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August 4, 2008

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

RE: Comments on Proposed Rule Part 706; Unfair or Deceptive Acts or Practices

Dear Ms. Rupp:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions (FCUs), I am writing in response to the request for comment on the proposed rule regarding unfair or deceptive acts or practices (UDAP). The rulemaking, jointly issued by the Board of Governors of the Federal Reserve System (Board), the National Credit Union Administration (NCUA), and the Office of Thrift Supervision (OTS) (collectively, the Agencies), was proposed pursuant to the Agencies' authority under section 5(a) of the Federal Trade Commission (FTC) Act and would prohibit certain acts or practices with regard to consumer credit and overdraft services. Additionally, simultaneously with this rulemaking the Board issued two separate but related proposals to amend Regulation Z, the Truth in Lending Act (TILA), and Regulation DD, the Truth in Savings Act (TISA). NAFCU previously submitted separate comments on these related rulemakings.

NAFCU and its member credit unions are strongly supportive of efforts to frustrate unfair or deceptive acts in the financial services industry. Always remaining true to their original mission of promoting thrift and serving the provident credit needs of their members, America's credit unions continue to be firmly committed to promoting fair and equitable practices in the provision of financial services. However, we do not believe that certain practices described in the proposal, many of which are common industry-wide standards, rise to the level of "unfair" or "deceptive" as set forth under section 5 of the FTC Act. NAFCU maintains that while it may be appropriate to provide greater clarity to supervised institutions by establishing clear principles for responsible credit and overdraft practices, we believe that many of these principles can be addressed through joint guidance and the promotion of best practices.

Further, for the reasons described in more detail below, NAFCU has significant concerns about the operational difficulties in complying with certain provisions of the proposed rule, particularly with regard to the restriction on the ability of credit card issuers to retroactively raise interest rates on preexisting credit card balances, the partial opt-out requirement, and the ban on over-the-credit-limit and overdraft fees where the fee is triggered solely by a hold on the consumer's account. NAFCU is also troubled by the substantial regulatory burden imposed by the proposal. We elaborate on our specific concerns in detail below.

Unfair or Deceptive Acts or Practices

The proposed rule would generally prohibit seven credit card practices as unfair or deceptive: (1) Unfair time constraints for consumers to make payments; (2) Unfair allocation of payments among balances with different interest rates; (3) Unfair application of increased APR to outstanding balances; (4) Unfair fees for exceeding the credit limit solely because of a hold placed on an account; (5) Unfair balance computation method; (6) Unfair financing of security deposits and fees for issuance or availability of credit; and (7) Deceptive firm offers of credit. With regard to these provisions, NAFCU would like to provide the following comments.

1. Unfair time constraints for consumers to make payments

Safe harbor

The proposal would provide a safe harbor for creditors that create reasonable procedures to ensure that periodic statements specifying the payment due date are "mailed or delivered" at least 21 days before the due date.

NAFCU generally supports the proposed approach to the safe harbor; however, we recommend that the timing standard be revised from the date the periodic statement is "mailed or delivered" to the date of mailing. While NAFCU believes that the 21 day timeframe is reasonable, calculating this time period based on the more nebulous delivery date could create undue operational difficulties and compliance costs for credit unions. Because it is difficult to anticipate post office delays or other potential interruptions in mail delivery, financial institutions would need to build in extra days as a margin of error to mitigate this compliance risk. Additionally, basing the timing requirement on either the mailing "*or*" delivery date may create confusion. NAFCU believes that a "mailing date" standard is more tangible and less ambiguous and should be adopted in the final rule.

Prohibition against treating certain payments as late

The Agencies have requested comment on whether a rule should be adopted that prohibits institutions from treating a payment as late if it is received within a certain number of days after the stated due date. NAFCU strongly opposes such a rule. NAFCU does not believe that such a rule is justified, particularly in light of the additional protections afforded to consumers under this rulemaking relative to the crediting payments.

NAFCU feels that mandating what is essentially an "extended due date" or "mandatory grace period" could create consumer confusion about the true due date, or even reinforce negative consumer behaviors and encourage poor financial management habits. NAFCU strongly believes that in preserving a firm terminate due date, consumers are encouraged to meet their payment obligations on time.

Most credit unions voluntarily allow for a grace period after the specified due date. However, institutions should not be required, by regulation, to honor late payments as timely. While NAFCU agrees that consumers must be fully informed of the terms of any late fee policy, we also believe that consumers should be held to the terms of such reasonable polices.

