

United States House of Representatives  
Committee on Financial Services  
2129 Rayburn House Office Building  
Washington, DC 20515

August 14, 2008

The Honorable Ben S. Bernanke  
Chairman  
Board of Governors of the Federal Reserve  
20<sup>th</sup> and Constitution Avenue, NW  
Washington, DC 20551

The Honorable Michael E. Fryzel  
Chairman  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314

The Honorable John Reich  
Director  
Office of Thrift Supervision  
1700 G Street, NW  
Washington, DC 20552

Dear Chairman Bernanke, Director Reich and Chairman Fryzel:

We commend the Federal Reserve, Office of Thrift Supervision, and the National Credit Union Administration (“regulators”) for using their existing regulatory authority and taking important first steps to curb abusive credit card and overdraft protection practices. These proposals are long-overdue and will lead to increased fairness and transparency for American financial consumers.

As Members of Congress, we are acutely aware of the impact that unfair and deceptive financial practices have on consumers. Numerous complaints from our constituents as well as Congressional hearings and reports have detailed several common practices that can trap hardworking families in a downward spiral of debt. On July 31<sup>st</sup> the Financial Services Committee marked up and passed H.R. 5244, the Credit Cardholders’ Bill of Rights, which addresses many of these abusive practices. We are pleased that your agencies have also come to recognize the tremendous costs that consumers bear as a result of such credit practices, and appreciate the effort you have undertaken to address them through substantive regulatory restrictions and improved disclosures.

### **The Proposed Regulations**

We strongly support the proposed additions and revisions to Regulation AA (Unfair and Deceptive Acts and Practices) and Regulation Z (Truth in Lending), and believe that they will ensure that consumers are treated fairly and receive the information necessary to make informed decisions when they use these credit services. These include: (i) banning retroactive interest rate increases on existing balances, (ii) requiring a fair allocation of payments, (iii) banning two-cycle billing, (iv) banning over-the-limit fees resulting from credit card holds, (v) increasing the number of days for advance notice of certain interest rate increases from 14 to 45 days, (vi) establishing consistent and reasonable time for on-time mailed payments, (vii) restricting

deceptive offers of credit, (viii) giving consumers some control over their participation in overdraft protection programs, and (ix) banning overdraft fees resulting from debit holds.

### **Recommended Improvements**

We applaud the regulators for this important progress but believe that you should strengthen the proposals in a number of ways:

Strengthen restrictions on subprime credit cards. The UDAP proposal would continue to permit companies that issue subprime credit cards to charge large up-front fees and security deposits to vulnerable consumers. Subprime issuers recognize that credit cards have become increasingly necessary to fully participate in the modern financial system, and therefore aggressively market cards for which fees and deposits consume a significant percentage of the account's available credit. The UDAP proposal's restriction on financing of certain security deposits and fees for credit availability on subprime credit cards does not go far enough to protect many consumers. Specifically, we believe that the 50% threshold for prohibiting card issuers from financing fees is too high to discourage the issuance of these cards, and that allowing issuers to spread the cost of fees that exceed 25% of the initial credit limit over the first year will do little to curb abusive activities. We urge you to follow the approach taken in H.R. 5244 which prohibits the financing of fees for cards with annual fees that exceed 25% of the credit limit.

Ban universal default. Under the UDAP proposal, credit card companies may continue to utilize abusive universal default clauses which permit them to increase a cardholder's interest rate on new transactions if the consumer makes a late payment to another creditor or the individual's overall credit score declines. These clauses are inherently unfair because they penalize cardholders for events that are outside the account relationship, even if they consistently pay their bills on time and are in good standing with the issuer regarding that specific account. While the UDAP proposal would prohibit the most damaging aspect of universal default clauses by prohibiting retroactive interest rate increases on existing balances (except under limited circumstances), the proposal should go further and prohibit penalty rate increases altogether for events that occur outside the account relationship. Despite assertions from some issuers, universal default does not appear to be an inherent part of risk-based pricing: some major issuers have already discontinued the practice and/or only permit "off-us" universal default repricing after the contract period has expired.

