Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

*Re*: *Study of Prescreened Solicitations – Comments of Discover Bank*

*Docket No: OP-1195*

Discover Bank submits these comments in response to the Board's May 24, 2004 Request for Information concerning the study of prescreened solicitations that the Board is conducting pursuant to Section 213(e) of the Fair and Accurate Credit Transactions Act ("FACT Act") (69 Fed. Reg. 29539).

Discover Bank of Greenwood, Delaware, as the sole issuer of the Discover Card, is one of the largest issuers of general purpose credit cards and a major user of prescreened credit offers In fact, the prescreening process is the principal means used by Discover to identify potential Discover Card applicants. The growth of Discover Card could not have occurred without Discover's use, and widespread consumer acceptance, of credit prescreening.[1]

During the past two years, Congressional consideration of amendments to the Fair Credit Reporting Act that resulted in the enactment of the FACT Act provided an opportunity for legislators to consider the impact of credit prescreening and the legal requirements governing it that are codified in the FCRA. Credit prescreening was explored in some detail during hearings on the legislation in testimony by lenders, financial regulators, and consumer groups. We think that this process demonstrated that prescreening is a beneficial practice, that the law governing it has worked well, and that concerns about a link between prescreening and consumer abuses like identity theft are misplaced. Congress did not find it necessary to make significant revisions to the prescreening provisions of the FCRA, electing instead to leave current law and its preemption of state restrictions largely unchanged[2]. We believe that the Board's review of the impact of prescreening on consumers and financial institutions will demonstrate that changes in the law are not needed.

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[1] Our comments address credit prescreening only.

[2] The FACT Act made minor changes to the FCRA prescreening provisions that focus on consumers' understanding of their right to "opt out" of prescreening by contacting the national consumer reporting agencies.

The following are Discover's responses to specific issues on which the Board has requested public comment:

*1. What statutory or voluntary mechanisms are available to consumers to notify lenders and insurance providers that the consumer does not wish to receive prescreened solicitations?*

*Statutory mechanisms.* The statutory mechanism is provided in Sections 604(d) and 615(d) of the FCRA. As amended by Section 213 of the FACT Act, the FCRA requires every prescreened offer of credit to include a "clear and conspicuous" prescreening notification that is "simple and easy to understand." The notification informs the recipient that consumer report information was used to determine the consumer's eligibility for the offer, and that the consumer has the right to "opt out" of receiving future offers through an address or toll free number maintained for that purpose by the major consumer reporting agencies. Consumers may use this mechanism even if they have not yet received a prescreened offer containing opt-out information. Instructions on how to do this are available from consumer organizations, the credit reporting agencies and government agencies.

Another form of statutory relief from unwanted credit offers is provided through the recently implemented National "Do Not Call Registry." Consumers whose telephone numbers are placed on the Registry list can avoid receiving unwanted telephone calls from all commercial entities subject to the FTC and FCC telemarketing rules. This would include calls offering credit products to customers whose names were acquired through prescreening. Nearly 60 million telephone numbers are on the "do not call" registry.[3]

*Voluntary Mechanisms available to non-customers.* The mechanism established under the FCRA, which allows consumers to block prescreened offers from all creditors by making a single toll-free call, makes a creditor-by-creditor opt-out unnecessary. While few consumers have an interest is directly contacting individual credit grantors with whom they do not have a business relationship for the purpose of opting out of future offers, Discover accepts written or telephone requests from persons who do not want to receive communications and will delete the names of such individuals from marketing lists.

In addition, the "mail preference service" offered to consumers by the Direct Marketing Association serves as an effective voluntary mechanism for avoiding prescreened offers sent through the mail. A consumer who places his or her name on the DMA list can avoid receiving unwanted mail – including mail containing prescreened offers - from all marketers who utilize the list. Discover and other major credit grantors screen the prescreened lists they receive from the credit bureaus against the DMA list so that the names of consumers on the DMA mail preference list will not receive mailings. Thus, even consumers who have not availed themselves of

[3] FTC Press Release, March 31, 2004

the prescreening opt out mechanism managed by the consumer reporting agencies will still avoid offers sent through the mail by utilizing the DMA service.