In addition, a rule prohibiting the treatment of certain payments as late fails to recognize modern payment trends. Today, most financial institutions provide consumers with numerous convenient payment options, including electronic bill pay, ACH transfer, in-person, and pay-by-phone. Thus, in most cases payments can be posted to a consumer's account very quickly or even on the same day. Given the availability of such fast and convenient payment options, ample opportunities are available for consumers to submit timely payments. Accordingly, NAFCU believes that a rule prohibiting the treatment of payment as late if it is received within a certain number of days after the due date is unreasonable.

Reversing a decision of lateness

Comment is also requested on whether the Agencies should adopt a rule that requires institutions, at the consumer's request and with evidence of timeliness, to reverse a decision to treat a payment mailed before the due date as late. NAFCU opposes the adoption of such a rule.

Given the additional protections provided under proposed §227.22, which requires institutions to provide a reasonable amount of time to make a payment, NAFCU believes such a rule is unwarranted. As noted in the preamble to the proposed rule, "The Agencies believe 21 days to be reasonable because it allows *sufficient time for even delayed mail to be delivered* while also allowing most consumers at least a week to review their bill and make payment." 73 FR 28913 (emphasis added). Indeed, this timeframe "would allow seven days for the statement to reach the consumer by mail, seven days for the consumer to review the statement and make payment, and seven days for that payment to reach the institution by mail." *Id.* NAFCU agrees that 21 days is reasonable; however, we do not believe that a rule allowing consumers to seek a reversal of a late payment is justified.

Further, NAFCU is concerned with the compliance burden that such a rule would impose. Although the consumer would bear the burden of proof, financial institutions would nevertheless be burdened with significant costs associated with monitoring and investigating consumer reversal requests. Moreover, many credit unions do not process their own payments and would need to work with third-party processors to manage reversal requests, resulting in additional compliance challenges.

2. Unfair allocation of payments

While the proposed payment allocation methods are viable alternatives for credit unions, NAFCU believes that it is appropriate for the method of allocation to be determined by the individual institution and best addressed in the terms of the account agreement. The method of payment allocation can certainly be disclosed in a manner that is clear and understandable for consumers. NAFCU feels that while payment allocation disclosures should be regulated, the method of allocation should not.

NAFCU would also like to note that most financial institutions generally allocate payments to balances at the lowest APR first. The proposed payment allocation methods are inconsistent with general industry standard and will likely reduce the availability of low and beneficial promotional interest rates.

Additionally, although we oppose it, should institutions be prohibited from raising interest rates on outstanding balances as proposed, NAFCU believes that credit unions should be permitted to apply amounts in excess of the minimum payment to such balances first. As we discuss in more detail below, prohibiting rate increases on preexisting balances would adversely impact institutions' ability to effectively manage risk. Thus, if interest rate adjustments on preexisting balances are prohibited, it is our opinion that institutions should be permitted to allocate payments to these lower interest balances first.

3. Unfair application of rate increases to outstanding balances

The proposed rule would prevent institutions from increasing the interest rate on outstanding balances, except in certain limited circumstances. NAFCU strongly opposes this change and we urge the Agencies to withdraw this portion of the proposal. In particular NAFCU is significantly concerned about the negative impact on credit unions' ability to manage risk and the adverse ramifications for responsible risk-based lending.

In addition, NAFCU feels that such prohibition is unnecessary in light of the Board's proposed changes to Regulation Z. In June 2007, the Board proposed to increase the advance notice required before a changed term can be imposed for open-end credit. NAFCU supports a 30 day requirement for change-in-terms notifications. We believe that a 30 day advance notice requirement will provide consumers with ample opportunity to reject upcoming changes and mitigate concerns about re-pricing on outstanding balances.

<u>Risk management</u>

NAFCU has significant concerns about the ramifications of the proposal on effective Asset Liability Management (ALM). Eliminating the ability of institutions to raise rates on preexisting balances would remove a vital risk management tool. NAFCU believes it is imperative that financial institutions have the ability to effectively mitigate their exposure to interest rate risk in order to maintain safe and sound operations.

Most credit unions will not unilaterally raise interest rates on outstanding balances. However, in some cases rate adjustments may be necessary to protect the credit card portfolio due to rising interest rates, particularly in this challenging economic environment. In the event of any rate increase, most credit unions give consumers the opportunity to reject the application of increased rates to preexisting balances. In this case, the credit card is typically canceled and the consumer will be permitted to pay off the remainder of the balance at the current rate and in accordance with the original terms.

If the provision is finalized as proposed, financial institutions will lose the ability to manage this increased risk exposure, which may create indirect harms for consumers. This is particularly true for federal credit unions due to their member-owned not-for profit cooperative structure. Ultimately, denying institutions this important risk management tool may lead to higher fees and loan rates or lower savings rates. Due to these negative ALM impacts, NAFCU strongly objects to the proposal to restrict rate adjustments on existing balances.

