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By electronic delivery

Ms. Jennifer J. Johnson,
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
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Truth in Lending
Regulation Z
Advance Notice of Proposed Rulemaking
Docket No. R1217
Federal Register

The American Bankers Association ("ABA") is pleased to submit our comments to the Federal Reserve Board's request for comment on an advance notice of proposed rulemaking ("ANPR") to begin a review of open-end credit rules of the Board's Regulation Z, which implements the Truth in Lending Act ("TILA"). The ANPR seeks comment on a variety of specific issues relating to three broad categories: the format of the open-end credit disclosures, the content of the disclosures, and the substantive protections provided under the regulation. The Board invites comment on other issues that the Board should consider addressing.

The American Bankers Association, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership--which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks--makes ABA the largest banking trade association in the country.

General comments.

1. ***The open-end credit disclosure scheme of Regulation Z is generally sound.*** ABA believes that overall, the basic approach of the disclosures required for open-end credit works well. While some disclosures requirement provisions need updating and revising, it is not necessary or desirable to dismantle or replace them.

2. ***The Board should also use other mechanisms besides Regulation Z to address open-end credit issues.*** For example, the Board should consider improving consumer understanding of credit terms through education. Board guidance and best practices, after public comment, should be used to address issues related to industry practices.

3. ***Disclosures should be reviewed with an eye toward making them more concise, readable, and understandable.*** For "summary" disclosures such as those required on open-end solicitations, disclosures that are not relevant for most consumers should be eliminated. Summary disclosures should avoid information overload and limit disclosures to those ***most*** consumers will find ***most important.*** In making revisions, the Board should recognize that there is no "typical" borrower or account holder, particularly for credit cards, and the summary disclosures should not strive to provide a ***comprehensive*** notice of ***all*** terms. Summary disclosures should advise consumers to review the agreement for additional, important information.

4. ***The Board should consider model terminology to promote uniformity and consistency, and for solicitations and initial disclosures, uniform formatting in summary disclosures.*** Consumers will be more likely to use and understand disclosures if terminology is consistent and, for summary disclosures, formatting is uniform. However, it is important to provide sufficient flexibility in terminology and formatting to permit innovation and competition, especially for periodic statements.

5. ***The Board should develop a Credit Card Users' Manual or Credit Card Instruction Manual to assist consumers in understanding credit cards and credit card offers.*** Such a document would complement specific product disclosures to improve consumers' understanding of credit card practices and pricing generally. Shifting the explanations about common credit card features, fees, and practices would help ensure that the product-specific disclosures remain concise, readable, and easily understood. A glossary could include detailed explanations of terms that are inappropriate and not useful when included with a solicitation or other summary disclosure. This includes, for example, explanations about balance computation methods and grace periods, the APR, and how fees may impact the APR. The manual should be available from federal agencies, such as the Board, by mail, phone, and internet. The regulation should not require that creditors distribute the material: information will appear more objective and official and be more likely to be read if it is obtained from a federal agency; if provided by creditors, households will be inundated with manuals, and more likely to

throw out the information. Moreover, distribution by creditors will add significant costs for little gain.

6. ***The Board should use focus groups as a resource to determine which terms should be disclosed and how they should be disclosed.*** Focus groups may be useful for gaining insight into what consumers will find most valuable and useful. However, to be useful and usable, the focus groups must be carefully designed and managed. Too often, consumers may claim that they would like additional and complete information, but in fact, are unlikely to read it or use it. It is critical to perform tests so that the program measures what consumers actually do, not what they think they did or are likely to do.

Responses to specific questions.

Q2 and Q3 Formats: Initial disclosures.

The Board has asked about formatting rules that would enhance consumers' ability to notice and understand account opening disclosures. For credit cards, we believe that some kind of summary, similar to the table required for credit card solicitations, might be appropriate for the initial disclosures to enhance consumer understanding and serve as a later reference. The model used for solicitations seems to work well; consumers read it. However, it is critical that the summary be limited to those terms that ***most*** people would be interested in, recognizing that there may be some terms that only a minority of people would find most important. Otherwise, the disclosures will not be used or useful. The cost of making the changes will not be justified. The disclosures should also advise consumers to review other important information not contained in the summary.

There should also be some flexibility so that creditors may incorporate terms elsewhere in the disclosures to ensure that the overall disclosures are rational and predictable for the customer and are not overly repetitive.

Any font requirements for the summary should be considered carefully. They add costs to disclosures and reduce flexibility, but may not be effective: for example, critics have charged that default rates are disclosed in the fine print, when, in fact, pursuant to the Commentary, they are typically disclosed in 10 or 12 point font clearly and conspicuously. The Board should also be sensitive to state laws that may require other disclosures to be prominent that could create compliance challenges, ambiguity, and liability risks.

We do not recommend any special summaries for home equity lines of credit ("HELOCs"). The current disclosures, a result of extensive Congressional and regulatory debate, work well. There are few, if any, complaints about these disclosures or of consumer understanding of the terms of HELOCs, despite their immense popularity.

