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By Electronic Delivery

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Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: OTS-2007-0015

Ladies and Gentlemen:

This comment letter is submitted on behalf of Visa U.S.A. Inc. in response to the advance notice of proposed rulemaking ("ANPR") issued by the Office of Thrift Supervision ("OTS") seeking comment on whether the OTS should expand its current prohibitions against unfair or deceptive acts or practices ("UDAP"). Visa appreciates the opportunity to comment on this important matter.

Approach to Prohibiting Unfair or Deceptive Acts or Practices

Based on the ANPR, Visa understands that the OTS is considering a variety of approaches to provide further definition concerning which acts or practices are unfair or deceptive. Given the broad scope of current regulation of the activities of savings associations in areas relating to consumers, by the OTS and other federal agencies, including the Board of Governors of the Federal Reserve System ("FRB"), the scope for application of a UDAP standard should be narrow, consisting primarily of isolated practices that have yet to rise to a level that warrants regulation.

As a result, Visa believes that it would be most appropriate for the OTS to adopt general UDAP guidance that is consistent with the UDAP guidance issued by the FRB, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency.[1] In this regard, a consistent approach among the federal agencies, including the Federal Trade Commission ("FTC") where practices may involve institutions that are subject to FTC rather than banking agency jurisdiction, with respect to UDAP is important to achieve the desired consumer protection results. Without consistent standards, unfair or deceptive practices may grow among unregulated market participants. Any UDAP initiative beyond bringing OTS guidance into line with the UDAP guidance provided by the other federal banking agencies should be undertaken only after careful consideration of the appropriate UDAP standard, the specific practices giving rise to UDAP concerns and coordination with all other relevant federal agencies.

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[1] *See* FRB and Federal Deposit Insurance Corporation, *Unfair or Deceptive Acts or Practices by State-Chartered Banks* (Mar. 11, 2004); Office of the Comptroller of the Currency, *Guidance on Unfair or Deceptive Acts or Practices*, Advisory Letter 2002-3 (Mar. 22, 2002).

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UDAP includes two separate and distinct concepts, "deception" and "unfairness." While a deceptive practice also may be viewed as unfair, an unfair practice by itself generally will not lead to deception. Further, because it is at least related to the common law concept of fraud, deception may be easier to identify than unfairness. Accordingly, it is appropriate to consider the practice of deception first. Visa believes that, in considering the need for UDAP guidance or rules in the area of deception, the OTS generally should defer to existing disclosure regimes, such as the Truth in Lending Act ("TILA"), particularly where there is broad rulewriting authority. First, a practice that complies with a detailed federal disclosure regime should be presumed not to be deceptive. Second, any deception in an area covered by such a regime should be remedied by the responsible agency improving the disclosures, in part, to ensure that the solution "works" with the rest of the disclosure requirements.

With respect to the concept of unfairness, practices that are not deceptive should rarely be unfair because consumers typically will be able to avoid those practices. It is important to note that, consistent with this principle, the Federal Trade Commission Act ("FTC Act") provides that the FTC may not declare an act or practice to be unfair "unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition."[2] In this context, "unfairness," absent deception, appears to be limited to those situations where there is no duty to disclose the practice or where the practice exploits a lack of competition to cause substantial injury.

Even in such cases, it is necessary to consider countervailing benefits such as innovation. Countervailing considerations are particularly significant in the market for financial products and services. This market is driven by innovation and is evolving at a faster pace than ever before, providing consumers with benefits whose potential will be limited in an environment of prescriptive rules or guidance.

Credit Card Practices

In the ANPR, the OTS identifies a targeted-practices approach as one possible manner in which to address UDAP. Specifically, under this approach, the OTS would list a number of practices that would be prohibited as unfair or deceptive. In this regard, the OTS highlights a number of credit card practices that could be addressed under such a targeted-practices approach. The following discusses the application of the concepts of deception and unfairness in the context of these practices.

Universal Default

The OTS highlights a practice, commonly known as "universal default," which the OTS describes as a credit card issuer "imposing an interest rate increase that is triggered by adverse information unrelated to the credit card account or card issuer."

[2] 15 U.S.C. § 45(n).