*Voluntary Mechanisms available to existing customers.* Discover and other lenders strive to avoid the expense and customer confusion that would result if prescreened offers were sent to existing customers who already have the credit product that is being promoted in the mailing. Existing customers are excluded from prescreened lists through arrangements with consumer reporting agencies that furnish prescreened lists, or with service providers that assist creditors in making prescreened offers. For example, the prescreening criteria provided to the consumer reporting agencies typically require that existing customers not be included on the lists. In addition, Discover and many other credit grantors allow existing customers to elect not to receive direct mail. Mailing lists used to send promotional materials to existing customers – including prescreened offers for new or additional credit products – are screened to remove such customers' names from the lists.

*2. To what extent are consumers currently using existing statutory and voluntary mechanisms to avoid receiving prescreened solicitations? For example, what percent of consumers (who have files at consumer reporting agencies) opt out of receiving prescreened offers of credit or insurance?*

We believe that relatively few consumers utilize the FCRA mechanism to opt out of prescreening, although Discover does not have information as to the number or percentage of consumers who have done so. (This information may be maintained by the consumer reporting agencies). Indeed, the utility of prescreening would be sharply reduced if large numbers of creditworthy borrowers were to opt out. Similarly, we understand that a relatively small number of consumers opt out of receiving direct mail, including prescreened offers, through the Direct Mail Association Mail Preference List[4]. On the other hand, as noted previously, many millions of consumers have opted out of receiving marketing communications (including prescreened offers) via telephone by enrolling in the National Do Not Call Registry.

We would observe that a failure to "opt out" is not an indication that a consumer is unaware of the right to opt out or of how to effect that right. Every consumer who receives a prescreened offer is notified at that time of the right to opt out of prescreened offers and of the simple means that is available to do so. Consumers who receive multiple prescreened offers receive multiple notices advising them of the availability of the opt out mechanism. Thus, consumers who do not opt out after receiving such notices have presumably made an affirmative decision to remain in the prescreening "pool." In that regard, the rapid and overwhelming response to the Do Not Call Registry is noteworthy. While neither telemarketers nor communications companies were obligated to publicize the availability of the mechanism to avoid

[4] There are reportedly 3.5 million names on the DMA Mail Preference list.

receiving unsolicited telephone solicitations, millions of consumers placed their numbers on the FTC list in just a few months' time. This clearly demonstrates consumers'ability to learn about, and willingness to use, an "opt out" program that addresses a business practice that concerns them. It contrasts with the relatively low levels of participation in the prescreening opt out over the years it has been in existence, and suggests that consumers may understand the benefits and minimal intrusion associated with the receipt of prescreened credit offers.

Moreover, it is important to remember consumers who do not opt out, for whatever reason, suffer no harm. To the contrary, and as discussed in more detail below, we strongly believe that credit prescreening is beneficial to consumers, and that avoiding prescreened offers provides no real benefit to the consumer. Changes in the law or regulatory action that would significantly increase the numbers of consumers who opt out of prescreening would not be in the best interest of consumers.

*3. What are the benefits to consumers of receiving prescreened offers? Please be specific.*

Prescreening provides the best mechanism available for targeting credit offers to customers who may have an interest in the product and who meet the qualifications for the offer. Its principal consumer benefit is that it provides an efficient way for consumers to receive information, at a time that the information may be most useful, about credit products that can lower borrowing costs and provide additional sources of credit to meet personal and family needs. For example, prescreened Discover Card offers allow consumers to reduce credit costs easily by moving high-interest loan balances held by other lenders to lower-rate Discover accounts. Prescreening indirectly reduces consumer credit costs and increases credit availability by lowering lenders' costs of marketing their products. This generates savings that are passed on to consumers in the form of lower credit rates, and that allow credit to be offered to larger numbers of consumers.