Q4 – Q6 Formats: Periodic statements.

The Board notes that there are few formatting disclosures for periodic statements and seeks comment on whether there should be. We strongly discourage the Board from imposing formatting requirements on periodic statements.

First, the current rules work well, with important terms highlighted. There are few complaints that customers do not understand their periodic statements or overlook important information, whether it is for understanding how they have used their account or deciding how to use it in the future.

Second, card issuers compete by differentiating the format of their statements to appeal to particular audiences. The formatting can be tailored for individual customers and products. For example, a "family plan" might segregate transactions in a certain fashion. Other plans might segregate information by the type of transaction to appeal to those who might be interested in using it as a budget or record-keeping tool. Imposing a "one-size-fits-all in this case, would chill innovation and restrict issuers' ability to respond to customer demand.

Finally, it would be very expensive to impose formatting requirements on periodic statements. Unlike other disclosures, which are static, periodic statements are dynamic, changing each month. Thus, the software systems, often proprietary, are necessarily more sophisticated and expensive. Formatting requirements would require expensive new systems and new forms.

The Board has also asked whether the cost of credit could be more effectively presented on periodic statements if less emphasis were placed on how fees are labeled and all fees were grouped together on the periodic statement. We oppose grouping fees together. Modifications to segregate charges would be significant, but would only provide marginal benefits to a few.

There is no evidence that lumping fees together or providing a sum of the fees further enlightens consumers about their costs. The fees are already disclosed along with other information, such as transaction charges, that are at least if not more important and are therefore reviewed. Any "shock value" is minimal because a review of charges to the account already readily reveals to the reader any multiple fees. Moreover, few would be affected: only a small percentage of customers incur multiple fees in a statement period. The cost does not justify any minimal and speculative benefit. In addition, as discussed above, banks compete by differentiating their periodic statement formats. Imposing rigid formatting rules that will affect few will constrain issuers' efforts to provide innovative features attractive to their customers. Finally, the effort should be toward limiting disclosures to those relevant to most consumers. Otherwise, the disclosures risk overwhelming consumers and discouraging them from reviewing important information.

Q7 – Q8 Credit card application disclosures (solicitation box).

The Board asks whether it should change the disclosures for credit card solicitations and applications, including those presented in tabular or boxed format. We believe that generally, the format required for credit card solicitation disclosures, including the solicitation box, works well. Disclosures are limited and segregated so as to ensure that consumers are aware of the information most important in shopping and applying for credit. It essentially provides the equivalent of the food nutrition pyramid.

It is critical that terms disclosed in solicitations and in the box be limited to those that are ***most important and relevant*** to ***most*** people. Congress, before passing the Fair Credit and Charge Card Disclosure Act in 1988, considered requiring that comprehensive disclosures, such as the initial disclosure, be included with solicitations. ABA supported disclosure, but strongly advocated limiting the information to the most important terms. Congress ultimately rejected the comprehensive disclosures for the shorter form. It is vital that the Board retain this concept, which we believe it has historically tried to do.

Before revising, it should be recognized that the solicitation disclosures should not contain terms or fees that may be important to a few people. Otherwise, the notice will invariably become cluttered. Consumers will become distracted, overlook important information, or ignore the notice altogether, intimidated and discouraged by its length and complexity.

Properly conducted focus groups could help identify which other terms should be removed and which added. In any case, disclosures should not be added unless the same number is removed.

One item we suggest the Board consider eliminating is the minimum finance charge, which must be disclosed in the solicitation box. Yet, the minimum finance charge is typically so small (50 cents) so as to be irrelevant to consumers. It should be removed unless the minimum finance charge is a significant amount.

The Board asks whether balance transfer fees should be required to be disclosed inside the solicitation box. Currently, creditors have the choice to disclose them inside the box or clearly and conspicuously elsewhere on or with the application. Most card issuers today include them inside the box. In the interest of uniformity that will make the disclosures more familiar and predictable for consumers, we recommend that the regulation require that they be inside the solicitation box.

Q10 – 12 Model forms and clauses.

The Board asks whether existing model clauses and forms can be improved and whether additional model clauses and forms would be helpful. We encourage the Board to selectively provide model terms and definitions that creditors may use which may assist consumers in better understanding credit card terms and in evaluating credit card products. For example, card issuers typically use the term "default" rate to refer to a rate increase triggered by certain behavior, such as a late payment. The dictionary supports this meaning of the term default. However, many consumers might consider "default" to be something more than a late payment, perhaps a more persistent and committed failure to pay, and would therefore overlook information labeled as such, thinking it irrelevant to them. The terms could also be explained in the Credit Card Users' Manual.

Q13 – Q20 Rules for classifying and labeling fees as "finance charges" and "other charges."

In reviewing Regulation Z, the Board plans to consider whether there are ways to provide more clarity for creditors as to how particular fees should be classified. Specifically, it requests comment on how to clarify the basis for determining whether a fee is a finance charge or other charge for open-end credit plans. The classification is important as it determines whether the fee is included in the annual percentage rate ("APR") calculation and determines how it is disclosed.

