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Via Electronic Mail

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Regulation Comments
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Re: Federal Reserve Regulation AA; Docket No. R-1314 (12 C.F.R. Pt. 227)
Docket ID OTS-2008-0004 (12 C.F.R. Pt. 535)
NCUA RIN 3133-AD47 (12 C.F.R. Pt. 706)

Ladies and Gentlemen:

MasterCard Worldwide ("MasterCard")[1] submits this comment letter in response to the Proposed Rule under 12 C.F.R. Pt. 227 (Regulation AA), 12 C.F.R. Pt. 535, and 12 C.F.R. Pt. 706, published by the Board of Governors of the Federal Reserve ("Board"), the Office of Thrift Supervision ("OTS"), and the National Credit Union Administration ("NCUA" and, together with the Board and the OTS, "Agencies") in the *Federal Register* on May 19, 2008 ("Proposal"), 73 Fed. Reg. 28904. MasterCard appreciates the opportunity to provide its comments on the Proposal.

[1] MasterCard Worldwide (NYSE:MA) advances global commerce by providing a critical link among financial institutions and millions of businesses, cardholders and merchants worldwide. Through the company's roles as a franchisor, processor and advisor, MasterCard develops and markets secure, convenient and rewarding payment solutions, seamlessly processes more than 16 billion payments each year, and provides industry-leading analysis and consulting services that drive business growth for its banking customers and merchants. With more than one billion cards issued through its family of brands, including MasterCard®, Maestro® and Cirrus®, MasterCard serves consumers and businesses in more than 210 countries and territories, and is a partner to 25,000 of the world's leading financial institutions. With more than 24 million acceptance locations worldwide, no payment card is more widely accepted than MasterCard. For more information go to www.mastercard.com.

The Proposal to amend the rules under the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 45 *et seq.*, is a sweeping effort to prohibit numerous credit card practices that are commonly followed by issuers. The Proposal thus stands to require significant changes by the credit card industry. Applying the standard used by the Federal Trade Commission ("FTC") to determine "unfairness" under the FTC Act, the Agencies have indicated that these changes are needed to protect consumers from substantial injury that consumers cannot reasonably avoid themselves, and that the potential injury to consumers from these practices is not outweighed by countervailing benefits to consumers or competition.

The informed use of credit card services is important to the healthy use of consumer credit and a competitive credit card industry. While MasterCard fully supports reasonable efforts to improve consumer understanding of credit card pricing and terms, and supports the Agencies' efforts to identify areas in which such improvements can be made, MasterCard believes strongly that there are several serious problems with the Proposal. Most fundamentally, the prohibition on unfair practices in the FTC Act (the "Unfairness Doctrine") is the wrong regulatory tool to address well-established credit card practices that have long been accepted as lawful – practices that the federal banking regulators have endorsed in either express or implied terms through the examination process and otherwise, as discussed more fully below. In addition, the Unfairness Doctrine should not be used where, as here, there is no adequate factual record to support a finding of unfairness. Finally, contrary to the assertions in the Proposal, some of the proposed changes would inflict more harm than help on consumers in many respects.

One of the most troublesome aspects of the Proposal is that the Agencies take the unprecedented step of essentially prohibiting APR increases on existing balances with only certain limited exceptions. This aspect of the Proposal turns the historic short-term interest rate on credit cards into a five-year rate, which is tantamount to a price control. This thereby creates artificial restraints on credit card offerings. MasterCard respectfully submits that establishing price controls and artificial restraints is unsound policy. Further, any limitation on the ability to change terms on balances incurred before the effective date of the regulatory changes – unsecured credit which was extended by issuers on the justifiable expectation that the APRs could be adjusted – creates very significant safety and soundness issues.

The Proposal also addresses a number of practices related to overdraft services on deposit accounts. MasterCard believes that a number of these aspects of the Proposal should also be reconsidered by the Agencies in enacting any final rule.

In this letter, we first discuss MasterCard's general comments on the use of the Unfairness Doctrine in this context, and our belief that there are more appropriate regulatory tools that the Agencies should use (Part I). We then discuss the proposal to restrict APR increases on existing balances (Part II) and to mandate certain payment allocations on credit card accounts (Part III), which we believe are the most significant and troubling aspects of the Proposal. Finally, we comment on one additional aspect of the Proposal relating to credit card practices and the implementation time (Part IV), and then we briefly addresses aspects of the Proposal relating to overdraft practices on deposit accounts (Part V).

DISCUSSION

I. General Comments on the Agencies' Rulemaking Under the FTC Act

A. The Unfairness Doctrine Should Not Be Used To Change Well-Accepted Credit Card Practices

MasterCard believes that the Proposal involves a fundamental misapplication of the Unfairness Doctrine. The Proposal would declare unlawful, largely through use of an unfairness label with its attendant negative implications, many practices that issuers have legitimately followed for many years – including through many years of examination by the federal banking regulators. If the Agencies are going to require modifications to well-established credit card practices that have been both expressly and impliedly approved under federal or state law, it should not do so through the Unfairness Doctrine and the general limitations imposed under the FTC Act.

The Unfairness Doctrine as currently enunciated by the FTC, which the Agencies have indicated they will follow, has long been recognized as employing an extremely vague and general standard that is highly susceptible to unpredictable results. *See, e.g.,* Neil W. Averitt, "The Meaning of 'Unfair Acts or Practices' in Section 5 of the Federal Trade Commission Act," 70 Geo. L.J. 225 (1981); Richard Craswell, "The Identification of Unfair Acts and Practices by the Federal Trade Commission," 1981 Wis. L. Rev. 107 (1981). Although such a standard may be appropriate to prevent abhorrent practices that defy express prohibition,[2] improper application of the standard also limits legitimate business conduct – as is the case here. As the Proposal illustrates, the unwarranted application of the FTC's standard to mainstream business practices simply involves an ordinary policy determination regarding what is best for consumers and competition using unfairness labels, rather than an effort to root out insidious business practices. Thus, the federal banking agencies and the FTC previously have limited use of the Unfairness Doctrine to regulate conduct that meets a significant level of moral turpitude with little or no utility. In contrast, the Proposal seeks to use the Unfairness Doctrine largely to effect changes in mainstream creditor practices or redefine existing technical compliance rules under Regulation Z.

For example, the Proposal would prohibit the ability of creditors to increase APRs on outstanding balances, subject to limited exceptions, notwithstanding that federal and state laws specifically authorize the practice. Under the exportation doctrine, the ability to change interest

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[2] The legislative history indicates that Congress adopted a general standard because specifically defining "unfairness" would be a hopeless task:

> It is impossible to frame definitions which embrace all unfair practices. There is no limit to human inventiveness in this field. Even if all known unfair practices were specifically defined and prohibited, it would be at once necessary to begin over again. If Congress were to adopt the method of definition, it would undertake an endless task. It is also practically impossible to define unfair practices so that the definition will fit business of every sort in every part of this country. Whether competition is unfair or not generally depends upon the surrounding circumstances of the particular case. What is harmful under certain circumstances may be beneficial under different circumstances.

H.R. Rep. No. 1142, 63d Cong., 2d Sess. 19 (1914), *quoted in FTC v. R. F. Keppel & Bro.*, 291 U.S. 304, 312 (1934).

rates is governed by the laws of the state in which the bank is located, 12 U.S.C. § 85,[3] and many states in which credit card issuers are located expressly allow increased APRs to be applied to outstanding balances (although sometimes an opt-out right is required). *See, e.g.*, 5 Del. Code § 952; Official Code Ga. § 7-5-4(c); S.D. Codified Laws § 54-11-10; Utah Code § 70C-4-102(2). These statutory provisions and their application to change credit card terms have been routinely upheld by federal and state courts. *See, e.g., Homa v. American Express Co.*, 496 F. Supp. 2d 440, 449 (D.N.J. 2007); *Grasso v. First USA Bank*, 713 A.2d 204 (Del. Super. 1998).