Prescreened offers are superior to other forms of credit solicitation in bringing specific information about credit products to consumers who are most likely to utilize the products. In contrast, untargeted solicitations (e.g., television or newspaper ads, "take one" solicitations) and "targeted" offers that are do not utilize consumer report information (e.g., mailings to members of affinity groups or to residents of neighborhoods selected on the basis of demographic information about the area) are less efficient and ultimately more costly. These solicitations invite all recipients to apply for credit. However, many recipients may not have an interest in the product, as when a home equity loan solicitation is sent to an individual who is not a homeowner. Others may already be customers of the lender, and will simply discard the solicitation or question why they are being sent an offer for a product they already have. Still other recipients may not meet the lender's creditworthiness criteria. When individuals in this category respond to the solicitation and a credit check reveals that they do not qualify, the FCRA's adverse action procedures, and the attendant costs, are triggered.

Because prescreening allows credit offers to be targeted based on the likely interest and creditworthiness of a specific individual, it enables lenders to make offers on terms that may be unavailable elsewhere. For example, prescreened credit card offers that carry low interest rates and attractive award features may not be publicized through other channels (e.g., in newspaper ads or on the lender's Web site). If such offers were advertised to the general public, the lender would be exposed to the expense of processing applications, obtaining consumer reports, and sending adverse action notices, to large numbers of unqualified applicants.

Prescreening allows consumers to receive updated information about credit products that may be most attractive to them as they move through different stages of their personal and financial life. A young consumer who opts out of prescreening because he "does not need" an additional credit card will be deprived of information that may be of interest in later years, when he or she may have a full-time job, a new family, a different credit profile, and an interest in additional unsecured credit, an automobile loan or a home mortgage. This individual may not realize that an opt-out decision made years earlier is blocking useful information about financial services appropriate to his or her current financial situation.

Prescreening fosters competition among financial services providers, lowering individual consumers' credit costs and increasing credit availability. Discover Card's own experience is a good example of how this works. When Discover began offering credit cards in 1985, most bankcards carried an annual fee, typically $18, and no reward features. Bankcard users typically held cards that were offered by the local bank where their savings and checking accounts were maintained. Prescreening allowed Discover Card to offer an attractive credit card product – with no annual fee card and the innovative "Cashback Bonus" - to consumers nationwide, lowering millions of consumers' credit costs. Widespread consumer interest in prescreened card offers made Discover one of the nation's the largest credit card lenders within a few years, and set the stage for the nationwide credit card market that exists today.

*4. What significant costs or other adverse effects, if any, do consumers incur as a result of prescreening? Please be specific. For example, to what extent, if any, do prescreened solicitations contribute to identity theft or other fraud? What percent of fraud-related losses are due to identity theft emanating from prescreened solicitations?*

Adverse effects of prescreening are insignificant, if not nonexistent. The consumer can avoid receiving these offers by making a single toll free telephone call. A consumer who elects not to "opt out," but who may not have an interest in a particular offer, can simply discard it. If this is not cost-free, it comes close. Surely, the cost of disposing of an unwanted credit offer is not "significant."

*No abuse of privacy*. It has been suggested that prescreening raises privacy concerns because it allows lenders to look through credit reports of consumers with whom they have no business relationship or consumer consent. But this is based on a misunderstanding of how the prescreening process works and of the protections afforded to consumers under the FCRA.

The prescreening provision of the FCRA does not permit creditors to look at or obtain a copy of consumers' credit reports or to pick and choose among consumers who meet the creditor's criteria for the offering. All that the lender may receive is a list of consumers (excluding, of course, those who have opted out of prescreening) who meet the lender's pre-established credit criteria**.** In addition, the FCRA requires that every consumer who meets the pre-determined credit criteria for the offer receive a "firm offer of credit." [5] This prevents a creditor from obtaining a large number of consumer reports and sifting through them to select a subset of the prescreened group. It guarantees that every individual whose consumer report data was made available to a potential creditor through the prescreening process will be informed of that fact when the offer is made, and given a chance to prevent other creditors from obtaining similar information.

