



November 5, 2007

Regulation Comments  
Chief Counsel's Office  
Office of Thrift Supervision  
1700 G Street, NW  
Washington, DC 20552

**Re: OTS-2007-0015**

The American Financial Services Association ("AFSA") thanks the Office of Thrift Supervision ("OTS") for the opportunity to comment on the issues the OTS is considering in reviewing its regulations on unfair or deceptive acts or practices.

The American Financial Services Association is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. The Association encourages and maintains ethical business practices and supports financial education for consumers of all ages. AFSA has provided services to its members for over ninety years. The Association's officers, board, and staff are dedicated to continuing this legacy of commitment through the addition of new members and programs, and increasing the quality of existing services.

AFSA believes that the OTS should refrain from any rulemaking with respect to "unfair or deceptive acts or practices" involving consumer financial services. There is no demonstrated need for additional regulation and a rulemaking proceeding in this area could be very problematic.

Any federal agency rule proscribing certain practices in the consumer financial services industry must be based on a thorough analysis of reliable empirical evidence. A rule based on isolated anecdotes and untested economic assumptions could have unintended, and often undesirable, consequences. The history of the Federal Trade Commission's ("FTC") credit practices rule demonstrates that an agency's development of a substantive rule governing creditor practices is an enormously time-consuming and resource-intensive process. The Commission's rulemaking was based on a national commission's empirical study of the industry, followed by the FTC's industry-wide investigation subpoenaing more than 7,000 consumer loan files, with more than 300 witnesses at nationwide hearings and more than 1,300 public comments on the proposed rule, numerous econometric studies and extensive agency deliberations, spanning a 12-year period.<sup>1</sup> It is undoubtedly for this reason that the FTC has not proposed a new

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<sup>1</sup> The FTC's Credit Practices Rule was the culmination of: (1) an extensive survey by the National Commission on Consumer Finance in 1972, which examined the consumer credit market and reached a variety of conclusions based upon empirical data and econometric analysis; (2) a massive two-year investigation by the FTC staff, which subpoenaed more than 7,000

rulemaking involving creditor practices, but has chosen to allocate its resources to industry guidance and case-by-case determinations.

Moreover, Congress required the OTS and the other federal banking agencies to adopt their own versions of a credit practices rule in order to assure uniformity of treatment among all creditors and all credit customers. In each case, the federal banking agencies based their rules on the FTC's rule, with only minor variations. Thus, the agencies' credit practices rules were dependent on the FTC's extensive rulemaking process, and were not the product of separate agency determinations as to what practices should be proscribed. Unless and until the FTC promulgates its own rules proscribing unfair or deceptive acts or practices based upon a rulemaking process comparable to the credit practices rule, the OTS and the other agencies should refrain from embarking upon their own separate rulemaking proceedings. It is important to note that the other banking agencies have specifically avoided a rulemaking process with respect to their issuance of UDAP guidance. AFSA urges the OTS to do the same to avoid placing any of the institutions under its jurisdiction at a competitive disadvantage.

If the OTS determines that it is appropriate to take any action with respect to unfairness, it should consider the adoption of industry guidance, rather than substantive rulemaking, and any such guidance should be informed by the codification of the unfairness standard in the FTC Act. In this regard, it is noteworthy that the FTC promulgated the credit practices rule after the FTC had issued its policy statement on unfairness *but before Congress codified that statement's standard in Section 5(n) of the FTC Act*. In the FTC's Statement of Basis and Purpose accompanying the credit practices rule, the Commission expressly acknowledged that it had applied the policy statement's unfairness standard to the rule, even though the standard had not yet been codified into law.<sup>2</sup>

The FTC's policy statement on unfairness and Congress's decision in 1994 to codify this standard reflect the determination, by the Commission and Congress, that the

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individual files from 12 large national consumer finance companies; (3) the FTC's Initial Notice of Rulemaking published in the Federal Register on April 11, 1975, which generated more than 1,300 written comments from industry, consumers, legal services, state attorneys general, labor unions, consumer organizations and other interested parties, (4) the Commission's Final Notice of Rulemaking published on June 24, 1977, scheduling public hearings on the proposed rule and enumerating 14 issues designated by the Presiding Officer under the Commission's Rules of Practice, (5) hearings conducted in Dallas, Chicago, San Francisco and Washington, D.C., from September 1977 to January 1978, at which 319 witnesses testified; (6) the rulemaking record based on those hearings, with findings by the Presiding Officer, as well as public rebuttal submissions and recommendations by the Commission's rulemaking staff and by the Bureau of Economics for a revised Trade Regulation Rule; (7) and the FTC rulemaking staff's recommendations for a final modified proposed rule based on the record, which was submitted in April 1983. The FTC ultimately promulgated the final rule on March 1, 1984.