Q14 The Board asks how consumers learn about fees that will be imposed in connection with services related to an open-end account, and any changes in the applicable fees. Fees classified as finance charges or "other charges" are disclosed as required, in the initial disclosures and periodic statements, as appropriate, as well in change in term notices.

If a fee is not a finance charge or "other charge," e.g. an expedited card delivery charge, research fee, statement, copy fee, under the regulation, as the Board notes, it does not have to be disclosed in the initial disclosures. Banks typically inform consumers orally of these fees when the consumer makes the request for the service. This is the "teachable" moment and the most convenient way for the consumer to learn of the fee. Rather than trying to locate the agreement and, in the agreement, the particular fee, consumers learn of the fee at the actual time they are considering whether to use the service. The fees are again disclosed in the periodic statement. Some issuers include some of these fees in the cardholder agreement.

It would be inappropriate to require inclusion of these optional fees in the initial agreement because it is not always possible to anticipate customer requests and new services in advance. Moreover, requiring a change in term notice would inhibit creditors from responding to customer requests and adding new, attractive services.

Q15 The Board also asks what significance consumers attach to the label "finance charge," as opposed to "fee" or "charge." In the open-end credit environment, we submit that consumers very clearly understand "fee," or "charge." Qualifying fees not currently classified as finance charges as finance charges would more likely confuse consumers than enlighten them, if past behavior is a predictor. In the current environment, occasions when non-interest charges are added to the APR or finance charge prompt calls to customer service for explanations because consumers do not understand. Explanations appear to do little to enlighten them.

Q16 The Board notes that the industry has in the past argued that the test for whether a fee is a finance charge should be whether the fee is required. (See attached: letters from ABA on 9 January 2002 to Governor Gramlich, on 18 September 2000 to Dolores Smith and Adrienne Hurt, and on 22 January 2003 re Docket No. R-1136) In brief, we believe that the critical test for determining whether a fee is a finance charge is whether the fee is required by the creditor in connection with the extension of credit. The Board asks how creditors would determine if a particular fee is optional. We suggest that the Board take the approach that a fee is "optional" if it is a fee for an optional service that is not integral to the credit plan. A fee for an optional service that is integral to the credit plan is not optional if there is no reasonable alternative. Thus, if a creditor were to impose a fee for paying by any means other than by internet, the fee would not be considered optional. This is consistent with the Board's recent amendments to the Commentary to Section 226.6(b) regarding, for example, classification of fees for making single payments as "not other charges."

In the alternative, for open-end credit, the Board should consider eliminating all non-interest charges from the finance charge and simply treat non-interest fees separately. Simply put, the historical APR does not work for short term loans because it inflates APRs in a manner that puzzles and misleads consumers. Based on calls to customer service, it is clear that, even after an explanation, consumers simply do not understand the historical APR, which can vary wildly based on a single, one-time fee that is conspicuously disclosed elsewhere. Thus, we do not believe that consumer education will resolve the confusion. These spikes distort and mislead consumers who may erroneously conclude that they should choose another plan. For example, because of a single fee and a low balance, customers in a given month, may see a triple digit APR instead of the usual contractual rate. They may conclude that they should close their 14% APR card and instead opt for a 21% APR card. Thus, rather than assisting consumers in comparing credit cost and shopping for credit as the Truth in Lending Act is intended to, the historical APR can harm consumers.

The spikes and unpredictability of the historical APR may also lower the value of the APR generally and cause more serious harm as consumers become less certain about its meaning and how they should use it. They are less likely to use it for important loans, such as mortgages and car loans, if they are unsure of its significance.

In any case, the test should not be, as the Board inquires, whether a consumer was offered a "plan without that feature." It is not clear how this would work. Would creditors have to disclose all optional fees and then allow the consumers to choose among a menu and then notify the creditor? Once consumers have made a choice, can they change it? We also do not see how such a test would assist consumers in comparing plans as many of the services and fees at issue are not fees on which consumers typically base their credit card choice.

Q18 The Board asks about other fees that are not finance charges that must be disclosed at account opening, on applicable statements, and in some instances, on change in term notices. The Commentary interprets the rule as applying to "significant" charges. The Board asks whether this interpretation has been effective in furthering the purposes of the statute.

We do not believe that the standard offers much clarity or useful guidance. However, we also do not believe that additional criteria for judgment, e.g. the frequency with which a consumer is likely to incur the charge, the proportion of consumers likely to incur the charge, etc. will offer a workable solution. Such an approach will require uncertain predictions based on expensive analysis of possible customer behavior that may change, even over a short period. In addition, if customer behavior does change, must the creditor then alter its systems and disclosures?

Rather than another subjective test, the Board should consider identifying and classifying existing fees and provide examples, as appropriate. Moving forward, fees for new services would not be considered significant charges until the Board or staff classified them as such, which it could accomplish in less than a year by amending the Commentary. Thus, any uncertainty would be brief.