The existing TILA disclosure scheme requires credit card issuers to disclose to applicants any "penalty rate that will apply upon the occurrence of one or more specific events."[3] This disclosure allows a consumer who believes that the "penalty" pricing that applies or that would apply on his or her account is too high to take steps to obtain a new or different credit card with more favorable pricing. Visa believes that, if a credit card issuer discloses its universal default practice consistent with the TILA disclosure scheme, the practice should not be deceptive. Moreover, the FRB recently issued a proposal that would significantly amend the disclosure requirements of Regulation Z with respect to open-end credit. In this proposal, the FRB chose not "to prohibit universal default clauses or similar practices."[4] Instead, the FRB's "proposal seeks to improve the effectiveness of the disclosures given to consumers regarding the conditions in which penalty pricing will apply."[5] The FRB's proposal drew a wide range of comments, totaling nearly 2,500, and Visa believes that, until this rulewriting is resolved, it would be inappropriate to address this practice as deceptive.

Moreover, attempting to define a "universal default" practice that would be unfair under the FTC Act standard or any other standard would be difficult at best. The practice of "universal default" fundamentally relates to addressing increased risk by raising prices. The concept of adjusting loan prices to address increased risk is not inherently unfair, rather it is prudent. If a credit card issuer increases an interest rate based on adverse information from any source because that information reflects greater risk to the issuer, the practice should not be viewed as unfair. Accordingly, if the OTS were to address "universal default" in its UDAP standards, the OTS would need to ensure that those standards do not have the effect of limiting a credit card issuer's ability to price risk.

Over-the-Limit Fee Triggered by Penalty Fee/Consecutive Penalty Fees Based on Same Activity

The OTS highlights the practice in which a credit card issuer "impos[es] an over-the-limit fee that is triggered by the imposition of a penalty fee, such as a late fee." The OTS also highlights the practice in which a credit card issuer "charg[es] penalty fees in consecutive months based on previous late or over the limit transactions, not on a new or additional transaction offense."

As in the case of "universal default," the existing TILA disclosure scheme requires credit card issuers to disclose to applicants various fees that may be imposed on an account, including, for example, over-the-limit fees.[6] In addition, the FRB's proposal would expand this disclosure and also would place additional emphasis on fees.[7] This disclosure allows a consumer who believes that a fee that is imposed or that could be imposed on his or her account is too high to take steps to obtain a new or different credit card. Visa believes that, if a credit card issuer

[3] 12 C.F.R. § 226.5a(b)(1).
[4] 72 Fed. Reg. 32,948, 33,012 (June 14, 2007).
[5] *Id.*
[6] 12 C.F.R. § 226.5a(b).
[7] *See* 72 Fed. Reg. at 33,047.

discloses its fee practices consistent with the TILA disclosure scheme, those practices should not be deceptive.

Nevertheless, we note that it is possible that a consumer whose credit will not enable them to obtain a new credit card may be caught in a cycle of fees from which the consumer cannot escape. In such a case, it would be theoretically possible for a creditor to "unfairly" increase the consumer's debt burden, while at the same time reducing the likelihood that the issuer will recover the balance on the account. In practice, a credit card issuer has little incentive to increase the outstanding obligation on an uncollectible account and, therefore, has incentives not to impose unreasonable fees that will drive away customers who can pay and not to impose fees that will not be recoverable from customers who cannot pay and, therefore, any such occurrence would most likely result from an error on the part of the issuer. Thus, while it is possible to hypothesize penalty fee practices that might be viewed as unfair, a rule or guidance on such practices is likely to have little practical application and is more likely to curtail legitimate fees. Fees are a legitimate pricing mechanism for credit card account management. In this regard, a key function of fees is to shape cardholder behavior by imposing fees on behavior that can lead to higher costs for the issuer, such as increased account administration costs, or greater risk. The fact that one fee triggers another fee or the fact that multiple fees result over a period of time from one activity should not be determinative of whether those fees are unfair. In this context, differentiating fees that are "unfair" can only be done on a case-by-case basis, if at all.

Mandatory Arbitration

The OTS highlights the practice in which a credit card issuer requires, as a condition of a credit card account, that the consumer waive "his or her right to a court trial and consent to binding mandatory arbitration." Visa does not believe that the concern about mandatory arbitration is based on a belief that the practice is deceptive—it must be disclosed in the consumer's agreement to be effective. Rather, some appear to view the practice as limiting the potential deterrent effect of class action penalties.