<sup>2</sup> This Statement of Basis and Purpose provided the Commission's support for codifying the unfairness standard in the FTC Act. See 49 Fed. Reg. 7740, 7743 n. 13 (March 1, 1984).

unfairness standard needed to provide “a greater sense of certainty” about what would be deemed an unfair act or practice under the FTC Act.<sup>3</sup> A 2003 Senate Report noted that Congress codified this standard to “limit the Commission’s potential for broad rulemaking with respect to ‘unfairness’ interpretations.”<sup>4</sup> In fact, prior to the issuance of the FTC’s policy statement on unfairness, Congress had imposed a moratorium on “unfairness” rulemakings to ensure that the FTC was not using the unfairness standard too broadly.<sup>5</sup>

For several reasons, following the unfairness standard developed by the FTC and affirmed by Congress is undoubtedly the wisest approach for the OTS in creating industry guidance with respect to acts or practices deemed to be unfair or deceptive. First, reliance upon the codified unfairness standard would reflect the measure established by Congress. Second, this approach would acknowledge the body of case law and policy developed over decades by the FTC. Third, it would be consistent with the approach taken by the other federal agencies in this area.<sup>6</sup> Fourth, it would promote a uniform standard for industry to follow. Fifth, it would be the most effective way to avoid the risk of unintended consequences. Sixth, it would reflect the history of the OTS and the other banking agencies to exercise caution when considering the use of the unfairness rulemaking authority.

In sum, although the FTC Act’s unfairness standard was originally intended to be flexible enough to respond to an ever-evolving marketplace, the check provided by that standard’s current, more formalized iteration ensures that it is not used irresponsibly to prohibit practices that do more good than harm.

For the reasons set forth above, OTS should not consider creating a list of any specific practices deemed to be unfair or deceptive in the area of credit card lending, residential mortgage lending, gift cards, and deposit accounts. In addition to the problems inherent in an agency rulemaking, the inappropriateness of applying the FTC’s unfairness standard, and the inflexibility of a laundry list, AFSA believes that banning the suggested practices would harm, not help, consumers. AFSA suggests that based on the definitions provided by the FTC<sup>7</sup>, none of the practices mentioned in the ANPR are either unfair or deceptive. We set forth below our specific objections to the practices identified in the Advance Notice of Proposed Rulemaking (“ANPR”) as potentially unfair or deceptive:

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<sup>3</sup> FTC Policy Statement on Unfairness, at p. 2.

<sup>4</sup> S. Rep. 108-127, \*4 (2003).

<sup>5</sup> See S. Rep. 108-127, \*3 (2003).

<sup>6</sup> This is noted in the OTS ANPR at note 14.

<sup>7</sup> For “unfair practices” these are: (1) whether the practice injures consumers; (2) whether it violates established public policy; (3) whether it is unethical or unscrupulous. For “deceptive acts” these are: (1) there must be a representation, omission or practice that is likely to mislead the consumer; (2) an examination of the practice from the perspective of a consumer acting reasonably in the circumstances; (3) the representation, omission, or practice must be a “material” one.

## Credit Cards

Many of the payment card billing practices offered in the ANPR as potentially per se unfair or deceptive cannot be considered in isolation, as these practices are individual factors that determine the overall cost of credit to the consumer. Thus, by eliminating any one practice, the cost of open-end credit potentially increases for all consumers.

Specifically, with regard to the repricing of credit terms based on adverse credit behavior with unrelated creditors, in pricing for risk, open-end creditors must look at a totality of the consumer's behavior on all his or her credit obligations. In an original determination of a consumer's interest rate, the consumer's overall credit history is examined. Because the ability to reprice based on a material change in that consumer's credit profile is essential to a lender's ability to adequately mitigate credit risk, AFSA believes that the OTS should continue to permit this safe and sound banking practice. In addition, the ability to reprice is clearly disclosed in the card agreement, minimizing the likelihood of consumer confusion. Finally, repricing upwards based on a consumer's increased risk profile has the additional benefit of discouraging that now-riskier consumer from continued reliance on that lender's products.

