



August 1, 2008

Jennifer J. Johnson
Secretary
Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

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

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

RE: PROPOSED AMENDMENTS TO REGULATION AA, DOCKET NO. R-1314

To whom it may concern:

This comment letter is submitted by the American Financial Services Association (“AFSA”)¹ in response to the Proposed Rule issued by the Board of Governors of the Federal Reserve System (“Board”), the Office of Thrift Supervision (“OTS”), and the National Credit Union Administration (“NCUA”) (collectively, “Agencies”) amending Regulation AA relating to unfair or deceptive acts or practices (“UDAP”) (“AA Proposed Rule”). AFSA appreciates the opportunity to provide its comments on the AA Proposed Rule to the Agencies.

Summary

AFSA believes it would be more appropriate for the Agencies to consider regulations governing several of the practices addressed in the AA Proposed Rule elsewhere. AFSA does not believe that it is appropriate to characterize many of the practices as “unfair” or “deceptive,” as those terms have been applied by the Federal Trade Commission. Not only are these practices not inherently unfair or deceptive, but the concerns raised by the Agencies can be addressed through improved consumer disclosures under existing law instead of using the blunt tool of Regulation AA.

¹ Founded in 1916, AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA members are important sources of credit to the American consumer, providing approximately over 20 percent of all consumer credit. AFSA member companies offer many types of credit products, including credit cards, installment loans, vehicle financing, and mortgage loans.

Throughout the Supplementary Information, the Agencies appear to acknowledge that the adoption of the AA Proposed Rule will increase costs for cardholders. It is important that the Agencies understand that costs will increase for the *majority* of cardholders who are able to get credit if the AA Proposed Rule is adopted. The minority of cardholders who will have lower costs, assuming they can still get credit at all, are those whose credit profile deteriorates, those who violate the terms of their credit card agreements, and those who do not adhere to payment deadlines the Board has explicitly stated are reasonable² today. Indeed, those are the cardholders who appear to be the Agencies' primary beneficiaries. At no time do the Agencies provide any analysis, however, of how these costs and benefits will be quantified or distributed. Nevertheless, the Agencies repeatedly declare that the costs of the AA Proposed Rule will be outweighed by purported benefits. We believe the AA Proposed Rule should have included statistics, analysis, data, or other information reviewed by the Agencies to come to its conclusion that the 'benefits' to some consumers outweigh the costs to others. Without such information, it is difficult for AFSA and others to comment on the Agencies' methods.³

We question whether the Agencies have given adequate consideration to alternative approaches to address the practices discussed in the Proposed Rules. For example, many (if not all) of the substantive provisions of the AA Proposed Rule could be handled in a more complete and appropriate manner under existing authority granted by Congress. Specifically, the Truth in Lending Act ("TILA") provides the Board ample authority to address identified shortcomings as they relate to credit card practices. Similarly, the Electronic Fund Transfer Act ("EFTA") provides the Board authority to address the key overdraft issues discussed in the AA Proposed Rule. This is a critical point, as TILA and EFTA each allow the Board to address regulatory concerns on an unambiguously *prospective* basis. We fear that others, however, may attempt to use the AA Proposed Rule to impose retroactive liability on card issuers for widely accepted and condoned (or even expressly permitted) practices. In this regard, there is little evidence in the AA Proposed Rule to suggest that the Agencies have considered the potential risk for liability they will create—and may have already created—by stating that common, widespread, risk-appropriate, and agency-condoned practices are suddenly *per se* "unfair" or "deceptive." These two terms have meaning not only under federal law, but also under state law. Absent significant attention from the Agencies, we believe that credit card issuers of all types could be subject to significant numbers of state lawsuits, the basis for which will be references to the Agencies' own words in the AA Proposed Rule and, possibly, final rules. Even if the Agencies make it clear that this rule is only prospective, AFSA is concerned that the rule opens the door to meritless challenges for past actions.⁴

As we discuss below, AFSA believes that, to the extent any additional regulations are deemed necessary by the Agencies, such regulations be adopted by the Board in the form of

² We reiterate here that suddenly deeming practices "unfair" or "deceptive" which are currently *explicitly* deemed "reasonable" does not make sense.

³ We recognize that the Agencies may not be required to undertake a rigorous statistical analysis for purposes of amending Regulation AA. However, the Supplementary Information suggests the Agencies did not undertake much of an objective analysis, if any. Nor do the Agencies have a record which supports the AA Proposed Rule.

⁴ AFSA requests, in the event that Proposed Regulation approach is taken, that the Agencies do in fact clarify not only that the rules operate only prospectively, but also state that neither the rule nor any proposals related to it shall be used to support liability for any past actions.

amendments to Regulation Z. Regulation Z is the more appropriate place for regulations that improve consumers' understanding of consumer credit and the Board's adoption of amendments to Regulation Z will mitigate the possibility of significant but unnecessary state law liability.

