum payment requirements is a critical function of management. The failure of minimum payments to sufficiently amortize the debt in a reasonable timeframe not only elevates credit quality concerns and consumer protection issues but can also understate the level of delinquent accounts. Such an understatement could affect decisions made by parties interested in the financial conditions of the portfolio and the bank, including investors in securitizations of the portfolio.

Competitive pressures combined with desires to sustain outstanding balances and/or customer performance had led many banks to ease minimum payment requirements over time. Such easing often delayed principal repayment, thereby increasing credit risk and masking portfolio quality. While initially attractive to many consumers, the low payments often ultimately caused those consumers to face repaying a growing balance. The liberal repayment requirements resulted in negative amortization, a phenomena in which the outstanding balance owed on the card builds even though no new charges are made. The rising balance occurs because minimum payments fall short of covering all finance charges and fees assessed. The hazards of negative amortization are magnified when subprime lending is involved.

Further, programmatic, recurring over-limit fees and other charges often exacerbate the situation. In general, these types of fees are considered inappropriate when they are primarily aimed at increasing recorded income rather than at serving as a tool to enhance the borrower's performance or access to credit. Programmatic, recurring fees are typically defined as fees charged on an account as the result of the bank's fee program. These types of fee programs become problematic if they result in a cardholder's balance continuing to grow due to interest and fee assessments even if the cardholder meets subsequent minimum payment requirements. For example, if the bank has an over-limit fee program that assesses an over-limit fee every month an account is over-limit, even if the event that caused the over-limit occurred in prior billing cycles, yet the minimum payment does not require payment of the entire over-limit amount, the account balance would normally grow. Assume for this example that an account becomes over-limit by $100 and is assessed an over-limit fee of $30 at the end of the billing cycle. If the subsequent minimum payment required is not sufficient to cover the over-limit fee and the over-limit amount ($130) plus normal interest and fees, and the borrower only makes the minimum required payment (and thus, remains over-limit), the bank then assesses another $30 over-limit fee in the next billing cycle in accordance with its over-limit fee program. This type of program is clearly problematic since it results in continual fee assessments without requiring sufficient payment to cure the event that is resulting in the fee.

To address the liberalized minimum payment environment and the reality that minimum payments were not keeping pace with industry changes such as elevated line assignments; increasing and complex fees; and higher interest rates (risk-based pricing); the Agencies designed the AMG to specifically speak to minimum payments and negative amortization. The AMG calls for required payments to amortize the existing balance over a reasonable period of time, consistent with the unsecured, consumer-oriented nature of the debt and the borrower's documented credit-worthiness. Safety and soundness concerns arise when prolonged negative amortization, inappropriate fees, and other practices inordinately compound or protract consumer debt or mask portfolio performance and quality. When proper minimum payment requirements are not evident, examiners are expected to voice criticism and ask management to take proper and timely action which could include augmenting allowances, revising the design of minimum payment requirements, and/or altering their courses of action for fee assessments, depending on the situation.

According to the AMG, minimum payments should cover all finance charges and fees assessed during the billing cycle. Within the industry, fees included in minimum due requirements continue to vary. With the innumerable fees and ever-changing fee terminology evident in the industry, developing guidance specifically naming fees that would be consistently interpreted uniformly as well as would be comprehensive for all portfolio types would be difficult, if not impracticable. Rather, regulators generally allow management to look at the particular structures of the bank's products and set the minimum payment requirements for each product or segment in the context of those structures, as long as it amortizes the debt in a reasonable timeframe. A minimum payment method that is acceptable on one portfolio or segment might not be acceptable or reasonable for another portfolio or segment.

Because a uniform minimum payment structure has not been specified, minimum payment methods continue to vary. Some banks tier the total percentage due based on the outstanding balance. Several banks have designated an "equal to the greater of" approach where the balance due is the greater of a flat percentage of the outstanding balance, a flat dollar amount, or a certain percent of the balance plus interest charges and applicable fees.

Whatever minimum payment method(s) the bank uses, examiners should look for evidence that the method(s) provide for a reasonable amortization period. Interpretations of "reasonable amortization period" vary. Some banks require a one percent principal reduction per month in addition to payment of interest, late fees, and over-limit fees. Under that structure, a cardholder is generally required to demonstrate that he or she could amortize the debt in less than 10 years if he or she were to make the same dollar-level payments going forward. In reality, because the one percent principal reduction would be based on a declining principal balance (assuming no new charges are made), the amortization period is generally longer if, in subsequent months, the cardholder pays only the minimum due as requested by the bank. But, by making such payments, the cardholder proves that the ability to repay the debt in less than 10 years from that point exists. Minimum payment requirements that would not confirm a cardholder's ability to amortize the debt in less than 10 years or that are so small as to draw into question whether the borrower has the proper financial capacity likely warrant close review to determine how and whether such a payment structure meets the spirit and intent of the AMG. This is not to say that amortization periods that are greater than 10 years cannot be acceptable or that amortization periods of 10 years or less are automatically acceptable. Rather, it reflects that longer-term structures, such as those greater than 10 years, have generally shown higher propensities to increase credit risk and mask portfolio quality, and, as such, are usually considered as a starting point for examination analysis.

In any case, including whether it is occurring on a small or large scale, regulators are likely to object to programmatic negative amortization. The concept of programmatic negative amortization has been introduced in previous comments of this section, and in a broad sense, may be considered to occur when the card's fee and interest structure, as prescribed by management and as programmed into the bank's systems, results in negative amortization when combined with the card's minimum payment structure and the cardholder's normal behavior pattern. These cases could involve the assessment of charges, which sometimes could be purposefully regular and methodical, to a cardholder population that normally behaves in such a manner that the assessments combined with the population's payment and other behavior patterns produce rising balances over a short timeframe, even if the cardholder is meeting the account's minimum payment requirements. Fees also usually end up representing a disproportionate share of the balance.

Prior to the implementation of the AMG, many cardholders were making payments larger than the minimum due. These cardholders are likely experiencing minimal impacts from changes prompted by the AMG, and some (albeit the minority of) customers are even experiencing declines in payment required. However, some cardholders face higher minimums due and have found it a challenge to meet the higher requirements. To assist these customers and to control negative amortization, including from a programmatic standpoint, many lenders are modifying fee and interest structures. For example, some banks are decreasing interest rates and/or are waiving fees. Other banks are limiting the frequency of over-limit fees per each over-limit occurrence and are capping the number of late fees or other fees that tend to recur and, as such, often make up a disproportionate amount of the outstanding balance, especially in subprime portfolios. Examiners should evaluate how and to what degree the practices help the bank to meet the guidance, thereby assisting cardholders to reasonably amortize their debt and access credit. Examiners should pay close attention to lending decisions that do not factor in the customer's ability to repay the debt consistent with a reasonable amortization.

Management practices encouraged by examiners include periodically conducting negative amortization analyses on the credit card portfolio(s) to determine the prevalence of, and trends in, negative amortization. Many banks focus on identifying negative amortization that occurs based on payments made, sometimes considering the size of the payment. Analyses that consider cardholder performance can help management identify negative amortization that exists in the portfolio at that point in time for performing cardholders. However, if not structured properly, the analyses can be misleading and might not identify the true susceptibility to negative amortization. For example, if cardholders make payments larger than the minimum due, the analysis could indicate that negative amortization does not exist or is immaterial and, thus, could falsely lead management to believe its minimum payment structure is appropriate. If minimum payments are not sufficient to reasonably amortize the debt and if cardholders would have only paid the minimum due (rather than voluntarily submitting more than required), the level of negative amortization identified would be higher. More comprehensive analyses include not only negative amortization that is occurring based on payments made but also testing negative amortization that would occur if consumers only made the minimum payment as required. This analysis is more of a "what if" scenario.

Some bankers believe that late accounts should be excluded from negative amortization analysis because the lack of payment normally causes the account to negatively amortize, usually due to late payment or other assessments. However, considering late accounts in the analyses would expand the analysis pool available to determine whether or not negative amortization would have occurred if cardholders would have paid the minimum due. Further, an account could have been current and negatively amortizing and then falls delinquent during the month the analysis is conducted. In this case, delinquency could potentially be a symptom or result of negative amortization rather than a cause. If delinquent accounts are excluded, these types of accounts that are now delinquent but recently exhibited negative amortization even while current would be overlooked, depending on how the analysis is structured. Moreover, the AMG generally points to the inclusion of all fees (which would include late fees), or does not identify delinquent accounts as an exclusion to its guidelines. Regardless of whether or not payment is made and what the size of any payments made are, examiners should be concerned when the required minimum payment as prescribed by management is not designed to amortize the debt timely.

In addition to verifying whether proper minimum payment requirements have been established in policies and cardholder agreements, examiners should look for evidence that the bank's systems factor in proper minimum dues. If processing systems are not set correctly and/or if minimum payments are billed incorrectly, the bank might be under-reporting past dues. While these comments are not specifically addressed to partial payments, partial payments could constitute one example of how systems could be set inappropriately. A discussion about partial payments is housed under the Delinquency section of this chapter.