Q19 The Board asks whether HELOCs present any unique issues. We are not aware of any at this time.

Q20 The Board has asked how important it is that the rules used to classify fees for open-end accounts mirror the classification for rules for closed-end loans. It notes that in a 1998 report to the Congress concerning reform of close-end mortgage disclosure, the Board endorsed an approach that would include "all required fees" in the finance charge and APR.

The APR calculations for closed-end and open-end credit should not be the same. While it may be appropriate and workable to add certain fees to the finance charge for closed-end credit, as explained in our response to question 16, adding those fees to the APR calculation for open-end credit distorts and dilutes the value of APR. Ultimately, doing so thwarts the goals of Truth in Lending.

Moreover, as the study makes clear, it focused on closed-end mortgages: page 1 of the executive summary states:

> The report discusses various ways of streamlining and simplifying the current statutory requirements for ***mortgage loans***, to provide consumer with more meaningful cost information about ***home-secured transactions*** and to make compliance easier for creditors. (Emphasis added.)

The footnote further clarifies:

> ***This report focuses on closed-end mortgage loans***, whether first or subordinate liens. The impact of reform could be much broader. For example, TILA and RESPA also address home-secured open-end credit plans. Further, any revisions to TILA, whether adjusting the component of the finance charge or eliminating other disclosures could affect all credit transactions. (Emphasis added.)

Thus, it seems, the Board's recommendation was intended for closed-end mortgage loans.

Q21-- Q22 Over the limit fees.

The Board describes concerns about some card issuer's practices of allowing consumer to remain over the credit limit for multiple billing cycles. As a result, the creditor may impose an over-the-credit-limit fee on a continuing basis for each month the consumer carries a balance over the limit. The Board asks whether there is need for guidance with respect to whether over-the-limit fees are finance charges when the creditor does not require the consumer to bring the account below the original limit, but imposes an over-the-limit fee each month.

We advise the Board not to create a confusing distinction between over-the-limit fees that are finance charges and those that are not. Consumers will not understand why an over-the-limit fee is sometimes disclosed as a finance charge and sometimes not. Moreover, treating over-the-limit fees differently will create operational and compliance burdens, especially as it is not intuitive to make such a distinction.

Over-the-limit fees should not be classified as finance charges under any circumstances. Consumers understand very well fees expressed as single, dollar figures contained in periodic statements. Moreover, to include over-the-limit fees in the APR calculation, as explained in the response to question 16, only distorts the APR and confuses and potentially misleads consumers.

The Board also asks about when over-the-limit fees are assessed and whether disclosures can be improved. Card issuers inform consumers about over-the-limit fees in solicitations, initial disclosures, and periodic statements when charged. It is not feasible, as the Board observes, to advise consumers at the time of a transaction, that that transaction will cause the customer to exceed the limit.

First, because of technical limitations, neither the credit issuer nor the merchant may know whether an authorized transaction will cause an account to exceed its credit limit. Transactions are not real-time. At the time of a particular transaction, other, earlier transactions may have not yet posted. Some merchants do not seek authorization or process the transaction online. There may be intervening transactions, such as an automatic periodic payment. In addition, merchants such as hotels and car rental agencies may have requested an authorization amount that exceeds the amount of the actual transaction, temporarily inflating the balance. For these reasons, many banks create a "cushion" in deciding whether a balance has exceeded the limit. Card issuers also, as a matter of competition and good service, monitor customer habits and increase limits based on customer need and eligibility.

Second, even if feasible to know in each case whether the transaction will cause the limit to be exceeded, most consumers prefer that the transaction be approved. They wish to avoid the embarrassment of having the transaction denied at the counter, especially after a frustrating wait in a crowded store, for example, and of the merchant knowing that they have exceeded their limit.

We believe that over-the-limit fees are adequately disclosed. A lengthy explanation of how over-the-limit fees work will only clutter the disclosures and distract consumers from more important terms. Concerns that consumers do not understand when an over-the-limit fee is imposed or its impact on the cost of an account should instead be addressed by education, for example, by inclusion in the Credit Card Users' manual we have suggested. The manual could explain how a transaction may cause customers to exceed the limit even if the transaction is approved.

Q23 – 25 Use of historical APR disclosed on the periodic statement.

The Board asks how consumers use the historical APR disclosed on periodic statements. As explained in Q16, we believe that the historical APR, when it differs from the contractual APR only confuses consumers. Creditor explanations to customer inquiries fail to further enlighten them. (See response to Q16.) Adding to the periodic statement an explanation about the vagaries of the historical APR will achieve little except to distract consumers from more relevant information. If the concept of the historical APR is retained, it should be explained in the recommended Credit Card Users' Manual and other educational materials.

We also do not believe that a periodic or year-to-date summary of the total dollar amount of all account-related fees assessed during the billing cycle or the total dollar amount of fees by type is warranted.