Prohibit the practice of "any time, any reason" repricing. The UDAP proposal would also continue to permit credit card issuers to engage in the common and troubling practice of arbitrarily changing the terms of the contract (generally increasing a cardholder's interest rate) under "any time, any reason" repricing clauses. This practice is harmful to consumers and undermines true competition – without knowing specifically and in advance the potential reasons that they might be subject to rate or fee increases, consumers cannot effectively comparison shop. Requiring that issuers clearly specify the conditions or actions that could trigger interest rate or fee hikes increases the fairness of the process and enables consumers to better plan and conform their behavior to prevent default.

Extend the 5 p.m. cut-off for all payments, not just mailed payments. The TILA proposal would add important consumer protections to prevent creditors from establishing a cut-off time for mailed payments before 5 p.m. on the due date and prevent creditors from setting due dates on the days on which the creditor does not accept payments. Given that the consequences for late payments are often severe (in the form of penalty interest rates and hefty late fees) and that an increasing number of consumers pay their credit card bills on-line or by phone, we urge you to expand the coverage of the proposal to include all payments regardless of method or form.

Strengthen consumer protections for overdraft programs.

i. Require that consumers opt-in to overdraft programs. Under the UDAP proposal, banks may continue to automatically enroll consumers in costly overdraft programs without their knowledge or advance consent. While the proposal does create a helpful opt-out from overdraft programs, it should go further. Studies suggest that consumers prefer not to be enrolled in overdraft loan programs and that the harm from overdraft fees outweigh the benefits for non-check transactions. We urge you to follow the approach taken in H.R. 946, which requires consumers to opt-in to overdraft programs.

ii. Require that overdraft disclosures be governed by TILA. The Board proposes to establish the types of additional disclosures that banks must provide to consumers regarding overdraft programs. We support the improved disclosures but urge the Board to reconsider the placement of the regulations within Reg DD (Truth-in-Savings) rather than Reg Z (Truth-in-Lending). The placement of these useful disclosures in the Reg DD undermines their effectiveness by limiting enforcement to the bank regulatory agencies and reducing the ability of consumers to compare the cost of overdraft credit to all other available options. There does not appear to be a credible rationale for failing to place these disclosures within TILA. The bank regulatory agencies have generally deemed overdraft loans as credit and the Board has explicitly reserved the right to issue overdraft regulations under TILA if it would benefit consumers.

iii. Prohibit banks from manipulating the order in which transactions are processed to create overdrafts. We are concerned that the UDAP proposal does not address the harmful practice of banks manipulating the order of credits and debits to maximize the number of overdraft fees they collect. Banks acknowledge that they typically debit transactions with the highest dollar amount first rather than in the order they are presented to the bank, but justify this practice on the basis that those checks are the most important. This ignores the fact that banks routinely pay all overdrafts so that the checks and debit withdrawals are paid regardless of the order in which they are posted. Debiting accounts with the highest dollar charge first merely increases the likelihood of the account balance going negative, thus increasing the chances that overdraft fees will be charged for the smaller transactions that follow. We encourage you to target this practice in your proposal in a manner similar to H.R. 946 which would prohibit manipulation of account activity if the result is to increase overdrafts. We understand that at least one agency has recognized the inherent harm to consumers resulting from this practice: OTS guidance on overdraft protection programs currently warns thrifts that transaction clearing rules should not be “administered unfairly or manipulated to inflate fees.”

iv. Where feasible, require a warning when a consumer is about to overdraw at an ATM and provide a chance to cancel the transaction. The regulators should also require that to the extent possible financial institutions provide notice to customers when an ATM withdrawal is about to trigger an overdraft and give consumers a choice to accept the overdraft coverage and the associated fee, or to reject them. We understand that there are presently significant technical barriers to providing this notice and choice in certain circumstances (particularly at the “point of sale” in many retail transactions), but 2005 guidance issued by the agencies encourages institutions to alert consumers (when feasible) that a transaction will trigger an overdraft fee and allow consumers to cancel the transaction. We urge you to formalize this approach in regulations.

In all, we are encouraged that the regulators have taken significant measures to enhance protections for consumers in credit cards and overdraft protection programs. The proposed rules clearly make the case for regulatory intervention, and we strongly urge you to resist pressure to weaken these much-needed reforms. Industry has done very little to self-regulate in these areas, and we remain concerned that the voluntary improvements in practices recently made by some financial institutions may be short-lived. We anticipate that you will finalize these regulations as quickly as possible.



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