July 30, 2008

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Office of Thrift Supervision
Chief Counsel's Office
1700 G Street, NW
Washington, DC 20552
Attn: OTS-2008-0004

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Dear Ms. Johnson, Mr. Bowman and Ms. Rupp:

Re: Unfair or Deceptive Acts or Practices
Federal Reserve System: Docket No. R-1314
Office of Thrift Supervision: Docket ID. OTS 2008-0004
National Credit Union Administration: RIN 3133-AD47

On behalf of the California and Nevada Credit Union Leagues, I appreciate the opportunity to comment on the rules proposed by the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, and the National Credit Union Administration (collectively, the "Agencies"), which seek to prohibit institutions from engaging in certain acts or practices—deemed "unfair" or "deceptive"—in connection with consumer credit card accounts and overdraft services for deposit accounts. By way of background, the California and Nevada Credit Union Leagues (the "Leagues") are the largest state trade associations for credit unions in the United States, representing the interests of more than 400 credit unions and their 9 million members.

The Leagues recognize that there are legitimate concerns about abusive credit card and overdraft protection plan practices. We applaud the Agencies' efforts to end discriminatory, predatory, deceptive, and abusive practices in this regard, and note that credit unions have a long history of providing fair and competitive rates and products to members/consumers, including credit cards and overdraft protection plans.

While we support the spirit and scope of the proposal—and many of its provisions—we have strong concerns that several requirements in the proposal are unbalanced, unreasonable, and will lead to unintended and adverse consequences for consumers and regulated institutions, not the least of which being making credit more expensive for consumers.

Credit Card Practices

Late payments

The proposal will prohibit creditors from considering a payment as late unless the consumer is provided with reasonable time to make payments, which is deemed to be at least 21 days before the due date. The Leagues concur with the Agencies' position that consumers should be given a reasonable amount of time to make their payments, and do not find the proposed 21-day period, on its face, to be unreasonable. However, the 21-day period appears to be at odds with the provision under Regulation Z which provides for at least a 14-day time period between mailing of the statement and the date by which the payment in full must be made in order for the customer to receive a grace period.

Currently, the minimum grace period due date and the minimum payment due date provided by regulation are the same number of days. The proposal, however, prescribes a 21-day time period for purposes of late fees and other consequences while retaining the 14-day rule. As a result, minimum grace period due dates and minimum payment due dates may differ. In other words, consumers would have two payment dates on their credit cards: the date by which any payment in full must be made and, seven days later, the date by which payment must be made to avoid being late (i.e., the minimum payment). This does not appear to be an evenhanded approach, and is very likely to be confusing for consumers. Therefore, we urge the Agencies to reconsider implementing this provision as written.

Although not part of the proposed changes, the Agencies have requested comment as to whether the Agencies should adopt a rule that requires institutions, upon the request of a consumer, to reverse a decision to treat a payment mailed before the due date as late. Without a doubt, the additional time and expense required to receive, research, and process such requests would be extremely burdensome for credit unions and other financial institutions. Such a rule would also encourage consumers to make—or, at least, would not dissuade them from making—late payments via mail, while lessening the appeal of online payment options. Further, many credit unions already allow fee reversal in these situations, as long as the occurrence is not excessive. Therefore, the Leagues strongly discourage the Agencies from adopting

such a rule as unneeded and contrary to sound personal financial management practices.

Allocation of Payments

For a credit card that includes balances subject to different rates, creditors will be required to allocate the amount in excess of the minimum payment under one of the three following methods, or by another method, as long as it is no less beneficial to the consumer:

- Apply the amount first to the balance with the highest interest rate and then apply any remaining amounts to the other balances in order from the highest rate to the lowest rate.
- Divide the amount equally among the balances.
- Divide the amount in a pro-rata manner among the balances. This would allocate the amount among the balances based on the percentage of that balance as compared to the total of all the balances.

The Leagues certainly understand consumer confusion and frustration regarding the use of the "low-to-high" allocation method used by many creditors, and appreciate the extensive consumer testing of payment allocation disclosures done by the Agencies to attempt to determine a manner to address these issues. While we support the goals of this provision (i.e., fair and easily understandable payment allocation), the overly prescriptive, technical, and complicated nature of the proposed allocation methods leave us unsure that greater transparency and consumer acceptance will be achieved by implementing them as proposed. The Leagues suggest that additional consumer testing is warranted in order to determine consumer preferences for a single allocation method.