Similarly, the Proposal effectively would establish a new requirement to mail billing statements 21 days before a due date, notwithstanding that creditors have operated under an express 14-day rule in Regulation Z for over 25 years. *See* 12 C.F.R. § 226.5(b)(2)(ii). Given the breadth of the creditor practices that the Proposal would modify under FTC Act rules, and the lack of any factual study to support its findings of unfairness, MasterCard seriously questions what credit practices the Agencies would not consider regulating under the Unfairness Doctrine. If the Proposal is any indication of the Agencies' view of the scope of the Unfairness Doctrine, it may be reasonable to question whether the Agencies might seek to impose general cost controls on the basis that consumers are incapable of understanding cost disclosures and shopping for credit. Because this is the Agencies' first independent foray into adopting unfair practices rules, MasterCard is of the strong view that the Agencies should follow more traditional notions of how the Unfairness Doctrine should be applied.

In that respect, the extraordinary breadth of the Agencies' application of the Unfairness Doctrine in the Proposal is plainly inconsistent with past precedent by the federal banking agencies and the FTC. Past enforcement actions regarding credit practices have focused on practices that prevent consumers from defending collection actions, billing charges that were not authorized, and marketing products that did not have the common attributes that consumers would expect without appropriate disclosure. *See, e.g.*, Julie L. Williams and Michael S. Bylsma, "On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks," 58 Bus. Law. 1243, 1253 (May 2003) (collecting history of banking agency actions). Likewise, enforcement actions outside of credit practices similarly have involved highly objectionable practices which essentially involved theft, fraud, coercion or intentional misconduct. Stephen Calkins, "FTC Unfairness: An Essay," 46 Wayne L. Rev. 1935 (Winter 2000). The guidance offered by the federal banking agencies on the Unfairness Doctrine similarly targets primarily traditional deceptive marketing concerns and does not in anyway foreshadow to issuers that FTC Act rules might be used to adopt new regulatory requirements that change previously legally permitted practices. *See, e.g.*, "Unfair or Deceptive Acts or Practices by State-Chartered Banks" (Mar. 11, 2004), issued by the Board and the FDIC[4]; OCC Advisory Letter AL 2004-4, "Secured Credit Cards" (Apr. 28, 2004)[5]; OCC

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[3] The ability of credit card issuers to export the interest rates allowed by their home states has been confirmed by the Supreme Court twice, in *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978), and *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735 (1996).
[4] Available at http://www.federalreserve.gov/boarddocs/press/bcreg/2004/20040311/attachment.pdf.
[5] Available at http://www.occ.treas.gov/ftp/advisory/2004-4.doc.

Advisory Letter AL 2004-10, "Credit Card Practices" (Sept. 14, 2004)[6]; OCC Advisory Letter AL 2002-3, "Guidance on Unfair or Deceptive Acts or Practices" (March 22, 2002).[7]

In the Proposal, 73 Fed. Reg. at 28907, the Agencies have indicated that they intend to follow the guidelines for unfairness established by the FTC and codified (though only with respect to the FTC's rulemaking) in the FTC Act. *See* 15 U.S.C. § 45(n). MasterCard urges the Agencies also to consider the unique context of the banking industry, and particularly the credit card industry, in applying this standard. Indeed, although the statute provides for the Agencies to enact, for the entities under their respective jurisdictions, the rules that the FTC promulgates, the statute *requires* the agencies to consider whether those FTC rules "would seriously conflict with essential monetary and payments systems policies of such [Agency]." 15 U.S.C. § 57a(f)(1). Here, in applying the FTC's unfairness standard, the Board should consider that credit card issuers – unlike general business subject to the FTC's rules – are already heavily regulated and subject to examination. Further, issuers are subject to safety and soundness rules, which may be seriously impacted by some of the Agencies' proposals (as discussed below). These factors should be considered in determining what FTC Act rules are appropriate.

MasterCard stresses that application of the Unfairness Doctrine is not simply an academic issue. There are potentially serious consequences that may flow from the misapplication of the Unfairness Doctrine in the Proposal. The declaration of common and accepted practices as unfair carries a negative inference that issuers have engaged in unscrupulous practices, notwithstanding that those practices were followed industry-wide and were permitted, and in some cases expressly authorized, by applicable law. More importantly, mislabeling a new restriction as unfair may unintentionally create potential liability for issuers, especially for conduct occurring before the effective date of any new requirements. Although Regulation AA and other FTC Act rules are enforced administratively by the federal banking agencies, most states have statutory prohibitions against unfair or deceptive conduct. The Agencies' mischaracterization of a practice as unfair, as opposed to as a new regulatory requirement, creates the serious risk that private plaintiffs and state attorneys general will bring enforcement actions under state laws against issuers for past conduct that clearly was legal when it occurred. While MasterCard believes that any such litigation would have no merit, issuers should not be put to the potentially extensive cost of defending such claims or the risk (however remote) that a court might misapply any new provisions enacted pursuant to the Proposal, and the Agencies' findings in adopting it, to create liability for issuers under state law. This risk to issuers is entirely avoidable by recognizing the proper scope of the Unfairness Doctrine and not misapplying it to changes in regulatory requirements that should be adopted under other regulatory regimes (such as Regulation Z).

B. Practices Should Not Be Prohibited Using the Unfairness Doctrine Without Full Administrative Fact Finding

MasterCard also respectfully submits that the administrative fact finding supporting the Proposal is inadequate. Consequently, the Proposal fails appropriately to consider significant adverse impacts on consumers and competition, and the effectiveness of alternatives that would

[6] Available at http://www.occ.treas.gov/ftp/advisory/2004-10.doc.
[7] Available at http://www.occ.treas.gov/ftp/advisory/2002-3.doc.

adequately address the concerns that have been identified in a manner that has less adverse consequences. If the Agencies intend to base the changes to existing credit card regulations on the Unfairness Doctrine, MasterCard believes that additional factual investigation is necessary. Moreover, MasterCard recommends strongly that the Agencies follow guidance from the FTC not only on the substantive standard used to determine unfairness under the FTC Act, but also on the procedural safeguards that should be followed to prevent improper limitations on legitimate business practices.

As an initial matter, the Agencies should allow additional time for gathering and reviewing information relating to the Proposal. The Agencies allowed only 75 days for comments, and that period fell in the summertime. This is far shorter than the periods provided by the FTC in prior rulemakings, and far too little time to allow affected creditors to review, analyze, and respond to the proposal. We also understand that the Agencies expect to issue a final rule during 2008. Again, we believe that this gives far too little time to study the Proposal, which would enact sweeping and substantial changes to long-established norms.

1. A Substantial and Clearly Documented Factual Record Is Required

The FTC has expressly recognized that there must be a preponderance of substantial reliable evidence to support a rule that finds a practice to be unfair, and that such evidence must be clearly recorded. *See* 49 Fed. Reg. 7740, 7742 (Mar. 1, 1984) (discussing standard in connection with Credit Practices Rule); *see also Pennsylvania Funeral Directors Ass'n v. FTC*, 41 F.3d 81, 85 (3d Cir. 1994) (discussing standard of review of FTC rulemaking). This is necessary because an unfair practices rule can dramatically impact industry practices and competition, as well as the products that are available to consumers, and can impose substantial expenses and costs on industry participants. It also is necessary to ensure that the lack of specific guidance in the general unfairness standard does not improperly restrict legitimate conduct, and to avoid unnecessary reputational and liability consequences of improperly declaring a practice to be unfair. In short, the regulatory authority to adopt unfair practices rules involves substantial power that must be exercised in a careful and measured fashion, based on facts and not unsupported conclusory statements. It is not sufficient to identify an area in which consumers might need protection and fashion a proposed remedy under the Unfairness Doctrine, without a thorough and thoughtful factual study. Proper application of the Unfairness Doctrine requires actual study (and not anecdotal evidence) of both the extent of the consumer harms being addressed and the actual advantages and disadvantages of various alternatives being considered.

Several examples illustrate the extent to which the FTC has studied consumer issues before adopting a rule under the Unfairness Doctrine. The FTC's work leading up to its Credit Practices Rule, which served as the basis for the existing provisions of Regulation AA, spanned nearly a decade, and involved numerous proposals and revisions, extensive hearings and testimony, supporting empirical data and econometric analysis, and agency investigations. *See America Fin. Servs. Ass'n v. FTC*, 767 F.2d 957, 963 (D.C. Cir. 1985) (discussing history of rulemaking). Similarly, the FTC's work on its Consumer Claims and Defenses Rule covered almost five years and involved extensive hearings, testimony and factual study. *See* 40 Fed. Reg. 53506, 53506 (Nov. 18, 1975). In these instances, and many others in which the FTC has exercised its rulemaking authority under the Unfairness Doctrine, the FTC relied on extensive studies of the consumer harms being addressed and the alternatives that might be used to address

them. Importantly, these hearings and studies were conducted for the specific purpose of the proposed rulemaking. In this regard, MasterCard submits that factual investigations that are not prepared in consideration of a proposed solution to perceived consumer harms are much less likely to provide information that will help fashion an appropriate regulatory solution and avoid unintended consequences.