Payment Deferral Programs

Payment deferral programs allow cardholders to defer one or more minimum monthly payments and are also known as **skip payment programs** or **payment holiday programs**. Interest continues to accrue on the balance during the deferral period. Cardholders selected for a payment deferral program are usually notified by telephone, monthly statement inserts, or separate mailings. Normally these marketing efforts occur during high purchasing periods such as holidays or peak vacation periods. Some banks allow flexibility by offering the right to skip one or more minimum payments at any time during the year.

Before implementing payment deferral programs (or to continue offering payment deferral programs) management is expected to carefully weigh the customer base to determine whether these types of programs would be appropriate for the card program offered. Skip-payment programs generally should be only offered to the most credit-worthy customers, if offered at all. For example, subprime programs or small balance programs may be directed to individuals who have had trouble maintaining or who are trying to establish consistent, favorable payment performance. Payment deferral programs might not be appropriate in some of these cases.

Payment deferral programs interrupt the regular payment stream, diminish management's ability to monitor performance and promptly identify problem accounts, and might be to some degree counterintuitive to the spirit and intent of the AMG, particularly if resulting in prolonged negative amortization. As such, some banks have discontinued these types of programs. However, for banks that still use such programs, evidence should substantiate whether management has established clearly defined policies and procedures for determining the credit criteria for account selection and for program parameters, such as how often a cardholder can qualify and for how many payments. Management may also consider the impact of these types of programs in any amortization analyses it conducts. Their failure to monitor the program's success, regularly review accounts for performance, and periodically evaluate eligibility requirements is normally cause for concern as are deferred payment plans that are offered to cardholders who are anticipated to abuse the privilege and create safety and soundness problems.

Pre-Payment Programs

Pre-payment programs, or **pay-ahead programs**, are similar to payment deferral programs in that they allow the cardholder to skip one or more minimum monthly payments. However, these programs are targeted to cardholders who make payments in excess of the minimum monthly payment and entail the application of excess payment amounts to the next consecutive payment(s). Pre-payment programs vary. Some allow cardholders a zero minimum payment requirement until the pre-payment amount is exhausted, while other programs have set time limits. For example, a bank might only allow a zero minimum monthly payment for one billing cycle, regardless of whether the excess paid surpasses one minimum monthly payment.

Pre-payment programs in and of themselves might not be problematic, but have the potential to be counterintuitive to the spirit of the AMG. Similar to payment deferrals, they interrupt the payment stream and diminish management's ability to monitor performance and promptly identify problem accounts. Consideration of the impact of these types of programs in any amortization analyses the bank conducts may be helpful. Examiners should look for evidence that corroborates that before management implements pre-payment programs (or continues offering such programs) it carefully looks at the customer base to determine whether these types of programs are appropriate for the card program offered. Well-structured programs generally only offer the option to the most credit-worthy customers and are subject to clear guidelines, including identifying the maximum number of payments that can be skipped and monitoring the programs.

Credit Line Management

The AMG addresses credit line management, and in general, requires careful consideration of borrowers' repayment capacities when establishing or modifying credit lines. It also expects banks to test, analyze, and document line-assignment and line-increase criteria prior to broad implementation. In the past, many banks inappropriately used line assignments and line increase strategies to maintain asset growth and/or to mask poor portfolio performance (for example, using line increases to "cure" over-limits).

Initial Credit Line Assignment:

Initial credit line assignments are discussed in the Marketing and Acquisition chapter as well as the Underwriting and Loan Approval Process chapter. In summary, concerns normally arise when the initial line assigned is not commensurate with the consumer's willingness and ability to repay the credit under established, reasonable terms (which would include minimum payment and amortization configurations consistent with the AMG's guidelines). Situations where support for the line assignment does not include documentation of relevant credit decision factors or where management has not ensured that the level of available credit and card utility offered is reasonable and well-disclosed warrant close inspection.

Credit Limit Increases:

Similar to multiple account strategies, liberal line increase programs can increase the risk profile of a borrower quickly and can result in rapid and significant portfolio deterioration. Concerns normally arise if the bank does not have the capacity to fund the increased lines if drawn or has not carefully considered the borrower's repayment capacity, including any other accounts that the customer has with the bank. Most often, repayment capacity is determined with the use of scores and consideration of the borrower's performance history rather than income verification. Some banks charge a fee for increasing the credit line. Risks of improper management of line increases are that earnings could be unduly overstated and/or that the bank could be taking on credit risk that it cannot handle. According to the AMG, management should be testing, analyzing, and documenting line increase criteria prior to broad implementation.

Credit limit increases are normally prompted with management-initiated, system-wide automated programs or through cardholder requests. Most management-initiated programs use scoring models, behavior models, or a combination of both, to screen the cardholder base and determine the pool of eligible accounts. The systemic programs also usually consider other qualifying criteria, such as the time elapsed since an account's origination and/or since prior line increases, and usually incorporate champion/challenger strategies. With automated line increase programs, the increases are granted whether or not the customer needs or wants the increase. However, consumers may ask the bank to withhold their accounts from the automated strategies.

For customer-initiated line increase requests, banks process the requests as each is received. The process generally involves a credit analyst reviewing cardholder requests manually, making a determination based on prior credit history, the increase requested, and the bank's policies. Thus, in general, proper policies clearly establish approval criteria, specify the approval process, define verification steps, assign responsibility, establish lending authorities, and outline documentation requirements. Similar to management-initiated programs, scores and time elapsed since origination and/or prior line increases are usually considered. Section 112 of the FACT Act (and correspondingly, section 605A of the FCRA) provides that, for a credit line increase requested by a consumer whose credit report contains a fraud or active duty alert, the bank must use proper identification procedures regarding the identity of the person making the request. However, it is prudent to verify a consumer's identity even if no alerts are evident.

Examiners should direct their attention to situations in which management is increasing credit limits on accounts that fall below the cut-off credit score and/or other underwriting standards. Because sufficient time is necessary for the cardholder to demonstrate that he/she can handle the existing line amount in a consistent, satisfactory manner, examiners expect management to normally refrain from granting line increases shortly after an account's origination or shortly after another line increase was granted. As such, notably short seasoning periods (such as six months or less) usually are subject to elevated scrutiny to determine whether they are appropriate in the particular bank's situation. In general, main components of line increase policies include identification of:

- The approval process and approval criteria.
- Verification procedures.
- Lending authorities.
- Documentation requirements.
- Testing expectations.
- Limitations on the number of line increases per account
- Some type of limit (dollar or percentage or both) on the increase per line as well as seasoning (time lapse) criteria.
- A requirement that line increases outside of established criteria be reported on an exception list and reviewed by management on a regular basis.

Credit Limit Decreases:

Line decreases are generally based on evidence of adverse information, although some cardholders may request a line decrease. Credit limit decreases can be conducted manually or with an automated system. In the case of decreases prompted by adverse information, the credit lines are often reduced to the outstanding balance or to the nearest established increment above the balance at the time of the decrease (for example, to the nearest $100 above the outstanding balance). The increment method helps avoid a quick run into over-limit status when finance charge or other fee assessments occur shortly thereafter.

As stated in FIL-45-2005, *Home Equity Lending: Credit Risk Management Guidance,* banks should refuse to extend additional credit under, or should reduce the credit limit of, a home equity line when appropriate. Regulation Z (Truth in Lending) only permits such steps in certain circumstances, including, for example, when the collateral value declines significantly, when default of a material obligation under the loan agreement is evident, or when deterioration in the borrower's financial circumstances is evident. To freeze or reduce credit lines due to deterioration in a borrower's financial circumstances, both of these conditions must be met: (1) there must be a material change in the borrower's financial circumstances, and (2) as a result of the change, the bank reasonably believes that the borrower will be unable to fulfill the plan's payment obligations.

Multiple Credit Lines:

The Underwriting and Loan Approval Process chapter talks about multiple account strategies. Due to added management requirements, granting multiple credit cards with smaller lines generally results in as much or more risk than granting a consumer one card with a higher line. The AMG expects banks that offer multiple credit lines to have sufficient internal controls and systems to aggregate related exposures and effectively analyze performance.

Authorizations

Authorization is the process of verifying that the card account has sufficient credit available to cover the amount of the transaction. The transaction's risk is assessed, and the process yields an approval, a decline, or a pending response in which the merchant must take additional steps, such as calling a toll-free authorization phone number. If the authorization is approved, the amount of the transaction is reserved on the card. In some cases, as with car rental companies and hotels, the exact amount of the transaction may not be known before the customer uses the product. In these situations, temporary holds are placed on the card accounts to provide merchants with a level of assurance that they will be paid for the services used.

The authorization process is structured to prevent transactions being approved for cardholders who have not satisfactorily maintained their account or who may be over-limit (and, hence, limits credit risk) and is also designed to protect against the unauthorized use of stolen or fraudulent cards. An effective authorization system allows good customers to make transactions within preset limits while preventing other transactions that pose undue risk to the bank. In most instances, banks automatically authorize transactions unless the transaction exceeds the authorized limit tolerance (either based on percentage or dollar amount), fraud is detected, or some other type of mismanagement is evident on the account. For example, a system might be set to authorize good customers to transact purchases up to five percent over their credit limit. If the purchase would put the cardholder at six percent over the credit limit, the authorization would be declined or might be referred for manual review. Authorization criteria beyond the normal credit limit, such as when a bank sets the system to allow certain cardholders to go a certain percentage above their credit limit, are sometimes referred to as expansion criteria.