AA Proposed Rule: Late Payments

The AA Proposed Rule states that a credit card issuer may not treat a payment on a credit card account as late “for any purpose” unless the cardholder has been provided a reasonable amount of time to make the payment. The general prohibition does not apply in the context of payment deadlines associated with grace periods. The Agencies provide that an issuer would not violate the prohibition if the issuer has adopted reasonable procedures designed to ensure that periodic statements specifying the payment due date are mailed or delivered to consumers at least 21 days before the payment due date. To justify this portion of the AA Proposed Rule, the Agencies state that: (i) late payments cause injury in the form of fees, increased annual percentage rates (“APRs”), or the reporting of negative information to consumer reporting agencies (“CRAs”); (ii) the injury is not reasonably avoidable unless the consumer has a reasonable amount of time to make a payment; and (iii) that the possible increase in costs to consumers would not appear to outweigh the benefits to consumers of receiving a reasonable amount of time to make a payment.⁵

It would appear that Congress has already opined on how long a cardholder should have to make a payment, at least in connection with an account that enjoys a grace period. Congress specifically enacted the so-called “14-day rule,” providing that a card issuer must mail a periodic statement “at least fourteen days prior to the date specified in the statement by which payment must be made in order to avoid imposition of [a] finance charge.” Although the Agencies do not attempt directly to modify the payment time period as it relates to the amount of time a cardholder should be given to make a payment before the expiration of a grace period, the Agencies avoid any discussion of why Congress has given specific sanction and approval for the mailing of periodic statements within 14 days of a grace period expiration, but Regulation AA would treat as presumptively unfair a statement that is sent less than 21 days before a due date for a late payment.⁶ Not only has Congress determined that a 14-day time period should be sufficient for cardholders to avoid negative consequences relating to the expiration of a grace period, *but the Board has already specifically addressed the issue of avoiding late fees by applying the 14-day rule in the context of late payment fees.* In so doing, the Board has expressly permitted card issuers to mail a periodic statement 14 days before a late payment deadline. AFSA believes it is unusual—if not unprecedented—for the Agencies to provide a detailed analysis of how an activity is allegedly unfair when such activity is expressly contemplated,

⁵ It does not appear that the Agencies have provided tangible support for the latter assertion. The Agencies have attempted to quantify neither the costs nor the benefits to consumers relating to the time a consumer has to make a payment.

⁶ The AA Proposed Rule provides that the 21-day time period is a safe harbor. However, the Agencies are certainly aware that the safe harbor will almost certainly become a *de facto* requirement for purposes of examination and state UDAP liability determinations.

addressed, and permitted under an Agency's existing interpretation and implementation of the law.⁷

We also note that the AA Proposed Rule apparently assumes that consumers will receive periodic statements, and mail payments, using the U.S. Postal Service ("USPS"). In other words, the Agencies' justification for the 21-day rule appears to rely entirely on the notion that it may take 7 days for the USPS to deliver the mail in each direction, and that consumers should have 7 days to review a periodic statement. It is not clear why the 21-day rule would apply, therefore, in circumstances where cardholders have agreed to the electronic delivery of periodic statements, or regularly use electronic bill payment methods, neither of which are subject to the USPS's alleged unreliability.

To the extent the Agencies believe that payment deadlines need to be addressed, we believe it would be important to conduct a review of existing practices and late payment behaviors to determine whether TILA and/or Regulation Z should be updated. In so doing, the Agencies may be able to determine: (i) the likelihood that a piece of mail will be delivered within 2, 3, 4, or even 7 days after having been sent; (ii) the costs associated with requiring approximately a 22- to 24-day lag between statement closing and payment being received;⁸ (iii) the likelihood that issuers will feel obliged to provide a 25-day grace period so that payment deadlines match (and the costs associated with such determinations); and (iv) how the requirement will likely affect all cardholders, including those who do not incur late payment charges today. Once the Agencies have obtained and reviewed this information in a deliberate and reasonable fashion, we believe the Agencies (and other interested parties) may be in a better position to determine whether any additional action is warranted.

If the Agencies choose not to gather additional information regarding the need to alter the current 14-day rule, AFSA asks that the final rule simply require an issuer to have reasonable policies and procedures in place to provide cardholders with seven days to review the periodic statement and make a payment before the due date. This would allow for more reasonable timeframes in connection with accounts that rely on electronic delivery of statements/payments or for circumstances in which the issuer can demonstrate that it has allotted sufficient time for the mailing of the statement and/or payment.

We also note that the Board has addressed late payment deadlines in Regulation Z, such as in connection with the current 14-day rule. It is not clear why the Board could not continue to address this issue in Regulation Z, as opposed to Regulation AA. We specifically request that any final rule addressing this issue be in the form of an amendment to Regulation Z. To the extent such a rule is adopted, we also urge the Board to amend Regulation Z to provide an option for the disclosure of two payment deadlines (one for late payments, and the other for the expiration of the grace period) on periodic statements.