The FTC Act itself sets forth several procedural safeguards that MasterCard believes the Agencies should follow in adopting any new requirements under the FTC Act. *See* 15 U.S.C. § 57a(b). Although the Agencies have indicated their belief that these requirements do not expressly apply to the Agencies, 73 Fed. Reg. at 28907, MasterCard submits that the same considerations that have lead the FTC to recognize that it should carefully exercise its unfair practices regulatory authority require the Agencies to do the same. The statutory requirements in the FTC Act that help ensure proper determinations under the Unfairness Doctrine include (i) a requirement to publish an advance notice of proposed rulemaking, (ii) a requirement to provide an opportunity for informal hearings, and (iii) requirements for such informal hearings, including a presiding hearing officer and the right to submit rebuttal evidence on disputed factual issues. 15 U.S.C. § 57a(b)(1)(A), (b)(1)(C), (c). These types of procedural safeguards help ensure that the difficult determinations involved in applying the Unfairness Doctrine are made on the basis of a fully developed and considered factual record, with full industry participation, and not based on the views of relatively few individuals who may not be expert in the economic or other issues involved.

Notably, the Board has previously recognized the importance of factual records in assessing whether a particular practice is unfair under the FTC Act. In 2002, Representative LaFalce urged the Board to exercise its authority under the FTC Act to identify specific practices that were unlawful under the Unfairness Doctrine. In declining to do so, Chairman Greenspan stated that "[i]n the absence of specifics generated through the case-by-case complaint and enforcement approach . . . it is difficult to craft a generalized rule sufficiently narrow to target specific acts or practices determined to be unfair or deceptive, but not allow for easy circumvention or have the unintended consequence of stopping acceptable behavior." Letter, dated May 30, 2002, from Chairman Greenspan to Rep. LaFalce.[8] MasterCard believes that the Board was correct when it previously indicated that determinations of unfairness are best made in an examination context where a complete consideration of relevant facts is most easily conducted, and that the best use of an unfair practices rule is to codify established enforcement positions after they are sufficiently developed so that case-by-case determinations are not likely to be helpful or recurring. However, to the extent that the Agencies determine it is necessary to adopt an unfair practices rule without such enforcement experience, MasterCard believes that it is critical to do so only on the basis of a fully developed and considered factual record.

2. The Factual Record for the Proposal Is Not Adequate To Determine Unfairness

MasterCard does not believe that there is an adequate factual record to support the Agencies' determinations underlying the Proposal. Only the OTS issued an advance notice of proposed rulemaking to solicit views on areas of potential concern and potential solutions; that

[8] Available at http://www.federalreserve.gov/boarddocs/press/bcreg/2002/20020530/attachment.pdf.

notice hardly presaged the significant changes now set forth in the Proposal, and banks and credit unions could not be expected to respond to an advance notice from an agency with no jurisdiction over them. There also have been no hearings held by the Agencies on any aspect of the Proposal.[9] Moreover, it is truly remarkable (and most likely without precedent) that the Proposal would make findings under the Unfairness Doctrine without even a single analytical report or study prepared by the Agencies or any other party specifically for the purpose of the Proposal. Indeed, the Proposal appears to be based largely on the conclusory judgments of the Agencies' staffs on factual issues without any supporting basis other than articles written in other contexts.

The studies cited by the Agencies in the Proposal were conducted in connection with the Board's recent proposals to amend Regulation Z, and related to increasing the effectiveness of certain credit card disclosures. Those studies, however, were extremely limited and largely did not consider disclosure issues relevant to the Proposal. The studies cited by the Agencies have considered targeted issues such as the effectiveness of table formats of disclosure, historic APR disclosures, periodic statement disclosures, and the use of certain terminology.[10] Moreover, consideration of the effectiveness of certain credit card disclosures is but a small part of the broader inquiries that need to be made concerning a proposal that contains the types of sweeping substantive limitations that are included in the Proposal. For example, the Proposal includes absolutely no factual basis to support its conclusions regarding the impact that the substantive restrictions would have on consumers, competition and the marketplace. The Agencies' analysis of whether a practice is unfair plainly must be supported by a clear factual record on these points, which is conspicuously missing.

Probably the most glaring omission from the Proposal is the lack of any factual support for the conclusions regarding the impact of prohibiting the application of increased APRs to outstanding balances. The Proposal expressly acknowledges that this change will increase the interest rates offered to some consumers and will reduce the ability of less creditworthy consumers to obtain loans. 73 Fed. Reg. at 28919. Increasing interest rates and decreasing eligibility for consumer credit is likely to impact the economy generally, and such impact may be real and substantial given the prevalence of credit card financing. But incredibly, the Proposal concludes that these consequences are acceptable without any attempt (from either the Board's extensive staff of economists, other Agency staff, or others) to quantify the extent of these obvious consequences, or to measure the effectiveness of any alternatives. It is highly problematic to modify dramatically long settled change-in-terms practices affecting billions of dollars of consumer credit without any basis to assess the impacts of the modifications. Additionally, as discussed below, MasterCard believes that (contrary to the conclusion in the Proposal) the proposed limitation on APR changes will adversely and materially affect both consumers and the economy and is not justified given the alternatives that consumers have to

[9] The April 8, 2008 informational forum held by the Board, *see* 73 Fed. Reg. 28906, was not the type of proceeding contemplated by the FTC Act and prior FTC precedent. The hearings must present the opportunity to present and rebut evidence before a hearing officer, and with a formal record of proceedings. *See* 15 U.S.C. § 57a(c).

[10] The studies were described in the Board's May 2008 proposal to amend Regulation Z, 73 Fed. Reg. 28866 (May 19, 2008). Prior to its earlier 2007 Regulation Z proposal, the Board engaged Macro International for a study that consisted of four focus groups (each of eight to thirteen people) and two rounds of cognitive one-on-one interviews (the first involving nine people, and the second involving 33). Between the 2007 and 2008 proposals, the Board worked with Macro on one additional round of cognitive interviews.

avoid rate increases through opt-out rights and balance transfers, especially in light of the Board's proposal increase the time period before a change in terms can become effective.

In sum, MasterCard respectfully submits that substantial additional work needs to be done to analyze the impact of certain of the changes in the Proposal (such as the rule on increasing APRs) and the effectiveness of alternatives. Moreover, we believe that the level of factual support for the conclusions in the Proposal is insufficient under the standards of the FTC Act.

C. Any Changes To the FTC Act Rules Should Be Based On Preventing Unfair or Deceptive Practices

Leaving aside for the moment the merits of imposing the substantive limitations in the Proposal, as described throughout this letter, the relevant practices are not unfair within the meaning of the FTC Act as it has been interpreted and applied in the past, and there is not a sufficient record to support any such finding. To the extent that the Agencies nonetheless determine to include one or more of the proposed limitations in rules under the FTC Act, MasterCard requests that the Agencies clearly indicate in the accompanying Supplementary Information published in the Federal Register that the Agencies are doing so on the basis of their authority to "prevent" unfair practices, and not because they have determined the practices to be unfair.

The Agencies' regulatory authority under Section 18(f) of the FTC Act extends not only to prohibiting acts or practices that are themselves unfair or deceptive, but also to requirements imposed to "prevent" unfair or deceptive acts. 15 U.S.C. § 57a(f)(1) (Agencies to adopt regulations "containing requirements prescribed for the purpose of preventing [unfair or deceptive] acts or practices"). The Proposal indicated that the Agencies were considering whether certain acts were unfair and requested comment on the related issues. Given the extremely thin factual record for finding that the practices are unfair, as noted above, it would be more appropriate to adopt any changes on the basis of "preventing" unfair acts rather than on a finding that the acts are themselves unfair. In this respect, to avoid misunderstanding, MasterCard requests that the Agencies affirmatively state that the Proposal did not find the acts unfair or deceptive, and that nothing in the Agencies' rulemaking should be viewed as finding or suggesting that such acts are in fact unfair or deceptive.

