

Credit Cards Business- Regulatory nuances from issuance to co-branding

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Introduction

The credit card business has been growing in India, the reasons ascertained for this growth are multivariate. An active and aggressive credit card issuing policies adopted by the banks and correspondingly availability of granular credit level data on customers. The ease in assessments of customer creditworthiness of customer as India moves more towards a formal economy has catered to the supply side of the business. While with the increase in consumer spending and acceptance of credit as the new norm in the society keeps up with the demand side to the supply. However, it is to be borne in mind that the quality of credit card portfolios not only mirrors the economic environment in consumer finance but also has a high-risk co-relation with the prevailing overall macroeconomic position of a country. From the regulator's perspective, the deterioration in credit standards through relaxed credit underwriting criteria and risk management standards owing to market competition can pose a significant systemic threat to the financial markets. Therefore banks and entities issuing credit cards have to follow prudent policies and practices imposed by RBI for managing the risks in the credit card business. Before devolving directly into the topic of credit cards and surrounding regulations, it is pertinent to have a brief overview of the categories of cards specified by the RBI on basis of their issuance, usage, and payment by the cardholder.¹

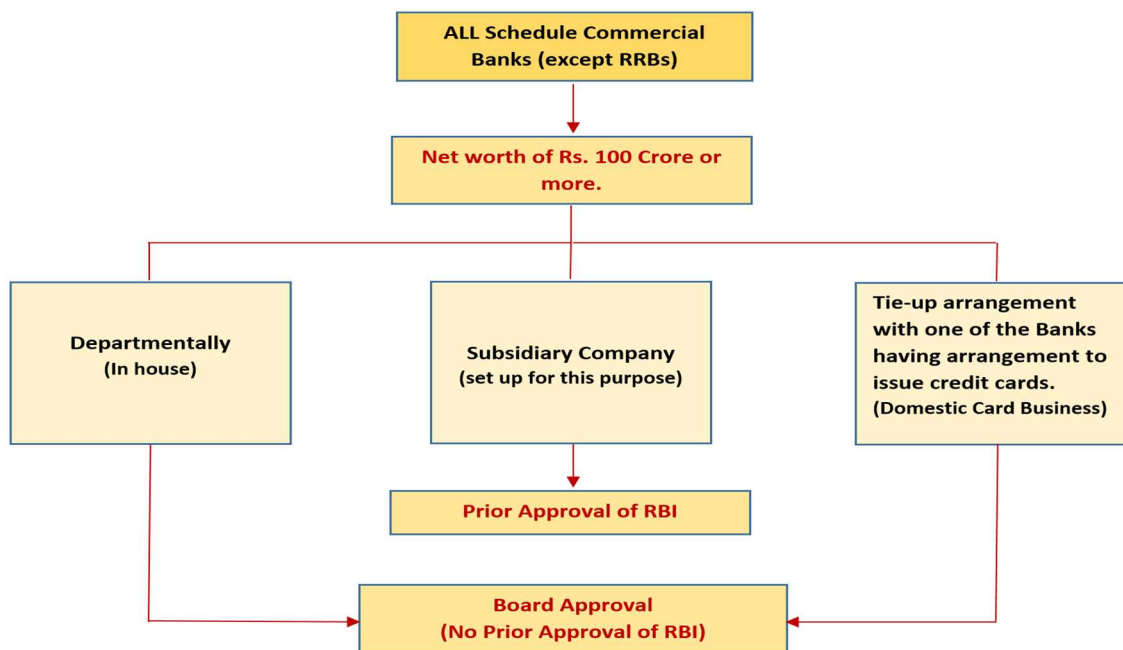
- **Debit Cards:** The debit card is used to withdraw cash from an ATM, purchase goods and services at Point of Sale (PoS) or e-commerce purchases, and are linked to a bank account.
- **Credit Cards:** Credit cards can also be used for the purchase of goods and services at PoS terminal/e-commerce. Further, the credit cards can also be used to withdraw cash from an ATM and for transferring funds to bank accounts, debit cards, credit cards, and prepaid cards within the country, subject to prescribed limits and conditions.
- **Prepaid Cards:** The usage of prepaid cards depends on who is the issuer of such cards. Prepaid cards can be open or semi-closed in nature and can be used to withdraw cash from an ATM, purchase of goods and services at PoS terminals/e-commerce and for domestic funds transfer from one person to another, subject to prescribed limits and conditions. While open system prepaid cards are issued by banks, semi-closed system prepaid cards can be issued by bank and non-bank entities.
- **Electronic Cards:** Electronic cards can be considered as debit cards issued in specific overdraft accounts that are in the nature of personal loan without any specific end-use restrictions. Banks can issue electronic cards to natural persons having overdraft accounts (CC/OD) so as to enable domestic digital transactions in such accounts. For all purposes like security, Additional Factor of Authentication (AFA), Merchant Discount Rate (MDR), etc., the instructions relating to debit cards are applicable on such electronic cards as well.