Merchants process customer charges many ways, including but not necessarily limited to, a **paper-based transaction**, a dial-in terminal, or an electronic card reader. Clearing customer charges via paper sales drafts and dial-in terminals can be slow and costly. Speed and cost advantages prompt many merchants to use electronic card readers. The electronic networks enable virtually immediate authorization for most point-of-sale transactions. And, while most use electronic networks, the authorization process differs depending on merchant and transaction type. For example, for restaurants, an authorization might be obtained for the total check amount and a preset authorization tolerance. If the customer provides for a gratuity beyond what the preset authorization would cover, an additional authorization must be obtained. For card-not-present transactions (such as for mail or phone orders), other processes, such as address verification, are incorporated.

Authorization systems vary but commonly intend to provide reasonable assurance that charges are only authorized within prescribed credit limit tolerances and that accounts are appropriately blocked to prevent future authorizations when fraud is detected. Regardless of the authorization process used, examiners normally look for evidence that:

- Management has adequate policies and procedures in place that reflect the bank's risk tolerances.
- Management regularly reviews and updates the policies and procedures as needed.
- Sufficient controls exist to monitor adherence to the policies.
- System settings are consistent with the bank's policies.

Renewals

General purpose credit cards have pre-set expiration dates, usually two to three years after issuance. Expiration dates have generally lengthened not only to help reduce expenses that accompany renewal but to help control fraud by limiting the volume of cards within the mail system. Although cardholder accounts are evaluated for creditworthiness periodically throughout the account relationship, the expiration date gives management the right not to renew (or reissue) the account relationship at that time (and, hence, the ability to control credit risk). In general, proper written credit and performance guidelines establish credit criteria, consider the length of the relationship, and include performance criteria such as average outstanding balance, usage rate, payment and delinquency patterns, and account profitability. Normally, the renewal process is automated, uses scoring and behavior models, and is applied to the entire portfolio. Examiners should analyze management's practices for periodic testing of the integrity of the system and evaluating the effectiveness of renewal strategies.

Customer Service

Customer service encompasses a wide variety of activities, including, but not limited to, activating cards, initiating balance transfers, and handling account inquiries. Customer service can be conducted through written correspondence but is more often conducted via phone and increasingly online.

Consumer Complaints and Litigation:

The customer service area might identify consumer complaints. Complaints can serve as an early warning signal for compliance, credit, and operational issues, including discriminatory, unfair, deceptive, abusive, and predatory practices. Concern is normally warranted when banks are not prepared to handle consumer complaints promptly, including maintaining well-defined procedures. Recognition of bank staff responsible for handling the complaints that is broadcast to all bank staff can help expedite referrals.

Failure to be sensitive to complaints can ultimately result in litigation (and hence, potential financial and reputation implications) or eventually result in legislation that is broader, more rigid, and more restrictive than was the particular practice that brought the complaint. Even if legal at the time, a bank's policies and practices may prompt objections that lead to new regulations.

As mentioned in the Identifying Involvement in Credit Card Activities chapter, the FDIC's Consumer Response Center is a source available to examiners to help identify the volume and types of complaints that consumers are bringing against the bank. Evidence gathered during the examination should help form an assessment as to whether or not management closely monitors complaint activity. Such evidence often involves complaint and litigation logs. The bank most likely only hears from a small proportion of its dissatisfied customers. Consequently, the impact of the potential problem may be much more far-reaching than a simple review of the volume of complaints might suggest. The type of complaint, therefore, is also very important to consider when assessing the level of risk.

Closures and Retention:

Many account closures occur voluntarily (the customer requests to close the account). Retention programs are critical to relationship management and in controlling attrition. With the credit card market remaining highly competitive, banks generally try to retain accounts when possible and when it would benefit the bank. If retention programs are not properly structured, **adverse retention** could occur. Monitoring the performance of retained accounts helps management detect adverse retention and determine whether retention practices are appropriate and effective.

Account closures may also occur involuntarily, usually when the cardholder mismanages their account. For example, the account may be delinquent or over-limit when it is closed by the bank. The remainder of the Account Management section focuses on the management of these types of higher-risk accounts, which is generally referred to as collections.

Collections (General)

Collection activities serve to control and minimize credit card debt losses. In the past, collection activities have mainly focused on delinquent and over-limit accounts. However, more and more, management is identifying a need to spot potential warning signs for current accounts that may wind up in collections in the future. As debt-to-income ratios mount, it becomes more difficult for management to predict how a delinquent account will behave without sophisticated analytics. It is even more challenging to predict how a current account will behave. As such, sophisticated analytics capable of scoring individual accounts against specific treatment strategies and the resources available to apply those strategies are being deployed to not only address accounts already evidencing higher-risk (such as delinquent or over-limit) but also to head off delinquency or other problems for current accounts likely to become higher-risk. Early intervention on such accounts could significantly reduce the bank's costs (and, hence, impact earnings) in the future.

Changes in underwriting standards, saturation of the card industry, escalation in bankruptcies, and stagnation in some geographic regions have heightened the need to carefully attend to collection practices. In addition, consumers often consider non-secured loans a low priority. Problems created by poorly-managed collection processes include, but are not limited to:

- Abuse of re-aging or other programs to mask delinquency and loss, which may also result in untimely, inaccurate management reports and inadequate loss allowances.
- Failure to maximize recoveries.
- Violations of laws or regulations.
- Reduced earnings due to increased losses, lowered recoveries, or assessed fines. Some banks have been ordered to pay large restitution and penalties for engaging in poor business practices, including deceptive or abusive collection practices.
- Reputation and legal risk, such as when collection activities are not consistent with regulations.

The management and structure of collection activities vary depending on the bank's size as well as its available technology and expertise. Internal collection departments normally include one or more collection supervisors, and management monitors those supervisors to ensure they routinely review collectors' performances. Assessments of collector performance are usually based on a number of factors which, in general, include the number of accounts per collector, the number of contacts made, average time per contact, and dollars collected (as opposed to dollars promised). The optimum number of accounts per collector varies depending on factors such as the technology employed, type of account, and stage of delinquency. Potential negative ramifications of ineffective employee compensation programs include, but are not limited to, encouraging protracted repayment plans and aggressive account re-agings.

Collections are sometimes outsourced to collection agencies. The Third-Party Relationships chapter talks about general outsourcing controls, including due diligence processes and contract provisions. Forward-flow contracts are sometimes established. They provide the third-party agencies with a set number of accounts at a determined frequency and assist management with forecasting collection placements. Concerns with outsourcing arrangements may include cases where the outside firms fund loan payments to cure delinquencies and thereby mask poor collections performance on their part or poor initial credit risk selection on the bank's part.

Collection strategies are not static and are not uniform across all banks. The growing size and complexity of the credit card business, along with the labor-intensive nature of collections, makes the collections function increasingly difficult to manage. Specialized, state-of-the art technology such as complex automated dialing systems and intricate skip tracing tools is frequently used to optimize productivity and control overhead costs. The collections area also frequently uses champion/challenger strategies.

Collection strategies generally attempt to direct efforts to those accounts with the greatest risk of loss and the greatest potential for collection. Ineffective strategies could result in reduced collections (and, thus, reduced earnings and liquidity). Some banks use scoring models to help predict the likelihood of collection and then employ collection practices such as phone calls, collection letters, legal letters, statement messaging, or enrollment in repayment programs, depending on the severity of the delinquency and what the score indicates. Successful subprime lenders have historically employed heightened collection efforts, such as calling delinquent borrowers more frequently, investing in highly-complex technology, and assigning more experienced collection personnel to seriously delinquent accounts. Collections for subprime lending is very labor intensive but critical to the program's success.

Fee waivers are sometimes used as a collection tool. Collections personnel attempt to entice consumers to pay by surrendering or reversing certain fees. Often, the customer might be persuaded to pay more when fees are waived. Fee waivers are normally governed by policies that give clear guidelines as to acceptable limits on the level of fees waived (by dollar and/or percentage) as well as the types of fees that can be waived. The level of fees forfeited may be tied to collectors' compensation packages (with fee waivers reducing compensation to some degree). In this respect, collectors using fee waivers as a tool are not inclined to abuse such practices, where the abuse could substantially impact the institution's earnings (both due to fees lost and to potentially excessive compensation paid). Along the same lines, collection departments may focus on **promises kept** measurements as compared to **promises to pay** measurements when establishing incentive pay programs because a wide disparity sometimes exists between the volume of payments or dollars actually received from cardholders compared to the volume promised by cardholders.

Collection activities encompass, but may not be limited to, over-limit accounts, delinquent accounts, charge-offs and recoveries, re-pricing, re-aging and various cure programs such as workout programs. The following sections discuss each of these areas.