Visa believes that mandatory arbitration should not be considered unfair in light of the fact that, since at least the 1920s, arbitration has been an encouraged and favored means of resolving disputes under federal law, namely, the Federal Arbitration Act.[8] Arbitration provides a cost effective and swift means of arising at rough justice in which efficiency is balanced with accuracy. In this regard, Visa believes that arbitration provides the most efficient and cost-effective method in which to resolve credit card disputes. Some have argued, however, that mandatory arbitration favors businesses and is biased against consumers. But, a recent Ernst & Young study found that the arbitration process in connection with consumer-initiated, credit-related arbitration cases "does not appear to be biased against the consumer because they are not settling for unfavorable outcomes prior to hearings, and when the hearing takes place, consumers

[8] 9 U.S.C. §§ 1-16.

are not losing a disproportionate number of cases. In fact, one could conclude just the opposite, that consumers receive fair treatment that benefits them."[9]

Some have also argued that mandatory arbitration has the effect of blunting class actions. This argument is based on the view that class actions are an important deterrent to creditors, not that individual consumers are unable to obtain fair redress if class actions are not available. In this regard, broader enforcement issues, such as the availability of class actions, are issues of public policy and, at least under the FTC standard, "may not serve as a primary basis for" determining that an act or practice is unfair.[10]

Payment Application

The OTS also highlights the practice in which a credit card issuer "appl[ies] payments first to balances subject to a lower rate of interest before applying to balances subject to higher rates of interest or applying payments first to fees, penalties, or other charges before applying them to principal and interest."

While credit card issuers typically disclose their payment-allocation practices for contractual purposes, the existing TILA disclosure scheme does not require such disclosure. However, the FRB's Regulation Z proposal would require such a disclosure in certain instances in which a card issuer offers a discounted initial rate on balance transfers or cash advances (that is lower than the rate applicable to purchases) and the issuer allocates payments to the lower rate balance first.[11] Visa believes that, if a credit card issuer adequately and appropriately discloses its payment allocation methodology, that methodology should not be deceptive.

Nonetheless, assuming that a card issuer's payment allocation is disclosed and, therefore, is not deceptive, Visa believes that it should not be viewed as "unfair." The manner in which a credit card issuer applies a cardholder's payment is a part of the issuer's pricing scheme for the account. Credit card pricing is extremely competitive. In addition, mandating payment allocation methodologies may be counterproductive. For example, if payments must be applied to higher rates, low introductory rates on credit cards, including balance transfers, likely will disappear, thereby making it less attractive for consumers to change accounts to avoid changes in terms or prices or for other reasons.

Gift Card Practices

The OTS also lists two gift card practices that could be addressed under a targeted-practices approach. Specifically, the OTS highlights the imposition of "fees that exceed a certain amount or percentage of the original gift amount." The OTS also highlights the setting of "an expiration date less than one year from the date of issuance."

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[9] Ernst & Young, *Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases* 15 (2004).
[10] 15 U.S.C. § 45(n).
[11] 72 Fed. Reg. at 33,047.

As an initial matter, Visa notes that the term "gift card" itself connotes a gift rather than a store of value, and, in this regard, the disclosure of fees and expiration dates are consistent with that purpose. Further, while there is no statutory disclosure scheme for gift card practices, the OTS has issued guidance outlining its "supervisory expectations for savings associations' gift card programs."[12] For example, under this guidance, the OTS expects that savings associations will provide consumers with disclosures that are "readily available to both the [card] purchaser and the recipient," including disclosures relating to expiration dates and fees.[13] Visa believes that, if a gift card issuer adequately and appropriately discloses the practice to both the card purchaser and the card recipient, the practice should not be deceptive.

Assuming that these gift card practices are disclosed and not deceptive, Visa believes that gift card fees and expiration dates are a legitimate pricing mechanism that is utilized for account management. In this regard, fees and expiration dates are ways that issuers deal with inactivity and small amounts that remain on gift cards after a certain period of time in order to avoid prolonged account maintenance costs.

Further, in many cases, gift cards are distributed by employers and others for the express purpose of bestowing a benefit for which no consideration has been provided. In such cases, the terms of the card define the benefit. The consumer suffers no injury because the consumer has a windfall benefit in the form of the card, rather than the card being a bargained-for exchange.

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Once again, we appreciate the opportunity to comment on this important matter. If you have any questions concerning these comments or if we may otherwise be of assistance in connection with this matter, please do not hesitate to contact me, at (415) 932-2178.

Sincerely,

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[12] OTS, *Gift Card Programs* at 1 (Feb. 28, 2007).
[13] *Id.* at 2.