Increasing Interest Rate on an Outstanding Balance

The proposal prohibits creditors from increasing the interest rate on an outstanding balance, unless: 1) it is a variable rate that rises due to a change in the underlying index; 2) it is a promotional rate that expired or otherwise no longer applies according to the terms of the account agreement; or 3) the minimum payment was not received within 30 days after the due date.

Credit unions and other creditors use risk-based pricing both to set initial interest rates on new accounts, and to re-price existing accounts, commensurate with the creditworthiness of members/customers and changes in market interest rates. For example, creditors must often examine a card holder's credit report in order to approve a credit line increase. Negative information on that credit report (e.g., a lower

credit score) will often lead a creditor to re-price the credit line to compensate for an increased risk of repayment (a risk, we might add, that lies with the cardholder's existing balances, and not just future charges). The imposition of restrictions on creditors to manage its risk in such situations would severely impact their ability to effectively manage assets and liabilities. To offset this increased cost and risk, creditors would likely have to issue cards at higher rates and/or with higher fees. This would not only raise the price of credit for all, but could result in cutting off access to credit for those underserved consumers who need it the most.

If the Agencies are still insistent on implementing such a provision, the Leagues recommend—rather than outlawing all default criteria with the exception of being 30 days late—that the proposal permit re-pricing based on any default event that 1) is related to the account; 2) adequately disclosed; and 3) reflects a materially increased risk of default. The final rule should include as a safe harbor certain events that the Board, based on comments and data it receives, can state with confidence meet that standard.

Assessing fees if credit limit is exceeded

The proposal will prohibit creditors from assessing a fee if the consumer exceeds their credit limit solely because a hold is placed on the available credit (e.g., when a hold placed by a merchant exceeds the amount the consumer is obligated to pay). For most credit cards, there is a static credit line used to determine overlimit status. Any holds or authorizations do not affect the actual credit line, nor do they count against the credit line for an overlimit determination. Rather, they are used to determine whether a new charge will be approved. Overlimit fees are only charged when an actual purchase—when posted to a cardholder's account—causes the balance to go over the credit line; holds or authorizations do not generate overlimit fees.

Debit card practices are entirely different, for there is no set credit line. Our comments on the proposed parallel debit card hold provisions are included below.

Prohibition of double-cycle billing
Security deposits and fees for issuing credit
Offers of credit that advertise multiple interest rates and multiple credit limits

We are unaware of credit unions that engage in double-cycle billing, or require security deposits in excess of the limits proscribed in the proposal. The Leagues support these provisions, as well as the requirement to disclose, in advertisements for firm offers of credit involving multiple interest rates or multiple credit limits, the factors for qualifying for the lowest interest rate or highest credit limit.

Overdraft Protection Plan Practices

Opt-out right

The Leagues agree with the proposal's requirement that consumers should be given the opportunity to opt-out of an overdraft protection plan. As we indicated in our comments on the recent proposed changes to Regulation DD, most credit unions that offer overdraft plans already provide their members with the ability to opt-out of the service. However, we do have concerns about the proposal's partial opt-out provisions, which would allow consumers to limit the opt-out to ATM and POS debit card transactions. (The idea contemplated by the proposal is that consumers would not be subject to merchant fees or other adverse consequences if the overdraft is not paid for these transactions.)

It appears that the proposal does not explain which debit transactions are classified as POS transactions. For example, does this category include other debit transactions, such as online purchases, PC banking transactions, recurring and automatic bill payments, and over-the-phone transactions? Even ATM transactions create some confusion, since the proposal does not indicate whether ATM transactions that do not involve a cash withdrawal, such as loan payments initiated by a consumer at an ATM or an inter-account funds transfer, would be subject to partial opt-out. Any inconsistency in treatment among the various types of debit card transactions will likely generate confusion among consumers, as well as financial institutions.

The implementation of a partial opt-out program will also be expensive. As the proposal acknowledges, "some processors do not currently have systems capable of paying overdrafts for some, but not all, payment channels." Even those processors that do possess the capabilities will incur substantial programming costs to implement the partial opt-out program. Instead of requiring financial institutions (and ultimately, consumers) to incur such steep costs, we urge the Agencies to rely on the proposal's comprehensive blanket opt-out right, and increased disclosure requirements to improve the uniformity and effectiveness of consumer understanding.

Overdrafts due to debit holds

Under the proposal, financial institutions would be prohibited from assessing a fee if the overdraft results solely from a hold placed on funds that exceed the actual purchase amount of the transaction. A fee may be imposed: 1) if the purchase amount itself would have caused the overdraft; 2) if other transactions have been authorized but not yet presented for settlement; or 3) if a deposited check in the account is returned. (This assumes the consumer did not opt-out of paying overdrafts in these situations.)