Over-Limit Accounts

When an account is over-limit, it means that the account's balance has surpassed the account's credit limit, due to purchases or other assessments, such as fees. Over-limit authorization requests occur either by the cardholder contacting the bank or more frequently by the cardholder attempting to make a charge through the payment network. Customer-initiated requests can be routed to a credit analyst where, based on the credit analyst's lending authority and the account's history, credit score, or other criteria, the transaction is approved or denied. In many cases, over-limit approvals for purchases are automated rather than manually reviewed. Advanced systems use behavior scores, adaptive controls, and management's parameters to approve or deny over-limits without human involvement. In addition, a combination approach is sometimes used. Authorizations up to a pre-set dollar amount or percentage above the credit line (expansion criteria or buffers) might be handled by automated systems, and transactions falling outside the expansion criteria would be referred for manual review or in some cases, automatically declined. Even with reasonable authorization parameters set, certain instances can occur in which authorization is granted above the credit limit or even beyond established expansion criteria. For example, "variable amount" and "under the **floor limit**" charges can result in charges above an account's established credit limit or above the expansion criteria.

A bank's authorization practices could be a contributing factor in causing over-limits. Failure to establish proper guidelines for when and under what conditions over-limits will be granted could result in increased credit risk. Over-limit authorizations on open-end accounts, particularly those that are subprime, should be restricted and subject to appropriate policies and controls.

Examiners should direct their attention to practices whereby line increases are used to mask over-limit statuses. Further, without proper controls for handling payments returned for insufficient funds and for handling large-payment holds, these items can prematurely create available credit because only later (when the insufficient funds payment is returned) would the payment credit be reversed. In the mean time, the cardholder would have the opportunity to use the inflated available credit for purchases. Then, after reversal of the payment application, the cardholder could easily be over-limit to a degree which normally would not have been approved.

Prudent over-limit practices are important for all credit card accounts, including both prime and subprime accounts. When a bank's fee assessment practices are designed to compound fees and other charges in order to trap its customers in a cycle of pyramiding over-limit debt, supervisory attention is warranted. Cases where cardholders go over-limit as a result of fees being assessed on their accounts have the potential of happening more often when the credit limits are small, such as with subprime accounts. In these cases, the account holders might go over-limit shortly after opening the account, especially when a small credit line is largely consumed by upfront fees leaving limited utility at account inception. When credit lines are small, the assessed over-limit fee(s) usually result in the over-limit balance being very high in proportion to the established credit line. No matter what size the credit lines are, fees are usually contributing factors to the level of over-limit balances.

Some banks notify customers ahead of time of upcoming fee assessments, such as annual fees, such that the cardholder would have time to remit payment(s) to free up available credit to cover the upcoming assessment. Once an account is over-limit, some banks take steps to reduce the impact of fee assessments. For example, some banks do not allow a late fee to trigger an over-limit fee if the late fee is what makes the account over-limit. Other banks cap the number of over-limit and/or other fees that can be assessed or suspend over-limit and other fee assessments in certain cases, such as when an account reaches a certain past-due status. The waiving or capping of fees is intended to help control the level of the over-limit amount and, thus, hopefully help and motivate the customer to pay off the over-limit balance in a timely manner as well as retain a reasonable amortization timeframe.

The AMG points out that practices that do not provide for timely repayment of over-limit amounts can significantly increase the credit-risk profile of the portfolio, and the increase is often magnified for subprime portfolios. It also notes that deficient reporting and loss allowance methods as a result of imprudent over-limit practices can understate credit risk. All banks are to carefully manage over-limit practices and focus on reasonable control and timely repayment of amounts that exceed established credit limits. In accordance with the AMG, examiners should look for proof that management's objective is to ensure that the borrower remains within prudent established credit limits that increase the likelihood of responsible credit management. The *Home Equity Lending: Credit Risk Management Guidance*, which would be applicable to home equity credit card lenders, declares a similar position to that of the AMG.

The regulatory guidelines are written broadly to allow banks flexibility. Clearly fee structures, products, authorization strategies, and portfolio dynamics differ among banks, and absolute, un-flexible guidance would most likely not be reasonable or effective for all portfolios.

Examiners should assess management's practices for ensuring over-limit accounts are repaid in a timely manner. Those practices generally include formalized (or defined) repayment programs that require cardholders to repay over-limit balances in a structured fashion. When an account goes over-limit, management might initially utilize techniques such as calling strategies and letter campaigns to attempt to get the cardholder to bring the account back within its established credit limit. Also, the cardholder's monthly payment due generally includes over-limit amounts, either in total or based on a structured pay-down that, if paid, would result in the timely repayment of the over-limit amount. In general, a bank's practices should strive to limit the dollar volume and number of chronic over-limit accounts. In some cases, chronic has been considered to be seven or more consecutive months. Failure by management to monitor the volume (dollars and number) of over-limit accounts, including appropriate segmentation to identify trends in chronic and non-chronic populations, is cause for concern. High or increasing volumes of over-limit accounts and/or balances, especially those considered chronic, suggest that the bank's over-limit controls and programs may not be effective. For the most part, the volume of over-limit receivables has declined since the AMG was issued. However, it still perpetually requires close attention and appropriate controls.

Reporting of over-limit statistics is sometimes unclear or confusing. For example, reports sometimes only reflect accounts that are over-limit and current and might exclude accounts that are both over-limit and delinquent. Reports may be segmented based on the severity of over-limit amount, such as less than 10 percent over-limit, 10 to 20 percent over-limit, and so forth. This type of information provides management with further information to assess the severity of over-limit amounts and compliance with policy parameters. The examination's evaluation of over-limit practices considers both accounts that are over-limit and current as well as accounts that are over-limit and delinquent. Delinquent accounts (which might or might not be over-limit) are discussed next.

Delinquent Accounts

Delinquencies are a primary indicator to consider when assessing the quality of card portfolios. Delinquency rates change constantly due to fluctuation in consumer behavior patterns and changes in general economic conditions. Rising delinquencies are usually the first sign of credit deterioration. The level and trend of the delinquency rate combined with projected loan growth can give an indication of potential charge-offs which, in turn, impact earnings and capital. As such, delinquency status is often the primary segmentation tool used in credit card loss allowance methods, as discussed in the Allowances for Loan Losses chapter.

For regulatory reporting purposes, banks are to report the full amount of the credit card receivables that are past due, not simply the delinquent payment amounts. Past due status should be determined in accordance with contractual repayment terms. Grace periods allowed after the loan technically has become past due but before the imposition of late charges are not to be taken into account in determining past due status. Open-end credit cards are to be reported as past due when the customer has not made the minimum payment for two or more billing cycles. Closed-end credit card loans that require scheduled monthly payments are to be reported as past due when either principal or interest (or both) is unpaid and is in arrears two or more monthly payments. However, at a bank's option, they may be reported as past due when one scheduled payment is due and unpaid for 30 days or more.

The term **delinquency bucket** is often used when referring to delinquent accounts. Buckets are generally described as periods of about 30 days. For example, there is a current bucket, a 1 to 29 days delinquent bucket, a 30 to 59 days delinquent bucket, a 60 to 89 days delinquent bucket, and so on. Sometimes banks refer to buckets as bucket one, bucket two, and so forth.

When a cardholder fails to make his or her first payment due on the credit card account, it is typically referred to as a **first payment default**, or first-pay default. First-pay defaults can be segmented into two categories:

- No-use, no-pay accounts - the cardholder has not made any purchases or cash advances and did not make the first payment due (where payment due is prompted by fees or other upfront charges assessed to the card).

- Use, no-pay accounts - the cardholder has used the account to make purchases or cash advances and has not made the first payment.

The two categories can represent very different types of risk, but the risks of these accounts are not mutually exclusive. In the case of no-use, no-pay accounts, the consumer could be suggesting (by not remitting payment) that they did not understand the fees being assessed to the card upfront or that they no longer want the card (possibly due to its fees). Either of those scenarios might suggest compliance and/or reputation risk. Or, financial stress may be preventing the cardholder from making the first payment due. With no-use, no-pay accounts, the bank generally has not lost cash because no payment has been made to merchants. Rather, if the account never pays, the bank would have lost costs incurred in originating the account. However, in the case of use, no-pay accounts, the bank has remitted payment to merchants for the purchases, and if the cardholder does not pay, the bank will not recover the amount given to the merchant (unless the transaction is subject to charge-back). Use, no-pay accounts might be an indication of fraudulent activity. Or the lack of payment may be due to financial stress. If that is the case, it may suggest flawed underwriting criteria, particularly if the volume is substantial. Subprime portfolios usually reflect higher rates of first-payment default than do prime portfolios.

Collection strategies for delinquent accounts vary, often depending on whether delinquency is considered early stage or late stage and on the type of account. Typically, accounts in earlier delinquency stages require less collection effort than those in later stages. Early-stage collection efforts often include statement messaging and letters to the cardholder. Later-stage collection efforts usually consist of frequent calls to the cardholder and may also encompass enrollment in defined repayment programs that are discussed later in this chapter. Accounts that are both over-limit and delinquent generally require strong collection efforts as do subprime accounts.

