August 4, 2008

Jennifer J. Johnson
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Chief Counsel's Office
Office of Thrift Supervision
Attention: OTS-2008-0004
1700 G Street, NW
Washington, D.C. 20552

Mary Rupp
Secretary of the Board
National Credit Union Administration
Attention: RIN 3133-AD47
1775 Duke Street, Alexandria, VA 22314-3428

RE: Unfair or Deceptive Acts or Practices (Regulation AA; Docket No. R-1314)

Ms. Johnson, Chief Counsel's Office, and Ms. Rupp:

The Office of the Illinois Attorney General appreciates the opportunity to comment on the proposed amendments to Regulation AA. Of the over 32,000 consumer complaints that the Office of the Illinois Attorney General received in 2007, over 1,000 of them are about credit cards. Consumers complained to this office about a variety of issues pertaining to credit cards, including being charged a higher interest rate than they expected, due to universal default provisions in their contracts or to confusing balance transfer offers that applied different interest rates to transferred balances than to future purchases. Some consumers complained of surprise balance transfer transaction fees. Others reported that after they missed just one payment, their account balances soared as a result of penalty interest rates and a bevy of penalty fees, making it significantly less likely that they will be able to pay off their balances.

With the mortgage crisis and the overall downturn in the U.S. economy, it is more important than ever that consumers be treated fairly and understand their credit card terms so that they can manage their finances accordingly. The Office of the Illinois Attorney General believes the proposed rule amendments will help address some of the unfair and deceptive practices in today's credit card industry, and we generally support

those reforms. In a number of instances, however, we urge the Federal Reserve Board, Office of Thrift Supervision, and the National Credit Union Administration (the Agencies) to strengthen the proposed rules to provide greater protections to credit card and debit card consumers.

Time to Make Payments

We support the proposal to provide consumers with an additional seven days to pay their credit card accounts without incurring a late fee or other adverse action. Although consumers are increasingly choosing to receive online billing statements and pay electronically, we know from reviewing complaints that many consumers still prefer to pay their bills the traditional way, with a paper payment stub and a paper check mailed via U.S. mail.

The amount of time required under the current rule (14 days from the date the statement is mailed) does not provide consumers much leeway to review their statements and place their payments in the mail far enough in advance to ensure that the payment is posted timely to their account. Such a short time frame increases the likelihood that even consumers who make a good faith effort to pay their monthly credit card bills in a timely manner will eventually incur penalty charges and other penalties. By expanding that time frame to 21 days, the proposed rule should result in substantial savings for credit card consumers who make their payments by mail.

Allocation of Payments

We support the proposal to prohibit the practice of applying payments first to the balances with the lowest applicable interest rate and to require instead a payment allocation that is at least as beneficial to consumers as one of the three methods specified in the proposal. We have heard from consumers who agreed to accept the favorable interest rate provided in a balance transfer offer, only to learn later that the payments they *believe* they're making toward current purchases are first applied to the transferred balance at the lower interest rate. This payment allocation practice prevents consumers from receiving the benefit of the lower interest rate if they use the card for other transactions and also often prevents consumers from taking advantage of grace periods on current purchases (because of company grace period policies). Some complaining consumers report that they would not have accepted the balance transfer offer if they had known their payments would be allocated to payment of the transferred balance at the reduced interest rate instead of to current purchases.

Although we generally agree that this amendment offers more protections for consumers than the current payment allocation practices, we urge the Agencies to modify the proposal to require credit card companies to apply payments to the balance with the highest annual percentage rate. Alternatively, we request the Agencies to permit *consumers*, rather than the credit card companies, to specify how their payments should be allocated among different types of balances. This would allow consumers to plan their finances and make it more likely that their balances will be paid.

Applying Rate Increases to Existing Balances

We support the proposal to prohibit credit card companies from increasing the interest rate on outstanding balances in all but three sets of circumstances (i.e., upon a change in the index for variable rate cards; upon the expiration or loss of a promotional rate; or when the minimum payment is not received within 30 days of the payment due date). We also support limiting the amount of these permissible increases to the standard rate as opposed to the penalty rate, which can be much higher than the standard rate. Additionally, we agree that consumers should be given a reasonable amount of time to pay off balances on accounts when the credit card company increases the interest rate on outstanding balances.

Universal Default

While we support limitations on when and by how much the industry can increase interest rates on outstanding balances, we urge the Agencies to strengthen the proposal by banning universal default as a permissible reason to raise interest rates on existing balances. In our view, universal default clauses are fundamentally unfair and should be prohibited from credit card agreements altogether.

