From: Mike Vehle [mailto:mvehle@cortrustbank.com]
Sent: Monday, August 04, 2008 6:40 PM
To: _Regulatory Comments
Subject: Comments on Proposed Rule Part 706 by Michael Vehle (RIN 3133-AD47)

MICHAEL VEHLE
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August 4, 2008

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
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Regulation Comments, Chief Counsel's Office
Office of Thrift Supervision
ATTN: OTS–2008–0004
1700 G Street, NW
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Mary Rupp, Secretary of the Board
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Re: Docket No. R–1314
OTS–2008–0004
RIN 3133–AD47
Proposed Changes to Regulation AA
Unfair or Deceptive Acts or Practices
73 *Federal Register* 28904, May 19, 2008

Dear Sir or Madam:

I have thought about this letter for a long time and am trying to decide if I am tainted by being in the credit card business for over 15 years or whether that experience allows me to have a better perspective on the issues. I have determined it's a little of both, and so I will try to use the experience aspect and filter out the bias.

Often I have told my staff that a few spoil it for the many. To a degree I believe this is true of today due to the reaction both legislators and regulators have made regarding the credit card industry. Because of the practices of a few, the resulting over-reaction will adversely affect the other banks that are trying to serve the under banked, the unbanked, and those with previous credit problems. The sad result will be that many of these people will be forced to seek other unregulated sources of credit that also do not report to the credit bureaus and therefore do not give these debtors an opportunity to improve their credit standing. Although retiring at the end of the year, I have managed a subprime credit card operation for CorTrust Bank for over 15 years and many of the practices the Federal Reserve is trying to stop are ones which we never even considered utilizing. However, I sincerely request that you do not take away the ability of a bank to price the risk of its loans. To do that is contrary to all sound lending principles.

Since its settlement, South Dakota has not been the easiest place to hue out a living, and in times of drought, blizzards, etc people fall on hard times. Therefore we understand the need for people to have an opportunity to re-establish themselves and get back on their feet.

That is what our subprime card allows. Do they all make it? No. But do we so regulate the industry that there is no bank there to offer them the opportunity to re-establish themselves? I liken it to Small Businesses. It is often said that 4 out of 5 small businesses fail within the first 5 years. Therefore since only 20% survive should we make it so difficult for banks to lend to small businesses that the small business opportunity ceases to exist? If you did that the hue and cry would be deafening -- and rightly so. Therefore let's not price the subprime credit card so that no bank can afford to offer them an opportunity to re-establish themselves.

In reviewing your list of proposals, time to make payments, and two cycle billing should be fixed. But please remember the "law of unintended consequences" when considering the other issues. With *Allocation of Payments,* remember that 1) cash advances cost more and generally are more risky to the issuer than purchases, and 2) if a bank has a promotion of very low interest rates for a period of time, they want that money back first as its more costly money (just remember by forcing this change, it will therefore limit those offers that a bank may make for cheaper money).

Two Cycle billing is a practice that you are correct in having it eliminated.

Credit Card holds are interesting, as it is the merchant that places these holds, not the issuer, but it is the issuer that is being penalized. For instance the Hotel places a hold on funds in excess of the room charges in order to hopefully compensate for meals and drinks charged to the room during the cardholder's stay. The merchant is trying to guess how much the bill will be to assure there are sufficient funds to pay for everything at check-out. It is an issue over which the credit card issuer has no control. Maybe you should require the merchant who places the hold to inform the cardholder of such hold in writing; therefore the cardholder would be aware of that hold and not have the unfortunate over limit situation or the embarrassing denial at another merchant.

Of most concern is the proposed rule requiring any amount of fees over 25% of the credit limit be spread over the remaining 11months of the first year. This is not a prudent requirement for the bank, the regulator, or the consumer who has had problems dealing with credit in the past. There are two reasons for the up-front fee; first is to pay for the increased cost of losses and increased costs of servicing accounts associated with providing

subprime credit, and second is that the initial fee utilizes varying amounts of the initial credit limit which protects the bank from losses. By limiting the amount of initial purchases, it requires the consumer to judiciously use the credit available and then to pay down the balance to obtain more credit. Safety and Soundness of the Bank demands that we protect the depositor's funds. By providing a large open to buy upon opening the account, it would increase losses to the bank. This line of reasoning to require more open to buy is totally inconsistent with lessons that should be learned from today's subprime mortgage mess. That industry loosened credit standards, dropped requirements for down payments, and also dropped the amount of those down payments – now just look at the mess that was created. The regulators lost, the banks lost, the former homeowners lost, and the economy lost. The subprime credit card industry instead has kept the down payment (initial fees on the card) and underwriting credit standards pretty much unchanged. I would contend that is a much wiser and safer avenue for both the banks and the regulatory bodies. It is a very basic lending principle – *pricing the risk*, which the subprime mortgage industry got greedy and forgot. Do not encourage the subprime credit card industry down that same disastrous path as the subprime mortgage lenders.