The examiner's evaluation of past due loans may incorporate the Lagged Delinquency Ratio which is the ratio of credit card loans that are past due 30 days or more plus those credit card loans on non-accrual measured against total outstanding credit card loans on a three quarter lag (total outstanding loans approximately 270 days, or three quarters, prior to the current period). It is particularly helpful when a bank has experienced rapid growth. A large volume of new loans being booked can mask credit problems by artificially lowering the current delinquency ratio as new loans (which would not yet be delinquent) are added to the denominator. A relatively high ratio can be an early warning sign of weak underwriting standards and potential future delinquency problems as the loans season.

The accuracy and integrity of the bank's system for reporting past due credit card loans is critical to the proper and timely identification of credit risk. The examiner's evaluation of past dues and the associated credit risk considers the bank's partial payment, non-accrual, and re-aging practices, as well as the volume and trends of delinquencies. It also considers whether minimum payments are sufficient to reasonably amortize the debt.

Partial Payments:

The *Uniform Retail Credit Classification and Account Management Policy* (Retail Classification Policy) and Call Report instructions address partial payments. A payment equivalent to 90 percent or more of the contractual payment due may be considered a full payment in computing past due status. Alternatively, the bank may aggregate payments and give credit for any partial payment received. For example, if the payment due is $40 per month and the borrower makes payments of $20 per month for a six-month period, then the loan would be $120 ($20 shortfall times six months), or three full months, past due. A bank can use either or both of the methods in its portfolio but may not use both methods simultaneously with one loan. Improper partial payment practices could mask delinquencies and losses.

Non-accrual:

Regulatory guidelines do not require consumer loans (including credit card loans) to be placed on non-accrual status when principal and interest remain unpaid for 90 days (nor do they require a similar loan secured by a 1-4 family residential property, such as a home equity credit card, to be put on non-accrual status). However, these loans are subject to alternative methods of evaluation to assure that the bank's net income is not materially overstated. Management's non-accrual practices are evaluated on a case-by-case basis.

Proactive non-accrual policies provide a more accurate and timely reflection of actual operating performance. Examples of proactive policies include placing accounts on non-accrual status when the account becomes 90 days past due, when the cardholder enrolls in a **Consumer Credit Counseling Services (CCCS)** program or workout program, or when the borrower threatens to file for bankruptcy protection. These types of policies can be encouraged; but, the lack of them is not necessarily grounds for criticism. Some credit card servicing platforms do not have the capability to place individual loans on non-accrual. To the extent that a bank elects to carry loans as non-accrual on its books, the bank must also report those loans as non-accrual on its Call Report. Furthermore, when one of a borrower's loans is assigned to non-accrual status, any other loans outstanding to that borrower should be evaluated to determine whether one or more of them should also be assigned to non-accrual status. Lastly, state statues, regulations, or rules that impose more stringent standards for non-accrual of interest take precedence.

Re-aging:

Re-aging is technically defined as returning a delinquent, open-end account to current status without collecting the total amount of principal, interest, and fees that is contractually due. It generally refers to the removal of a delinquent account from normal collection activity after the borrower has demonstrated over a specified period of time and through some degree of performance that he or she is capable of fulfilling contractual obligations without the intervention of the collection department. It is viewed as one method of helping borrowers overcome temporary financial difficulties, such as job loss, medical emergency, or change in family circumstances, and is meant to be used for borrowers who have the capacity to satisfactorily service their debt, but are unable to catch-up on prior delinquency. Re-aging is often referred to as curing or rolling-back an account and is intended to prevent the account from remaining perpetually delinquent. A few banks continue to re-age on an exception basis, and some banks re-age manually. However, most banks re-age as a regular practice and use automated systems to complete the re-ages. While re-aging practices are usually reviewed during the examination, cases where re-agings total a sizable percentage of accounts (such as more than five percent) or have unexplained spikes should be even more carefully looked into.

Overly lenient practices can cloud the true performance and delinquency status of accounts and, potentially, of the card portfolio as a whole. Improperly managed re-aging practices can result in understated charge-offs and can impede accurate analysis of loss allowances. As such, establishing clearly defined policy guidelines and parameters for re-aging is critical, as are ensuring the reasonableness of those guidelines and monitoring their effectiveness. Other important practices for management include monitoring both the number and dollar amount of re-aged accounts, collecting and analyzing data to assess the performance of re-aged accounts, and determining the impact of re-aging practices on past due ratios.

The Retail Classification Policy governs re-aging. According to its provisions, an open-end account can be considered for re-aging if:

- The debtor has demonstrated a renewed willingness and ability to repay the loan,
- The account has existed for at least nine months, and

- The borrower has made at least three consecutive minimum monthly payments or the equivalent cumulative amount. (Funds may not be advanced by the bank for this purpose.) This requirement may be satisfied in any one of three ways:
  - Receipt of three consecutive monthly payments. For example, if the minimum due is $20, the cardholder would have paid $20 in month 1, $20 in month 2, and $20 in month 3.
  - Receipt of a cumulative amount equating to three minimum monthly payments within the three month period, regardless of the size or timing of the payments. For example, if the minimum due is $20, the cardholder could have paid $15 in month 1, nothing in month 2, and $45 in month 3.
  - Receipt of one lump sum equal to or exceeding three minimum monthly payments. For example, if the minimum due is $20, the cardholder would have paid a lump sum of $60.
- For an over-limit account, all of these conditions must be met:
  - The account meets the other re-aging criteria.
  - It is re-aged at its outstanding balance.
  - No new credit is extended to the cardholder until the balance falls below the pre-delinquency credit limit.

Adequate information systems should identify and document any account that is re-aged, including the number of times such action has been taken. The Retail Classification Policy states that an open-end account should not be re-aged more than once within any 12-month period and no more than twice within any five-year period. In addition to the one time per year/two times per five year rule, a bank may re-age an account after it enters a workout program. Re-aging for workout purposes may only occur after receipt of three minimum consecutive minimum payments, or the equivalent cumulative amount, as agreed upon under the workout program. Re-aging for workout purposes is limited to once in a five year period. Banks may also adopt re-aging standards more conservative than those identified in the Retail Classification Policy.

The decision to re-age, like any other modification to the contractual terms, should be well-supported. Documentation should normally show that the bank's personnel communicated with the borrower, the borrower agreed to pay the loan in full, and the bank personnel confirmed that the borrower has the ability to repay the loan. However, with the use of auto-re-aging, the borrower's willingness is usually less clearly documented. In general, meeting the three payment requirement has been considered adequate to demonstrate both the ability and willingness to repay. While this practice may be considered acceptable, it also emphasizes the need to segregate the auto-re-aged population from the manually re-aged population for the purpose of being able to monitor performance of the two populations independent of one another. Management can also take other actions to augment and support the auto-re-aging process. For example, as a good faith effort, some banks send a letter to the cardholder in an attempt to ensure ability and willingness and to provide for contact should the cardholder wish to discuss the transaction. Some banks also review current credit reports and behavior scores to assess a borrower's capacity. If the quality of the auto-re-aged population shows continued deterioration, the practice of auto-re-aging may be considered to be imprudent and cited as such by examiners. For example, if a high percentage of auto-re-aged accounts return to delinquent status and/or go to charge-off, management's policy and procedures may be overly liberal and ineffective. The same holds true for the performance of manually re-aged accounts.

Examiners should review management's re-aging practices and the volume of accounts and receivables re-aged. In doing so, they may consider the Dollar Volume of Re-aged Accounts to Total Credit Card Loans on a Three Quarter Lag Ratio. Combined with delinquency and loss rates, it indicates the level of accounts that have experienced difficulty meeting minimum payment requirements. If relatively high, this could indicate management's aversion to recognizing losses.

Re-Pricing

Re-pricing is the process by which finance charges and/or fees (most often finance charges) are adjusted to reflect perceived changes in the risk-profile of the account. Re-pricing initiatives can include bureau-based, performance-based, or other initiatives. Re-pricing is often used to adjust pricing upward as a collection strategy and is frequently referred to as **penalty pricing**. Penalty pricing generally is used to offset collection costs (as compared to other fees which may be primarily intended to help the institution invest in technology, expand **Automated Teller Machine (ATM)** networks, or address other initiatives).

Bureau-based re-pricing refers to finance charge changes made to accounts based on changes in borrower credit-worthiness identified through shifts in credit bureau scores or other credit bureau information. As such, it is tied to the customer's performance with all creditors. While the technique can be used to adjust the pricing down or up, it is most often used to increase pricing.

Performance-based re-pricing refers to finance charge changes made in response to borrower performance on the account with the issuing creditor. The strategy typically relies on internal behavior scores and delinquency patterns, but may also incorporate a number of factors including line utilization and bureau score. Like bureau-based analysis, performance-based analysis can be used to increase or decrease charges, but is most frequently associated with default price increases. When employed for delinquent accounts, there is often a provision to return to a lower finance charge following a specified period of sustained on-time payments.

Increasingly, banks are running periodic analysis of their portfolios and changing the terms of individual loans based on the results. For example, some banks have determined that certain yields have not been sufficient to offset risk, so they have implemented aggressive up-pricing campaigns. **Universal default** provisions have also become popular and subject consumers to upward pricing for various reasons. For example, a declining credit score can cause default pricing to kick-in. In addition, paying other credit obligations late or one of many other factors can also cause default-pricing to kick in. In some cases, these re-pricing practices may drive away good customers, leading to a concentration of higher-risk accounts. Examiners should determine if re-pricing initiatives received thorough and controlled testing before full implementation and how the re-pricing initiatives impact the portfolio and the bank's performance.