AA Proposed Rule: Allocation of Payments

⁷ To this point, the Agencies have also not provided evidence to suggest that mail delivery is *slower* than it was when the 14-day rule was adopted. Indeed, we suspect that the mail delivery has become more efficient since that time.

⁸ The statement will not necessarily be mailed the day the statement cycle closes.

The AA Proposed Rule states that if different APRs apply to different balances on a credit card account, the issuer must allocate any amount paid by the cardholder in excess of the minimum payment among the balances in a manner that is “no less beneficial” than one of three methods (highest APR first, equal distribution, or pro-rata distribution).⁹ If the account has one or more balances at a promotional rate or on which interest is deferred, the issuer may not allocate any amount paid in excess of the minimum payment toward the promotional rate or deferred interest balance(s) unless other balances are repaid first. The Agencies would permit an issuer to allocate payments to an interest deferred balance during the two billing cycles immediately preceding the expiration of the interest deferral period. Furthermore, a card issuer may not require a cardholder to pay any portion of a promotional rate balance or interest deferred balance on a credit card account to receive a grace period. To justify its assertion that violations of these requirements are unfair, the Agencies state: (i) consumers pay increased interest when payments are allocated to balances with lower APRs first; (ii) consumers have no control over payment allocation and do not understand disclosures about payment allocation; and (iii) the benefits of “enhance[d] transparency” in pricing will outweigh the inevitable increased APRs, fewer promotional offers, and fewer deferred interest offerings.¹⁰

AFSA believes that cardholders understand that payments may be applied to balances with lower APRs first. Indeed, AFSA members report that cardholders generally use their credit cards in a manner that optimizes promotional rates, differential APRs, and the like, suggesting that cardholders understand how these programs operate. To the extent that the common industry-standard payment allocation methods are surprising to consumers, we believe that it should be possible to disclose to consumers that payments may be applied in certain ways. Although the Agencies state that, to date, they have not crafted such a disclosure with which they are satisfied, we do not necessarily believe that such a satisfactory disclosure does not necessarily exist.

We are surprised that the Agencies have not spent additional time or resources to develop satisfactory disclosures to address the concerns raised, given the likely impact the AA Proposed Rule will have on all cardholders’ APRs and promotional offerings. In response to this portion of the AA Proposed Rule, issuers will likely do one or more of the following: (i) increase APRs; (ii) increase promotional APRs; (iii) provide fewer promotional APRs; and (iv) provide fewer “interest free” promotions. These results, which appear to be expected by the Agencies but allegedly outweighed by pricing transparency, should also be the type of results that the Agencies should strive to avoid if other alternatives exist. We believe these consumer harms can largely be avoided through improved disclosure instead of naked price controls (in the form of payment allocation restrictions) by the Agencies. The cardholder would then be empowered to use the credit card accordingly. The Board could implement this disclosure through an amendment to Regulation Z.

⁹ AFSA notes that where a purchase money security interest is involved, there is a conflict between the Proposed Rule and a number of state laws with regard to application of payments. In fact, if this rule is adopted, creditors may have to use two different application of payment methodologies – one for determination of the applicable APR and one for determination of security interests.

¹⁰ It does not appear that the Agencies have offered tangible support for the latter assertion. The Agencies have attempted to quantify neither the costs nor the benefits to consumers relating to the payment allocation proposal.

AFSA also asks the Agencies to consider the impact of the AA Proposed Rules on consumers who enjoy deferred interest promotions. The Agencies would *prohibit* an issuer from crediting more than the minimum payment amount to the deferred interest balance until the last two billing cycles, assuming there are other balances on the account. In effect, the Agencies would force the consumer to repay the deferred interest balance in the last two months. This may not be reasonable, nor may it comport with cardholder expectations.¹¹ Furthermore, it could result in the consumer paying more interest than if the balance were repaid in a different manner. The Agencies falsely assume that the “go to” APR on the deferred interest balance will be lower than, or equal to, other balances on the account. This is not necessarily the case. Regardless, AFSA members believe that the proposed restrictions will result in significant consumer confusion and customer service issues.

If the Agencies determine that they must impose some form of payment allocation hierarchy, we ask that creditors have the flexibility to choose among several permissible options, beyond those provided in the AA Proposed Rule. AFSA believes that one of the options should permit an issuer to choose to use a “first in, first out” or “FIFO” method for payment allocation. AFSA believes this alternative may be less burdensome for at least some creditors to implement, yet is also relatively easy to explain to consumers.

