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Unfair or Deceptive Acts or Practices

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Submitter Information

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Organization: USAA Federal Savings Bank
Government Agency Type: Federal
Government Agency: OTS

General Comment

See attached letter.

Attachments

OTS-2008-0004-DRAFT-0215.1: Comment on FR Doc # E8-10247



USAA FEDERAL SAVINGS BANK

August 1, 2008

Mr. John Bowman
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attn: OTS-2008-0004

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

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

Re: Office of Thrift Supervision 12 CFR 535: Docket ID. OTS 2008-0004;
Federal Reserve System 12 CFR Part 227: Docket No. R-1314; National
Credit Union Administration 12 CFR 706: RIN 3133-AD47

Dear Mr. Bowman, Ms. Johnson, and Ms. Rupp:

USAA Federal Savings Bank and USAA Savings Bank (collectively "USAA") are pleased to submit this comment letter in response to the proposed rules pertaining to the Unfair and Deceptive Practices published in the *Federal Register* on May 19, 2008 by the Office of Thrift Supervision ("OTS"), the Board of Governors of the Federal Reserve ("Board"), and the National Credit Union Administration ("NCAU") (collectively, the "Agencies").

USAA's parent company, United Services Automobile Association, is a member-owned Fortune 500 company that offers insurance, banking, and investment products primarily to members of the United States military and their families. Its mission is "to facilitate the financial security of its members, associates and their families through the provision of a full range of highly competitive financial products and services...." In providing service to our

members, we always adhere to our core values of service, loyalty, honesty, and integrity.

USAA commends the Agencies for attempting to regulate abusive credit card practices. USAA does not engage in the practices followed by some credit card companies, such as two-cycle billing and payment due date practices. Therefore, USAA generally supports the substance of the proposed credit card rules regarding time to make payments, fees due to credit holds, account-opening fees, double-cycle billing, and disclosures for firm offers of credit, but USAA has concerns with three elements of the proposal.

First, USAA believes that credit card issuers should be able to increase the interest rates on outstanding balances to properly manage their credit card portfolios. Second, USAA believes that the acts and practices specified in the proposed rule should not be considered unfair and deceptive under Regulation AA, because it creates litigation risk to the credit card issuers. Third, the payment allocation requirements in the proposed rule drastically alter the assumptions under which introductory interest rates were offered and would have an adverse impact on consumers and credit card issuers.

1. (a) Effect of Limiting Rate Increases on Existing and Future Securitizations. More than half of all credit card receivables in the United States are securitized. Securitization provides lenders with liquidity to make loans to consumers. Investors who purchase these receivables assume that the credit card receivables can be repriced, if necessary, to make the principal and interest payments on the securities issued against them. The proposed rule changes the arrangement between the credit card issuers and their investors.

The liquidity that future securitizations provide may be limited when investors realize that the credit card issuer cannot increase the interest rates on outstanding balances to service the securities issued against them. At a minimum, the elimination of the ability of issuers to raise rates on outstanding balances will make credit card securitizations less efficient, because ratings agencies will require issuers to provide greater credit enhancements (e.g., overcollateralization and yield spread accounts) to support the credit quality and ratings of the structures. If credit card issuers are unable to increase the interest rates on an entire portfolio, or segments thereof, credit card issuers likely will increase interest rates on new balances and new customers significantly so they can ensure that the margins will satisfy investors when delinquency and charge off rates increase.

(b) Alternatives to Increased Pricing. USAA recommends alternatives to the proposed rule that will protect consumers while giving card issuers the ability to increase rates on outstanding balances. If consumers are given sufficient notice of the changes and have the ability to avoid them, USAA believes both consumers' and issuers' interests will be protected.

We propose that section 226.9 of Regulation Z be amended to add the following consumer protections:

- More Conspicuous Notices. More conspicuous and simplified change in terms notices, ensuring that consumers know that the interest rate will change.
- Opt-Out Rights. If a consumer cannot find alternative financing to avoid a rate increase, then he can refuse the rate increase. However, the credit card issuer may suspend the available balance and prevent the consumer from making further charges on the card.

A credit card issuer should have the following flexibility to serve the customer appropriately:

- When a consumer becomes 30 days past due (generally, two missed payments), the likelihood of charge-off increases significantly. Thus, limiting rate increases to only those accounts that are 30 days past due will not provide sufficient revenue to absorb the losses. USAA proposes that the rule be modified to allow interest rate increases if an account has been delinquent twice in a twelve-month period.
- The credit card issuer should have the ability to increase the interest rate on an account if the borrower is delinquent on other credit accounts with the same lender or with the lender's affiliates.

2. Regulation Z, Not Regulation AA, Should Contain Any New Rules.

USAA is concerned that the proposal characterizes as unfair and deceptive practices that previously were not prohibited by any federal banking regulations. The proposed rule is tantamount to a finding that these practices are unfair and deceptive and this determination will lead to expensive litigation and will expose the banking industry to unquantifiable liability. If the Agencies adopt the proposal, the provisions should be adopted as amendments to Regulation Z to shield the credit card issuers from unnecessary litigation exposure.