Not all re-pricing occurs as a result of adverse trends in the consumers' profile. For example, some institutions offer graduation programs that reward sustained successful performance of higher-risk borrowers by moving them from a subprime-type account (typically a low credit limit with a high price) to a more traditional or mainstream product that would have a lower interest rate, lower overall fees, and/or a higher credit limit.

Examiners should assess management's internal controls and on-going monitoring of re-pricing initiatives. Provisions of re-pricing policies and procedures generally include:

- When re-pricing initiatives can be instituted.
- The length of time an account will stay re-priced before being re-evaluated for additional price changes (either upward or downward).
- Remedies for cardholders who remain delinquent despite being penalized.
- Any other additional requirements of the cardholder.

Examiners may encounter accounts that are subject to the *Soldiers' and Sailors' Civil Relief Act of 1940* (SSCRA). The SSCRA addresses service members' credit obligations that were incurred prior to active military duty and that service members are unable to meet due either to their absence from home or from the financial consequences of significantly lower military pay in comparison to pay received for their normal (civilian) employment. The SSCRA does not apply to any obligation entered into by a borrower after their military service has commenced. Some key provisions of the SSCRA include:

- Applies to all persons on active duty in military service of the United States as well as to certain dependents of those service members and certain other liable individuals.
- Requires no specific form of notice to creditors, but sufficient proof of entry to military service is to be retained in creditors' records.
- Provides for re-pricing, limited to a six percent interest rate cap, effective upon commencement of active duty regardless of when the creditor is notified. Interest charges in excess of the limit are to be forgiven and may not be collected after the customer is released from active duty.
- Burden of proof is on the bank to show that the borrower has not sustained a material impact from active duty status (and thus may not be subject to the rate cap).

The SSCRA is discussed in FIL-134-2002. Management normally consults with legal counsel about the SSCRA and with its external accountants about applying the provisions of the SSCRA.

Repayment Plans

Banks have instituted various repayment plans such as workout plans, temporary hardship programs, and Consumer Credit Counseling Services (CCCS) programs. The object of these programs is to collect the amount due and improve the borrower's subsequent performance. Banks are encouraged to work with borrowers on a case-by-case basis keeping in mind that use of these types of repayment programs to defer losses or to mask poor initial credit risk selection practices is improper.

Workout Programs:

A former open-end credit card account upon which credit availability is closed and the balance owed is placed on a fixed (dollar or percentage) repayment schedule in accordance with modified, concessionary terms and conditions is considered a workout credit. Generally, the repayment terms require amortization of the balance owed over a defined period. These arrangements are typically used when a customer is either unwilling or unable to repay the account in accordance with its original terms but shows the willingness and ability to repay the account in accordance with modified terms and conditions. Workout programs are generally directed at cardholders with longer-term moderate to severe credit problems. Temporary hardship programs which are intended to help borrowers overcome short-term financial difficulties are not considered workout programs unless the program's duration is longer than 12 months (including renewals).

Characteristics of improperly managed workout programs include liberal repayment terms with extended amortizations, high charge-off rates (although loss rates on workout programs are normally higher than loss rates on the remainder of the credit card portfolio because of the cardholders' weakened financial conditions), moving accounts from one workout program to another, multiple re-agings, and poor reporting of program performance. Repayment terms for workout accounts vary widely and sometimes have not included sufficient reduction of interest rates to facilitate timely repayment and assist borrowers in extinguishing the debt. In some cases, reduced minimum payment requirements coupled with the continued assessment of fees and interest extended repayment well beyond reasonable timeframes.

To address these problems, the AMG set workout program parameters. Per the AMG, the design of workout programs should maximize principal reduction and generally strive to have borrowers repay debt within 60 months. To meet these guidelines, banks might have to substantially reduce or eliminate interest rates and fees such that more of the payment is applied to reducing the principal. In addition to clearly documenting any exceptions to the AMG's guidelines, including compelling, supporting evidence that eased terms and conditions are warranted, management should have policies and procedures specifying:

- When workout programs can be used.
- Terms of the agreement.
- Remedies for cardholders who do not fulfill the agreed upon payment obligations.
- When and if accounts can be re-aged.
- And any additional requirements of the cardholder.

Examiners will also confirm whether management has instituted strong internal controls and on-going monitoring for determining if the programs are effective and beneficial.

The Dollar Volume of Workout Credits measured against Total Credit Card Loans on a Three Quarter Lag may be considered during the examination. Combined with delinquency, loss, and re-aging rates, the ratio indicates the level of accounts which have experienced difficulty meeting minimum payment requirements. If relatively high, this could indicate management's aversion to recognizing losses. Where workout programs are not managed properly, examiners should criticize management and require appropriate corrective action, which may include increasing loss allowances, accelerating charge-offs to an appropriate timeframe, and revising the design of the bank's workout programs for future entrants.

Temporary Hardship Plans:

Temporary hardship programs are designed for borrowers with specific, short-term difficulties and who are expected to return to satisfactory performance in a relatively short time. As mentioned, most temporary hardship plans are not considered workout programs for purposes of the AMG. Accounts are adjusted back to the original repayment terms when the agreed-upon term is completed or when the account is dropped from the program due to missed payment.

Consumer Credit Counseling Service (CCCS) Plans:

CCCS is a third-party, nonprofit organization designed to assist consumers who have on-going delinquency problems. A consumer's acceptance into the program is based on a CCCS counselor's determination that the consumer's financial situation is salvageable. Under the direction of the CCCS counselor, the cardholder is required to establish and adhere to a budget as well as make debt payments. Debt payments are remitted to CCCS which then submits the payments to the bank according to the negotiated terms. The negotiated terms can vary from full payment to significant reduction in payments of principal and interest. When a consumer is accepted into CCCS, collection procedures cease. The bank may elect to waive late charges or any other fees. The account may also be re-aged (if it meets the appropriate criteria) and/or may be put on non-accrual. If a cardholder fails to pay as agreed under the program, the agreed-upon terms revert back to the account's contracted terms and collection procedures resume. Examiners normally determine whether management has established policies and procedures to monitor and evaluate accounts in the CCCS program and has accurately reported and sufficiently accounted for CCCS accounts in allowance calculations.

Settlement Agreements

In lieu of repayment plans, banks sometimes negotiate settlement agreements with borrowers who are unable to service their unsecured open-end credit. Settlements are also known as debt forgiveness programs. In a settlement arrangement, the bank agrees to forgive a portion of the amount owed, and the borrower agrees to pay the remaining balance with a lump-sum payment or with defined payments over a specific short period. Well thought out policies, in general, limit the amount (dollar or percentage) forgiven and establish guidelines for repayment timeframes. Further, they provide for the establishment and maintenance of adequate allowances for accounts subject to settlement arrangements. Actual credit losses on individual consumer loans should be recorded when the bank becomes aware of the loss and, in general, the amount of the debt forgiven in a settlement arrangement should be charged-off immediately. However, immediate charge-off may not always be practical. In those cases, banks may treat amounts forgiven as specific allowances, and upon receipt of the final settlement payment, charge-off deficiency balances within 30 days. Generally, if a cardholder who is settling an account has more than one account at the bank, all of the customer's accounts should be considered for settlement. Clearly, the inability of the customer to perform under the contracted terms of one account suggests the potential inability to perform on the other accounts as well.

Charge-Offs

Loss rates are a reflection of credit underwriting and marketing efforts. They also reflect economic conditions and other external factors. Common drivers of credit loss include rapid growth or poor origination strategies that have resulted in adverse selection. High levels of subprime lending also drive loss rates up.

Credit card loans are charged-off when they are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. Charge-off does not mean that the credit card loan has absolutely no recovery or salvage value but, rather, that it is not practical or desirable to defer writing off this basically worthless asset even though partial or full recovery may eventually occur. While credit card losses for individual credit should be recorded when the bank becomes aware of the loss, in no case should charge-off exceed the timeframes stated in the Retail Classification Policy:

- For open-end accounts, when the account becomes past due 180 cumulative days from the contractual due date.
- For closed-end accounts, when the account becomes past due 120 cumulative days from the contractual due date. Open-end accounts that are placed on a fixed repayment schedule are subject to this timeframe.

For operational purposes, charge-off should be taken no later than the end of the month in which the applicable period elapses. Any full payment received after the applicable period but before month-end charge-off may be considered in determining whether charge-off remains appropriate.

Loss timeframes specific to accounts of bankrupt or deceased customers are also articulated in the Retail Classification Policy:

- For loans in bankruptcy, the shorter of (i) the normal timeframes specified in the guidance or (ii) within 60 days of receipt of notification of filing from the bankruptcy court, unless the bank clearly demonstrates and documents that repayment on the account is likely to occur.
- For loans of deceased customers, the shorter of (i) the normal timeframes specified in the guidance or (ii) when the loss is determined.

Loss practices for fraudulent loans are discussed in the Fraud section of this chapter.