We also question how cardholders who transfer a balance—which was incurring interest charges on another account that had no grace period due to such balance—suffer injury when they transfer the balance to an account with a lower APR to which payments will be allocated last where such account also does not have a grace period. It is not clear why the consumer is better off not receiving the promotion in the first place (a likely result of the AA Proposed Rule), and keeping the balance on a card with a higher APR and no grace period than having the *option* of transferring the balance and enjoying a lower APR on that balance. Similarly, it is not clear how a consumer suffers an injury by taking a deferred interest offer if the alternative is to make a purchase with cash or on a credit card that has a higher rate. To the extent the Agencies believe that cardholders do not understand that a balance transfer results in the loss of a grace period, AFSA members report that cardholders do understand this notion and behave accordingly. It would appear that this could also be the topic of a disclosure under Regulation Z, if necessary. In short, if consumers are provided a clear disclosure about the promotional rate offer, consumers should have the flexibility to determine whether the offer is worthwhile. We fear the Agencies’ approach, however, would greatly eliminate the opportunity for consumers to have such choices.

AA Proposed Rule: Repricing of Existing Balances

There is no question that card issuers have relied on improved methods to measure and allocate risk in a credit card portfolio. We believe this should be encouraged from both a safety

¹¹ Anecdotal evidence collected by AFSA suggests that consumers often “bifurcate” their debts and obligations in a manner that allows them to make major purchases (such as a refrigerator or another relatively costly item) and pay them off interest-free on a schedule before the interest is ever due. The Agencies’ proposal would seemingly allow that luxury only to consumers who don’t have any existing debt with that creditor. This means that Consumer A, who has no credit cards, can budget a new household item and never pay any interest on it, but Consumer B, who has a credit card with a balance, can not. It further limits the type of promotions that retailers often rely on to move a good percentage of their merchandise—the importance of which should not be taken lightly in today’s economy.

and soundness perspective, but also from the average consumer’s perspective. As the Agencies are aware, federally insured financial institutions must retain the appropriate flexibility to adjust risk as necessary, including by adjusting the cost of credit on open-end accounts. We trust the Agencies do not need a primer on this topic and, as we discuss below, the AA Proposed Rule implicitly recognizes this fundamental need. However, as it relates to consumers, risk-based pricing of credit cards—both at account opening *and on a continual basis*—has resulted in an increase of credit availability and lower costs of credit. Again, we do not believe the Agencies lack information on this topic, as a variety of public and private sector analyses have been published on this topic recently.

Despite the fact that risk-based pricing protects both card issuers and consumers, the Agencies have determined the practice somehow unfair as it relates to existing card balances in many circumstances. Generally, the AA Proposed Rule would prohibit a card issuer from increasing the APR applicable to an “outstanding balance” on a credit card account except in limited circumstances. Specifically, the prohibition does not apply if the APR is increased due to the operation of a variable rate, the expiration of a promotion, or if the cardholder’s payment is at least 30 days late. If an issuer increases an APR on an account, but is prohibited from applying the increased APR to outstanding balances, the issuer must provide the consumer with a method of paying the outstanding balance that is “no less beneficial” to the consumer than using a five-year amortization schedule or doubling the percentage used to calculate the required minimum payment. In the Supplementary Information, the Agencies state plainly that there may be circumstances in which institutions would accelerate repayment of the outstanding balance to manage risk, but that the AA Proposed Rule would provide little effective consumer protection if cardholders were not afforded a minimum time period to pay the outstanding balance. The Agencies justify this extreme intrusion into card issuers’ risk management by noting: (i) the application of an increased APR to an outstanding balance causes injury in the form of increased interest charges; (ii) this injury is not reasonably avoidable as a general matter because consumers have no control over APRs (among other reasons); and (iii) some consumers will benefit greatly while the broader adverse effects will likely be small.¹²

It would be difficult to overstate AFSA’s concerns with this portion of the AA Proposed Rule. Our concerns generally relate to the following issues: (i) risk management generally; (ii) the justifications for the prohibition; (iii) the use of Regulation AA to address an issue that can be addressed through disclosures (to the extent it needs to be addressed at all); and (iv) the impact on cardholders.

Risk Management Generally

The Agencies appear to recognize that repricing existing balances has value in terms of allowing banks to manage risk appropriately. Not only do the Agencies refer to risk management issues in connection with their discussion of this provision, but they concede that the repricing of a balance may be appropriate in some circumstances when the consumer has demonstrated increased risk to the bank, such as if the consumer’s payment is at least 30 days late. Therefore, the question is not whether the repricing of an existing balance is an appropriate

¹² It does not appear that the Agencies have offered tangible support for the latter assertion. The Agencies have attempted to quantify neither the costs nor the benefits to consumers relating to the prohibition on account repricing.

tool in managing risk; rather, the question the Agencies have posed is where they should arbitrarily draw the line.

The AA Proposed Rule would essentially eliminate the ability to manage certain types of risk after credit has been extended on an open-end, unsecured line of credit. The Agencies appear to believe that managing interest rate risk is a reasonable justification for repricing an existing balance through the use of a variable APR.¹³ The Agencies do not explain, however, why the management of interest rate risk through the repricing of account balances in connection with an increase in a variable APR is acceptable, but the repricing of account balances to manage credit risk is *per se* unfair. Indeed, it would seem that a cardholder has no control over an increase in a variable APR. Yet, a card issuer would be liable under federal (and possibly state) law for increasing an APR on an existing balance in connection with something the cardholder has control over, *i.e.*, his credit profile and performance on the account.