¹ RBI FAQs on Card transactions, dated May 18, 2020 <<https://m.rbi.org.in/Scripts/FAQView.aspx?Id=103>>

Credit Card Issuance and RBI Approval

Despite the functional description of credit cards as given by the RBI, a credit card commonly is a revolving short-term credit facility with the issuer of the card. The primary regulation governing credit card is through 'RBI master circular on Credit Card, Debit Card and Rupee Denominated Co-branded Pre-paid Card operations of Banks and Credit Card issuing NBFCs' dated July 01, 2015 ('master direction').² The master direction provides general guidance to banks/NBFCs on their credit card operations, and the systems and controls expected by the regulator in managing the risks in the credit card business. Banks by the very nature of their business have existing payment systems in place and hence require no prior permission of RBI in certain cases. The reference to having a payment system is of relevance here and discussed in the write-up below.

As under the master direction banks with a net worth of more than Rupees 100 crores can undertake credit card business either independently or in tie-up arrangements with other card-issuing banks. While in cases where a separate subsidiary route is taken by the Bank for commencing credit card business, prior approval of RBI is needed. The figure below provides a flowchart on the mode of issuances of the credit card by the Banks.



While the master direction is directed to both, Banks and NBFCs, but prima facie from the provisions of master direction and the language used it seems that only banks can issue credit cards. Therefore the master directions leave a broader question on entities other than banks and their eligibility to issue credit cards. In the FAQs dated May 18, 2020, by RBI, on entities who can issue cards, the RBI clarified that credit cards are generally issued by banks and a couple of non-banks, but can also be issued by other approved entities.³ However, neither the FAQs nor the master direction provides a

² Credit Card Master Direction, dated July 01, 2015

https://m.rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9838

³ RBI FAQs on Card transactions, dated May 18, 2020 <<https://m.rbi.org.in/Scripts/FAQView.aspx?Id=103>>

clear classification on which entities other than banks are eligible to undertake credit card business in India.

In a single credit card transaction, there are multiple contractual parties involved, from the merchant to a payer and the credit card issuer company to the merchant's receiving bank, along with other participants in the payment system. Thus there is a substantial multiple counterparty credit risk involved even in a single payment transaction vis-à-vis through credit card. Hence card issuances business cannot overlook the regulatory requirements and oversight of the payment system as governed under The Payment and Settlement Systems Act, 2007(PSS Act).

“(i)—payment system means a system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them, but does not include a stock exchange.

Explanation.—For the purposes of this clause, — “payment system” includes the systems enabling credit card operations, debit card operations, smart card operations, money transfer operations or similar operations;”

The credit card operations form part of the payment system, thus it is quite evident that to be a credit-issuing entity one has to have an RBI authorised payment system in place. Further, the PSS Act provides that the payment system operators take prior approval of RBI before commencing or carrying on a payment system.⁴ The entities involved in the payment system can either participate as a 'payment system provider' or 'payment system participant'. While the payment system participant has a wider connotation and includes payment system providers under its ambit.