*No Increased Risk of Identity Theft.* Claims that prescreening might expose consumers to the risk of identity theft (e.g., if prescreened offers are stolen from a consumer's mailbox and "accepted" by a thief) are not borne out by the facts. Prescreened offers actually reduce the potential for abuse by identity thieves, and restrictions on prescreening would increase, not reduce, identity theft.[6]

According to the FTC, most identity theft complaints involve access to the victim's identity by a person with a relationship (e.g., family member) or by the theft of identification from the victim's wallet or purse.[7] An individual who intercepts a prescreened credit card application in the mail is likely to be foiled by security protections such as identification confirmation, address matching, and card activation requirements that Discover and other lenders use to insure that cards are issued only to the intended recipient.

The name and address of the consumer are preprinted on prescreened Discover Card applications. The consumer who decides to accept the offer is required to

[5] "The [FCRA] requires a clear connection between the creditor and the consumer before the creditor obtains a consumer report. A firm offer of credit provides this link." *FDIC Financial Institutions letter (FIL –62—91), December 13, 1991.*

[6] A June, 2003 study that explored the purported link between credit prescreening and identity theft found that "information obtained from prescreened solicitations is rarely used to commit identity theft." It concluded that proposals to ban prescreening as a means of stemming identity theft "would likely result in an increase in fraud and identity theft – precisely the opposite of the intended effect." *M. Turner, "The Fair Credit Reporting Act: Access, Efficiency & Opportunity" (Information Policy Institute, 2003), at pp. 61-62.*

[7] GAO Report on Identity Theft, March, 2002 (GAO-02-363), Table 12.

add additional information (such as a Social Security number and date of birth) to the application before returning it. If a potential identity thief intercepts a preapproved offer before it reaches the intended consumer, he would have to cross out the preprinted address and add another address to which he hopes the card will be sent. However, this action is an indication of fraud and would of itself prevent the mailing of a new credit card without additional address verification. The potential thief would also have to furnish the proper Social Security number and birth date. If he cannot guess or obtain this from some other source and furnishes incorrect information, another fraud indication exists which would also prevent the mailing of a new card.

Additionally, Discover's card activation procedures for new cards require the consumer to call a toll-free number to confirm the receipt of the card before using it. If this call is placed from a number other than the one associated with the intended customer's home address, another fraud indicator is triggered.

*Prescreening Does Not Increase Consumers' Debt Burdens*. Finally, some critics of prescreening feel that this method of credit promotion encourages consumers to open accounts they do not need, and exposes them to risks of insolvency. This ignores the fact that lenders have just as great an interest as consumers in preventing over-extensions of credit. Creditors, and unsecured credit card lenders in particular, bear the ultimate loss when loans are not repaid, and have no interest in offering credit to consumers who are unlikely to repay. Regulatory requirements and market forces weigh heavily against the making of improvident loans, and make no exceptions for loans originated through prescreening. .

Prescreening is superior to other forms of credit advertising (that would increase if prescreening were restricted) in reducing the chances that credit will be extended to unqualified individuals. Prescreening helps lenders identify consumers whose prior use of credit indicates that they have the ability and willingness to use credit responsibly. It therefore reduces the instances in which consumers will receive offers for credit products for which they are unqualified or cannot afford.

The fact that some consumers may receive multiple prescreened offers does not support the charge that lenders who make these offers ignore consumers' ability to repay. Underwriting is not based on the *number of offers* that an consumer has received or on the *amount of credit that has been offered* by competing lenders, information that is not available to a creditor who is about to make a prescreened offer. What is of interest to lenders is a consumer's *acceptance and use* of credit offered by others. That information is reflected in the consumer's credit report and it is included in the prescreening criteria used to determine whether the consumer qualifies for additional credit. When consumers accept or use new credit, their credit reports reflect a higher debt load or an increase in unused credit lines. This change in the consumer's creditworthiness and credit capacity will be taken into account as the file is prescreened in the future, and will likely reduce the number of prescreened offers that are made.