The Retail Classification Policy does not preclude the adoption of more stringent internal charge-off policies. Further, when a portfolio's history reflects high losses and low recoveries, accelerated charge-off timeframes are normally appropriate and necessary. Some banks have instated, at their own will or at the prompting of regulators, policies that accelerate charge-offs.

If a cardholder has more than one account with the bank and one of the accounts is charged-off, appropriate actions for the consumer's other accounts at the bank need to be determined. Depending on the situation, appropriate action might include charging-off or closing the account and/or increasing allowances.

At the time of charge-off, most credit card banks only charge a portion of the gross loss to the ALLL. Rather, they attempt to only charge the loan's principal balance to the ALLL. The remainder of the balance (fee and interest losses) is charged back directly against the income statement. This process of splitting principal losses from fee and interest losses is known as **purification**. The Allowances for Loan Losses chapter discusses principal losses versus fee and interest losses in more detail.

In lieu of charging-off the entire loan balance, loans with non-real estate collateral (for example, deposits) may be written down to the value of the collateral, less cost to sell, if repossession of collateral is assured and in process. Guidelines for loans secured by real estate are detailed in the Retail Classification Policy. Business cards, such as travel and entertainment cards, are evaluated on a case-by-case basis. Under no circumstances should the formula approach be used to charge-off large business type loans serviced by the bank's installment department.

Examiners should review charge-off rates and volumes. They may consider the Lag Ratio, which is the ratio of net credit card losses for the last three quarters measured against total delinquent credit card receivables as of three quarters ago (delinquent loans include loans past due 30 to 89 days plus total non-current loans). The lag ratio provides an estimate of the percentage of delinquent loans which subsequently are charged off. Examiners should review system settings for charge-offs to verify that the parameters correspond to those described in the bank's policies and comply with the Retail Classification Policy. Examiners should also review cases where credit card loans have not charged-off at the shorter of the timeframes within the banks' policies or within the Retail Classification Policy. When reviewing the banks' charge-off data and reports, examiners should be careful to factor in any changes made in the bank's charge-off timing and practices that may be impacting charge-off volumes and should also understand how the bank's purification processes are impacting the reported volumes.

Post-Mortem

Once an account charges-off, the bank normally is still not done managing the account. The need and desire for post-mortem (or post-charge-off) portfolio grooming continues to grow. Customized models that can project potential cash flow from charged-off portfolios have been developed and help the bank determine the value of keeping or selling the accounts. In addition, post-mortem analysis can help to identify weak points in portfolio management that may have influenced the breakdown of the program or account. By identifying the weak points, management can then take appropriate action to ensure the weaknesses are corrected and to address any remaining risks from existing actions of the same or similar nature.

Recoveries:

As part of post-mortem practices, the bank manages recoveries. Recoveries represent the money (collected payments) received on an account after it is charged-off and can consist of principal, interest, and fees. The amount recovered is dependent on several factors, including policies for collections and charge-offs, systems for internal control, supervision over the collection department, experience of the collection staff, and collection efforts during the various delinquency stages. A high level of recoveries compared to charge-off volume may indicate a conservative charge off policy. Or, it may indicate inadequate collection efforts prior to charge-off, a poorly trained collection staff, or inadequate management supervision. A low level of recoveries compared to charge-off volume may indicate a lax charge off policy, inadequate collection efforts, a poorly trained collection staff, or inadequate management supervision.

Recovery efforts may be in-house or outsourced to collection agencies. In addition, charged-off accounts can be sold to third-party entities. Most often, banks maintain charged-off accounts in-house for several months before turning them over to collection agencies or selling the accounts. The collection agencies normally agree to collect the accounts based on a fee that depends on the degree of complexity of the collection. The basis for sales of charged-off accounts is usually a certain percentage of the dollar amount of the charged-off account.

Banks are expected to properly report recoveries, as set forth in many instructional materials including, but not limited to, the AMG, accounting guidance, and Call Report instructions. Usually some or all of the recoveries are reported as recoveries to the ALLL. However, if the amount that the bank credits to the ALLL is in excess of the amount previously charged against the ALLL for that loan (which may have been limited to principal), the bank's net charge-off experience will be understated. Rather, any recovery amounts collected in excess of the amount charged against the ALLL for a loan should be recognized as income. Also, the rebooking of charged-off assets is an improper practice.

Fraud

Fraud is a continuing problem for banks that engage in credit card activities. As a result, banks, the Networks, and other vendors have strengthened systems and controls to reduce fraudulent activities. Advances in fraud detection have resulted in fraud losses, measured as a percentage of total sales volume, decreasing over time for many banks. Entities can curb the amount of fraud losses by tracking fraudulent activities according to type and by designing control systems that detect fraudulent activities in a timely manner. Some activities banks have instituted to reduce fraud include:

- Improved application review, including verification procedures.
- Call-to-activate requirements for new cards and re-issued cards.
- Pattern recognition programs and systems.
- Increased level of payment review.
- Authorization improvements.
- Increased training of employees in fraud detection practices.

Many banks have dedicated fraud staffs that oversee the many activities required when potential fraud is identified. When a cardholder alleges fraudulent activity on their account, an investigation is undertaken and, if delinquent, the account's delinquency status is either rolled-back or frozen. If the investigation negates the fraud allegation, proper actions include returning the account to its previous delinquency status and immediately reinstating collection efforts. For accounts that do constitute fraud, the fraudulent loan should be charged-off within the shorter of (i) 90 days of discovery or (ii) the general delinquency timeframes specified in the Retail Classification Policy (and discussed in the Charge-off section of this chapter). The charge-off should be taken by the end of the month in which the applicable time period elapses. Fraud losses are reported as a miscellaneous expense and are not applied against the ALLL.

REPORTING AND TRACKING

Tracking and monitoring the credit card portfolio is one of the most critical risk management functions performed and is one of the best defenses against an economic downturn. The quality of accounts, reflected in credit scores or other indicators, is constantly changing through attrition, new solicitations, and/or demographic shifts. Delinquency and loss rates also change constantly because of fluctuation in consumer behavior patterns and changes in general economic conditions. If management is not aware of these changing conditions, it cannot quickly react to adverse trends and build upon past successes. Reports are prepared at various intervals (daily, weekly, monthly, quarterly), depending on the report's intended usage. In addition, the complexity and sophistication of reports varies depending on the size and complexity of the programs as well as of the bank itself.

Because credit card portfolios generally consist of a large number of relatively small-balance accounts (as compared to other types of loans), identifying the changing conditions and evaluating the quality of the credit card portfolio on a loan-by-loan basis is inefficient and burdensome. Rather, reporting and tracking of the portfolio and its various segments provides the most efficient method of identifying changes and evaluating portfolio dimensions, composition, and performance. Effective reporting and tracking promote early and accurate identification of existing or potential problems (operational or otherwise) and promptly identify needed policy and procedure revisions. Successful reporting and tracking informs and arms management with the tools to understand the risk characteristics of the portfolio, which can be quite varied in nature. Review of management reports should be undertaken during the on-site examination to ascertain the comprehensiveness and accuracy of the information provided therein. In the absence of sufficient reporting, examiners may need to request that management develop additional reports or the examiner may need to calculate certain data (such as utilization rates, average outstanding balance per account, delinquency ratio, charge off rates, or other items of interest) with whatever information may be available. If sufficient reporting is not evident, management should be appropriately criticized.

Many well-run companies have highly evolved analytics and reporting systems. Effective reports provide management with the tools to assess whether operations remain consistent with strategic objectives and within established risk, return, and credit performance tolerances. They also aid management in identifying developing trends, making strategic decisions, detecting potential problems, managing vendor relationships, and responding to changes in economic, industry, and regulatory environments.

Segmenting

To maximize the effectiveness of portfolio tracking, management uses segmentation, which was introduced in the Marketing and Acquisition chapter. The various sub-populations comprising the credit card portfolio may have vastly different performance patterns and levels of risk. These differences might be masked if receivables are only analyzed on a total portfolio basis.

Management can segment a portfolio many ways. The use of multiple approaches is common and encouraged. Each segmentation method provides different perspectives and insights. With more information, management is better able to analyze and understand their customers, pinpoint the cause of asset quality problems, eliminate unsuccessful strategies, and further refine successful strategies. Common segmentation methods include, but are not limited to:

- Product line.
- Geographic location.
- Vintage.
- Time-on-book.
- Marketing channel or acquisition method.
- Credit bureau score.
- Delinquency stage.
- Behavior or other risk score.
- Utilization rate or bands.
- Owned (on-book) portfolios, securitized portfolios, and other off-book portfolios (potentially such as portfolios associated with Rent-a-BIN programs).

Dollars and Units

Management reporting often includes insight both on a dollar basis and on a number of accounts (or unit) basis because trends might be more distinct or may arise earlier in one type of reporting as compared to the other.

Levels, Trends, and Performance

Effective reporting provides for an analysis of levels and trends to determine the bank's condition from a strictly analytical viewpoint. Concerns may arise if reports merely depict data and do not clearly evidence analysis of performance results and trends. For example, credit line increase reports should not only identify the number and volume of credit line increases granted but should also depict the performance of those accounts after they receive the line increase so that management can assess whether its line increase practices are effective.