As explained in the responses to Q4 – Q6, there is no evidence that lumping fees together or providing a sum of the fees further enlightens consumers about their costs, whether on a periodic basis or year-to-date basis. The fees are already disclosed along with other information, such as transaction charges, that are at least if not more important and are therefore reviewed. Any "shock value" is minimal because a review of charges to the account already readily reveals to the reader any multiple fees. Moreover, few would be affected: only a small percentage of customers incur multiple fees that might amount to a significant figure. The cost does not justify any minimal and speculative benefit. Finally, we strongly believe that it is critical to keep disclosures manageable so that consumers will understand and read them. Adding information that may be relevant only to a small number of people will obscure important information relevant to the majority of consumers and discourage consumers from reviewing important information.

Q26 – Q27 Disclosures about rate changes.

The Board asks whether mailing a notice 15 days before the effective date of a change in interest rate is adequate to provide timely notice to consumers. As a practical matter, consumers receive notices earlier than 15 days prior to the interest rate change because the notices are typically sent with the periodic statement in order to minimize costs. The rate change does not take effect until some time after the next billing period. Requiring that it be provided earlier will create operational problems because which consumers are subject to the change may change over a period longer than 30 days. In addition, consumers already have options if they are dissatisfied with the new terms: most issuers, pursuant to state laws, will allow cardholders to close the account and pay off the balance at the existing rate and pursuant to the terms of the original agreement.

The Board has also asked for comment about default rates, that is, rate increases triggered by certain behavior such as late payments. Card issuers in recent years have used predictive models that help them to price credit card accounts based on risk, both for new and existing accounts. Late payments on other accounts and other negative information have been proved to be a precursor to a default on the account. Accordingly, default rate systems and policies have been designed to identify those who pose a significant risk of default.

The practice began a number of years ago when customers who had never been late paying on a credit card account, would suddenly file bankruptcy, often after just having reached the credit limit. Card issuers were suffering significant losses because they were only considering the payment history on their own account: they were not looking at the broader picture of the customer's financial situation, which would better predict whether the cardholder might default. Accordingly, they began to review credit reports and develop predictive models on that basis and adjust prices accordingly.

These models are increasingly sophisticated to identify those customers who are most likely to default. Card issuers generally do not increase rates based on a single transgression. Rather, they are designed to identify those who habitually do not comply with the agreement and pose a significant risk of default.

Rate increases triggered by defaults are reflected in the APR and periodic rate disclosures contained in the periodic statement. Most card issuers, when explaining default rates in the solicitation or initial disclosures often disclose that any late payment (or other explained behavior) may trigger the default rate. In fact, however, a single transgression will usually not trigger the penalty rate. Systems and policies take into account that good customers may occasionally be late or go over the limit, for example. Card issuers do not want to alienate those customers.

Q28 – Q30 Balance calculation methods.

The Board asks how significantly the balance calculation method affects the cost of credit "given the typical account use patterns." As noted earlier "the typical account use patterns" do not exist. Consumer behavior varies widely, as do credit card products. For this reason, it would not be feasible or meaningful to provide a sample disclosure that would apply to a significant percentage of credit card customers.

For a large percentage of customers who always pay their balance in full each month and do not take cash advances, the balance calculation method is largely irrelevant; they enjoy an interest-free loan for a month or more. For those who choose not to take advantage of the interest-free loan, that is, who revolve routinely or occasionally, the impact of the balance calculation method will depend on several variables, including whether the balance is composed of balance transfers, cash advances, or purchases, the amount of the balance, the interest rate, the amount and timing of transactions, cash-back and other features, and whether and how often the balance is paid in full. When an account is not paid in full, interest is usually charged from the date of the transaction, that is, from the date of the loan.

If there is to be a misunderstanding about balance calculation methods, it is most likely to be the first time that a customer who usually pays in full decides to only make a partial payment. The first time they move from being a nonrevolver to a revolver, having overlooked or forgotten the original disclosure, they may be unaware that they lose the interest-free loan or grace period from a prior period. However, if they were unaware, after one experience, they are now informed.

Initial disclosures must already provide an explanation of the balance computation method. We do not believe that adding an explanation, even if brief, to the solicitation disclosures or to the periodic statement will enhance consumers' awareness or understanding of its impact. Adding it to the periodic statement will unnecessarily crowd the periodic statement, which already must contain a large amount of important information. Adding an explanation to the solicitation disclosures will distract consumers from the more relevant information. Rather, if information about balance calculation methods and how they impact cardholders is needed, it should be provided in the Credit Card Users' Manual along with other general information that focuses on the big picture.

Q31 – 33 Disclosing Effects of Minimum Payments.

The Board requests comment about whether Regulation Z should be amended to require periodic statement disclosures about the effects of making only the minimum payment. It references bankruptcy reform bills currently before Congress that would require creditors to provide standardized examples of the time it would take to pay off an assumed balance if the consumer makes only the minimum payment. The bills would allow consumers to obtain an estimate of how long it would take to pay their actual account balance by calling a toll-free telephone number established by the creditor.