3. Allocation of Payments for Introductory Rates.

(a) Allocation of Payments to all Balances Undermines Issuer Assumptions When Rates Were First Offered. If properly disclosed, credit card issuers should be able to apply payments to the lowest rate balances before the interest rates on all other balances. USAA is particularly concerned with the proposed rule regarding promotional-rate balances (whereby payments could not be applied to promotional-rate balances until non-promotional rate balances are paid in full) and the proposed rule regarding grace periods (whereby payment of the promotional-rate and deferred balances would not be required to receive a grace period). The effect of this rule would be to severely restrict or eliminate the use of promotional rates on credit cards.

(b) Consumers benefit greatly from promotional rates. Balance transfer offers provide an opportunity to transfer higher rate balances to a card with a lower rate. Consumers frequently use promotional rate balance transfers to avoid higher rates on other cards. At USAA, more than one third of accounts with promotional rate balances do not have other balances. These customers are taking advantage of the lower promotional rates and, because they do not make purchases with the card, are not impacted by the payment allocation method or grace period requirements of the proposed rule. Those customers who have multiple balances still benefit, because they have a net savings over the accounts from which they transferred balances.

Consumers benefit a great deal from promotional-rate offers, notwithstanding the current payment allocation method of applying payments to the lowest APR first. For example, USAA offers 0% promotional rates on balance transfers and convenience checks for as little as six and as long as 15 months. The average balance transfer on this offer is about \$5,000. If a borrower transferred balances from an account with an interest rate of 13% (the industry average for all customers), he would save approximately \$650 in the first 12 months. Because transferred balances tend to come from higher-rate cards that probably average 18% or higher, the actual average savings per member is likely to be \$900 on the same \$5,000 balance transfer. Furthermore, we do not believe the savings is impacted significantly on accounts that have both promotional-rate balances and non-promotional rate balances. If the average account balance for these accounts is \$10,000, and the blended interest rate of the promotional and non-promotional interest rate is 6%, the cardholder would realize a \$600 savings if the interest rate on the account from which the balance was transferred was 12%.

The proposal to prohibit a card issuer from conditioning a grace period on the payment of a promotional rate creates an operational problem. Under Regulation Z, a card issuer is required to disclose on each billing statement the amount that must be paid to avoid additional finance charges. USAA and other credit card issuers comply by disclosing that the account balance must be paid by the payment due date to avoid additional finance charges on purchases. If an account has a promotional rate balance, we would have to build a system to calculate a new amount equal to the account balance less any promotional balances and indicate that this is the amount that must be paid.

(c) Consumer Protection Alternatives.

(i) Disclosures. USAA supports revising Regulation Z to require a clear payment allocation disclosure in the initial or account-opening disclosures. Additionally, Section 226.5a should be revised to require a payment allocation warning on all applications and solicitations that include promotional rate offers. If the promotional rate applies to balance transfers, the disclosures should also be required at the time the consumer makes a request for a balance transfer.

The following model disclosure language could educate consumers on how best to take advantage of the promotional rate:

PROMOTIONAL INTEREST RATE WARNING
<p>This promotional interest rate applies to balance transfers made before [insert date].</p> <p>If you take advantage of this promotional rate:</p> <ul style="list-style-type: none">• YOUR PAYMENTS WILL NOT REDUCE OTHER BALANCES. Payments will be applied first to the promotional balances and then to other balances. This means you must first pay off all your promotional balances before you can pay down any of your other balances or the promotion ends. You will pay interest at the non-promotional interest rate on the full amount of your other transactions during this entire period.• NO GRACE PERIOD. As long as you carry a promotional interest rate balance, you do not have a grace period. When you have a promotional interest rate balance outstanding, your other transactions will not receive any grace period.

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(ii) Alternative Payment Allocation Methods. If the rule authorizes certain payment allocation methods, it should allow payments to be allocated to the oldest transactions first (the "first-in, first-out" or "FIFO" method). The FIFO method is intuitive and can be easily understood by consumers. FIFO is not a new concept under Regulation Z. It is the method mandated by Regulation Z for determining how the payment amount that may be withheld by a cardholder who is asserting a claim or defense under section 226.12(c). If a cardholder uses another payment allocation method, Regulation Z should be clarified to provide that FIFO would still be used for determining the amount that may be disputed under a claim or defense.

USAA thanks you for the opportunity to submit this letter in response to the proposed rules pertaining to the Unfair and Deceptive Practices. We look forward to working with you as the rule becomes finalized.

Sincerely,

A handwritten signature in black ink, appearing to read "Ron DiGiacomo", with a long horizontal flourish extending to the right.

Ron DiGiacomo
Senior Vice President
and General Counsel