*5. What additional restrictions , if any, should be imposed on consumer reporting agencies, lenders, or insurers to restrict the ability of lenders and insurers to provide prescreened solicitations?*

We do not believe that additional restrictions on prescreening are warranted. The consumer protections included in the FCRA (including the FACT Act amendment addressing the consumer notice and opt-out requirement) are fully adequate. They allow any consumer to prevent credit report data from being used in prescreening, and protect consumers who do not opt out by restricting creditor use of consumer information in the prescreening process.

*6. How would these additional restrictions affect the costs consumers pay to obtain credit or insurance, the availability of credit or insurance, consumers' knowledge about new or alternative products or services, the ability of lenders or insurers top compete with one another, and the ability of insurers or lenders to offer creditor insurance products to consumers who have been traditionally underserved?*

We cannot comment on any specific restriction absent information about the details of a proposed restriction. But we believe that virtually any restriction would negatively affect both consumers and lenders.

*Consumer costs*. Prescreening is not an inexpensive process for lenders, but the benefits of using prescreened lists outweigh the costs and allow lenders to pass the savings along to consumers in the form of lower-priced credit products. Prescreening saves the cost of sending information about credit products to consumers who do not need the product or may not qualify for it. It is a more efficient means of finding customers who are likely to actually use the credit that is offered to them and remain long-term customers. Prescreened offers have higher consumer activation rate than applications generated by mass-media advertising, untargeted mailings, or solicitations targeted based on criteria other than the creditworthiness of individual applicants. As a result, the costs of acquiring new (activated) accounts through prescreening are lower than the costs of acquiring accounts through direct mail and telephone campaigns that reach individuals whose creditworthiness has not been evaluated in advance.

Any legal restriction that makes prescreening more expensive to use or results in the exclusion of large numbers of qualified individuals from the pool of potential applicants will increase the cost of reaching new consumers. This in turn would increase the cost that the individual consumer pays for credit and reduce the number of individuals who to whom credit can be offered.

*Credit availability.* Prescreening has increased the amount of credit that is offered and has enlarged the universe of individuals to whom offers are sent. It has allowed credit cards, which were once used principally by affluent borrowers, to become an everyday source of credit for consumers of modest means. Prescreening has also allowed lenders like Discover to offer credit on a regional or nationwide basis, and bring credit opportunities to residents of areas or communities where local resources may be inadequate.

There is no plausible scenario under which restrictions on prescreening could result in the growth of consumer credit availability. Restrictions on credit prescreening would inevitably have a negative impact on credit availability. By forcing lenders to use more expensive and less efficient means of finding and retaining qualified applicants, such restrictions would lead to a reduction in the amount of credit that can be offered. Consumers on the margin are most likely to be impacted adversely by such a reduction.

*Consumer Knowledge.* Prescreening enhances the ability of consumers to learn about products for which they are prequalified and in which they may have an interest. An example is a prescreened balance transfer offer sent to a creditworthy individual with high credit card balances with other lenders, offering an opportunity to move the balances and reduce monthly borrowing costs. Offers like this arrive when the consumer is most likely to have a current need for the product and is most likely to respond. Because prescreened offers can promote the specific credit terms for which the individual recipient qualifies, they inform consumers about best available loan rates and the latest product enhancements, including products or features that may not be promoted to the general public.

Restrictions on prescreening would lead to a reduction in useful consumer information about loan products. Instead of offers for specific loan products at stated terms, consumers would receive more generalized invitations to apply for credit through mass media advertising or other solicitations. They might receive "more" information as the volume of these general promotional materials increased, but not more useful information. In the end, a reduction in prescreened offers would make it more difficult for consumers to learn about the most competitive products available in the marketplace and compare different loan products.

Rather than allowing consumers to compare real offers, restrictions on prescreening would require consumers to shop for credit by submitting loan applications to find those for which they qualify. This would not only be an inconvenience, but could actually impair the consumer's creditworthiness. Credit applications submitted by a consumer are reflected on the consumer's credit report as "inquiries" that may indicate to other creditors an increased level of risk.[8] Prescreening inquiries, on the other hand, though disclosed to consumers who obtain copies of their credit reports, are not reported to other creditors who obtain a consumer report, and do not affect the consumer's credit profile.

