

Preparing for S.414:

Understanding the Implications of the Credit CARD Act of 2009

On March 31, 2009, the Senate Banking, Housing and Urban Affairs Committee narrowly passed, by a 12 to 11 vote, S. 414, legislation to regulate and reform credit card policies. The Credit Card Accountability, Responsibility and Disclosure Act (the Credit CARD Act), introduced by Senator Christopher Dodd (D-CT), intends to protect consumers from certain practices followed by credit card companies. Although modifications to its current form may be required to gain passage by Congress, banks that have not yet begun to plan for the implications of the passage of the Credit CARD Act may face challenges meeting imposed requirements and implementation deadlines.

Key Provisions

In preparing to address the new requirements of the Credit CARD Act, issuers need to be aware of some of the key changes that will likely be mandated. The table below provides your Cliff Notes for the key provisions of S.414:

Provision	Description
Prohibition Against Universal Default	Prohibits issuers from increasing interest rates on cardholders in good standing for reasons unrelated to the cardholder's behavior related to the affected credit card.
No Interest on Debt Paid on Time	Prohibits interest charges on any part of a credit card debt which the cardholder paid on time during a grace period.
45-Day Notice	Requires a 45-day notice to impose a higher interest rate.
Higher Interest Rates Only for Future Debt	Requires higher interest rates to apply only to future credit card debt, and not to debt incurred prior to the increase.
No Interest on Fees	Prohibits the charging of interest on credit card transaction fees, such as late fees and over-the-limit fees.
Restrictions on Over-Limit Fees	Prohibits the charging of repeated over-limit fees for a single instance of exceeding a credit card limit.
No Pay-to-Pay Fees	Prohibits charging a fee to allow a payment on a credit card debt, whether the payment is by mail, telephone, electronic transfer, or otherwise.
Fair and Prompt Crediting of Cardholder Payments	Requires payments to apply first to the credit card balance with the highest interest rate and to minimize finance charges.
Fixed Credit Limits	Requires credit card issuers to offer consumers the option of operating under a fixed credit limit that cannot be exceeded.

Interest Rate Decreases	Requires card issuers to lower penalty interest rates imposed on cardholders after six months, if no further violations occur.
Stopping Unfair and Deceptive Practices	Gives each federal banking agency the authority to issue regulations prohibiting unfair or deceptive practices.
Improved Disclosures	Requires credit card issuers to disclose the period of time and total interest needed to pay off a card balance if only minimum monthly payments are made, as well as other enhanced disclosures.
Fair Billing Practices	Requires credit card issuers to issue bills 25 days before the due date and accept payments postmarked one week before the due date.
Protections for Young Consumers from Credit Card Solicitations	Requires card issuers soliciting persons under the age of 21 to obtain the signature of a parent, guardian, or other individual who will co-sign for the debt; proof the applicant can independently repay the debt; or proof the applicant has completed a certified financial literacy course. Prohibits credit bureaus from furnishing credit reports for consumers under age 21, unless the consumer initiates the request. Allows consumers at least 18, but not yet 21, to choose to receive card solicitations.

Implications for Issuers

It is as yet unclear which provisions will be included in the final version of the Credit CARD Act and how much time issuers will have to implement required changes. Nevertheless, issuers need to understand the implications of the current provisions and make plans to comply once Congress passes the final version.

We have categorized the implications into two categories: those primarily impact compliance requirements and those that primarily impact profitability.

Increased Compliance Requirements

Four of the Credit CARD Act provisions appear to have the biggest impact from the perspective of compliance difficulty, the most challenging of which may be the provision that protects young consumers from credit card solicitations.

<i>Provision</i>	<i>Implications</i>
Stopping Unfair and Deceptive Practices	Providing federal banking agencies with far-reaching authority to issue regulations prohibiting unfair or deceptive practices (which have yet to be identified) may impact any number of pricing, product, and other card terms and conditions.