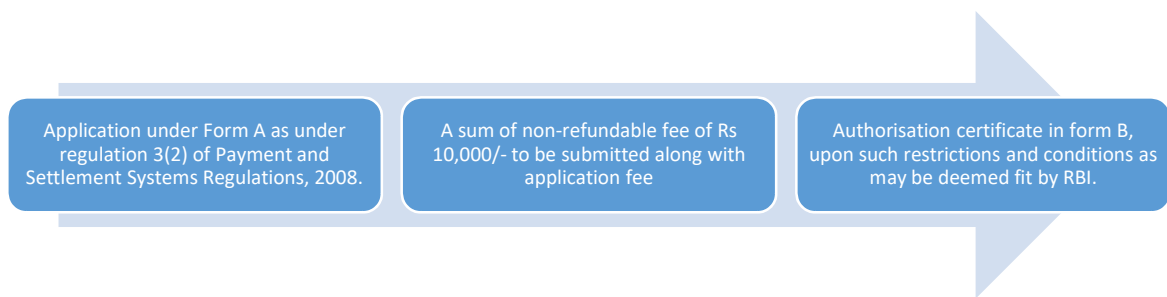
“(p) —“system participant” means a bank or any other person participating in a payment system and includes the system provider;

(q) —“system provider” means a person who operates an authorised payment system;”

Nevertheless, system provider and system participant enables payment between a payer and beneficiary, through all or either of the functions in the payment ecosystem such as clearing, payment, and/or settlement of payments. These functions could be discussed separately as they have a specific meaning attached to each of them, but the objective of the write-up commands focus on credit card issuances.

The flowchart below provides a brief guide to license, approval, or authorisation for payment systems under the PSS Act.

⁴ The certificate of authorisation issued by RBI under PSSA;
<https://www.rbi.org.in/scripts/PublicationsView.aspx?id=12043> last accessed November 18, 2020.



It is obvious to mention that banks have an authorised payment system in place, unlike NBFCs and other non-bank entities, therefore prior approval of RBI does not arise in case of banks desirous to take credit card business. However, the situation materially alters in the case of non-bank entities, since they pose a greater risk of default and requires regulatory oversight due to the nature of the business, thereby causing concerns not only from the standpoint of credit business itself but also run credit risk in the payment systems.

Types and basic features of a Credit Cards

As it was argued that the basic feature of a credit card is that it is in the form of a revolving credit facility provided to the customer by the issuer. However with the penetration of technology (virtual cards) and participation of other entities into the card business the features and modes of issuances have substantially altered. Though the broader meaning might qualify, the definition of credit card has blurred over time.

The erstwhile Master Circular on credit card dated July 01, 2013, described the credit card as

"1.2 Basic features of credit cards

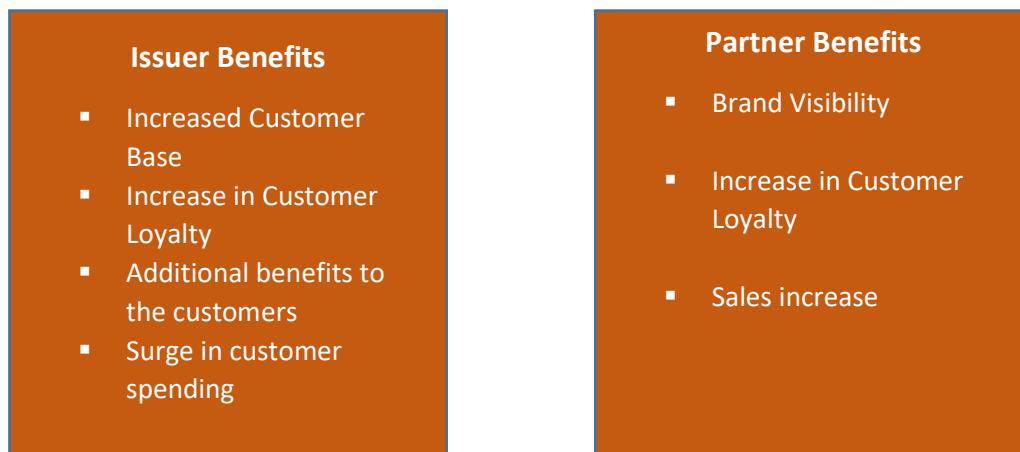
*The term "credit card" usually/generally refers to a plastic card assigned to a cardholder, usually with a credit limit, that can be used to purchase goods and services on credit or obtain cash advances ** "*

