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March 27, 2005

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

Re: Docket No. R-1217
Advanced Notice of Proposed Rule Making on Truth-in-Lending

Dear Ms. Johnson:

Land of Lincoln Legal Assistance Foundation, Inc. is a federally funded legal services provider, serving low income individuals, families, and community groups in 65 counties in southern and central Illinois. I have worked in the East St. Louis office since 1994, primarily representing homeowners threatened with foreclosure. I have handled over 100 Truth-in-Lending claims, and many rescission claims. For five years, I also served as corporate counsel for the largest nonprofit provider of affordable homeownership opportunities in East St. Louis and in that capacity was responsible for ensuring the organization's compliance with Regulation Z. I currently serve as a member of the Consumer Advisory Council of the Board of Governors of the Federal Reserve System.

I hope the Board will use the opportunity of this review of open-end credit to move towards substantive protections for consumers. Since the last review of TILA in the 1980s, the shape and nature of credit has changed dramatically. Credit has become omnipresent in most Americans' lives, of all income levels. At the same time, the substantive protections formerly offered consumers from overreaching and abusive credit have been eliminated, largely through exportation doctrine and increasing federal preemption.

The current disclosure regime does not adequately inform consumers as to the true cost and risk of open ended credit. Surely, finding a method of disclosure that will promote market efficiency, not overwhelm consumers with extraneous or overly detailed information, and provide all required information, will not be easy. But even the needed improvements in disclosure will not level the playing field between consumers and the financial services industry.

Schumer Box/ Standardized Disclosures

The Schumer box has been enormously helpful to consumers in shopping for credit. It is efficient for consumers and issuers to have a standardized disclosure, that discloses the most significant credit terms in a uniform manner.

The great limitation of the Schumer box is that it is not carried through to all stages of the credit card agreement. The Schumer box should be used not only for solicitations, but again for initial disclosures (to check for bait and switch), change of term notices, and on periodic statements, so that consumers can quickly and easily comparison shop their current credit with other offerings. This is particularly true for change of terms notices, which are now (at least judging by my own change of terms notices) difficult to read and harder still to understand the bottom line dollar and cents effect.

Credit card issuers can constantly and unilaterally change the terms of credit. Consumers need to be able to understand how those changes will affect their cost. Consumers need to retain their ability to comparison shop for credit, even after they have obtained credit. The most efficient way to promote that result is by carrying the Schumer box through. The Schumer box should be used at the initial solicitation, for account opening disclosures, on periodic statements, and for change of terms notices. At each stage, it should have the same critical information in the same format.

Disclosure of True Cost of Credit

One of the primary purposes of TILA is to promote efficient markets. There is good evidence that the APR, for all of its limitations, has served as an effective shopping tool. A majority of consumers understand that the APR represents the true cost of credit, even if they do not understand the mathematical alchemy that creates the APR.

As the number of fees charged has increased and the complexity of the various methods of calculating fees has magnified, the need for a one-stop shop that accurately represents the true cost of credit has increased. Consumers need some method of comparing quickly the actual costs of obtaining credit from various sources. Consumers, to shop efficiently, need to know how much the credit will cost, without themselves calculating the statistical probabilities of each fee (particularly since the card issuer can change those statistical probabilities and the amount of the fees constantly with virtually no notice), and how much it has cost, without themselves computing the APR.

For consumers to be able to make efficient decisions about the cost of credit, they need to have their effective APR retained. Consumers need to be able to compare how much the credit is costing them, as well as how much they were promised it would cost. The information that the consumer receives on the periodic statement in conjunction with the effective APR should be improved. Many consumers do not understand the difference between the periodic rate and an effective rate, and that difference could be explained, simply by noting that the effective rate includes fees. Credit card fees now produce significant revenue streams for creditors. Consumers need to have the information necessary to decide if they want to open the account, incur certain charges, or switch to another plan, or use a debit card instead. The effective APR, in conjunction with a broad definition of a finance charge, is critical to achieve the goals of TILA. Simply disclosing the total of fees charged during the billing cycle gives the consumer no sense of the total cost of credit during that period. It is the *combination* of the interest generated by the periodic rate and the finance charges that alerts the consumer to the true cost of the credit. The effective APR most appropriately represents this blend.