By arbitrarily distorting how a federally insured bank may manage risk after a loan with an indefinite duration has been extended to a consumer, the AA Proposed Rule will force card issuers to take unnecessary steps at account opening that will affect *all* cardholders. For example, in order to “price in” potential future credit risk, a card issuer may need to offer credit cards with APRs that are higher than a consumer’s existing credit profile would warrant. Indeed, the consumers who are harmed are those who manage their credit well, as they will pay higher costs for credit than they would pay today.

As we discuss below, we believe the Agencies could address issues relating to the repricing of existing card balances through a notice and opt-out regime. We believe such a result would be preferable as the disclosures will address many of the issues raised by the Agencies in terms of consumer injury and avoidance, while still allowing card issuers some ability to manage open-end credit risk.

Justifications

Although we take exception to most of the justifications provided by the Agencies in the AA Proposed Rule, AFSA believes the nature of the Agencies’ justifications for this portion of the AA Proposed Rule is such that they warrant specific discussion. For example, the Agencies dismiss the ability to cure any potential injury associated with repricing existing balances in response to cardholder behavior through use of disclosures for a variety of reasons, including the fact that consumers may overestimate their ability to avoid the circumstances described in the disclosure. This simply cannot be a justification for a UDAP finding. If Agencies truly believe that disclosures are inherently faulty because consumers will essentially ignore the disclosures’ applicability to the consumers’ specific circumstances, then it is not clear how any practice that results in costs to consumers is not susceptible to a UDAP claim. Furthermore, if the Agencies believe that consumers will essentially ignore disclosures due to the so-called “hyperbolic discounting” effect, AFSA urges the Board to consider what other disclosures under Regulation Z can be discarded due to “hyperbolic discounting.” We also note that it seems unusual that an

¹³ The Agencies do not explain why card issuers should not be able to increase nonvariable rates in connection with a rising interest rate environment. If the AA Proposed Rule is adopted, we suspect card issuers will convert virtually all credit card accounts to variable APRs.

informed adult with the competence to contract should not be held accountable to the contractual terms to which he/she has agreed on account of “hyperbolic discounting.”

The Agencies also note that the application of an increased APR to an existing balance is beyond the cardholder’s control because the cardholder may not have control over whether the rate increases. This is also of course true in a variable rate context—consumers cannot control interest rate policy—but the Agencies have not yet attempted to prohibit use of variable rate APRs in connection with existing balances. Nor do we believe that such a prohibition on the use of variable APRs would be appropriate. There are circumstances that are directly related to the consumer’s behavior, however, that may warrant an increase in the APR on an existing credit card balance, such as a deterioration in the consumer’s overall creditworthiness. The fact that a consumer does not understand what a given lender considers when determining the consumer’s credit risk should not be a predicate for a determination that the risk evaluation—or the lender’s determination based on that risk evaluation—is somehow an unfair practice. By the Agencies’ logic, it would appear that engaging in risk-based pricing at account opening *could* be an unfair practice since some consumers will pay higher costs for credit and consumers cannot control how their risk profile will be evaluated. The only question is whether a federal or state agency, judge, jury, etc. concludes that the harm outweighs the benefits. AFSA specifically requests the Agencies to repudiate this justification in any final rule to avoid any risk that the use of risk-based pricing becomes the predicate for a UDAP claim.

We also question the Agencies’ claim that cardholders’ cannot be expected to avoid a violation of account terms, and therefore avoid repricing based on such trigger. The examples provided by the Agencies relate to a consumer exceeding a credit limit due to the assessment of interest or fees, or the issuer’s “delay” in replenishing a credit limit. If a cardholder exceeds his or her credit limit, that is a violation of a contract—one that has not been held to be unconscionable or otherwise invalid. Furthermore, if the Agencies have evidence of card issuers “delaying” the replenishment of credit, the Agencies should take the appropriate steps to prevent this from occurring. To use the examples as justification for the broader claim that a cardholder cannot reasonably be expected to adhere to account terms generally is a dangerous proposition that could be used in other contexts to negate other account terms. We suspect this is not the Agencies’ intention, and we ask the Agencies to clarify their views accordingly.