This description/feature of a credit card above might not qualify as an essential to the modern-day and age in the credit card business. This is why the same has been rightly done away with under the extant master direction. The introduction of virtual credit cards, which could be used by the user without carrying any physical cards is a step up that looks forward to revolutionising the payments business in India. While RBI also permits card not present transactions (CNP) or remote transactions while issuers ensuring additional factor authentication (AFA). Further commercial usage and features have made credit cards highly issuer entity-specific. The market participants and issuers describe features of credit cards based on indigenous terminologies like regular credit cards, commercial or business cards, pre-paid credit cards, cashback cards, etc. Neither there is any regulatory restriction on such classification, nor any specified criteria for the end-user of such credit cards. Thus from the foregoing discussion, there is no restriction on the foreign entity or a non-bank entity from undertaking credit card business in India, provided such non-bank entities get RBI approval by implementing systems and controls expected in managing credit card business.

However, the master direction specifies a particular type of credit card issued by Banks 'co-branded credit cards', which are often confused in the market between the issuer-specific regulations and partner-specific regulatory requirements.

Co-Branded Credit Cards

The co-branded cards in India have been more than a decade old concept, but have gain traction recently due to more nuanced business marketing strategies and increased credit card spending coupled with better consumer awareness. A co-branded credit card displays the name of both, the issuer bank and the co-branding partner. Thus a co-branded card could be referred to as a hybrid card having regular features of a credit card, additionally may offer its holders additional benefits at select merchants or may provide store like loyalty befits to its holders. The advantages of co-branded card from the issuer's and co-branding partner's perspective are as follows:



Who can be a co-branding partner? / Eligibility requirement?

It is primary to establish a difference between the issuer and the co-branded partner. An issuer entity has to be a bank or a non-bank entity that has been authorised by the RBI to conduct credit card business in India (Refer to the discussion above). However, the partner entity could be any non-bank entity such as an online e-commerce company, travel company, apparel company, etc. Though there are additional restrictions to be complied with in the cases where the co-branding partner is an NBFC.

Co-branding Partner is any entity
(online e-commerce company, Travel Company, Apparel Company and etc.)

- Due Diligence: Issuer Bank has to ensure the reputational risk

The master direction imposes an obligation on the issuing bank to undertake due diligence on the partner entity to protect themselves against reputation risk to which they are exposed in co-branding arrangement. It seems that there are no material restrictions on credit card issuer entities while choosing their co-branding partners. To highlight some of the suggestive commercial criteria while selecting a co-branding partner could be co-branding partners market or geographical area, customer outreach and customer acquisition capabilities, market segmentation (retail shopping, online aggregators, airline, hotel, and any other). There could also be other issuers specific contractual and mutual benefit arrangements between the parties.

Co-branding Partner is NBFC

NBFC shall have:

- Net Owned funds of Rs. 100 crores
- Net Profit as per last two years audited balance sheet
- Net NPA to net advances less than 3 %

In cases where a co-branding partner is an NBFC, such tie-up arrangement should be limited to the marketing and distribution of co-branded credit cards (without a risk-sharing basis). All the other conditions pertaining to the KYC, settlement of credit card payments, legal risks shall be with the issuer bank. Since NBFCs are involved in financial activities and by the nature of their business hold substantial credit risk and are leveraged. Therefore it could be argued that additional net owned fund requirement and other conditions in the case of NBFC acting as a co-branding partner, could be in line to safeguard credit card issuing banks reputation from the insolvency of partner NBFC.

Risk Sharing and Reputation Risks

Risk-sharing would mean a situation where the co-branding partner would take part in the credit risk of the credit card customer on its balance sheet. While in the case of NBFC the master direction specifically provides for co-branding partnership has to be on a non-risk sharing basis. In the case of a co-branding partner other than NBFC, there is no provision limiting the issuer bank from transferring risk to such a non-NBFC partner entity. Though all the activities of billing, debt collection, and others are to undertaken by credit card issuing bank, except where such or any of the functions are undertaken by agents or DSA/DMA, the same is to be governed by policy framed as under the master direction. The thrust of the master direction is on an obligation on the issuer bank to undertake due diligence on the non-bank co-branding partner to protect themselves against the reputation risk. The term reputational risk is not defined in the master direction, yet it carries utmost weightage in determining obligations of the issuer bank in a co-branding transaction. The reputation risk is highly subjective, but would materially cover the ability of the co-branding partner to perform its contractual obligation under the co-branding contract. Default or lapse by a co-branded partner could lead to material adverse impact on the business of credit card issuing bank, while other sources of risk could include co-branded partner own brand's reputation and its customer dealings. Therefore in our view from the intention of the master direction, it is quite clear that the issuer of the credit card shall not transfer its customer credit risk exposure to such its co-branding partner entity.