Consumers also need a disclosure, prior to account opening, as to the actual average cost of the product being sold. I urge the Board to adopt some disclosure as to the average cost to consumers of the product being offered. An average APR would be extremely helpful to customers in their efforts to comparison shop. The periodic rate does not take into account the effect that fees have on the cost of credit that creditors charge. There is no way for most consumers to measure the tradeoffs between low fees and a higher interest rate because the math is too complicated for most consumers, the late fee and over-limit fees are not finance charges under the present regime, and the actual fee income that this particular card with its particular terms has generated over a period of time is unknown to the consumer. An average APR would look to the actual fee income produced, ad thus give the consumer some of the same information the lender has available to it in making the decision. An average APR will reflect the reality of how much this credit card in fact costs for the average consumer who uses it. With an appropriate explanation accompanying the effective APR, the consumer will easily understand the difference between the periodic rate information and the typical APR. For example, the periodic rate could be listed as "the periodic rate." The typical APR could be listed as: "typical APR including fees."

Providing both the periodic rate and the typical APR at the time of solicitation, application, and account opening would be beneficial to consumers and would fit comfortably within the purposes of the Act.

<u>Treatment of Over-the-Limit Fees as Finance Charges</u>

In keeping with providing a complete disclosure of the cost of credit, I urge the Board to include over the limit fees in the finance charge. Federal banking agencies define over-limit fees as "interest" and therefore, this falls into the statutory definition of a finance charge under 15 U.S.C. § 1605(a)(1).

Moreover, credit card issuers largely control and manipulate the imposition f this fee, in ways often invisible to consumers. Approximately 8 to 10 years ago, VISA and MasterCard began employing electronic authorization on *all* card-based transactions originated in the United States. Thus, authorizations are effectively obtained for *all* such transactions virtually instantaneously. Thus, the card company is in a position to refuse the over limit charge or at the least to notify the consumer that they are over the limit.

In addition, card issuers typically now "pad" the nominal credit limit. For example, a consumer enters into a credit card agreement that specifies a credit limit of $2,000. Usually, after a relatively brief period during which the customer manages the account in an acceptable manner, the *pad* is instituted. The card issuer may increase the *effective* credit limit up to $2,500. The *effective* credit limit has become $2,500, even though the consumer may still believe the credit limit is the *nominal* amount of $2,000. This *effective* credit limit, or "break" point, may vary among customers and even for the same customer over time depending on the customer's standing with the card issuer. While it is certainly good business practice not to refuse minor over limit charges, this manipulation of the effective credit limit is invisible to the consumer and furthers the impression that the card issuer, not the customer, is controlling whether or not a given charge is subject to an "over limit" fee.

Such extensions are *not* 'unilateral' on the part of the consumer. _Rather, they are decisions *effectively made* by the credit card systems and their member banks. The fact that they are effectively made when the system architecture was created, as opposed to being made at the time the particular consumer presents the card to the particular merchant is frankly irrelevant. It is still a determination by the issuing bank to authorize the transaction. As such, any fees imposed by the issuing banks for exceeding the *nominal* credit limit are "imposed" when they are assessed against the consumer's account, *i.e.*, when the consumer becomes liable for their payment.

Based on this analysis, such extensions are now effectively made pursuant to individualized, conscious determinations by issuers.

For these reasons, over-limit fees are finance charges because they meet the definition in the Act as they are imposed on the consumer directly by the creditor and are payable by the consumer as incident to the extension of credit. Furthermore, fees imposed for exceeding the credit limit in each month in which the consumer does not bring the account balance below the agreed upon credit limit should be considered finance charges as well. Since the creditor, not the consumer, controls and decides whether or not to permit over the limit charges to occur, these fees are not akin to late fees or other charges imposed because the consumer unilaterally breaches the agreement. Nor is there any evidence that treating these charges as finance charges will harm the solvency of the card issuers.