When discussing whether the repricing of existing balances provides countervailing benefits to consumers, the Agencies state that in “most cases” it would not be “economically rational” for a consumer to accept the increased APR on an existing balance and keep the account as opposed to rejecting the increase and closing the account.¹⁴ We are not privy to the data the Agencies reviewed when coming to this conclusion, but we offer some circumstances in which the cardholder may want to keep the card despite the increased APR on the existing balance, and such decision would be perfectly rational (economically or otherwise) compared to the alternatives. For example, it may be that the cardholder could not qualify for better rates from any other lender. It may be that the cardholder could not qualify for another credit card from any other lender. It may be that the cardholder prefers the card in question due to other

¹⁴ Economic rationality simply cannot be the predicate of a UDAP claim. We do not believe the Agencies would seek to discourage use of checks or debit cards, for example, each of which may be economically irrational for consumers to use if they possess a credit card with sufficient “open to buy.”

benefits it provides, such as rewards or store discounts. It may be that the consumer would prefer not to open another account for purposes of financial management, managing the number of tradelines at a CRA, or because they prefer the current card issuer for other reasons (*e.g.*, customer service, web capabilities, corporate policies). Therefore, AFSA respectfully disagrees with the Agencies' unfounded conclusion that "assuming consumers understand their right to reject a rate increase, most would rationally exercise that right." Indeed, this may be an issue that is worthy of consumer testing before drawing such firm conclusions.

Use of Regulation AA/Consumer Disclosures

It is clear that the Agencies believe additional regulation of some type is necessary in connection with repricing existing balances. If this is true, AFSA believes it would be more appropriate for the Board to amend Regulation Z to ensure that consumers receive robust disclosures about the circumstances in which account balances may be repriced, and robust disclosures prior to such repricings. Consumers should also be given the opportunity to opt out of such repricing, so long as they are willing to close the account. We believe that this will actually *increase consumers' options* relative to the AA Proposed Rule as it will result in more circumstances when the cardholder chooses whether to continue the relationship as opposed to the card issuer simply closing the account as the primary mechanism to control risk.

AFSA believes the Board has full authority under TILA to adopt such amendments to Regulation Z. For example, the Board has adopted requirements pertaining to change in terms notices generally under its authority granted under TILA despite the fact that TILA does not specifically provide for such notices. TILA does, however, provide the Board the authority to promulgate regulations "to carry out the purposes of TILA" and that such regulations "may contain such...other provisions...as in the judgment of the Board are necessary or proper to effectuate the purposes of" TILA. A purpose of TILA is to "assure a meaningful disclosure of credit terms so that the consumer will be able to...avoid the uninformed use of credit." We believe that the notice and opt out approach would be proper to effectuate that purpose.

Impact on Cardholders

Although our comments have illustrated several of the potential impacts the repricing provisions of the AA Proposed Rule may have on cardholders, AFSA believes it is important to emphasize the cardholder impact. If the final rule were to prohibit the repricing of existing credit card account balances as proposed, we believe the Agencies would directly increase the cost of credit on all cardholders. We also believe that the inability to manage future risk will result in less credit being offered. AFSA is not alone in this prediction—a respected bank analyst has predicted that this portion of the AA Proposed Rule, by itself, will result in a reduction of 45% of available credit to consumers by 2010. In nominal terms, the Agencies' proposal would reduce

consumer purchasing power by \$2 trillion by 2010 according to this analyst.¹⁵ Such a result would not only affect many consumers, but the economy more broadly.¹⁶

AA Proposed Rule: Over-Limit Fees and Credit Card Holds

The AA Proposed Rule would prohibit a credit card issuer from assessing a fee or charge for the cardholder exceeding the credit limit on a credit card account if the credit limit would not have been exceeded but for a “hold” placed on any portion of the available credit on the account that is in excess of the actual purchase or transaction amount. The Agencies state that: (i) an over-limit fee constitutes an injury; (ii) consumers are generally unaware that a hold has been placed on their account; and (iii) there are no countervailing benefits.

It does not appear to us that many credit card issuers impose an over-limit fee in connection with authorization amounts. Rather, over-limit fees are generally assessed in connection with credit actually extended, not just authorized. However, we do not believe the Agencies have considered whether cardholders would prefer to have a credit card transaction honored if it will result in an over-limit fee as opposed to having it declined. AFSA members report that cardholders generally prefer to have a credit card authorization approved, even if the transaction will ultimately result in an over-limit fee, than to be denied authorization at the point of sale. We urge the Agencies to consider this perspective when considering the final rule.

AA Proposed Rule: Two-Cycle Billing

The Agencies would prohibit an issuer from imposing finance charges on balances that include any amounts from the previous billing cycle. There are two exceptions to this prohibition: (i) the assessment of deferred interest; and (ii) adjustments to finance charges following the resolution of unauthorized use claims or billing errors. The Agencies state that: (i) consumers incur higher interest charges under two-cycle billing; (ii) consumers do not understand disclosures relating to two-cycle billing; and (iii) more transparent pricing outweighs any increase in APRs or fees that may result from the adoption of this proposal.¹⁷

AFSA has been surprised at the allegations directed at the common practice of two-cycle billing. At its core, it simply means that if the cardholder does not pay his or her balance in full, the cardholder will forfeit the benefits of the grace period and pay interest on all purchases as of the date the loan was extended. Indeed, in these circumstances, the credit card loan would incur interest in the same manner that any other loan would incur interest: beginning on the date of the loan. There is nothing nefarious about this concept, and it would seem relatively simple to explain to cardholders.