With regard to overlimit fees triggered by penalty fees, it is important to note that these fees are an important tool in holding down costs for all borrowers. It is necessary for the lender to be able to charge fees so that they can recoup some of the losses associated with the account (beyond the amount which can be recouped through finance charges. Lenders actually lose money on accounts which repeatedly default on the account terms. Accounts that have multiple default events (the accounts that would be impacted by the situations described in the ANPR) charge off at a rate in excess of 50 percent. The assessment of fees on these accounts merely reduces the degree of loss. Furthermore, fees are not deceptive because they are clearly disclosed in both the solicitation and card agreement.

Additionally, AFSA believes that applying 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 is fair. In order to offer these attractive products, the cost of funds, which is not free to the lender, must be offset. If current card payment allocation practices are deemed unfair or deceptive, consumers will have fewer available products available to them, such as popular zero or low-cost balance transfer options.

The OTS also raises the issue of mandatory arbitration as a potentially unfair or deceptive practice. On the contrary, arbitration is beneficial due to its affordability, accessibility and efficiency. Mandatory arbitration is a key tool in providing fair and cost efficient dispute resolution for consumers and creditors alike. Arbitrations are fair and beneficial to borrowers who have meritorious claims and arbitration clauses do not deter such borrowers from pursuing their claims. For example, a recent Ernst and Young study

showed that 55% of arbitrations that went to hearing were resolved in the consumer's favor, that 79% of all arbitrations (including those that settled) were resolved in favor of the consumer, and that 69% of consumers surveyed indicated they were satisfied or very satisfied with the arbitration process. Many other studies have confirmed these results. Numerous courts have found arbitrations to be fair proceedings conducted by impartial forums with fair rules. Moreover, in a recent Roper Starch survey, when consumers were informed that arbitrations cost considerably less than a lawsuit, 82% of adults said they would opt for arbitration. Finally, the Federal Arbitration ACT and most state arbitration acts specifically permit and encourage arbitration. It would be inadvisable to have a rule or guideline directly contrary to a federal or state law.

### **Residential Mortgage Lending**

AFSA believes that lenders must be able to impose changes in loan terms upon default. Again, the ability to reprice based on a material change in that consumer's credit profile is essential to a lender's ability to adequately mitigate risk. Without the ability to price for risk, the lender might not be able to make the loan at all.

On its face, the possible OTS prohibition on layering discretionary pricing on top of pricing that has already taken risk into account suggests that the OTS believes that discretionary pricing does not have a place in direct lending. This would upend the current regulatory approach to credit pricing that depends on disclosure with an outer bound of unconscionability.

AFSA member companies already take a number of loss mitigation measures. Foreclosing on a property is an expensive and protracted process for lenders and borrowers alike. Almost always, mortgage lenders lose money in foreclosure situations. For this reason, many lenders are taking actions to help identify borrowers in need and prevent foreclosure. When possible, AFSA member companies engage in early-stage loss mitigation, modifying loan terms, and refinancing, and also partner with nonprofit organizations.

### **Gift Cards**

Gift card purchases are rapidly increasing and gaining popularity with consumers, retailers and issuers alike. They offer unique benefits, including convenience and flexibility, not available with traditional gifts, gift certificates or even cash. Like travelers checks and money orders, gift cards may be subject to fees established by the issuer to pay for maintaining the system to process the card, delivering the cards to the purchaser or recipient, maintaining the cards for extended periods of time, and accessing other special services associated with gift cards. Consumers find gift cards to be convenient and versatile enough to merit fees. For example, cardholders often find that the fees associated with gift cards are far less than the cost of buying a merchandise gift and the related packaging and shipping, particularly when the gift is for someone who lives in a different area of the country. In most cases, gift card recipients promptly use the full face

value of the gift card. Labeling a gift card with an expiration date less than one year is neither inherently unfair nor patently deceptive under the standards applied by the FTC.

As the analysis of each of the foregoing items shows, under a rational principled based approach, each item can be seen to be not only not unfair or deceptive but, in many cases actually beneficial to consumers. The first element of an FTC principled based analysis is whether there is “harm” to the consumer. If harm is seen as a cost or expense to the consumer not fairly justified by the circumstances, in each case it is clear that there is no harm. Banning the practices under consideration would simply spread the costs resulting from some consumers’ failures or preferences to all consumers. Having other consumers pay for the failures or preferences of some consumers would create actual harm.

The second prong of the analysis is that the “harm” can be avoided by the consumer. Assuming, for purposes of discussion, that the practices result in harm to the consumer, in each case the consumer can easily avoid that harm by not defaulting, delaying or otherwise triggering the undesired consequence.

