



# Update

NEWSLETTER

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A newsletter published by the Payment Cards Center, providing meaningful insights into developments in consumer credit and payments

## From the Director

*Bob Hunt, Assistant Vice President & Director*

The year 2009 will be remembered as a period of remarkable change for the consumer credit and payment markets. A year ago it was still unclear how deep the current recession would be. Today, we recognize that it is one of the worst since the Second World War. The most telling statistic is a national unemployment rate that is hovering around 10 percent. With so many consumers out of work and real estate markets continuing to struggle, it is not surprising to observe a dramatic rise in delinquencies on loans and, now, bankruptcy filings. The retrenchment in consumer spending earlier this year was so great that a noticeable change could be seen in the volume and composition of consumer transactions.

As always, the Payment Cards Center attempts to respond to the times. In this edition of *Update*, you will read about many examples of our responses, including three conferences organized around important questions raised by the current crisis: (1) What mortgage and real estate data do we need in order to identify at-risk markets or financial institutions and to mitigate the effects of falling home prices? (2) What alternatives to bankruptcy are available to consumers and do they work? and (3) What can the latest and best economic research tell us about the nature of the current crisis and how to avoid future crises?

This summer we introduced a new publication, *PCC Note*. This is a very short paper on a specific topic that can be produced in response to very recent developments. Industry Specialist Philip Keitel wrote our first *Note*, which re-



**Bob Hunt**



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views a new set of regulations, established in this summer's Credit Card Accountability Responsibility and Disclosure Act, that will apply to prepaid gift cards. Expect to see many new innovations and papers from the PCC over the coming months.

Finally, there have also been a number of changes within the center itself. In the previous issue, we announced the transition to a new director and I introduced myself to you. Since then, our very capable research assistant Christine Lemmon has left us for graduate school. Jamey van Opstal, a

recent graduate of Haverford College, has taken her place. We also have a new industry specialist, Stephanie Wilshusen, who joins us after working many years at the Credit Research Center at Georgetown University. Finally, Julia Cheney has been promoted to senior specialist in order to better assist me in developing the center's agenda and maintaining the high quality and timeliness of our work.



## The Future of Consumer Credit Counseling



**Payment Cards Center Visiting Scholar and keynote speaker for the conference, Michael Staten, Director, Take Charge America Institute, University of Arizona, addresses the audience.**

On July 30 and 31, 2009, the Payment Cards Center hosted a conference, "The Future of Consumer Credit Counseling." The conference brought together a variety of stakeholders to discuss the evolution of the credit counseling industry, its role in the U.S. consumer credit market, and the opportunities and impediments to offering consumers more effective counseling, financial education, and workout products as viable alternatives to bankruptcy.

ment companies, and proposed changes to state and federal regulations.

Conference speakers also presented the results of research studying the value of credit counseling and financial education. There was a consensus that more careful assessments of the effects of credit counseling services and debt workout products are essential. Developing a better understanding of consumer choices about incurring and repaying debt and the long-run impact of those decisions will be central to designing improved counseling treatments and workout products.

A summary of the conference is forthcoming.

Conference discussions centered on the challenges faced by the credit counseling industry, including the impact of the economic recession on the demand for counseling agency resources and the condition of consumers, declining budgetary resources, competition from the emergence of debt settle-



# Understanding the Housing and Mortgage Markets: What Data Do We Have? What Data Do We Need?

On June 25, 2009, the Community Affairs Department and the Payment Cards Center hosted a conference, "Understanding the Housing and Mortgage Markets: What Data Do We Have? What Data Do We Need?" Attendees from the conference included Federal Reserve System employees and representatives from government, academia, and nonprofit and for-profit organizations.

While the topic of mortgages has not typically been a research area for the Payment Cards Center, it would be a mistake to ignore the linkages between the mortgage crisis and other consumer credit markets. With that link in mind, we were happy to assist the Bank's Community Affairs Department in organizing this event.\* In a recent interview, Harriet Newburger of the Community Affairs Department explained the need for such an event: "The lack of readily accessible, standardized data on the mortgage market negatively affected the ability to predict how severe the mortgage crisis and its spillovers would be, and it has also

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\* Community Affairs works closely with financial institutions, nonprofit organizations, and government agencies on public-private partnerships that result in increased affordable housing and community and economic development. For more information about the Community Affairs Department of the Federal Reserve Bank of Philadelphia, visit the Community Development website: <http://www.philadelphiafed.org/community-development/>.