¹⁵ See Meredith Whitney, et al. “Far From Over: We Believe the Credit Crisis Will Extend Well Into 2009”. Oppenheimer & Co., Inc., May 19, 2008.

¹⁶ The Board does not opine in the Supplementary Information if the inevitable reduction in credit availability resulting from this provision and others in the AA Proposed Rule is consistent with the Board’s other macroeconomic efforts.

¹⁷ It does not appear that the Agencies have offered tangible support for the latter assertion. The Agencies have attempted to quantify neither the costs nor the benefits to consumers relating to the prohibition on two-cycle billing.

We do not believe it would be appropriate for the Agencies to install a *de facto* price control in the form of a prohibition on interest charged beginning on the date a loan is made if the cardholder forfeits the grace period. We understand that the Agencies have not yet found a disclosure that they find satisfactory. That does not mean that such a disclosure does not exist. In fact, we believe consumers can understand this concept through a basic disclosure explanation, and choose a credit card accordingly. Therefore, we believe the possible increase in the cost of credit resulting from the proposed price control would not outweigh the benefits provided through informed decision making by consumers.

If the Agencies proceed with well intentioned but misguided efforts to impose price controls on credit extension, AFSA offers the following comments. First, it cannot be the case that a cardholder must understand the interest calculation method in order for it to be a “fair” practice. Cardholders would be hard pressed to explain how to calculate the balance subject to a finance charge under the average daily balance calculations. We do not believe even the most ardent opponents of charging interest on a loan question this balance calculation—yet. Second, it cannot be the case that a balance calculation method that results in a higher interest rate than another method calls into question its fairness. Although the Agencies offer this logic in defense of the AA Proposed Rule’s treatment of two-cycle billing, this reasoning taken to its logical end would result in prohibitions on all interest. Finally, we believe it would be difficult for the Agencies to develop an exhaustive list of exceptions relating to when an issuer should be able to assess interest on balances from previous cycles. For example, it is not clear whether an issuer could assess interest on a balance from a previous billing cycle if that balance results from a returned check, fraud, or even a late posting date.

AA Proposed Rule: Financing Security Deposits and Fees

Under the AA Proposed Rule, a card issuer may not charge to a credit card account, in the first year, security deposits or fees for the issuance or availability of credit if the total amount of such deposits and fees constitutes a majority of the initial credit limit for the account. Furthermore, if the total amount of the security deposits and fees for the issuance or availability of credit charged to the account for the first year constitutes more than 25% of the initial credit limit of the account, the AA Proposed Rule specifies how those amounts may be charged. The Agencies state that: (i) the fees, interest on the fees, and diminished credit are injurious; (ii) that deceptive practices detract from disclosures and financing the fees is usually unavoidable; and (iii) if deposits and fees are too high relative to the credit limit, the costs outweigh the benefits.

AFSA believes that security deposits or fees for credit cards should be clearly and conspicuously disclosed. The AA Proposed Rule, however, establishes arbitrary formulas to calculate how a credit product will be governed. The Agencies have determined that it is by definition unfair to issue a credit card with a \$300 credit limit if the cardholder must pay \$155 in fees. We question whether this is, in fact, true. There may be many valid reasons why a consumer may prefer such a credit card if the alternative is no credit card at all.

We also question the Agencies’ justification for this portion of the AA Proposed Rule. If the Agencies believe that proper disclosures with these types of credit card products are insufficient due to other deceptive practices, the Agencies should take action against those

issuers engaged in deceptive practices. Indeed, it appears that specific UDAP enforcement against card issuers has been successful in the past, both in terms of preventing UDAP behaviors, but also in terms of providing the foundation for guidance in this area.¹⁸ If the Agencies seek to prevent truly unfair behavior, the existing enforcement actions relating to secured or higher fee cards provide a more appropriate context for a substantive UDAP rule as opposed to essentially banning certain types of products altogether.

As it relates to the Agencies' justification for its proposal, we also do not believe that incurring interest on a loan is a predicate for a UDAP violation as being somehow "unavoidable" because the consumer does not have the funds to pay the loan off. Indeed, this would suggest that interest on mortgage loans is injurious (it costs money) and unavoidable for most consumers (most cannot pay off a mortgage in a lump sum payment). The only question is whether someone in state or federal court would claim that the unavoidable injury of interest on a mortgage loan is outweighed by the benefits.