Numerous consumers have complained to us about interest rate increases on credit cards for events that are unrelated to their payment history on those cards—such as making a late payment on an unrelated account or carrying a high balance on another credit card. This is an unjust result amounting to a punishment for a future event—a default—that may or may not happen. In fact, it is debatable whether the industry's use of universal default as a risk management tool is even justified. Academics working independently of the credit card industry have cast doubt on whether rate increases imposed under universal default clauses are commensurate with enhanced risk.[1]

In an industry rife with abuses, few practices provoke stronger reactions from credit card consumers than universal default. The practice flies in the face of what consumers have come to reasonably expect from fair credit transactions. Consumers rightly complain that universal default is an invasion of their privacy. They question, for good reason, why the terms of their credit card agreement should be subject to unilateral change based on their performance on a contract with a third party or on events beyond their control that affect their credit score. Universal default produces an especially harsh result on struggling consumers who postpone paying another bill in an effort to make their credit card payment on time. Under universal default, these consumers are effectively denied the ability to avoid injury: either option—paying their credit card bill on time or paying it late—will result in a higher interest rate. A business practice that

---

[1] See, for example, Written Statement of Lawrence, M. Ausubel, Dept. of Economics, University of Maryland: Before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services of the United States House of Representatives, March 13, 2008.

penalizes consumers for choosing to pay their bills on time is unfair. We strongly urge the Agencies to put basic consumer protections in place by banning universal default.

Two-Cycle Billing

We support the proposed prohibition on imposing finance charges on balances on days in the billing cycle preceding the most recent billing cycle. This method of calculating interest is both confusing and unfair to consumers, and should be banned.

Financing of Security Deposits and Fees

We support the proposal to limit the amount of security deposits and fees permitted for a credit card account relative to the amount of the credit card limit. Credit card companies market cards with low credit limits and high fees to consumers with low incomes or poor credit histories, ostensibly as a device to establish good credit. Unfortunately, because credit card companies charge significant fees and security deposits to open the account, these consumers often begin incurring substantial interest charges before they even make a purchase using the card, quickly creating a cycle of debt that has the opposite effect of establishing good credit.

To further protect these consumers, we urge the Agencies to strengthen the proposal by prohibiting security deposits and fees that exceed 25% of the initial credit limit (as opposed to the proposed 50%), and by requiring that security deposits and fees exceeding 10% of the credit limit (as opposed to the proposed 25%) be paid over the first year. We also urge that all fees be calculated toward the fee cap, including fees that are not charged to the credit card account.

Credit Card and Debit Card Holds

We support the proposal to prohibit the assessment of over-limit fees that are incurred solely because of a hold placed on a credit card account. Merchants such as restaurants, gas stations, and hotels often place holds on consumers' accounts because the actual amount of the transaction is not known at the time the card is presented to the merchant. Often the hold amounts exceed the actual amounts of the transaction. In some instances, consumers may appear to have exceeded their credit card account limit when in fact the actual charge is lower and has not caused them to exceed the limit. Charging an over-limit fee in this circumstance is unfair, and we strongly support the proposal to prohibit this practice. For the same reasons, we also support the proposal to prohibit the assessment of overdraft fees on debit card holders when the overdraft is due to a hold on the consumer's account.

Firm Offers of Credit

The Agencies have proposed a requirement that credit card companies disclose the following in connection with firm offers of credit: "If you are approved for credit,

your annual percentage rate and credit limit will depend on your credit history, income, and debts."

We agree that credit card companies should disclose the factors that will be considered in determining the terms that may be offered to a particular consumer. We are concerned, however, that this message may not sufficiently convey to consumers the fact that they may not qualify for the best terms offered, even when "presented in a manner that calls attention to the nature and significance of the eligibility information," as the proposed rule would require. We are concerned that many consumers will not understand that they may not receive the best terms offered, but will instead erroneously believe that they qualify for the lowest APR and highest credit limit advertised.

To enhance the disclosure's effectiveness, we recommend a requirement that the disclosure be made *clearly and conspicuously.* The clear and conspicuous standard is an effectiveness standard for disclosures that is defined by case law and includes an evaluation of elements such as prominence, placement and proximity, absence of distracting elements, and understandability of message text.

While a disclosure requirement would help consumers, we believe it would be more effective for the Agencies to require that credit card companies tailor their offers to fit the profiles of their intended recipients. This could be achieved if credit card companies would more carefully match the information they receive from the consumer reporting agencies with their own credit granting policies.

A tailored marketing requirement should not work a hardship on institutions. The institutions know the qualification requirements of their own product line, and they know the basic credit profiles of potential card holders. They therefore possess all the information necessary to tailor each credit card offer to the appropriate group of potential card holders. By requiring that credit card companies use this available information to tailor their offers, the Agencies would be ensuring that consumers are protected from unnecessarily confusing offers.

Overdraft Services- Right to Opt Out

We support a prohibition on assessing overdraft fees unless consumers are provided with an opportunity to opt out of overdraft protection, and also given a choice of complete or partial opt out.

We urge the Agencies to strengthen the proposal by requiring advance affirmative consumer consent to overdraft protection after clear and conspicuous disclosure of the terms and conditions. Overdraft protection is a very costly option tantamount to a high interest, short term loan. Credit card companies should be required to disclose the terms and conditions of the overdraft protection and ask consumers in advance, as opposed to when they already have overdrawn their account, whether they want to avail themselves of this product or whether they prefer to decline a transaction that would cause them to overdraw their account.

Conclusion

The proposed rule amendments will help to address a number of the unfair and deceptive practices used by the credit card industry. The Office of the Illinois Attorney General strongly supports these proposed amendments. However, in a number of areas, the proposed amendments can and should go further to protect consumers. We urge the Agencies to consider our recommendations and take these additional consumer protection steps. We invite the Agencies to contact us to discuss our recommendations further.

Contact Persons:

Deborah Hagan (217) 782-9021
Thomas James (312) 814-3778