Risk-based pricing

Further, by significantly hindering credit unions from pricing to appropriately manage risk, responsible risk-based pricing programs will be jeopardized. Risk-based pricing programs provide an important means by which financial institutions may more effectively meet the needs of consumers, particularly low income consumers, individuals with little credit history or bad credit, and first-time borrowers. For example, risk-based lending utilizes a tiered pricing structure in which interest rates are based upon an individual borrower's credit risk. Although some borrowers may pay higher rates than others with strong credit histories, these consumers are able to obtain credit from a responsible lender without paying the exorbitant fees associated with payday and other predatory lenders.

NAFCU strongly believes that risk-based pricing can provide real benefits to underserved consumers by increasing credit availability for those who might not otherwise qualify for credit. Because we believe that the proposed restriction on rate increases to existing balances will negatively impact responsible risk-based pricing programs, NAFCU firmly disagrees with the proposed change.

4. Unfair fees for exceeding the credit limit solely because of an account hold

The Agencies have also proposed to prohibit institutions from assessing a fee if the consumer exceeds the credit limit solely because of a hold placed on the available credit. NAFCU is concerned that this provision may present operational difficulties for credit unions. Extensive and costly programming would be required to ensure that over-the-limit fees are not charged due to merchant holds. Implementation of these technical controls may present undue financial hardships for some credit unions, particularly smaller institutions. In the alternative, NAFCU recommends that merchants be urged to be more precise in the holds that they put on certain transactions.

5. Unfair balance computation method

Under the proposal, institutions would be prohibited from "double-cycle billing." In NAFCU's observation, credit unions do not "reach back" to impose two cycle billing. Accordingly, we generally agree with the proposed approach to unfair balance computation methods.

6. Unfair financing of security deposits and fees for issuance or availability of credit

NAFCU does not believe that security deposits and fees should be financed; as such, we are generally supportive of the proposed provision.

NAFCU would like to note, however, that some credit unions offer secured credit cards to help borrows with poor or limited credit histories to reestablish credit or improve their creditworthiness. Credit unions may require a reasonable security deposit, typically equal to the amount of the card, to be held in a dividend-bearing savings account for a specified length of time (e.g., one year) while securing the card. Once the consumer has demonstrated the ability to make timely payments for the given time period, the security deposit is released and the secured card will usually convert to a regular card. NAFCU believes that secured credit products can provide benefits to consumers by increasing the availability of credit for those with limited or flawed credit histories and we urge the Agencies to refrain from unduly restricting these products.

7. Deceptive firm offers of credit

NAFCU does not object to the proposed disclosure for creditors advertising multiple interest rates or credit limits in firm offers of credit. However, we would like to express our general concern that consumers are becoming increasingly inundated by the myriad disclosures that are being provided to them and consequently are not reading these disclosures. NAFCU emphasizes that the benefits of disclosures are lost if the information is being ignored by overwhelmed consumers.

Overdraft Protection Programs

The proposal also addresses certain practices pertaining to overdraft protection plans. In general, however, NAFCU does not believe it is necessary to expand regulation in this area. The Agencies are already utilizing various alternative tools to effectively curb unfair overdraft practices, including principles-based guidance with supervisory oversight, the promotion of best practices, and consumer education. For example, in February 2005, the federal financial regulators issued Joint Guidance on Overdraft Protection Programs, which established clear guidelines for the responsible operation of overdraft protection programs and communication with consumers. *See* NCUA Letter to Credit Unions 05-CU-03 (February 2005); *see also* NCUA Letter to Credit Unions 05-CU-21 (December 2005). Additionally, credit unions offering overdraft services must comply with regulatory requirements including those established by the Truth in Savings Act and its implementing regulations. *See* 12 CFR Part 707.

It is our view that such existing guidelines and regulation already provide for a prudent approach to addressing overdraft abuses without unduly hindering responsible financial services providers from offering products to better serve consumers.

NAFCU member credit unions consistently report that overdraft services continue to be one of the most popular and highly-demanded service offerings being provided today. Many credit unions offer responsibly managed and marketed overdraft programs as a service to their members. Typically, overdraft services are very closely monitored for overuse or other abuse by consumers. Where a member-consumer is observed to be struggling, credit unions will extend a helping hand to assist the member in making better informed choices and to provide education to promote fiscal responsibility. NAFCU believes firmly that fairly and responsibly managed overdraft programs can provide real benefits to consumers and should not be unduly restricted by burdensome regulation.