As the Board notes, the industry has disagreed with such proposals. First, they would be largely ineffective. They assume that the consumer will discontinue using the account for new transactions. Second, the information would affect only a small percentage of customers who persistently only make the minimum payment. However, the cost of a system to be able to provide the information on a personalized level, regardless of whether the system is actually used, is significant because it would have to take into account the specific account terms and facts of the individual case.

To the degree that minimum payment information is useful, it should be provided with the general information of a Credit Card Users' Manual rather than with the specific disclosures. Otherwise, the information will obscure the important information that is relevant to most people.

Q34 – Q36 Payment allocation.

Noting how payment allocation can affect consumers' cost on open-end credit and that Regulation Z does not require disclosure of how payments are allocated, the Board asks about industry payment allocation practices and whether Regulation Z should be amended to require its disclosures.

Actual allocation practices are very complicated and involve numerous variables. Payment allocation is complicated because payments can be assigned by percentage to different categories: purchase balance, cash advance balance, transfer balances. There can also be tiers even within those categories. Many creditors will disclose a simple explanation, such as "high to low," giving the worst case scenario, but even those disclosures may be vulnerable to litigation because of exceptions.

We strongly recommend that Regulation Z not require new disclosures. Rather, a Credit Card Users' Manual could explain in plain language common practices, the potential impact on consumers' costs, and what consumers should look for. Issues with specific practices or disclosures related to payment allocation should be addressed through agency "best practices" or guidelines such as those the Office of Comptroller of the Currency released last year.

Q37 Tolerances

The Board asks whether it should expressly permit an overstatement of the finance charge on open-end credit. We believe that it should as it will make compliance easier and reduce potential litigation for harmless and good faith mistakes.

Q38 – 51 Other questions regarding the content of disclosures.

Q38 Costs and benefits of the proposed revisions.

The Board asks for cost estimates of the various proposals. We have included comments about costs in our responses to the specific questions. Costs include, not just the initial cost of reviewing the new requirements and altering disclosures, but also the initial and continuing costs related to educating staff, modifying staff education materials, auditing for compliance, and responding to bank examiner inquiries. Specific cost estimates are difficult to provide at this time for a number of reasons: 1) the general nature of the inquiry and proposals; 2) unknown critical elements and variables, 3) the cost of diverting valuable resources to conduct a detailed and thorough analysis of potential costs of a potential requirement

Q39 Special types of open-end credit accounts.

The Board asks whether there are particular types of open-end credit accounts, such as subprime or secured credit card accounts that warrant special disclosure rules to ensure that consumers have adequate information about these products. We do not believe that special disclosures are warranted. Rather, if issues are identified with these products, they should be addressed through Board guidelines or "best practices."

Q40 Other disclosures.

The Board asks whether the information currently provided with credit card applications and solicitations is adequate and effective to assist consumers in deciding whether or not to apply for an account. As noted throughout our responses, we believe that the information provided in applications and solicitations should be limited to specific account information that is most important to most consumers to ensure that consumers will read and understand the most important terms. Lengthy explanations and general information should be available through a Credit Card Users' Manual to be available from federal agencies such as the Board.

Q42 Wavier for certain borrowers whose income and assets exceed the specified amounts.

The Board asks whether it should provide a waiver for certain borrowers whose income and assets exceed the specified amounts. This provision was intended to respond to wealthy bank customers who wish to take advantage of the tax deductibility of home equity loans, but avoid the inconveniences of signing disclosures and waiting for the end of the rescission period to obtain funds. In addition, loans to high net-worth customers are often handled by a different part of the bank that is unaccustomed to and unfamiliar with Regulation Z. We believe that the Board should explore the possibility of allowing waivers for these sophisticated individuals.

Q43 Substantive provisions.

The Board solicits comment on whether there is a need to modify the substantive protections afforded consumers under Regulation Z, specifically, the provisions dealing with billing error resolution, merchant disputes, consumer liability for unauthorized transactions, card issuance, and prompt payment.

Overall, the consumer protections of TILA are extremely generous to consumers and allow card issuers little discretion or ability to prevent abusive exercise of these rights, for example, false claims that transactions were not authorized. A common complaint from card issuers involves situations where a family member or friend who was given the card and authorized to use it, exceeded the authority, either at the time of transaction or subsequently. In these cases, the card holder can make a claim and not be held liable.

We suggest that the Board consider adopting a provision similar to the one in Regulation E (Electronic Fund Transfer Act). Under the Comment 2 to Section 202.2(m) of Regulation E:

> If a consumer furnishers an access device and grants authority to make transfers to a person (such as a family member or co-worker) who exceeds the authority given, the consumer is fully liable for the transfers unless the consumer has notified the financial institution that transfers by that person are no longer authorized.

A similar provision for credit cards could be limited to those circumstances where the card is present at the transaction and a signature or personal identification number or similar security code is used.

Q44 Accessing Credit Cards.

The Board notes that credit card accounts are increasingly accessed using simply the account numbers, for example, in making purchases over the internet or by telephone. It asks whether industry is developing open-end credit plans that allow consumers to conduct transactions using only account numbers.