DSA/DMA and other Selling Agents

The Issuer bank can outsource operations of various credit card operations, but it shall not compromise the quality of customer service and the issuing bank's ability to manage credit, liquidity, and operational risks. Banks have to ensure that the marketing of credit cards by DSAs adhere to the Code of Conduct on credit card operations adopted by them. The co-branding partners can also extend marketing and sales support to partner issuers. Co-branded credit cards could be marketed to the partner's customers or other public at large through co-branded partners and other Agents. However, the underpinning is that the issuing bank shall not dilute its liability and obligation in any manner on the credit card business.

The table below summarises the policy compliances and obligations under the master direction which are to be complied by the credit card issuer.

	Regulation No	Particulars	Remark
Master Circular on Credit Card, Debit Card and Rupee Denominated Co-branded Pre-paid Card Operations of Banks and Credit Card issuing NBFCs (link)			
1	Policy Compliance (Reg 2.3)	To have a documented Fair Practice Code for credit card operations under the terms of the master direction.	
2	KYC /AML/ CFT (Reg. 4)	<p>Compliance with Know Your Customer Directions, 2016</p> <ul style="list-style-type: none"> • Appoint designated director and designated officer to ensure compliance with obligations under chapter IV of PML Act and Rules. • Conduct customer due diligence (CDD) and shall capture the KYC information for sharing with CKYCR. • Money Laundering (ML) and Terrorist Financing (TF) Risk Assessment' exercise periodically to identify, assess and take effective measures to mitigate its money laundering and terrorist financing risk for clients, countries or geographic areas, products, services, transactions or delivery channels, etc 	<p>There are additional compliances applicable to REs.</p> <p>KYC Directions are accessible at (link)</p>
3	Risk Assessment (Reg. 2.3)	<ul style="list-style-type: none"> • Independently assess the credit risk while issuing cards (especially students and others with no financial means). • Rejection reason is to be conveyed in writing, the main reason/reasons which have led to the rejection of the credit card applications. • Assess credit limit for customers on limits enjoyed by the cardholder from other banks on self-declaration/ credit information obtained from a CIC. 	<ul style="list-style-type: none"> • MITC indicated by RBI should be highlighted separately at all stages during marketing and sales. MITC

		<ul style="list-style-type: none"> • Most Important Terms and Conditions (MITCs): Mention in clear and simple language (preferably in English, Hindi, and the local language) comprehensible to a card user. 	accessible at <link>
4	Co-Branded Credit Card (Reg. 3)	<p>Banks may issue credit cards including</p> <ul style="list-style-type: none"> • Co-branded credit cards, • Corporate credit cards to the employees of their corporate customers, • Add-on credit cards. <p>Banks must undertake due diligence on the non-bank entity to protect themselves against the reputation risk to which they are exposed in such an arrangement.</p>	
5	Interest Rate and other Charges (Reg. 5)	<ul style="list-style-type: none"> • Publicise through the website and other means, the interest rates charged to various categories of customers. Indicate to the credit card holder, the methodology of calculation of finance charges with illustrative examples. • Quote Annualised Percentage Rate (APR) on card products. APR charged and the annual fee should be shown along with late payment charges, method of calculation of such charges and the number of days should be prominently indicated • Educate customers and explain about 'free credit period' loss on the balance of the previous outstanding amount. • A statement to the effect in the welcome kit and monthly statement, <i>"Making only the minimum payment every month would result in the repayment stretching over years with consequent interest payment on your outstanding balance"</i> 	
6	Over Due Status (Reg. 5.2. d)	<ul style="list-style-type: none"> • Uniform method of determining over-due status for credit card accounts while reporting to credit information companies and to levy penal charges. • Credit card account will be treated as NPA if the minimum amount due, as mentioned in the statement, is not paid fully within 90 days from the next statement date. The gap between the two statements should not be more than a month 	Relevant Notification (DBOD. _____ No. <u>BP.BC.78/21/04/048/2013</u>)
7	DSAs/DMA and other Agents (Reg. 7)	<ul style="list-style-type: none"> • Do not compromise customer service and issuer banks' ability to manage credit, liquidity, and operational risk. • Ensure that the DSAs engaged by issuer bank for marketing their credit card products scrupulously adhere to the Code of Conduct for Credit Card operations of the bank. 	For selling of credit card products by telemarketers, additional