**Panelists for the session on state and local data are (left to right): Richard P. Howe, Jr., Commonwealth of Massachusetts; Mark Kaufman, State of Maryland; Jeff Crump, University of Minnesota; Dan Immergluck, Georgia Institute of Technology; Kathe Newman, Rutgers University; and Claudia Coulton, Case Western Reserve University.**

hampered efforts to alleviate the effects of the crisis. Given the depth of the crisis, there hasn't been much time to sit back and consider how to most efficiently use and share the data that we have or to think about what data are needed going forward to lower the likelihood of a future crisis."

With the center's assistance, Newburger and Dede Myers, vice president of the Community Affairs Department, and former Community Affairs staffer Christy Chung Hevener developed a two-session agenda: one session on state and local data needs and another on federal data collection efforts related to the housing and mortgage markets. There was plenty of discussion, and one result was an increased knowledge of researchers' specific data needs. Many of the lessons learned at this event have already contributed to changes in the way the Federal Reserve System uses and shares mortgage-related data for the purposes of risk assessment, foreclosure mitigation, and research.

A conference summary is forthcoming.

# Recent Developments in Consumer Credit and Payments

On September 24-25, 2009, the Payment Cards Center and the Research Department co-sponsored the fifth in a series of joint research conferences focusing on important issues in consumer credit and payments. The conference brought together academic scholars and industry experts to present and discuss the latest research on these topics, which included both theoretical and empirical papers. Approximately 60 participants attended the conference, where seven research papers chosen from over 70 submissions were presented. The topics covered in these papers included securitization and distressed loan renegotiation, mortgage delinquency, payday borrowing, data breaches and identity theft, bankruptcy reform, global retail lending, and legal protection in U.S. financial markets.\*

A summary of the conference is forthcoming.

\* Abstracts and presentations for many of these papers can be found on the Payment Cards Center website at: <http://www.philadelphiafed.org/research-and-data/events/2009/consumer-credit-and-payments/program.cfm>.



Conference presenters are (left to right): William Roberds, Federal Reserve Bank of Atlanta; Adair Morse, University of Chicago; Simon Gervais, Duke University; Tomasz Piskorski, Columbia University; Ashlyn Nelson, Indiana University; Jörg Rocholl, European School of Management and Technology; and Michelle White, University of California, San Diego.

## Inaugural PCC Note Published

For the past eight years the Payment Cards Center has been expanding its Discussion Paper series, which includes papers based on PCC-sponsored conferences or workshops and original staff research.

Introduced for the first time in August 2009, *PCC Note* consists of a short article written by Payment Cards Center staff that highlights current topics related to consumer credit and payments. Like the discussion papers, *PCC Note* was developed to

provide timely information to a diverse audience, including professionals, regulators, consumers, and academics.

Industry Specialist Philip Keitel wrote the first *PCC Note*, "The Credit CARD Act of 2009 and Prepaid Cards." In this paper, Keitel highlights some provisions of recently enacted federal legislation related to prepaid cards and outlines the debate over whether these cards should be defined as "monetary instruments" under federal law.

\* Available on the center's website at: [http://www.philadelphiafed.org/payment-cards-center/publications/pcc-note/2009/pcc-note\\_credit-card-act-2009.pdf](http://www.philadelphiafed.org/payment-cards-center/publications/pcc-note/2009/pcc-note_credit-card-act-2009.pdf)

## Beyond the Walls of the PCC

Industry specialists at the Federal Reserve Bank of Philadelphia are often asked to serve on industry-related committees or to participate in special assignments within the Federal Reserve System where their expertise can best be used. In this edition of *Update*, we highlight the recent work of three Payment Cards Center employees.

In March 2009, Senior Industry Specialist Julia Cheney was asked to become a member of the BITS Fraud Steering Committee (FSC). BITS is a not-for-profit division of the Financial Services Roundtable whose program agenda focuses on sustaining consumer confidence and trust in consumer payment systems, including card-based systems. This goal is accomplished through a set of standing and ad hoc committees tasked with specific programming objectives. These objectives may relate to identifying best practices or global fraud trends or developing new research to help reduce the impact of fraud. Additionally, this committee serves as a platform for members to share fraud data or information about operational procedures. In its role as a steering committee, the FSC leverages a wide range of experience, including nonmember perspectives, to help set its fraud program agenda.