The Leagues recognize that there is no simple solution for the Agencies to craft a sound regulation that is agreeable to all parties. However, in its current form, the proposal overlooks or ignores the realities of the current debit card processing system, creating an extremely burdensome, expensive—and frankly, a flatly unworkable—set of requirements for all financial institutions. We fear this will lead many institutions of all sizes to rethink the efficacy of offering debit cards. Therefore, we feel it is important to correct the Agencies' misunderstanding of how these types of debit holds are processed.

As the Agencies correctly note, many merchants send an authorization hold in an amount in excess of the actual purchase amount in order to protect against potential risk of loss (e.g., restaurants including a tip amount, hotels for a multi-night stay, or a gas station). This authorization transaction is logged on the cardholder's account at the financial institution (in the form of the dollar amount and the transaction code provided by the merchant), a hold for the amount authorized is placed on the cardholder's account, and an approval for the authorization is sent back to the merchant. This approval response is an indication that the card is good and that the authorized amount is on deposit. Once the merchant finalizes the transaction with the cardholder, a ticket of completion is sent electronically for the actual amount of the purchase to the financial institution.

When the actual purchase is presented for payment (up to several days later), the financial institution matches this information to the authorization information already logged on the cardholder's account, drops the authorization hold from the account, and posts the final transaction to the account. This is all done automatically, without staff intervention or posting. Unfortunately—and this is key—the ticket transaction information for the actual transaction and authorization information do not always match. This mismatch of this transaction information, which is caused by merchants not following the transaction message formats required under MasterCard and Visa rules, leads to the financial institution retaining the authorization hold, even if the actual transaction is received and posted.

As should be apparent, financial institutions have virtually no control over the type of transactions addressed in this provision, and yet they are placed in the position of preventing it from happening (i.e., they are prevented from assessing a fee at the time the actual transaction is posted). The Leagues find this requirement to be highly unreasonable and impractical to meet. Even if the Agencies were to permit financial institutions to refund such fees retroactively, it would involve substantial costs to either develop the technological capabilities to carry out such an analysis, or to

manually research and identify invalid transaction code information, remove the hold that did not drop off, and reverse any overdraft fees applied to the cardholder's account. This burden would significantly impact all financial institutions, particularly small institutions.

We strongly urge the Agencies to withdrawal this provision, and involve the card networks and merchants in a more thorough study of the issue. The Leagues do recognize the Agencies' stated concern that consumers may be unaware of how debit holds function. We believe that, rather than the proposed method, a more practical approach would be to develop explanative consumer disclosures as to how debit holds operate and why overdrafts caused by debit holds may result in the assessment of overdraft service fees.

Transaction Clearing Practices

Although it does not create any new rules governing transaction clearing practices, the proposal does solicit comments on whether the Agencies should impose a requirement that would, absent consumer consent to the contrary, require financial institutions to pay smaller dollar items before paying larger dollar items when those items are received on the same day. The proposal aims to address the perceived problem of financial institutions manipulating their posting methods to increase fee income.

The Leagues understand the reasons for the Agencies' concern, and agree that manipulation of posting orders solely to increase fee revenue should be discouraged. However, we are unsure of the benefit of requiring consumers to affirmatively consent, separately, to a specific type of account posting method. Given the numerous permutations of transaction clearing practices currently in use, it is not unreasonable to believe most consumers would be unwilling or unable to discern the advantages and disadvantages of a particular method. Furthermore, imposing a regulation that has the practical effect of requiring that the lowest dollar amount transactions be posted first could actually harm consumers; as the Agencies are aware, the items most consumers want paid first are usually their highest dollar transactions (e.g., mortgage, rent, car payments, credit card payments, and utilities). Imposing a lower-dollar-amount first approach could leave the most important items unpaid, it would subject the consumer to the payee's and the financial institution's insufficient funds fee and could damage the consumer's credit rating.

Instead of requiring the use of a specific type of transaction clearing practice, the Leagues suggest that it would be more practical for financial institutions to disclose their posting order and method as part of their deposit agreements and new account disclosures, and with advance notice if they subsequently change their posting order.

In closing, the Leagues would like to thank the Agencies for the opportunity to comment on this important proposal. We appreciate your consideration of our views as you work to craft reasonable, fair, and effective regulations for consumers and financial institutions.

Sincerely,

Bill Cheney
President/CEO
California and Nevada Credit Union Leagues