Expressly basing any new FTC Act regulations on findings with respect to "preventing" unfair or deceptive acts also may reduce the risk of the Proposal's inadvertently causing potential liability under state law. The relevant state statutes generally prohibit unfair or deceptive acts. However, if any action in FTC Act rules is based on "preventing" such acts, the provisions of the final regulation and the Agencies' rulemaking should be irrelevant. For the reasons stated throughout this letter, MasterCard believes that proposed changes to credit card practices should not be implemented through FTC Act regulations. However, to the extent that any changes are included in such regulations, MasterCard also believes it is important for the Agencies to clearly state that they have not found the relevant practices to be unfair or deceptive.

D. Any Changes in the Proposal That Are Adopted Should Be Changes in Regulation Z

Again leaving aside the merits of the substantive aspects of the Proposal, MasterCard submits that any changes from the Proposal that are adopted should be made part of Regulation Z and not part of FTC Act rules. For the general reasons stated above, and for the specific reasons stated below regarding particular practices, using the Unfairness Doctrine to proscribe the practices at issue because they are unfair involves the proverbial square peg in a round hole. Rather than contorting the Unfairness Doctrine to fit the proposed limitations, MasterCard submits that it would be advisable to recognize that such limitations reflect policy decisions concerning how the Agencies believe the industry should be regulated, apart from whether the practices are "unfair," or refinements of existing credit card practice requirements in Regulation Z. As such, MasterCard believes that many of the procedural difficulties and unintended consequences outlined above might be addressed by moving the limitations to Regulation Z.

The Board has broad regulatory authority under Regulation Z. Under Section 105 of TILA, the Board is directed to "prescribe regulations to carry out the purposes of this title." 15 U.S.C. § 1604(a). The purposes of TILA are defined in Section 102 of the statute, and include promoting fair credit disclosure and also "protect[ing] the consumer against inaccurate and unfair credit billing and credit card practices." 15 U.S.C. § 1601(a). The Board is authorized to adopt "classification, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions...." *Id.* Thus, there can be little doubt that the Board has broad authority to regulate credit card practices under TILA.[11] The Supreme Court, moreover, has repeatedly noted the broad authority granted by Congress to the Board under TILA, and the need to defer to the Board's rulemaking unless it is "arbitrary, capricious, or manifestly contrary to the statute." *Household Credit Servs. v. Pfennig*, 541 U.S. 232, 238-39 (2004); *see also, e.g., Ford Motor Credit v. Milhollin*, 444 U.S. 555, 566 (1980); *Anderson Bros. Ford v. Valencia*, 452 U.S. 205, 219 (1981).

Moreover, the Board already has regulated several related or similar practices under Regulation Z. For example, Regulation Z already has change in terms notice requirements, and the Board has proposed to amend those requirements to allow consumers to have greater opportunity to transfer balances in the event of rate increases (12 C.F.R. § 226.9(c)); addressing rules on the ability to increase APRs on existing balances should logically be included with these Regulation Z provisions. Similarly, Regulation Z presently contains the 14-day rule, which requires creditors to mail billing statements 14 days prior to the date by which the consumer can pay in order to avoid additional finance charges or late fees. 12 C.F.R. § 226.5(b)(2)(ii); 12 C.F.R. Pt. 226, Supp. I, comm. 5(b)(2)(ii)-1. It would be potentially confusing to adopt additional provisions in Regulation AA and the other Agencies' FTC Act rules which, as described below, are inconsistent with the Regulation Z provisions as a practical matter; again, the proper place to address all of these timing rules on sending billing statements is in one place in Regulation Z where the topic is already addressed.

[11] Even if the Board's authority under TILA did not expressly extend to "unfair credit billing and credit card practices," the Board would arguably have the right to enact many (or all) of the elements of the Proposal under Reg. Z for the purpose of promoting "informed use of credit," if the Board concludes that certain practices cannot be effectively disclosed.

Addressing the relevant issues in Regulation Z has the added benefit of increasing uniformity of regulation across the industry. Even if the Agencies enact uniform FTC Act rules, creditors subject to FTC jurisdiction (such as retailers and state-chartered credit unions that issue credit cards) would not be subject to comparable limitations absent additional regulatory action by that agency. The sensible approach is to adopt a single set of uniform rules for the credit card industry that apply under Regulation Z.

II. Comments on Increasing APR on Outstanding Balances

Limiting the ability of issuers to increase APRs on outstanding balances is extremely troubling. Under the Proposal, issuers generally would not be permitted to impose such increases on existing balances, and would be required to allow consumers to pay off such balances at the existing rates over a five year period (in essence). Limited exceptions would allow an increased APR to be applied to existing balances in the case of variable rate accounts and for accounts with payment defaults of at least thirty (30) days.

A. Broadly Prohibiting APR Increases on Outstanding Balances Will Increase Interest Rates, Decrease Credit Availability and Adversely Impact the U.S. Economy

MasterCard strongly opposes the use of the Unfairness Doctrine to limit the common practice of changing terms on open end credit accounts and applying the changes to outstanding balances.

At the outset, we note that this aspect of the Proposal is flatly inconsistent with the historic nature of the bank credit card account and should not be implemented without a compelling need that has not been shown to exist. More specifically, consumers do not commit to borrow a particular amount of money, or to maintain a particular balance, on a bank card account; they also are free to move their balances to another creditor without any prepayment fee. As evidenced by the fierce competition for balance transfers, consumers are easily able to (and frequently do) move their balances among creditors to obtain better rate offers. In short, consumers provide only a "short-term" commitment to the card issuer. Similarly, credit card issuers do not provide a long-term commitment to provide an account to consumers and usually have the right to terminate credit privileges on the account at will.

Notwithstanding the "short-term" nature of these commitments, credit card accounts can (and frequently do) involve a long-term relationship. Many consumers have maintained the same credit card account for fifteen years or longer. This "open-end" aspect of the credit card relationship mandates that issuers retain the right to change terms on the account over time as circumstances require. These aspects of the credit card account relationship presently are well disclosed to consumers at the outset of the relationship and MasterCard submits that consumers understand that APRs can be changed. Moreover, the Board has proposed additional disclosures under Regulation Z to increase consumer understanding.

The issuers' ability to change terms on the accounts provides an efficient pricing model that inures to the benefit of consumers and competition. Because issuers can adjust interest rates later, they are able to provide more favorable initial rate offerings to consumers. Long-term

interest rates on unsecured credit generally will be higher than short-term rates because there is greater credit risk over a longer period of time. The sophisticated credit models used by credit card issuers today illustrate this principle very well. During the life of a credit account, issuers routinely review the creditworthiness of the consumer and may adjust the APR on certain accounts if credit risks increase. Issuers conduct such reviews to comply with safety and soundness requirements. However, such risk-based pricing adjustments also are fair and efficient to consumers: they ensure that consumers who present greater credit risk pay a higher price for credit and are not subsidized by more creditworthy consumers. This model has worked very effectively in the credit card industry in particular because of the intense competition between issuers, including frequent balance transfer offers. Further, there is ample evidence that issuers compete vigorously based on interest rates (including balance transfer offers), and that there is an efficient market. *See, e.g.,* Government Accountability Office, "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," GAO-06-929 (Sept. 2006) (concluding that "[i]ncreased competition among issuers ... likely caused the reductions in credit card interest rates" between the 1980s and 2006).

In addition, MasterCard believes strongly that restricting the ability of issuers to increase APRs on outstanding balances will lead to higher interest rates for consumers. This is not fair (or desirable) to consumers: consumers who maintain favorable credit should not be required to pay more so that consumers who present more credit risk can pay less. MasterCard also submits that these higher credit card interest rates will limit the ability of certain less creditworthy consumers to obtain credit and, given the importance of consumer credit generally and credit cards in particular to the U.S. economy, this is likely to cause further economic difficulties on top of those currently being encountered. It is neither necessary nor advisable for the Agencies to be involved in the regulation of interest rates on credit cards under the FTC Act or otherwise. The credit card market is highly competitive and, although consumers obviously may want lower interest rates, the Proposal contains no evidence of market failure that has resulted in consumers' being charged excessive interest rates.