Improved Disclosures	Revised disclosures may be necessary and could result in an increase in call center volume. May increase complexity to ensure compliance with new requirements.
Fair Billing Practices	May require card issuers to extend existing due dates and monitor postmarks on remittance envelopes to ensure compliance. May require system changes to allow for reversing of account charges due to incorrect posting dates.
Protections for Young Consumers from Credit Card Solicitations	May require card issuers to limit solicitations to individuals 21 and over, the burden of which may fall to the credit bureaus that may not provide a credit record for minors. Should issuers continue to accept responses from those under 21, they will require a co-signer. Issuers will need to determine whether the co-signer relationship will expire after the applicant reaches 21 and whether to have the applicant sign a new agreement. Issuers may need to develop guidelines regarding the proof required to determine if an applicant can independently repay the debt or has completed a certified financial literacy course.

Reduced Profitability

The remainder of the Credit CARD Act provisions may negatively impact profitability. Some changes will be required to comply with the provisions, although many changes may be relatively easy to implement.

<i>Provision</i>	<i>Implications</i>
Prohibition Against Universal Default	Interest yields that were designed to protect issuers against higher risk cardholders may decline. Other tactics may be required to mitigate this type of risk, including more aggressive account closures and, in the case of a default, more aggressive collection activities.
No Interest on Debt Paid on Time	Cardholders, particularly convenience users, may use the full grace period to make their payments and increase issuers' funding costs.
45-Day Notice	Cardholders will have additional time to arrange for a lower-rate card with another issuer or close the account before the higher rate goes into effect.
Higher Interest Rates Only for Future Debt/ No Interest on Fees/ Restrictions on Over-Limit Fees	Profitability may decline if a change to an issuer's current practices is required. However, many systems already provide parameters that allow for differentiated interest rates/fees, so system impacts may be minor.

No Pay-to-Pay Fees	Revenues may decline due to the discontinuance of charging a fee for processing certain payments. Issuer costs may rise due to customers who may increase the usage of making payments via a telephone call to customer service and/or collections units.
Fair and Prompt Crediting of Cardholder Payments	Charging higher rates to only new balances may decrease revenues. Card usage may decline as consumers may seek out alternative cards for new purchases. Delinquencies may rise on accounts where usage is discontinued as they would be less motivated to keep the account current.
Fixed Credit Limits	Over-limit income may decline. System enhancements may be required to flag accounts wanting this option to avoid line-increase programs with automatically increasing credit lines. Authorization-downtime processing and expansion parameters may require system modification. Association chargeback rules may require revision to deal with transactions that cause a credit limit to be exceeded. Issuers may need to think through how they want to deal with situations where interest and fees cause an account to go over its credit limit.
Interest Rate Decreases	May require system changes to track cardholder history and previous interest rates to automatically lower interest rates after six months of non-violation.

What Can Issuers Do Now to Prepare?

Some issuers may face challenges meeting requirements and implementation deadlines imposed by the Credit CARD Act, and may need to begin preparations in advance of legislation.

Preparation activities fall into four categories: strategic, risk management, systems, and compliance.

Strategic Considerations

1. Understand the impact on profitability that may result from the enactment of the Credit CARD Act and determine what levers need to be modified.
2. Determine whether the current portfolio characteristics and mix are appropriate given the provisions of the Credit CARD Act and how they may need to change.
3. Develop plans to minimize impact on portfolio size, behavior, and profitability.

Risk Management Considerations

1. Understand how the portfolio may react to changes in rates and terms, particularly to those that may result in decreased usage.

2. Determine which authorization parameters and collection practices need refinement due to potential changes in cardholder behavior.
3. Develop plans to align portfolio risk-management practices to potential changes in cardholder usage and portfolio mix.

Systems Considerations

1. Determine what system changes (parameter settings, enhancements, etc.) are needed to comply with the provisions of the Credit CARD Act, particularly those related to transaction authorization, assessment of rates and fees, and application of payments.
2. Develop business requirements for determining level of effort, costs, and implementation timing.
3. Finalize requirements once the provisions are approved for enactment.
4. Implement changes and revise procedures and training documentation.

Compliance Considerations

1. Understand what changes are needed to cardholder agreements and disclosures.
2. Confirm that agreements and disclosure changes are reflected properly in the business requirements and any necessary test scripts.
3. Confirm that the test scripts produce expected results.

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Because the Credit CARD Act passed so narrowly in Committee, it will likely be scaled back to gain wider acceptance. Issuers should begin preparing to comply with the requirements under the current version, however, as it will likely be the worst case scenario.

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