At this time, we are not aware of plans to provide an account without issuing a card or other physical device and do not anticipate that there will be any such plans in the near future. Transactions where the card is present are far more secure and less likely to be fraudulent than those where only the account number, coupled with other information, is used. The physical card, along with various and ever-evolving security mechanisms, offer some certainty to the card issuers and the merchant that the person making the transaction is the account holder or authorized user. For these reasons, we doubt that the industry would abandon those protections. Moreover, in order to use the account, account holders still need information about the account that they can carry with them. Carrying the information on the card is most convenient and familiar. Finally, the marketing value and reinforcement of the brand offered by the physical card also makes card issuers unlikely to discard the card.

Q45 Convenience checks.

The Board notes that convenience checks are not treated as credit cards under Regulation Z and subject to the protections regarding unauthorized use of the account, merchant disputes, and prohibition against unsolicited issuance. It asks whether these protections should be extended to convenience check transactions.

We are aware of few consumer complaints regarding such checks and strongly oppose extension of those provisions to convenience checks. Doing so is inappropriate and unnecessary.

Unauthorized transactions. We are unaware of complaints that consumers are being held liable for unauthorized transactions made using convenience checks. Banks generally resolve such claims in favor of the consumer because consumer protections provisions of state Uniform Commercial Code laws and other check laws cover convenience checks and under those laws, consumers generally are not liable for unauthorized convenience check transactions if they comply with certain timing requirements. That is, they usually must notify financial institutions of unauthorized transactions within 60 days of the transmittal or receipt of the statement related to the unauthorized transaction. This contrasts with TILA for which courts have found there to be no specific statute of limitations.

We believe that there are valid and strong reasons to limit the time to make a complaint about a convenience check transaction: 1) evidence fades and becomes more difficult to obtain as time proceeds, making the bank's investigation and potential recovery from the criminal more difficult; 2) early detection and notification prevents additional fraud on the account by alerting creditors so that they can take preventive measures; 3) the requirement to notify the creditor in a timely fashion is not onerous to consumers. If anything, Regulation Z should be amended to impose a time period within which consumers must make claims for unauthorized transactions made through use of a card or otherwise.

Merchant disputes. The provisions relating to disputes with merchants also should not be extended to convenience checks. Unlike credit card transactions, when convenience checks are used, the card issuer has no connection to, relationship with, knowledge of, or ability to contact the merchant. It is the consumer, not the creditor, who is in the best position to evaluate the merchant and the merchant's product and to contact the merchant in the event of a dispute. It would simply be unfair to shift the burden and loss to the creditor in these cases when the consumer is in the best position vis a vis the merchant.

Unsolicited issuance. Creditors receive few complaints from consumers about unsolicited issuance of convenience checks. Most consumers like them, demonstrated by the fact that they use them. As the Board observes, they can be used to charge transactions to the credit card account to pay merchants who do not accept cards. Most issuers will discontinue sending convenience checks upon request.

Q46 Additional cards.

The Board asks whether it should consider revising Regulation Z to allow creditors to issue additional credit cards on an existing account at any time, even when there is no renewal or substitution of a previously issued card. TILA generally prohibits creditors from issuing credit cards except in response to a request or application, but exempts cards issued as renewals or substitutions to replace an accepted card. Based on revisions to the Commentary, card issuers may replace an accepted card with more than one card, subject to certain conditions. Card issuers, can, for example, issue credit cards using a new format or technology (e.g. a key ring or fob) to existing accountholders, even though the new card is intended to supplement rather than replace the traditional card.

We encourage the Board to amend the regulation to permit the unsolicited issuance of additional cards on an existing account even when the accountholder's existing card is not being replaced. The rationale for the prohibition against unsolicited issuance of cards does not apply in these cases. Moreover, excepting additional cards from the prohibition will encourage development and adoption of new convenient services that pose no potential harm or negative element to consumers.

The prohibition against unsolicited cards was passed in response to the practice of mailing unsolicited credit cards to consumers. Critics of these practices were concerned that the cards would encourage some consumers to spend beyond their means, were inconvenient to dispose of, and were too easily stolen in the mail. In addition, though consumers were not responsible for unauthorized transactions, they would still suffer the inconvenience of refuting unwarranted claims of liability.

Sending an additional card to a customer who has already requested and received a prior card prompts none of these concerns. Providing an additional card presents no greater risk than sending the first -- which the customer has requested. Also, there is no greater risk sending an additional card than sending a renewal card. Consumers, as a practical matter, do not know when to expect a renewal card: they are often unconscious of the expiration date, especially if they hold several cards which most cardholders do, and the card often arrives well in advance of the renewal to ensure that the card arrives prior to the expiration date. Moreover, security practices and features have greatly improved to reduce the risk of an interceptor's use of a card, e.g., requiring cardholders to call in order to activate the card, a common practice, and sending subsequent notices alerting customers that the card was sent earlier and requesting that they contact the issuer if it wasn't received.