As noted above, the Proposal contains no factual analysis or study on the impact of the Proposal on credit card interest rates. The Proposal acknowledges that rates may increase, but baldly concludes (without any factual basis) that the risk is an acceptable one. It simply is not possible to determine if the risk is acceptable before the magnitude of the risk is known. Similarly, the Proposal makes no attempt to assess the numbers of consumers who will no longer qualify for credit cards, because issuers will be prohibited from adjusting interest rates on outstanding balances, or the impact on the economy caused by the increased costs to those consumers who can still get credit. MasterCard respectfully submits that, notwithstanding the potential popularity of restricting the imposition of higher APRs on existing balances, the Agencies must carefully review the potential impacts of doing so before taking this extraordinary step.

B. An Opt-Out Right Provides Consumers with a Reasonable Alternative To Application of APR Increases To Existing Balances

MasterCard believes that the Proposal incorrectly concludes that consumers do not have a reasonable alternative if a creditor increases the APR on existing balances. To start with, a consumer can easily transfer balances among card issuers if the consumer believes that the issuer

with which they have their account is charging too much. FTC Act regulations should not impose rate limitations merely because a consumer is unwilling to shop for alternative credit products. Moreover, in a competitive market like the credit card market, the failure of a consumer to be able to find a lower rate indicates that the rate appropriately reflects the consumer's credit risk. Requiring issuers to artificially keep interest rates low, even after the borrower's creditworthiness changes, will result in all customers' – including more creditworthy consumers – paying higher interest rates to subsidize less creditworthy borrowers. Such a result is not sound policy and, in any event, not the type of policy decision that should be made by the Agencies under the Unfairness Doctrine.

MasterCard supports an opt-out for consumers as a reasonable means by which consumers can avoid a rate increase on existing balances. The Proposal concludes that an opt-out is not a workable option, but again that *ipse dixit* conclusion is not based on any factual study or analysis. Contrary to the assertion in the Proposal that a consumer has no economic incentive to agree to a higher APR, 73 Fed. Reg. at 28919, there is a very significant reason why a consumer would not choose to opt out and instead accept a rate increase on existing balances: an opt-out requires the consumer to relinquish the right to obtain additional credit and many consumers may choose to retain that right and agree to pay higher APRs on their entire balances. MasterCard submits that it is entirely reasonable to provide the consumer the choice between continuing to receive credit by accepting a higher rate on all balances, or closing the account and paying off on existing terms. And there is nothing "unfair" about providing such a choice, especially when the right to change terms is fully disclosed to the consumer when the account is opened and there are additional disclosures when the choice is actually presented.

To the extent that the Agencies believe that better disclosure would enhance consumer understanding and exercise of opt out rights, MasterCard believes that disclosure should be the focus of the Agencies' efforts, rather than a broad and complicated effort to define the circumstances under which increased APRs can be applied to outstanding balances. The Board has proposed increased disclosure requirements in connection with changes in account terms to facilitate credit shopping and transfer of balances to another account if appropriate. *See* 72 Fed. Reg. 32948, 33090 (June 14, 2007). Those less drastic measures should be implemented and reviewed before the steps in the Proposal are taken. Moreover, the Board's increased change in terms disclosures might be supplemented or modified to reflect an opt-out right mandated by Regulation Z, and thereby increase consumer understanding of this substantial right.

MasterCard also notes that the proposed limit on increasing APRs may be tied to criticism of a practice commonly referred to as "Universal Default," under which the interest rate on a credit card account is increased based on the consumer's default on a credit account other than the credit card account (*e.g.* a mortgage or automobile loan). For the reasons stated above, MasterCard believes that it is appropriate to price credit based on risk and to re-price open-end credit based on changes in risk, with appropriate notice. Further, we believe that default on a credit obligation is a strong indicator of risk. Nonetheless, if the Agencies are concerned about Universal Default, a study and a proposal on this narrow and specific aspect of re-pricing is preferable to a rule that substantially restricts repricing.

C. The Exceptions for Default Pricing and Variable Rates Are Too Limited

The Proposal contains an exception that would allow issuers to increase APRs on existing balances if the consumer is at least thirty days' past due on the account. MasterCard supports the inclusion of a default pricing exception. As described above, MasterCard believes that risk-based pricing is an efficient pricing model that benefits consumers and competition and default pricing is a limited type of such pricing. However, MasterCard also believes that the proposed default pricing exception is too limited.

First, the Proposal would require that a consumer be at least thirty days' past due. MasterCard believes that the exception should apply as soon as a consumer misses a payment. Consumers who have missed payment due dates by thirty days are much more likely to not repay their account balances. Thus, default pricing that is based only on a thirty-day delinquency is less likely to result in consumers with higher credit risks actually paying for such increased risks. MasterCard believes that issuers should be able to implement their payment default pricing on existing balances in accordance with their program experiences and that it is not necessary for the Proposal to create an artificial number of days before payment default pricing can be implemented. Indeed, the presumption should be that all payment default pricing is covered. If the Agencies are going to use the Unfairness Doctrine to exclude certain payment defaults, MasterCard believes that the Agencies should develop an appropriate factual basis on which to establish that exclusion. The Proposal presently does not provide any factual basis for generally excluding payment defaults of less than a particular length, or for establishing a thirty-day payment default period as the basis for the exception.

The thirty-day requirement for payment delinquencies also contributes to an overly complex set of rules on default pricing that is likely to confuse consumers and be difficult for issuers to disclose and explain. The Proposal, together with the Board's pending proposals to amend Regulation Z, would create a fourteen-day period after the notice of a change in terms to determine the "existing balance" for purposes of the limitation; a thirty-day period that is used to determine payment defaults for purposes of applying the increased APR to existing balances; and a forty-five-day change in terms notice period. While the Commentary provisions in the Regulation Z proposal would provide examples of the interplay of these different notice periods, these examples illustrate the extreme and intricate complexity of the rules. Indeed, especially given the Agencies' other findings regarding consumers' abilities to understand credit card disclosures, MasterCard believes that it is highly unlikely that consumers will be able to understand these rules and that the rules' complexity creates unnecessary compliance risks for issuers implementing them.

MasterCard also recommends that the exception for default pricing not be limited to payment defaults. Issuers have instituted appropriate default pricing on factors other than payment defaults, such as on the basis of going over the credit limit or paying with a check that is returned for insufficient funds. Issuers have found that these other types of defaults are appropriate indicators of increased credit risk and have adopted default pricing policies on that basis. The Proposal does not offer any basis, or any factual support, for distinguishing between these different types of default pricing triggers. In the absence of any basis to conclude that different default pricing triggers are less effective than others, or that different triggers present particular concerns, MasterCard submits that it is not proper to use the Unfairness Doctrine to

prevent application of default-pricing practices on existing balances in accordance with policies and procedures developed, from time to time, in connection with ordinary issuer operations.

MasterCard also recommends that the exception for default pricing include changes based on the cardholder's default on another obligation with the same creditor or an affiliate. Thus, if a cardholder of ABC Bank also has an auto loan from ABC Bank, ABC should be able to reprice the credit card account based on a default on the auto loan. The reasons for this relate to fundamental principles of underwriting and safety and soundness. Regulators would expect a creditor to consider its overall exposure to any consumer in deciding whether or not to extend credit in the first instance; thus, creditors should also be able to evaluate the entire relationship on an ongoing basis.

With respect to variable rate transactions, we support the exception in the Proposal. However, we believe that the exception should be extended to cover other types of accounts in which the rate may change at a point in the future. For example, an account may provide a discounted rate for an employee that expires if the employee leaves his position. Or a creditor may provide a discounted rate to customers who also maintain other relationships (such as a deposit account or other loan account) with the creditor. Rate increases that are disclosed in advance, and triggered by these subsequent events, should be exempt from the proposed rule precluding APR changes.

We also note that the exception for variable rates, because it will be the only way for creditors to protect themselves from market interest rate fluctuations, could lead to the elimination of non-variable rate accounts. However, consumers may well be interested in having non-variable rate accounts. In order to preserve the feasibility of non-variable rates, while giving creditors protection in the event of market changes, the Board should consider adopting an exception for repricing that applies to an entire portfolio of accounts, and not to targeted individual accounts. In this regard, we note that there is an exception under Regulation B from the requirement to provide adverse action notices for such general repricing. *See* 12 C.F.R. § 202.2(c)(1)(ii). We submit that a parallel exemption under the proposed rule (subject to any applicable opt-out rights) would be appropriate.