Key Indices

Management reports should identify various key indices because such indices can be beneficial in determining the quality of the credit card portfolio. Key indices should generally be tracked for each portfolio segment to gauge performance within that segment or to the managed portfolio. Calculations of ratios can vary from bank to bank, and as such, the examiner will need to ensure that they understand each particular bank's reporting and measurement methods.

Projected Versus Actual Performance

Effective portfolio management clearly communicates portfolio objectives such as growth targets, utilization expectations, rate of return hurdles, and default and loss expectations. Management normally has a variety of reports that monitor actual performance as compared to projected performance for these types of objectives. For example, management may review variances between actual and projected performance of a certain portfolio to enhance or modify future marketing campaigns.

Peer Comparisons

Management often tracks performance and data on its peers. While this can be a valuable tool, peer data for comparative purposes may be distorted due to niche marketing, specialized card products, or extensive affiliate support. When using peer comparisons, consideration must be given to the ways the peers' programs are similar to the bank's programs as well as how the programs differ and how those differences may impact ratios and data reviewed.

Ownership and Clarifying Information

Although not required, the most effective reports identify the report's preparer (if not system generated) and include clarifying information, such as definitions of various items in the reports, when helpful. For example, the definition of active account can vary from bank to bank and even within a bank. The inclusion of such items helps to ensure that the reader is able to fully understand the report and accurately draw conclusions from the reported information.

Common reports

The following types of reports are common, although segmentation methods within the reports vary widely. The list is merely illustrative, not exhaustive.

Report Type	*Description and/or Common Contents*
Application Distribution Reports	These reports show the disposition of applications over time. The volume of applications received; approval, rejection, and override rates; and the distribution of scores are usually detailed.
Delinquency Distribution Reports	These reports show delinquency by credit bureau score over time. Consequently, they help validate the bank's scoring system by demonstrating whether delinquent accounts are rank-ordered by score. A decrease in the differentiation between scores and delinquency rates over time may indicate an erosion of the scoring system.
Chronology Logs	These reports detail significant events, both internal and external. Items recorded might include, but would not be limited to: major solicitation campaigns, change in cutoff scores or other underwriting criteria, economic recessions, policy changes, and regulatory changes. These logs can assist management in explaining changes in portfolio performance.
Over-Limit Reports	These reports usually detail the type, number, and dollar volume of over-limit accounts. They are often segmented into "over-limit and current" population and the "over-limit and delinquent" population. Performance of over-limit accounts is also tracked. Over-limit reports should correlate with delinquencies, charge-offs, and fraud losses to assist management in determining whether its over-limit parameters adequately control losses or need refinement. Tracking manual over-limit authorizations by credit analyst helps to ensure accountability and to assess the individual analyst's decision-making skills.
Utilization Reports	These reports depict utilization, usually by band or range (for example, in 10 percent increments). Since they extend beyond 100 percent utilization when needed, these reports sometimes overlap with over-limit reports. The reports can include a variety of data, including dollar volumes, units, and available credit. Purchase volumes and fee and interest assessment volumes may be split out. The reports also can track performance of accounts by utilization range.
Cure Program Reports	These reports depict volume (unit and balance), loss performance, and performance of the accounts at specified intervals after entering the cure programs. They are generally segmented by program and compare performance of those accounts in the particular cure program to those accounts in the general population.
Concentration Reports	These reports depict geographic, customer base, card type, or other types of concentrations and

	may include data such as the dollar volume, unit volume, and performance data (delinquency, payment rates, loss information, and so forth) for the accounts in the concentration population.
Re-aging Reports	These reports track re-aged accounts against total accounts and dollar amounts outstanding to evaluate the effect re-aging procedures have on overall delinquency and charge-off ratios. The reports also track performance of the re-aged population, usually by month, after the account has been re-aged and usually by type (manual or automated). Tracking manually re-aged accounts by credit analyst or approving officer and identifying the reason for re-age helps to establish accountability.
Credit Line Increase Reports	These reports usually identify the dollar volume and number of credit line increases as well as performance of the accounts after the increase. They might also depict average line increases.
Loss Reports	These reports usually measure the dollar volume and number of accounts charged-off. They often also include the average balance of charged-off accounts and recovery information. A break-out between principal and fees and interest is frequently included.
Roll-Rate Reports / Migration-to-Loss Reports	These reports identify the migration (or movement) of dollar balances and/or units through the delinquency stages and charge-off. These reports are discussed in detail in the Allowances for Loan Losses chapter.
General Collections Reports	These reports identify data on various collection department functions. For example, they might include productivity information (call penetration, right-party contacts, promises made, promises kept, dollars collected, and staffing summaries). They may also identify special handling queue information or a variety of other information.
Payment Reports	These reports generally depict payment volumes and numbers (usually by month), insufficient funds volumes and items, payment rates, and average payment size.
Exception and Override Reports	These reports identify instances where practices have been outside of established policy guidelines or where credit decisions are contrary to those suggested by the scoring system. Information included will vary depending upon what type of exception or override is being tracked.
Customer Service Reports	These reports identify various statistics for the customer service department. They might depict the volume of calls answered by automated systems, the volume of calls handled by customer service representatives, the average speed of answer, the average length of a customer service call, customer service mail

	volume handled, length of time to respond to mail inquiries, and so forth.
Ad Hoc or Special Study Reports	These reports are completed on a case-by-case basis when management wants or needs to know about something that is not normally tracked on a regular basis. For example, many banks developed such reports when the AMG was first issued (to determine the impact of the guidance) and when Hurricane Katrina occurred.
Other Types of Reports	There are many other reports, some of which cover fraud, settlements, and vendors. Examiners should ask for the main reports that management uses (such as reports contained in board packets and reports reviewed regularly by department managers).

SUMMARY OF EXAMINATION GOALS – PORTFOLIO MANAGEMENT

Overall goals when reviewing portfolio management are to assess the effectiveness of activities and strategies used to enhance performance and increase profitability of existing portfolios and to determine the implications of those activities and strategies have on the quality of the portfolio and the quantity and direction of risk within the portfolio. Furthermore, examiners should assess whether the bank's strategies comply with applicable regulatory guidance, such as the AMG and the Retail Classification Policy. A few summary concepts of examination guidance provided throughout the chapter include:

- Identify the departments or individuals responsible for portfolio management activities.
- Review policies, procedures, and analytical techniques for portfolio management to ensure they are comprehensive and thorough.
- Evaluate account management practices and the corresponding policies and procedures for adequacy, considering the individual bank's circumstances.
- Assess the tools, systems, and available MIS to ensure that management is provided with necessary and timely information.
- Determine whether management's segmentation strategies for the card portfolio and its analysis of the performance of the segments are sufficient. For example, do they allow management to effectively monitor credit card receivables, identify trends, and proactively address developing problems.
- Review segmentation criteria, and assess its usefulness for portfolio analysis, including adverse classifications (as outlined in the Adverse Classifications chapter).
- Assess systems and practices for authorizing transactions.
- Assess systems and practices for managing credit lines and determine whether the practices conform to regulatory requirements.
- Review over-limit policies and practices and determine whether the bank's management of over-limit accounts satisfies regulatory requirements.
- Determine fee assessment practices and fee waiver practices as well as the resulting impacts on the portfolio and earnings.
- Review minimum payment structures and the volume and trends of negative amortization within the portfolio(s), and determine whether the bank's practices in these areas satisfactorily address regulatory requirements.
- Review payment deferral and prepayment programs, and determine to what degree these programs impair management's ability to evaluate asset quality or significantly increase credit risk. Review management's process to establish these types of programs, and determine how management monitors the performance of and impacts from these types of programs.

- Evaluate the effectiveness of collection policy guidelines and procedures.
- Assess the organization and staffing of the collections function.
- Determine whether re-aging, workout, and/or other programs are used constructively or if they delay the recognition of delinquency and loss.
- Evaluate the bank's charge-off policies and practices. Determine if accelerated charge-off timeframes are warranted.
- Assess recovery practices and volumes on charged-off accounts.
- Evaluate fraud detection and prevention programs, consider the impact of fraud losses on earnings, and verify that such losses are promptly charged-off and properly reported.
- Assess the organization and staffing of the customer service function, and determine how management monitors the successfulness of services provided.
- Determine the extent that management relies on third-party vendors in the portfolio management process and how management monitors the third-party vendors.

The following items might signal current or future elevated risk and warrant follow-up:

- Very high or low recovery rates or significantly fluctuating recovery rates.
- High or increasing volumes of accounts/receivables in cure-type programs.
- High or increasing re-aging volumes.
- Changes in charge-off timeframe practices.
- High or increasing volumes of over-limit accounts/receivables, including those that are considered chronic.
- High volumes of credit line increases for the portfolio, or frequent credit line increases per account.
- Lack of sufficient segmentation strategies.
- Lack of sufficient management reports.
- High volumes of negative amortization, especially if prolonged.
- Lax authorization strategies.
- Unusual fee waiver activity or excessive fee assessment practices.
- High or increasing volume of consumer complaints, or consumer complaints of a significant nature (for example, accusation of unfair or deceptive practices).
- Lack of appropriate controls over third-party relationships.
- High or rising fraud volumes.