		<ul style="list-style-type: none"> • Telemarketers who comply with directions/regulations on the subject issued by the Telecom Regulatory Authority of India (TRAI) from time to time while adhering to guidelines issued on “Unsolicited Commercial Communications – National Customer Preference Register (NCPR)” • Random checks and mystery shopping to ensure that their agents have been properly briefed and trained to handle with care and caution their responsibilities. 	<p>compliance of TRAI.</p> <p>Guidelines for Telemarketers issued by DoT and Telecom Commercial Communications Customer Preference Regulations, 2018. (Like OSP Registration, like calling hours, the privacy of customer information, T&C of product and others)</p>
8	Non-Issuance of Unsolicited cards (Reg. 8)	<ul style="list-style-type: none"> • Written consent of the applicant would be required before issuing a credit card. • Banks not to unilaterally upgrade credit cards and enhance credit limits. Prior consent of the borrower should invariably be taken whenever there are any change/s in T&C. 	
9	Customer Confidentiality (Reg. 9)	<ul style="list-style-type: none"> • No information relating to customers be revealed to any other person or organization without obtaining their specific consent. • On customer’s consent bank sharing the information with other agencies, banks should explicitly state and explain clearly to the customer the full meaning/ implications of the disclosure clause. • Limited disclosure to DSA/recovery agent to extent that will enable them to discharge their duty. 	
10	CIC Reporting (Reg. 10)	<ul style="list-style-type: none"> • Explicitly notice of the customer that information is being provided in terms of the Credit Information Companies (Regulation) Act, 2005. • Before reporting default, should ensure procedure approved by Board, including sufficient notice to cardholder about the intention to report to CIC. The notice period for such reporting and withdrawn in the event the customer settles his dues. • Particularly to be careful in the case of cards where there are pending disputes. 	

11	Fair practices in debt collection (Reg. 11)	<ul style="list-style-type: none"> In the matter of recovery of dues, banks and their agents should ensure adherence to the instructions on the Fair Practice Code for lenders.⁵ 	
12	Redressal of grievances (Reg. 12)	<ul style="list-style-type: none"> The time limit of 60 (sixty) days may be given to the customers for referring their complaints/grievances. Designated grievance redressal officer should be mentioned on the credit card bills. 	
Enhancing Security of Card Transactions, Notification dated Jan 15, 2020 (RBI/2019-20/142)			
13	Enhancing Security of card transactions	<ul style="list-style-type: none"> All cards (physical and virtual) shall be enabled for use only at contact-based points of usage [viz. ATMs and Point of Sale (PoS) devices] within India. Issuers shall provide cardholders a facility for enabling card, not present (domestic and international) transactions, card-present (international) transactions, and contactless transactions, for enabling the following: <ul style="list-style-type: none"> facility to switch on / off and set/modify transaction limits (within the overall card limit, if any, set by the issuer) for all types of transactions – domestic and international, at PoS / ATMs / online transactions / contactless transactions, etc.; the above facility on a 24x7 basis through multiple channels alerts/information/status, etc., through SMS / e-mail, as and when there is any change in the status of the card. 	<ul style="list-style-type: none"> To comply w.e.f Sept 30, 2020
Guidelines on Regulation of Payment Aggregators and Payment Gateways. Notification dated March 17, 2020. (RBI/DPSS/2019-20-174)			
14	General Instructions (Reg. 12)	<ul style="list-style-type: none"> Payment Aggregators shall not place limits on transaction amount for a particular payment mode. The responsibility therefore shall lie with the issuing bank/entity; for instance, the card-issuing bank shall be responsible for placing amount limits on cards issued by it based on the customer's creditworthiness, spending nature, profile, etc. 	<ul style="list-style-type: none"> To comply w.e.f Sep 30, 2020.

⁵ <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=1172&Mode=0>