From June through September, Industry Specialist Philip Keitel worked at the Board of Governors' Division of Consumer and Community Affairs in Washington, D.C., on consumer payment regulations. Keitel helped to effect provisions of the Credit Card Accountability Responsibility and Disclosure Act of 2009\* (the Credit CARD Act) by assisting in the drafting of regulations related to consumers' use of credit cards and prepaid cards.

In addition to his work on Title IV regulations, Keitel conducted research related to section 102(b)(1) of the Credit CARD Act and studied various aspects of state banking laws that might conflict with overdraft regulations proposed by the Board. This section of the legislation would amend the Truth in Lending Act by requiring "reasonable and proportional" fees related to the terms of cardholder agreements. It will be interesting to follow the debate over how to define "reasonable and proportional."

In addition to managing the center, Bob Hunt has been busy participating in a number of industry and regulatory forums. For example, Hunt joined with two Federal Reserve colleagues (Cheryl Venable and Ken Isaacson) to present an overview of payment systems at NACHA's annual meeting. He made a presentation on the outlook for collections at the Risk Managers Roundtable, the Credit Grantor Consortium, and the Center for Financial Innovations 4<sup>th</sup> Annual Underbanked Financial Services Forum. In addition, he participated on a panel at the Federal Trade Commission's recent public forum on proposed debt relief amendments to the Telemarketing Sales Rule.

## Welcome to the Center

**James (Jamey) van Opstal** joined the Payment Cards Center as a research assistant in July after graduating from Haverford College in May with a B.A. in economics and a minor in East Asian studies. While at Haverford, he played for the school's lacrosse team and served on the honor council and on student council. In addition, he spent the summer before his senior year working with an economics professor at Haverford on research regarding social preferences and their effect on giving. Jamey is excited to be part of the Payment Cards Center and the Federal Reserve Bank of Philadelphia.



**Stephanie (Steph) Wilshusen** joined the Payment Cards Center as an industry specialist in May 2009. Before joining the Bank, she served as associate director of the Financial Services Research Program at George Washington University and as assistant director and senior research associate at Georgetown University's Credit Research Center. Her research and publications include analyses of consumer credit markets and payment behavior. We are happy to have Steph join us in the Payment Cards Center.

\* Signed into law by the President on May 22, 2009.

# PCC Workshops

During the course of the year, Payment Cards Center industry specialists organize a number of workshops on topics in consumer credit and payments. These internal workshops are most often led by invited presenters and follow a rather informal format. In some cases, the content discussed will lead to written discussion papers or future collaborations with the speaker; in other cases, the

workshop will simply serve to educate the audience. Since its inception in 2000, the workshop series has grown to be a focal point for the center's research agenda. From January to October 2009, the Payment Cards Center hosted a record-breaking nine workshops, with two more currently in the planning stages. Highlighted here are some of the workshops hosted during 2009.<sup>1</sup>

## MARCH 2009

### **Criminals and Payment Cards: Evolving Threats Posed by Criminal Use of Payment Cards and Related Regulatory Challenges**

*Horacio Madinaveitia and Braddock Stevenson, FinCEN*

#### **Topics discussed:**

- Roles payment cards can play in criminal activities such as money laundering, as well as the challenges facing regulators.
- Regulations currently in place.
- The potential expansion of the term "monetary instrument" to include stored-value programs and access instruments under the Grassley Amendment to the Combating Money Laundering and Terrorist Financing Act of 2007.
- Red flags that have been identified by suspicious activity reports (SARs) and/or enforcement actions.
- How criminals use payment cards and payment card processing systems, and what might be done about it.

## APRIL 2009

### **The Electronification of Transit Fare Payments: An Issuer's Perspective<sup>2</sup>**

*James Locke, Jameson Troutman, and Krista Gallagher, JPMorgan Chase*

#### **Topics discussed:**

- How the adoption of electronic payments by mass transit operators is likely to alter the course of consumer payments.
- How one major payment card issuer (JPMorgan Chase) views the electronification of transit fare payment systems.
- Examination of how the transition from transit fare payment systems based on paper and coin (tickets and tokens) to systems based on payment cards is likely to influence consumer payment behavior outside of transit.