<u>Tolerate No Tolerances</u>

Question 37 asks whether the Board should adopt tolerances for open-end credit disclosures under § 1631(d). This section allows the Board to establish tolerances for numerical disclosures other than the annual percentage rate if tolerances "are necessary to facilitate compliance" with the TILA.

Tolerances are unnecessary because of the nature of open-end credit disclosures. The initial disclosures primarily set forth the rules of the account. These disclosures require no difficult mathematical calculations. Asking the creditor to disclose its own rules accurately is a simple matter. There can be no credible claim that allowing inaccuracy in these initial disclosures is necessary to facilitate compliance. To the contrary, allowing inaccuracies in the initial disclosures would encourage bait-and-switch tactics, already a serious problem in the credit card industry.

Likewise, the numerical disclosures on the periodic statement require no complicated mathematical calculations. By the time the periodic statement is issued, the transactions reflected on it have already occurred, and the creditor is asking the consumer to pay the amounts shown. Creditors cannot claim that it is necessary to disclose imprecise amounts when they have kept track of the exact amounts for their own purposes and are asking the consumer to pay those amounts.

The Board asks in particular whether it should allow an overstatement of the finance charge. The answer is unequivocally "no." First, there no showing that such a tolerance is necessary. Since all the events and transactions on which the finance charge is based have already occurred by the time the creditor sends the periodic statement, and since the creditor is billing the consumer for the finance charge, it cannot be difficult for creditors to state the amount of the finance charge. If creditors claim that the problem is determining whether a particular charge is a finance charge, that is simply another reason to adopt bright-line rules for the finance charge.

Adjustment of Statutory Amounts

Question 53 asks whether the Board should adjust certain exceptions to Regulation Z that are based on de minimis amounts. Adjustment of these de minimis amounts is appropriate, but the Board should seek Congressional authority to adjust the TILA's other numerical thresholds.

In the ANPR, the Board mentions two de minimis amounts. First, Reg. Z § 226.5(b)(2)(i) allows a creditor not to send a periodic statement if the outstanding debit or credit balance is $1.00 or less and no finance charge is imposed. The $1.00 figure has been in effect since Regulation Z was adopted in 1969. Updating the $1.00 figure to account for inflation is justified. According to the Department of Labor's cost of living calculator at www.bls.gov, if this figure were increased to $5.15 it would equal the same purchasing power as $1.00 in 1969. (Whether or not the amount is increased, the Regulation should be revised to make clear that the creditor can dispense with the periodic statment only if nonpayment carries no negative consequences to the consumer, including not just finance charges but also late charges and negative credit reports.)

The second de minimis amount that the Board mentions is the simplified way to calculate the effective APR on periodic statements when a minimum finance charge is assessed that is 50 cents or less. The 50 cent figure has also been in effect since 1969, and should also be updated. Increasing it to $2.50 or $3.00 would take inflation since 1969 into account.

Far more important, however, is updating both the TILA's jurisdictional amounts for non-mortgage transactions and the statutory damage amounts . The Act currently only covers non-mortgage transactions in which the total amount financed exceeds $25,000. This limit leaves a significant number of consumer car sales and leases without even the disclosure protections of the TILA and Consumer Leasing Act. The erosion of these amounts due to inflation significantly undermines the Truth in Lending Act. According to the Department of Labor's cost of living calculator, the purchasing power of $25,000 had eroded to $4857.10 in 1969 dollars by 2004. When the exception for transactions over $25,000 was adopted in 1969, it excluded only a few very high-end consumer transactions. Increasing this figure to $128,678 would account for inflation only through 2004.

Likewise, the $1000 statutory damage figure adopted in 1969 is now the equivalent of just $194.28. Increasing it to $5147.14 would account for inflation only through 2004. It should be increased to at least $10,000 to take future inflation into account.

Conclusion

I appreciate the opportunity to comment on the Advanced Notice of Public Rulemaking and look forward to seeing the proposed rule. The Board and staff have a difficult task before them as they review the entire field of open end credit. I hope the Board will seek to promote both efficiency and transparency.

Sincerely,
/s Diane E. Thompson