*Competition Among Lenders*. As a more cost-efficient means of reaching potential customers, prescreening has greatly enhanced competition among lenders. Prescreening makes it possible to evaluate a consumer's creditworthiness without the need to maintain branch offices or sit across the desk from the individual borrower. This has been instrumental in turning credit card lenders into nationwide competitors and more recently has had the same impact on home mortgage lenders. It has reduced the cost of consumer credit and encouraged the development of better products and enhancements.

Restrictions on prescreening would undoubtedly impair the ability of lenders to compete. It would make it far more expensive for potential competitors to make offers to a lender's existing customers to encourage them to switch banks. Solicitations that today use consumer report information to offer the customer who transfers existing balances a specific interest rate would be replaced with less effective suggestions that the customer submit an application to learn if he or she qualifies for a loan that might be better.

*Credit to Traditionally Underserved Consumers*. Prescreening significantly enhances the ability of lenders to offer credit to this sector. In the first place, prescreening makes it possible to find, and offer credit to, potential customers based on their individual creditworthiness. This enables lenders to avoid decision-making based on broad assumptions inherent in other marketing techniques (e.g., assumptions about residents of particular areas or readers of particular publications) that could exclude creditworthy individuals. Second, the cost savings made possible by prescreening translates into funds that can be used to offer credit to less affluent consumers. With additional money to lend, and lower acquisition costs for new accounts, banks can adjust prescreening criteria so that credit offers can be extended to consumers who, though creditworthy, might otherwise fall below the cut-off point. Finally, as discussed above, by facilitating lending across state lines, prescreening has encouraged competition among lenders and the emergence of new competitors. Healthy competition ensures that lending opportunities are not available solely to the affluent, but increasing flow to underserved groups. In the words of Dr. Michael Turner:

> "Prescreening enables credit issuers to find good risks among underserved populations and to extend credit offers to them in ways that other marketing channels do not. <u>It is likely that prescreening has been one factor responsible for the widened access to credit, and that restricting it would reverse the progress that has been achieved. Further, results from</u>

[8] The Federal Trade Commission has observed that new account applications may be regarded as "inquiries" on the consumer's credit report and adversely impact the consumer's credit score. (Notice of Proposed Rulemaking implementing the FACT Act's identity theft provisions (RIN 3084-AA94)).

our analysis suggests that restrictions in prescreening would affect underserved populations disproportionately." [9]

*Safety and Soundness*. An ancillary benefit of prescreened lending is enhanced safety and soundness of financial institutions. Prescreening fosters portfolio diversification by making it easier to extend credit offers on a multi-state or regional basis. This helps avoids risks that arise when lending is concentrated in a single locality dependent on local economic conditions**.**

In addition, the prescreening process allows the creditworthiness of an applicant to be evaluated twice before credit is extended: once during the process of preparing the prescreened list, and a second time during the post-screening process that is used to confirm that the applicant continues to meet the pre-established credit criteria. Although the time delay is not lengthy, the ability to take a second look reduces the risk of missing changes in an applicant's creditworthiness that might have occurred in the interval between the preparation of the prescreened list and the opening of the account. This opportunity is not available for applications received outside the prescreening process. There, the application is submitted at a time chosen by the consumer, and the decision to extend credit is based on a "snapshot" evaluation using a single credit report. In such cases, subsequent access to the consumer's credit report that could reveal a deterioration in creditworthiness does not occur until after credit has been extended.

Restrictions on prescreening that would increase its cost, limit its use, or significantly reduce the number of consumers to whom prescreened offers can be made could increase institutional risk. Thus, proposed restrictions should be evaluated in light of their potential impact on the safety and soundness of financial institutions and the deposit insurance system.

Discover Bank appreciates the opportunity to comment on the issues affecting credit prescreening. If we can provide further information, please call me at (302) 323-7687 or Ray Messina at (202 654-2060).

Respectfully submitted,

Cathy Roberts
President
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[9] M. Turner, "The Fair Credit Reporting Act: Access, Efficiency & Opportunity (Information Policy Institute, 2003), p.59.