*Paper forthcoming.*

## MAY 2009

### **Moving from Rankings to Rating**

*Dr. Joseph Breeden, Strategic Analytics, Inc.*

*(Jointly coordinated with the Federal Reserve Bank of Philadelphia's Supervision, Regulation and Credit Department)*

#### **Topics discussed:**

- Credit scores and the U.S. mortgage crisis.
- Scores and their use with Basel II regulatory capital.
- Discussion of both the theory and practical aspects of building and using these scores.

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<sup>1</sup> For a complete list of workshops, visit the Payment Cards Center events page at: <http://www.philadelphiafed.org/payment-cards-center/events/>.

<sup>2</sup> Note: This workshop is a continuation of a topic discussed at a September 2008 workshop on the electronification of SEPTA's transit fare payment system under the new payment technologies project and its affect on consumers. The discussion paper can be found at: <http://www.philadelphiafed.org/payment-cards-center/publications/discussion-papers/2009/D2009AprilSEPTA.pdf>.

## JUNE 2009

### Limited and Varying Attention in Household Finance: Evidence from Shocks to the Salience of Penalty Fees

Jonathan Zinman, Dartmouth College, and Visiting Scholar, Payment Cards Center

#### Topics discussed:

- The impact of varying attention on the payment of bank account and credit card penalty fees.
- Measurement of fee payment using unusually rich, transaction-level, administrative data that span multiple accounts, across multiple providers, for each consumer.
- Implications for disclosure policy and firms' strategy.

## AUGUST 2009

### Anatomy of a Data Breach and Heartland's Response

Robert Carr, Heartland Payment Systems

#### Topics discussed:

- How the Heartland breach occurred and the company's post-breach efforts to improve coordination and information-sharing among merchant acquirers and processors.
- The need for measures to improve the security of consumer payments and review of three leading technology solutions aimed at better protecting cardholder information: tokenization, EMV/chip and PIN, and end-to-end encryption.

*Paper forthcoming.*

Discussion papers for many of the 2009 workshops are still works in progress; other workshops have broadened our expertise on a particular topic.

One notable Payment Cards Center workshop from the past that relates to current regulatory activity is "Unlocking the Risk-Based Pricing Puzzle: Keys to Cutting Credit Card Costs." The workshop took place in June 2007. This workshop resulted not only in a discussion paper,<sup>3</sup> but it also brought together two Federal Reserve entities: the Philadelphia Fed and the Board of Governors. Below is a summary of this workshop's discussion paper, which can be found on the center's website.

**Summary:** *On June 29, 2007, the Payment Cards Center of the Federal Reserve Bank of Philadelphia sponsored a workshop led by Jeanne Hogarth, program manager, Consumer Education and Research Section, Division of Consumer and Community Affairs, Federal Reserve Board of Governors, to discuss the Board's proposed*

*changes to disclosure requirements for open-end credit, in particular, credit card billing statements and solicitation materials. Hogarth tied the proposed changes to her own research that identified certain behaviors most likely to affect the interest rates consumers pay for credit card borrowing. Given these research findings, Hogarth argued that having access to easily understood information about critical credit card terms and conditions can help consumers make more financially efficient decisions.*

Check back at the center's events page<sup>4</sup> for event postings and links to associated discussion papers.

Do you have a research topic that you think would benefit the center's workshop series? Is there a recent topic in the news that you wish to see on the center's research agenda? In 200-500 words, submit your ideas to the Payment Cards Center at: [philpaymentcardcenter@phil.frb.org](mailto:philpaymentcardcenter@phil.frb.org).

<sup>3</sup> Available on the center's website at: <http://www.philadelphiafed.org/payment-cards-center/publications/discussion-papers/2008/D2008MarchRegulationZ.pdf>.

<sup>4</sup> <http://www.philadelphiafed.org/payment-cards-center/events/>

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The mission of the Payment Cards Center is to provide meaningful insights into developments in consumer credit and payments that are of interest not only to the Federal Reserve System but also to the industry, other businesses, academia, policymakers, and the public at large. The center carries out its mission through an agenda of research and analysis as well as forums and conferences that encourage dialogue incorporating industry, academic, and public-sector perspectives.