D. Any New Restrictions Should Not Apply to Balances Outstanding at the Time the Rule Becomes Effective

If the Agencies adopt a limitation on applying increased APRs to existing balances, MasterCard believes it is critical that the limitation apply only to balances created after an effective date for the change, and that the effective date is calculated to provide issuers a reasonable opportunity to change their underwriting and pricing policies to account for such a dramatic change.

There are literally billons of dollars of credit that have been extended by issuers on the understanding that the issuers could increase APRs and apply the increased APRs to outstanding balances. As noted above, issuers have been authorized under federal and state law to do so. Consumers have received the benefits of low, short-term pricing, because issuers understood that they could increase the APRs later if necessary. It is fundamentally unfair to "retroactively" require issuers to provide these short term interest rates to consumers. It is well settled in the

usury context that lowering the usury limit does not impact the permissibility of rates set by existing contracts. *See, e.g.*, 44B Am. Jur. 2d Interest & Usury § 8, at 33-34 (2007) ("a subsequent statute affecting the rate of interest recoverable will not ordinarily apply when there is an existing contractual obligation ... fixing the rate of interest"). This has both a fairness dimension, because a contrary rule would risk unsettling legitimate expectations, as well as a constitutional dimension, as applying changed law to existing contracts would affect vested contract rights. *See* 47 C.J.S. Interest & Usury § 82, at 92 (2005) (applying new usury law to existing contract "would amount to an impairment of the obligation of the contract").

Furthermore, retroactively changing the interest rate rules on outstanding balances would create major safety and soundness issues for issuers. Issuers have set current APRs on credit card accounts by taking into consideration a variety of factors, including the ability to adjust interest rates in accordance with sophisticated risk based pricing models. Issuers have not set these APRs on the assumption that rates could not be changed for five years and, as noted above, interest rates that cannot be increased in the future undoubtedly would be higher. Issuer profits thus stand to be reduced at a time when issuers are suffering increased credit card losses because of a deteriorating economy and many other business lines are suffering.

As already noted, the Agencies have not studied the impact on interest rates that will result from the Proposal. Similarly, there has not been a quantitative analysis of the impact on issuer profitability if the limit on increasing APRs is imposed on existing balances. MasterCard respectfully submits that the Agencies must fully evaluate and take such considerations into account if any limits on APR increases will be applied to balances outstanding when the Proposal becomes effective.

If limits on applying APRs are adopted, MasterCard requests that the Agencies provide an effective date that gives issuers sufficient time to make the significant changes in program operations (e.g. pricing and underwriting standards) that will need to be implemented for credit extended after the effective date of any new regulatory requirements. If there are going to be new rules on changing APRs, issuers must have an opportunity to determine how those rules will effect their credit card programs. As noted above, APRs will likely increase and certain consumers likely will cease to qualify for credit. The Proposal is likely to lead most issuers to change from fixed rate accounts to variable rate accounts, otherwise they will not be able to take advantage of increasing funding costs on existing balances. Issuers will need time to implement these programmatic changes, including modifying account documents and notifying consumers of the relevant changes. MasterCard further requests that the Agencies expressly confirm that issuers may modify account terms before the effective date of new regulatory requirements to take into account limitations imposed under the new rules.

III. Comments on Rule Restricting Allocation of Payments

In recent years, credit card issuers have offered increasing numbers of discounted interest rates designed to promote particular types of credit card usage. For example, issuers have offered special discounted rates for balance transfers, or to make certain types of purchases, or to make purchases at certain times of the year. These offers provide significant benefits to consumers through real and substantial reductions in the costs of borrowing, including zero percent APR offers in many cases.

The Proposal would significantly limit the ability of issuers to set repayment terms in connection with promotional interest rate offers. Using an analysis under the Unfairness Doctrine, the Proposal concludes (among other things) that creditors must apply payments in excess of a required minimum payment in a manner no less favorable than pro rata among balances at different promotional and standard rates. The Proposal would also require creditors to disregard promotional balances for determining whether consumers are entitled to a grace period on ordinary purchases. MasterCard is emphatic that the Unfairness Doctrine should not be used to regulate the repayment (and thus price) terms on which issuers provide promotional rate offers, that improved consumer understanding of promotional offers is far better than substantive regulation of repayment terms, and that the current Proposal is likely to harm consumers by either reducing the discount or duration of promotional rate offers or limiting the number of consumers who will be able to take advantage of them.

A. Issuers Should Be Able To Determine Credit Repayment Terms

Promotional rate offers from issuers have provided substantial cost savings to consumers. A consumer who does not have to pay interest on a balance transfer for several months, or who does not have to pay any finance charges because the consumer repays the purchase price of a large ticket item in full by the end of a "same as cash" offer period, has received real and substantial economic benefits. MasterCard believes that issuers should be able to set the terms and conditions on which such promotional offers are repaid, and that the Agencies should not regulate the prices of such offers through payment allocation and other requirements adopted under the Unfairness Doctrine.

Issuers should be able to set the discount in the APR and the duration of that discount without regard to limitations imposed under the Unfairness Doctrine. It follows that the Unfairness Doctrine should not limit the ability of issuers to establish the duration of the discount arrangement by specifying that the discounted interest rate balances must be repaid before the higher rate balances are repaid. The Proposal indicates that consumers are harmed by promotional rate offers if the lower rate balances must be repaid before higher rate balances. 73 Fed. Reg. at 28915. MasterCard respectfully submits that the Proposal fails to recognize that a lower rate offer, even if for a shorter period or in conjunction with a higher standard interest rate, may provide consumers with substantial cost savings. The fact that consumers would prefer to pay off higher rate balances before lower rate balances is understandable because they would save more money. But a preference for paying less is not the hallmark of unfairness, and issuer offers that do not permit such payment allocations do not satisfy the FTC's standards for unfairness. An unfairness determination cannot be supported simply by a general policy determination that consumers would be better off if they received promotional offers for a longer period of time.

Similarly, the Proposal would require issuers to disregard promotional balances for purposes of determining whether the consumer is entitled to a grace period on purchases. *Id.* at 28916. Issuers generally are not required by federal or state laws to provide a grace period for purchases. Instead, these interest-free loans are made as a customer service to enhance the utility of the credit card. Some issuers may provide a grace period for purchases regardless of whether the consumer repays their previous balance in full. However, since issuers are not required to offer grace periods, they should be able to determine the terms and conditions on which they are

willing to offer them. For example, there should be no dispute that a issuer can choose to not provide a grace period on purchases if the consumer maintains an account balance for cash advances. MasterCard does not believe that issuers should have any less right to condition the availability of grace periods for purchases on repayment of other types of balances, including promotional rate balances.[12]

Importantly, the Proposal offers no principled explanation why it is unfair for issuers to require lower rate balances to be repaid before higher rate balances, or to condition the availability of a grace period for purchases on payment in full of promotional balances. Some consumers may not appreciate that the overall cost of credit on their account is a blended rate that takes into account the promotional rate while it is in effect and the standard "go to" rate thereafter (or that regular purchases may be at a higher APR that the promotional rate). Similarly, some consumers may inadvertently lose the right to a grace period on regular purchases by engaging in a promotional rate offer. However, as discussed below, these concerns relate to consumer understanding and not to any creditor practice that is unfair.

We submit that the effect of the currently common payment allocation rules used by issuers is not a complicated fact. Payment allocation has not heretofore been a required Regulation Z disclosure, but we believe a new disclosure rule – with appropriate model language – would readily and understandably convey to consumers that payment allocation rules will result in higher finance charges if they engage in certain behaviors. That leaves the choice to the consumer, rather than prohibiting entirely a practice that provides benefits to many consumers by enabling low rate promotional offers.