In order to test benefits of our subprime product, I selected the first quarter of 2006 as a vintage (all the accounts that booked in first quarter 2006). After nearly 2.5 years fifty five percent had charged-off. However the other 45% were either still an active cardholder, had graduated to a card with better terms, or closed their account and either paid it in full or were paying on it. Do we want to eliminate this opportunity to the 45% in the above example? Twenty percent of the US population is below 620 FICO and that is where our customer base resides. If Banks do not have some type of fees to cover these increased costs and the ability to price the risk, these people will be left to the unregulated and possibly unscrupulous market with no way to better their credit rating.

When discussing costs to offer subprime credit, since CorTrust Bank has both prime and subprime accounts, we have an insight into the differences. For instance, we reserve for losses on a 12 month rolling basis over 7 times more for our subprime portfolio than we do for our prime portfolio in order to meet regulatory safety and soundness requirements. Therefore we must have some additional revenue to compensate for those losses, that is called *pricing the risk* and that is what good lending is about. What would happen if we told the automobile insurance industry that it was horrible what they charged a person who has had two DUI's and two unrelated car accidents; and that we were going to make it illegal to charge such a premium? They would either not insure that person, or increase the cost to their good drivers. Neither of which is a good or fair result and it is definitely not pricing that risk.

In addition it costs much more to service subprime accounts than our prime accounts, as they require more "people" time for assistance and collections. When using the internet, because costs are assessed per hit, it is approximately five times more expensive for us to service subprime customers than prime customers via our website. The increased cost to service and maintain subprime accounts can be observed in other areas as well, our non-dialer outbound call traffic is 400 times greater than our prime customers; and collection correspondence for subprime is approximately 80 times higher than for our prime customers.

I am also confused by the contention of injury to the consumer. With our subprime credit card, if you get the statement and decide that you don't like the initial fees because of "buyer's remorse", didn't read the offer, or *any* other reason; all you need to do is just call customer service, pay for the purchases you made, and we'll forgive the fees, close the account with no negative credit bureau reporting, and therefore resulting in "no harm – no foul". So where is the injury? However, if it is ten months later and you have been using the card, it's now over the limit, 90 days delinquent, and now you want to complain about the initial fees -- that is a different

story and will be treated differently as it should be. In this case, it's the bank that is probably going to be injured and the regulators, depositors, and bank stockholders better hope the risk was properly priced!

The contention that low limit cards are not of value, is not true and this fact was even recognized by our court system in Perry v. First National Bank in an opinion by the 7th Circuit Federal Court of Appeals which is the last stop before the U.S. Supreme Court. "We recognize that [the Bank's] credit solicitation requires card holders to pay a significant amount of money in fees, which are quite high in relation to the credit line offered. We realize that this is not an attractive deal for the great majority of consumers. However, the card is not without value. If the credit card holder paid off the card each month, the card would allow him or her to make almost $3,000.00 in purchases in one year. The credit card holder would also build up a credit rating, which is useful to individuals who are trying to establish credit for the first time or to reestablish good credit." This card had a minimum $250 initial card limit with $175 in initial fees. Thus if a person paid their bill in full each month for a year it provides $3000. The initial fees of $175, plus the $6 monthly participation fees for a year equals $241 divided by $2759 ($3,000 – the $241 = $2759) for the year is about 8.75% which is not a bad fee for a person with severely damaged credit (plus the person can pay off the account more than once a month and get even more credit to use).

Sometimes the contention is made that we should be able to underwrite the risk with less fees. Take the example of a divorced couple. Often the base cause of the divorce is that one is a "spender" and one is a "saver". They consequently get a divorce and both apply for a credit card at two different banks. Since they were married and everything was jointly in their names, both have the same credit score – therefore one bank will probably get a good customer, the other bank will get a costly "problem account". However, at the time of application the risk has to be priced the same, because many times they are both "spenders". Competition among credit card issuers with proper disclosure is the best manner to price this risk.

Finally, not only is it necessary to for people to have the opportunity to establish or re-establish their credit status, (about 35% of our customers improve their credit scores) but in today's cashless society these folks need a method of payment for such things as hotel reservations, car rentals, DVD rentals, and purchasing goods and services over the internet. Without a credit card, it's very difficult to avail yourself of these services.

In summary, drop the requirements for setting limits on the initial fees. Don't penalize those banks who are properly pricing the risk of serving the unbanked, the under banked, and those with previous credit problems. At CorTrust Bank all over limit and delinquent fees are $29 or less, within the first 4 months if you realize the card is not for you – call us, pay it off, and we'll forgive the initial fees, we've never used two-cycle billing, and we say right in the offer on the top half of the front page what the open to buy is likely to be. Let's not abolish the opportunity for people to establish or re-establish a better credit score. It's unfortunate circumstances like unemployment, divorce, or high cost medical bills that have caused many of these folks to lose their credit rating, let them decide if they want to pay a fee to obtain credit and as method to improve their credit rating. The market place with wide competition and full disclosure is a far better method to price risk. Your proposed alternative limits that opportunity and penalizes the very people you seek to help.

Thank you.

Sincerely,

Michael Vehle