#### **Questions:**

*1. Should OTS consider further rulemaking on unfair or deceptive acts or practices that would cover products and services in addition to consumer credit? If so, should the rule be limited to financial products and services and how should that scope be defined?*

AFSA believes that the OTS’s should not consider further rulemaking on unfair or deceptive acts or practices that would cover products and services in addition to consumer credit. Further expansion is unnecessary. The OTS has not demonstrated any need for additional regulation. Need would be demonstrated by an increase in specific supervisory enforcement against entities under the OTS’ jurisdiction. There has been no such increase. Without a specific need, further regulation is unnecessary. In addition, the OTS may stop actions it deems unfair or deceptive through its examination process.

*2. Should OTS consider further rulemaking on unfair or deceptive acts or practices that would cover more than just the savings association, but related entities as well?*

AFSA respectfully urges that the OTS not extend any further rulemaking on unfair or deceptive acts or practices to savings association holding companies and subsidiaries of such holding companies and savings associations that are not currently covered (collectively, "Non-FSBs"). Such an extension would be unnecessary and unduly burdensome for Non-FSBs. Savings associations are subject to the exclusive cradle-to-grave jurisdiction and supervision of the OTS, under HOLA and OTS regulations. Non-FSBs, however, are subject to oversight by the OTS but also to regulation and enforcement by other regulators. The FTC has jurisdiction to enact rules under and

enforce the Federal Trade Commission Act against Non-FSBs. 15 U.S.C. §§ 45(a)(2), 57a. State statutes that prohibit unfair and deceptive acts and practices, often enforced by the state attorneys-general as well as private plaintiffs, also apply to Non-FSBs. Given the existing legal regimes, as well as the OTS's supervisory authority, it is not necessary to extend an OTS rule on unfair or deceptive acts or practices as well. Indeed, any such extension would only multiply the compliance costs of such entities without any consumer benefit. Nor would there be any benefit to the safety and soundness of savings associations, as the risks posed by unfair and deceptive acts and practices, such as reputational risk, are already addressed by existing law that is applicable to Non-FSBs and the OTS's supervisory powers. Further, because the business and activities of Non-FSBs may be very different from the activities conducted by savings associations, rules tailored to savings associations are likely to be ill-suited to the regulation of Non-FSBs.

*3. What would be the impact on the industry and consumers of any of the various models and approaches discussed?*

Targeting particular practices as unfair or deceptive would lead to increased excessive litigation that would harm both the lender and the consumer. Because some courts may view the list as all-inclusive and others as mere examples, lenders will be unsure what products they could offer. This would limit the availability of credit. AFSA believes that the best approach would be to implement guidelines similar to those implemented by the FTC. These clear, yet flexible, guidelines benefit both consumers and lenders.

*4. OTS's current Credit Practices rule lists specific acts or practices that are unfair or deceptive per se; it prohibits such practices regardless of the specific facts or circumstances. Would it be appropriate for OTS to determine that additional acts or practices are unfair or deceptive per se regardless of the specific facts or circumstances?*

It would not be appropriate for OTS to determine that additional acts or practices are unfair or deceptive. It is unlikely that the other banking agencies or the FTC would find any of the practices listed by the OTS in the ANPR as unfair or deceptive.<sup>8</sup> If the OTS were to deem legally permissible practices unfair or deceptive, its regulated entities would be treated differently – and more harshly – than its competitors. As described above, it is more appropriate for the OTS to pursue the FTC model for determining whether a particular practice is unfair or deceptive than to develop its own list of unfair or deceptive practices.

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<sup>8</sup> The ANPR suggests that the practice of “universal default” may be unfair or deceptive. It then defines the term to include ongoing risk-based pricing methods employed by open-end creditors (for example, raising a borrower’s rate because the borrower defaulted with another creditor). With respect to risk-based pricing, the Federal Reserve Board recently issued a Report to Congress stating that, “risk-based pricing expands access to credit for previously credit-constrained populations, as creditors are better able to evaluate credit risk and, by pricing it appropriately, offer credit to higher-risk consumers.” See Board of Governors of the Federal Reserve System, Report to Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit. O-5. See also Office of the Comptroller of the Currency, Advisory Letter 2004-10 (observing, approvingly, that banks may increase the APR when a consumer fails to make timely payments on accounts with other creditors).

*5. Should OTS consider a principles-based approach to a potential rulemaking that can evolve as products, practices and services change? If so, what principles should OTS consider in determining that a specific act or practice is unfair or deceptive? Please provide examples.*

The OTS should consider a principles-based approach to a potential rulemaking. The OTS should work with other banking regulators and use the FTC's standards as a guide. In particular, the OTS should note the FTC's standard that, "the injury must not be outweighed by any offsetting consumer or competitive benefits that the sales practice also produces." This is consistent with the approach taken by other banking agencies and would provide a flexible framework for its examiners and its regulated institutions.