The Proposal does not contain any factual basis for concluding that consumers cannot avoid the perceived problems. Consumers who do not want to take advantage of a promotional rate offer because the lower promotional rate balance will be repaid before higher rate balances can choose not to take advantage of the promotional rate offer, as long as the consumer is given adequate disclosure of the relevant facts. Similarly, consumers can choose whether it is in their best interests to take advantage of a promotional offer if it means losing a grace period on regular purchases, again as long as the credit terms are properly disclosed. The Proposal's suggestion that current practices force consumers to use a credit card account as a closed-end account in order to obtain the benefit of the promotion, 73 Fed. Reg. at 28914, ignores the important flexibility that the account provides: it is up to the consumer to decide when to use the account for new purchases, based on the financial terms of the accounts as well as other circumstances. Indeed, for consumers who plan on maintaining a regular purchase balance, it would be immaterial whether the promotional rate balance prevents them from receiving a grace period.

In considering whether consumers can avoid the effects identified by the Agencies, it is imperative for the Agencies to apply the Unfairness Doctrine to protect consumers from coerced or otherwise inhibited decisions, not to protect consumers from their own voluntary decisions that the Agencies believe are not in the consumers' best interests. The Board previously emphasized this point in the guidance it provided on application of the FTC Act standards:

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[12] Indeed, it would be ironic if a consumer was not entitled to a grace period for purchases because the consumer maintained a cash advance balance, but the Proposal ensured that the consumer would be entitled to a grace period on purchases on another account if the consumer transferred the balance to that other account under a promotional rate offer.

> The [Board and the FDIC] will not second-guess the wisdom of particular consumer decisions. Instead, the [Board and the FDIC] will consider whether a bank's behavior unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decision making.

"Unfair or Deceptive Acts or Practices by State-Chartered Banks" (Mar. 11, 2004), at 3. MasterCard urges the Board to consider whether it is possible to impose requirements (such as disclosures) to ensure that consumers are making informed choices, rather than deprive them of choice altogether.

Finally, it is premature to conclude that disclosures will not address the Agencies' concerns, especially given that the Board's Regulation Z proposal has for the first time proposed disclosures on payment allocations to promotional rates. 72 Fed. Reg. at 32991. Any testing of consumer understanding, which was done in connection with the Regulation Z proposal, was very limited and not undertaken in connection with an examination of the relative merits of disclosure and substantive limitations. MasterCard thus believes that the drastic step of regulating the manner in which promotional offers must be repaid should not be taken at this time.

B. Improved Disclosures Would Better Address the Perceived Need

MasterCard believes that consumers generally understand that most banks apply payments to lower rate balances before higher rate balances. To the extent that there has been confusion in the past, the prevalence of promotional rate offers over the past years has provided adequate experience for most consumers to understand how the programs work. Moreover, issuers have devoted substantial customer service and promotional resources to reducing consumer confusion on payment allocation issues. However, irrespective of the need for additional consumer education, MasterCard believes strongly that the issues identified by the Proposal with respect to payment allocations do not require substantive regulation (and thus implicit price regulation), but rather efforts to ensure that consumers understand the terms and conditions of the promotional offer when they decide whether to take advantage of it.

The Proposal sets forth a complicated set of rules that issuers would follow in applying payments to accounts with balances at multiple interest rates. If consumers have difficulty understanding current issuer practices, MasterCard submits that they will have equal or greater difficulty in understanding the rules in the Proposal. Consumers are not likely to understand pro rata allocations of payments between multiple balances and are likely to be disappointed that their minimum required payments and a pro rata portion of their payments in excess of their minimum payment are being applied to a higher rate balance, just as they are disappointed that not all of their payments are applied to higher rate balances. In short, while the Agencies have tried to include some limitations on the payment allocation rules that tend to reduce their adverse impact on the ability of issuers to structure promotional offers, the Proposal does little to address the real issue of consumer understanding of payment allocation rules.

MasterCard respectfully submits that the Agencies should reconsider whether disclosures can adequately address the consumer protection issues that have been identified. The complexity

of the interplay of various account balances at different rates undoubtedly can make understandable disclosures difficult to prepare. However, the solution for a difficult disclosure problem is not to prohibit a practice. There should be few (if any) financial services that should be prohibited because of concerns about the ability to prepare appropriate disclosures, and extra steps should be taken with respect to disclosures on promotional rate offers given the substantial benefits they provide consumers. One potential approach the Agencies might consider is the adoption of a disclosure that sacrifices some detail for the purpose of ensuring that consumers understand the fundamental point that is important to their informed use of credit. For example, rather that attempting to craft a disclosure that contains significant level of detail on exactly how payments will be applied, it may be advisable to develop a relatively simple disclosure that warns consumers that "lower rate balances must be repaid before higher rate balances." Similarly, rather than substantively regulating grace period practices, it would be advisable to disclose to consumers that "interest will be charged from the date credit is extended for purchases if you have an outstanding balance transfer or other promotional transaction."

C. The Proposed Limits on Payment Allocations Would Harm Consumers

MasterCard also believes that the payment allocation provisions of the Proposal will increase the cost of credit to the detriment of many consumers. As a preliminary matter, the Proposal will create operational complexity, as issuers will need to develop the operational capability of applying payments consistent with the Proposal. Issuers will also need to draft new and complex disclosures of their payment allocations. These hurdles – which will include costs – may dissuade issuers from even making the promotional offers that trigger the rules.

More fundamentally, however, issuers that are subject to the new requirements that provide consumers the right to pay down lower rate offers slowly will need to make corresponding reductions in the amount or duration of the discount to maintain current revenue levels. Alternatively, issuers may tighten credit standards for promotional offers to reduce credit risk in the face of reduced revenues. Consumers who use their accounts solely for promotional rate offers will be disadvantaged because the amount or duration of their discounts will be adjusted to take into account consumers with higher rate balances which would be required to be paid down according to the new FTC Act rules.

As described more fully above, the Unfairness Doctrine is a blunt tool that is not designed to make pricing decisions like the manner in which payments are allocated between higher and lower rate balances. The Proposal contains no factual analysis of the impact that the new payment allocation rules would have on promotional rate offers or the consumers who would continue to qualify for them. MasterCard believes that an informed consumer receiving proper disclosures and robust competition should dictate pricing issues, including the terms of promotional rate offers, absent a well documented finding that the marketplace is failing to work properly.

The requirement to provide grace periods without regard to promotional rate balances is likely to have an even more profound impact on credit card pricing and offers. Although the Proposal contains no discussion or factual analysis of the issues, this aspect of the proposal also is likely to cause a reduction of program revenues that will need to be offset by either reducing the discount or duration of promotional offers or tightening credit standards to reduce credit

losses. Some issuers may simply choose not to offer a grace period for purchases on credit cards that receive promotional rate offers. MasterCard believes that these considerations must be more fully evaluated by the Agencies before they take the drastic step of regulating the manner in which grace periods must be offered.

IV. Comments on Other Specific Practice Limitations and Aspects of the Proposal

A. Time to Make Payments

The Proposal would effectively add a new timing requirement for sending out periodic statements, forbidding card issuers from treating consumers as late for any reason (except the expiration of a grace period for finance charges) unless the consumer is given a "reasonable amount of time to make the payment." The Proposal would grant a safe harbor for issuers that mail statements at least 21 days before the payment due date. Given the uncertainty of applying a "reasonableness" standard, this amounts to a 21-day rule for sending out periodic statements.

There is, to say the least, substantial tension between this new 21-day rule and the existing 14-day rule for sending statements prior to expiration of a grace period. The existing rule is found in Regulation Z, and is also codified in TILA. 12 C.F.R. § 226.5(b)(2)(ii); 15 U.S.C. § 1666b(a). Under the Official Staff Commentary, the current 14-day rule applies when a late fee may be charged to the account. 12 C.F.R. Pt. 226, Supp. I, comm. 5(b)(2)(ii)-1. The Proposal would overturn that provision, because the late fee would now be governed by the 21-day rule.

Moreover, if the Proposal is enacted, an issuer desiring to rely on both the 14-day rule (for the expiration of a grace period, and the beginning of the accrual of additional finance charges) and the 21-day rule (for all other purposes) would need to set and disclose two different due dates on each periodic statement. Making an effective and clear disclosure of those two dates and the meaning of each date (to our knowledge unprecedented in the industry) would present novel and difficult issues, and possible consumer confusion. As a result, it seems far more likely that issuers would be effectively forced to choose the "lowest common denominator," and abandon the 14-day rule in favor the 21-day rule even though the former has been expressly legislated by Congress. In other words, the Agencies' proposed FTC Act rule would override the express statutory TILA requirement. We believe that the record before the Agencies does not justify this departure from TILA. The record does not support either the conclusion that the 14-day rule is inadequate, or that 21 days is necessary. Among other things, the Agencies have used highly improbable estimates for the time it takes for mail to be delivered, and have entirely ignored the fact that consumers receive statements (and are required to make payments) at predictable intervals that they can anticipate and plan for. The proposal also fails to account for the increasing use of electronic statements and payments that all but eliminate the mail delay for many consumers.