Opt-out right

Under the proposal, before charging a fee, creditors would be required to provide consumers with a notice and a reasonable opportunity to "opt-out" of overdraft plans. Consumers would also be permitted to request a "partial opt-out," which would limit the opt-out to only certain transactions.

NAFCU has significant concerns with respect to the operational viability of the proposed provisions regarding the consumer's right of opt-out. In particular, we believe that credit unions that provide consumers with the option to opt-in to overdraft services should be excluded from the proposed opt-out requirements.

Furthermore, NAFCU is opposed to the proposed partial opt-out requirement, which would require institutions to provide consumers with the option of opting out only of the payment of overdrafts at ATMs and for debit card transactions at the point-of-sale.

Currently, most credit unions do not have the operational and/or technological capability to separate out process codes in order to pay overdrafts for some, but not all, payment channels. From a practical standpoint, the programming modifications necessary to accommodate a partial opt-out would be cost-prohibitive. As a result, some credit unions may have no choice but to halt this highly-valued member service. Consumers, however, would still be subject to merchant fees, penalties, or other adverse consequences if the overdraft is not paid for their transactions. Accordingly, NAFCU strongly objects to this provision. We urge the Agencies to reconsider this aspect of the proposal.

Overdrafts due to debit holds

The Agencies have also proposed that for overdrafts created by a debit card, creditors should be prohibited from charging a fee if the overdraft is caused solely by a hold placed on

funds that exceed the purchase amount of the transaction. NAFCU is not convinced of the necessity of this change and requests its reconsideration.

It is our understanding that the card systems have recently amended their processing rules to implement near real-time transaction clearing. These new processing changes will go into effect within the next few months. Under real-time clearing, transactions will be processed almost immediately and will significantly reduce the hold times that financial institutions place on consumers' accounts. This, in turn, will dramatically reduce the occurrence of overdrafts due solely to holds. Because of this fundamental change in card processing rules, NAFCU does not believe it is necessary for the Agencies to impose this proposed restriction.

Furthermore, if finalized, NAFCU is concerned there will be significant operational issues and undue costs in implementing this provision. In debit transactions, a stronger effort must be undertaken to ensure that merchant-placed holds are appropriate. Merchants should be responsible for greater precision between the hold and the actual transaction amount. The financial institution is merely an intermediary between the consumer and the merchant; it has no control over the amount of the hold placed by the merchant accepting the item. Institutions also lack contemporaneous knowledge of the actual amount of the transaction. Thus, in the event of a hold, it will require several days to reconcile the payment and determine if a merchant-placed hold is in excess of the settled transaction amount. Attempting to monitor debit holds to determine when a fee is or is not appropriate will present substantial operational difficulties. Most credit unions' data processing systems cannot presently accommodate the proposed approach to debit holds. Indeed, extensive and costly programming modifications would be required and may be cost-prohibitive for many credit unions.

Further, NAFCU would like to note that there are other types of holds that may be placed on a consumer account which might cause an overdraft. For instance, holds can be placed on a consumer's account pursuant to Regulation CC or due to a garnishment order. If the Agencies decline to withdraw this provision, NAFCU believes that it should be clarified that these types of holds are not covered by the rule.

Effective Date

NAFCU strongly encourages the Agencies to provide substantial time for institutions to implement and test the necessary system changes to comply with any new requirements that are promulgated by this rulemaking. Most credit unions must rely on third-parties to modify and test system enhancements; however, these data processors are already taxed by a myriad of compliance challenges and may be slow to meet the heightened demand, leaving credit unions with little control over the timeliness of the required system changes. Accordingly, NAFCU urges the Agencies to allocate ample time for institutions to work with their software providers in adapting their systems to accommodate the new requirements. NAFCU estimates that a minimum of 24 months would be necessary for credit unions to implement any substantive changes.

Parity for State-Chartered Credit Unions

The proposed rule would apply to federally-chartered credit unions but not state-chartered credit unions, which fall within the jurisdiction of the FTC. Because the FTC has not joined on the rulemaking, state-chartered credit unions would not be covered by the new rule.

NAFCU is strongly supportive of the dual chartering system. However, we are concerned that limiting the rule to federal credit unions will create a significant disparity between state and federal credit unions, and may present a threat to the continued strength of the federal charter. We urge the Agencies to encourage the FTC to enforce similar standards for state-charted credit unions and any other entities providing consumer credit.

NAFCU appreciates the opportunity to comment on this proposed rulemaking. Should you have any questions or require additional information please call me or Pamela Yu, NAFCU's Associate Director of Regulatory Affairs at (703) 522-4770 or (800) 336-4644 ext. 218.

Sincerely,

B. Dan Berger
Senior Vice President of Government Affairs

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