*6. Are the principles in the FTC guidance appropriate for the thrift industry? Should OTS consider adopting and incorporating them as part of an enhanced rule on unfair or deceptive acts or practices that includes standards to determine whether a particular act or practice is unfair or deceptive? Are any of the other models or approaches discussed in part III of this Supplementary Information appropriate for OTS to consider? What other models, approaches, or principles should OTS consider?*

AFSA believes that, to the extent that the OTS sees a need to regulate its institutions on unfair and deceptive acts or practices, it should follow the path developed by the FTC and generally followed by state and federal regulatory agencies.

*7. Can the acts or practices encompassed within any particular model or approach described in part III of this Supplementary Information be conducted in a manner that is not unfair or deceptive to the consumer? If so, how?*

Yes, the acts or practices encompassed within any particular model or approach described in part III of the Supplementary Information can be conducted in a manner that is not unfair or deceptive to the consumer and most are commonly so conducted. Please see the Credit Card, Residential Mortgage Lending and Gift Card sections above.

*8. The FTC has taken enforcement actions for violations of section 5 of the FTC Act. Should OTS draw specific examples of unfair or deceptive practices from FTC enforcement actions? If so, which examples?*

AFSA does not believe that it is necessary for the OTS to draw examples from the unfair or deceptive practices challenged in FTC enforcement actions. Instead, AFSA favors the FTC's flexible framework of ascertaining whether a particular conduct is unfair or deceptive.

*9. How would the practices in OTS's current Credit Practices rule and those identified in part III of this Supplementary Information fit into any of those approaches?*



AFSA does not believe that the OTS's current Credit Practices rule and those identified in part III of the Supplementary Information would fit into any of those approaches.

The Credit Practices Rule is the only instance of OTS exercise of its FTCA rule-making authority. This rule is still a viable mechanism for maintaining consistency across creditors in different sectors.

*10. Are the acts or practices currently listed in the Credit Practices rule the only ones that are capable of targeting specific conduct without allowing for easy circumvention or having unintended consequences?*

Yes, the acts or practices currently listed in the Credit Practices rule are the only ones that are capable of targeting specific conduct without allowing for easy circumvention or having unintended consequences. For more than 20 years, the FTC has not invoked its Section 18 powers to further regulate credit practices through rulemaking. However, that does not mean that the FTC or the OTS has been idle on applying UDAP principles. In fact, they do so during examinations and in various court cases.

*11. Has the current rule been easy to circumvent or created unintended consequences? What would be the impact, in this regard, of including additional acts or practices in the rule?*

AFSA member companies have not circumvented the current rule. The current regulations, as implemented by the OTS and the other federal banking agencies, effectively ban unfair or deceptive practices. AFSA does not believe that any further action is necessary.

## **Advertising**

*12. Should OTS expand its regulations on advertising to incorporate guides on advertising that the FTC has issued under the FTC Act? If so, which examples or principles should OTS consider?*

AFSA believes that it is not necessary for the OTS to expand its regulations on advertising to incorporate guides on advertising. AFSA also notes that asserting broad regulatory authority over the advertising and sales communications is a large undertaking that will demand much time and money.

*13. What other acts or practices that may not currently be covered by OTS's advertising regulation should OTS consider prohibiting as unfair or deceptive in the advertising or marketing of products or services offered by OTS supervised entities?*

There are no other acts or practices that the OTS should consider prohibiting as unfair or deceptive.

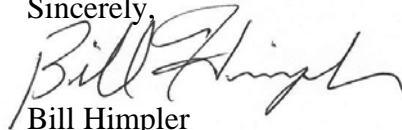
*14. What would be the impact on the industry and consumers of expanding OTS's advertising regulation?*

Since AFSA member companies already follow the advertising guidelines outlined by the FTC, it is unnecessary for the OTS to expand their advertising regulation.

**Closing**

Again, AFSA appreciates the opportunity to comment on the ANPR. Our member companies are committed to providing consumer credit fairly and openly. We would like to be a resource for the OTS, as needed, for purposes of crafting a proposed, and ultimately, a Final Rule. If you have any questions concerning these comments, or if we may otherwise be of assistance in connection with this rulemaking, please do not hesitate to contact us.

Sincerely,

A handwritten signature in black ink that reads "Bill Himpler". The signature is written in a cursive style with a large, sweeping initial "B".

Bill Himpler  
Executive Vice President  
Federal Government Affairs