B. Time for Implementation

In response to the Agencies' request for comment on the effective date of a final FTC Act rule, MasterCard believes that issuers will need at least 24 months to make the changes needed to comply with the rules. In that regard, several of the aspects of the Proposal will require

significant operational changes, and the development and testing of new business and technological processes and procedures. Most significantly, the rule on payment allocations will require the development of significant new technology to implement the terms of the Proposal, and will also require examination of existing (and planned) promotions (as well as other account terms, including the existence of grace periods). In addition, the rule restricting rate increases on existing balances will require issuers to adjust the current terms on accounts in order to properly price those accounts based on the inability to raise rates in the future. The 21-day rule will also require changes to the production of statements and other processes to ensure compliance. Generally, there will also be a need to develop and send new disclosures, and possibly amend existing contracts.

In connection with the time for implementation, we also believe the Agencies should make clear that the intent of any final FTC Act rules is for the rules to be enforced prospectively, after the effective date, by the designated federal agencies. This will preserve the reasonable expectations of parties to transactions that occur prior to the effective date. In addition, the Agencies should state expressly that it would be inconsistent with the goals and objectives of the rulemaking, and the Agencies' intent, for the final rule or any other aspect of the rulemaking to be used by state officials or private plaintiffs as support for enforcement or litigation over conduct prior to the effective date of any new requirements, such as asserting claims under state trade practices laws with respect to such conduct.

V. Comments on the Proposal's Rules for Overdraft Practices

The Proposal would add provisions to the FTC Act rules that define certain overdraft practices as unlawful, in addition to the credit card practices described above. Based on the same FTC standard of unfairness described above, the Proposal generally would prohibit banks from imposing a fee for overdrafts unless consumers are provided with the right to opt out of the payment of overdrafts and the consumer has not exercised that right after a reasonable opportunity to do so. The Proposal also would prohibit banks from assessing a fee for an overdraft if the overdraft would not have occurred but for a hold placed on funds in excess of the actual amount of a purchase or transaction. MasterCard appreciates the ability to comment on these overdraft provisions insofar as they apply to overdrafts caused by ATM and debit card transactions.

Overdraft services are long-standing banking practices that provide substantial benefits to consumers. The ability of banks to cover overdrafts in deposit accounts is well recognized in the relevant provisions of the Uniform Commercial Code, UCC § 4-401(a), and other payment systems laws. Most consumers take seriously the responsibility of managing their deposit account balances and maintaining sufficient funds to cover transactions on the accounts. However, payment of overdrafts is a valuable service to consumers for those instances in which there are inadvertent timing or other issues that cause an overdraft on the consumer's account. Moreover, the value of these services is equally important for consumers engaging in debit card or ATM transactions as for consumers who write checks. In either case, consumers appreciate the ability to complete transactions despite the fact that the presentment of credits and debits to their accounts in the ordinary course has caused a temporary overdraft. MasterCard further

believes that banks should be able to charge their customers fees providing these valuable services.[13]

In addition, MasterCard supports consumer choice and the ability of consumers to avoid obtaining services that they do not want or need. If a consumer wants their bank to deny transactions on their deposit account, MasterCard believes that the consumer should be able to do so, as long as banks are not required to stop transactions that cannot be stopped through reasonable means, and the manner in which the consumer exercises that choice likewise is reasonable. However, imposing overdraft fees without an opt-out requirement (or in connection with debit holds) is not an unfair practice under the FTC Act and any new rules should not be adopted as part of FTC Act rules. Rather, MasterCard believes that any new overdraft rules for debit cards should be adopted as part of Regulation E, which generally regulates consumer protections in connection with debit card transactions.

Indeed, many of the considerations that compel the conclusion that any limits on the credit card practices described above should be imposed under Regulation Z also compel the conclusion that any limits on overdraft practices for debit cards should be imposed under Regulation E. The labeling of overdraft fee practices as "unfair" is unwarranted, given the absence of a fully considered factual determination of the scope of any consumer harm, the legitimate benefits provided by the service, and alternatives to the Proposal. In this respect, the Agencies have not considered in a thorough fashion the effectiveness of alternatives available to consumers to avoid overdrafts, such as more carefully monitoring account balances (including using telephone, internet and other means to check balances) and maintaining a cushion in the account to prevent overdrafts. Further, MasterCard is concerned about the risk that private plaintiffs may misuse the Agencies' rulemaking to challenge past overdraft practices as unlawful under state unfair practices limitations, or as the basis to argue that the Unfairness Doctrine prohibits other legitimate business conduct. Such inadvertent adverse potential consequences can be avoided by recognizing that the proposed overdraft rules would represent a new regulatory requirement imposed for general policy considerations and not an appropriate application of the Unfairness Doctrine.

As noted above, MasterCard also believes that any opt-out rights that are provided to consumers should be designed to limit unnecessary operational burdens on banks. For example, MasterCard supports the Agencies' approach in the Proposal to not require banks to provide an opt-out right at ATMs, or retailer locations in debit card transactions; the extraordinary costs and operational burdens of developing "point of transaction" opt out rights simply is not justified.

Similarly, MasterCard supports the Proposal insofar as it recognizes that banks should be able to charge an overdraft fee on debit card transactions, even if the consumer opts out of the overdraft service, where the bank does not have a reasonable opportunity to prevent the overdraft from occurring for operational or other reasons. In these instances, banks should be entitled to

[13] The Proposal notes that some consumer advocates believe that overdraft services may be high-cost lending transactions that trap low- and moderate-income consumers. MasterCard submits that, to the extent that any such overdraft programs do exist, they are relatively isolated in comparison to the vast majority of traditional overdraft programs, and that the incidence of any such programs does not require imposing burdensome requirements on traditional overdraft programs.

compensation for the valuable services they provide even though they are prevented from trying to honor the consumer's request to stop avoidable overdrafts. Indeed, MasterCard supports the exceptions in the Proposal for transactions in which there were sufficient funds in the account at the time an authorization is provided, but the amount of the transaction presented exceeds the authorization amount, and for paper-based transactions that are not authorized in advance.

However, MasterCard recommends that the exemption be stated as a general rule that banks may impose an overdraft fee for overdrafts that the bank cannot reasonably prevent, together with several specific examples (such as the ones given by the Agencies), rather than an exclusive list of narrowly described circumstances. There undeniably are extreme complexities in the debit card and deposit account systems that prevent easy description of those overdrafts that cannot be reasonably prevented, including the interplay between different credits (*e.g.* clearing checks) and debits (*e.g.* checks, on-line debits and off-line debits) on the account, which may be presented through different settlement and authorization systems. Besides avoiding the need to categorize each reasonable basis on which it may not be reasonable to prevent overdrafts, the approach of a more general exemption would reduce the need to modify the exemption as systems and processes change.

Finally, MasterCard believes that it is premature to regulate debit hold practices. The fundamental overdraft issue presented with respect to such practices is impacted dramatically by how quickly debit transactions are settled by the merchant through the payment system. If transactions are settled quickly, the potential impact of a hold is not significant. Industry participants clearly are working to reduce this settlement time. For example, MasterCard is exploring ways to reduce the settlement/hold time that can be implemented on a system-wide basis. MasterCard respectfully submits that these industry-led initiatives should be given an opportunity before the Agencies embark on regulations in the area.

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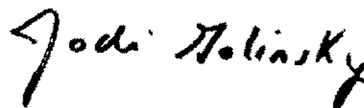
MasterCard appreciates the opportunity to provide its comments on the Proposal. Please do not hesitate to contact me at (914) 249-5978, or our counsels at Sidley Austin LLP in connection with this matter, Michael McEneney at (202) 736-8368, James Huizinga at (202) 736-8681, or Karl Kaufmann at (202) 736-8133, if you have any questions or would like to discuss our comments.

Sincerely,



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