AA Proposed Rule: Disclosures to Accompany Firm Offers of Credit

If an issuer offers a range of, or multiple, APRs for the same credit feature or credit limits as part of a firm offer of credit (as defined in the federal Fair Credit Reporting Act ["FCRA"]), and the APRs or credit limits for the account will depend on specific criteria bearing on creditworthiness, the AA Proposed Rule would require the issuer to disclose the types of the criteria in the solicitation. The Agencies state that consumers may reasonably believe that, because they have been "pre-selected," they can receive the lowest APR and highest credit limit stated in the offer and that the credit terms are material.

It is not clear to us that consumers believe that they will receive the lowest APR or highest credit limit offered in connection with a firm offer of credit. The Agencies do not indicate whether they actually asked consumers about this topic. AFSA believes it would be useful to learn whether or not consumers would have the expectations surmised by the Agencies. It is also not clear whether the Agencies considered the potential liability this provision could impose on larger credit card issuers, many of whom have provided millions of firm offers of credit that do not include the disclosures described. Finally, we ask the Agencies to consider requiring this disclosure as part of future rulemakings under the FCRA or for the Board to require it under Regulation Z.

AA Proposed Rule: Overdraft Fees

The AA Proposed Rule states that a bank may not assess a fee or charge to a consumer's account in connection with honoring an overdraft unless the consumer has not opted out of such services. The bank must provide the opportunity for consumers to give a "partial" opt out applicable only to debit card and ACH transactions. The Agencies state that: (i) overdraft fees injure consumers; (ii) consumers cannot reasonably avoid these fees due, in part, to the fact that consumers cannot be expected to know how much money is in their checking accounts; and (iii) the benefits of not providing an opt out do not outweigh the injury.¹⁹

¹⁸ See, e.g., OCC Advisory Letter 2004-4.

¹⁹ It does not appear that the Agencies have offered tangible support for the latter assertion.

Although AFSA generally represents non-bank creditors, we believe the issues raised in this provision are sufficiently troubling as to warrant brief comment. As the Agencies are aware, honoring a consumer's overdrafts is a discretionary activity, provided by banks as a convenience and accommodation to their customers. This accommodation has value for consumers, and likely more value than dishonoring the check. If the bank honors the overdraft, and charges a fee, that is better than dishonoring the check, assessing the relevant fee, and subjecting the customer to additional penalties from the payee. These penalties can be substantial, especially if the payment is for a mortgage, auto loan, etc. Honoring an overdraft debit card transaction also has value for the consumer. Of course, the most popular anecdote is the \$42 cup of coffee, \$39 of which is the debit card overdraft fee. It is not clear that this is a common occurrence, nor is the cardholder's responsibility to monitor his or her transactions discussed with much seriousness.²⁰ What is more likely is that the debit card is used for gas, groceries, or other important expenditures for which the debit cardholder may not have another viable form of payment. The Agencies do not appear to give much, if any, weight to these facts, circumstances, or consumer benefits.

If the Agencies decide that banks should dishonor more checks and debit card transactions—the inevitable result of the adoption of the AA Proposed Rule—we ask that it be done through amendments to Regulation E under the EFTA. Specifically, the opt-out should be limited to debit card transactions. Electronic fund transactions appear to be of most concern to the Agencies, and an approach under Regulation E would give the Agencies ample authority to achieve their goals. We also note that many financial institutions would be forced to offer a “full” opt out even if the Regulation E approach were used, since they cannot selectively opt out customers based on the manner in which the item posts (*e.g.*, paper check, ACH, debit card, etc.).²¹ This may further the Agencies' objectives.

Conclusion

AFSA requests the Agencies to reconsider significant portions of the AA Proposed Rule in terms of both form and substance. In many cases, the practices addressed in the AA Proposed Rule are entirely legitimate and proper. Therefore, it may be that improved consumer education and disclosure is the more appropriate approach to resolving any perceived consumer confusion. As we noted above, AFSA firmly believes that Regulation Z provides the Board with the ability to resolve the Agencies' stated concerns that results in more informed consumers continuing to have a variety of appropriately priced credit products available. Furthermore, use of Regulation Z will not necessarily result in the same allegations of liability in connection with industry standard behavior that could result if the AA Proposed Rule is adopted. AFSA also requests the Agencies to consider our comments in connection with revising the substance of the AA Proposed Rule, especially in connection with the repricing of existing balances and payment

²⁰ The Agencies' assertion that consumers should not be expected to know what is in their checking accounts is alarming at best.

²¹ For the same reason, a bank should not be forced to offer a partial debit opt out. Not only may such an opt out not be feasible, but the bank could always simply decline to honor any overdrafts if the consumer opts out of debit overdrafts. There is nothing that requires a bank to honor an overdraft.

allocation issues. Again, we appreciate the opportunity to comment on the AA Proposed Rule. Please do not hesitate to contact me if we may be of further assistance.

Sincerely,

A handwritten signature in black ink, appearing to read "Chris Stinebert". The signature is fluid and cursive, with the first name "Chris" being more prominent and the last name "Stinebert" following in a similar style.

Chris Stinebert
President and CEO
American Financial Services Association