Mailing an additional card is akin to allowing access to the account through alternate means, no different than using the account numbers for phone, mail, and internet transactions. Arguably, the latter is more significant with regard to the usability of the account than an additional card, yet the ability to use the account numbers to access the account does not require the specific consent of the customer.

Restricting additional cards will deprive consumers of creative and valuable conveniences which we do not believe Congress intended. For example, the value of the key ring or fob card is obvious. Because of its intended attachment to a key ring and its size, it may be easier to carry without losing and easier to locate. Constraints in distributing new types of convenient access devices will artificially delay acceptance of new devices, risking their abandonment.

We can identify no negatives for the consumer as the Commentary makes clear that the terms and conditions remain intact and liability for unauthorized use does not increase.

Card issuers should not have to wait until the current card expires or send out a replacement standard card with the additional card, when the existing card is perfectly good. Such waste and cost is simply not justified, given the added consumer convenience and lack of consumer harm. The regulatory restriction will also inhibit innovation, to consumers' detriment.

Because sending an additional card poses none of the dangers that prompted Congress to prohibit the issuance of unsolicited credit cards and because consumers may be deprived of valuable convenience, we urge to Board to except from the prohibition additional cards sent to existing accountholders, whether at the time of renewal or not.

Q47 – Q51 Prompt Crediting of Payments.

Under Regulation Z, payments must be credited on the date they are received. Creditors may establish "reasonable" cut-off hours. The Board has asked about creditor practices with regard to cut-off hours.

The cut-off times for creditors to credit a payment on the date of receipt vary from institution to institution and by type of payment. Some cut-off hours are as early as 1:00 PM, but 3:00 PM is more common. The cut-off time also typically depends on the type of payment, but creditor practices are not consistent. For example, for some banks, the cut-off hour is earlier for "nonconforming payments," such as electronic and phone payments submitted because they may take longer to process if they are submitted without the payment stub. Others apply a later cut-off time for electronic and telephone payments. Cut-off times are established to take into account varying account volume, staffing adjustments etc. to ensure that all transactions are in fact processed by the published cut-off time: payments received but not processed on the same day require the creditor to recalibrate, an expensive task. In addition, some creditors maintain an unpublished grace period: they do not consider the payment late until days after the due date in order to avoid customer complaints about borderline late payments.

For these reasons, a rule requiring creditors to credit payments as of the date they are received is inappropriately rigid and unfair. We believe that the current regulation which does not establish a fixed cut-off time provides the necessary flexibility, not just for existing practices and payment types, but for those in the future. As discussed, cut-off periods vary for valid reasons and if not "reasonable," will violate the regulation.

Q52 – Q58 Additional issues.

The Board requests information about a number of topics, including recommendations for changes not expressly addressed in existing rules, deletion of obsolete rules or guidance, legislative changes. We have incorporated many suggestions in our answers to specific questions.

The Board also asks whether existing rules are clearly stated and effectively organized and how to make the regulation and Commentary easier to understand. At this time, we have no specific comments. Regulation Z is one of the most complicated of the banking regulations and could probably be restructured so as to be more manageable and user-friendly. However, doing so would be like reconfiguring the standard typewriter keyboard. Those most familiar with and reliant on the object would face a major relearning task. However, we may in the future make suggestions about particular provisions or sections.

The Board has asked whether there are nonregulatory approaches that may further the Board's goal in improving the effectiveness of TILA. As we have emphasized, the Board should develop a Credit Card Users' Manual to explain generally credit card practices and terms to assist consumers in understanding the credit card industry. The manual would complement the disclosures associated with specific products and help ensure that those product-specific disclosures remain simple, understandable, and usable.

Conclusion.

ABA appreciates the opportunity to submit our comments on this important topic. We emphasize that disclosures, especially summary disclosures such as the credit card solicitation disclosures, must be simple, clear, and limited to key terms relevant to most consumers. In revising the disclosures, the Board should carefully avoid overloading the disclosures. Otherwise, consumer will ignore them. Consumers should, however, be encouraged to review all terms. We believe that explanations of many terms, particularly more complex terms, should be available to consumers from a Board-issued Consumer Credit Users' Manual. The Board should also look to other avenues to address open-end credit issues, including issuance of guidelines and best practices, after public comment, and consumer education. We are happy to provide any additional information.

Sincerely,

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**Docket No. R-1136
Proposed Amendments to
Commentary to Regulation Z
Truth in Lending Act**

Dear Ms. Johnson,

The American Bankers Association ("ABA") is pleased to submit our comments on the Federal Reserve Board's ("Board") proposal to amend the Official Staff Commentary to Regulation Z (the Truth in Lending Act), published in the *Federal Register* 6 December 2002. The proposed rule addresses treatment of certain optional charges imposed under open-end credit plans, specifically, fees for expedited payment and fees for expedited delivery of credit cards. In addition, it proposes to explain rules for replacing accepted cards with one or more cards in response to new technology that allows card issuers to offer convenient supplementary cards. The notice also seeks information on "bounce protection" programs and their coverage under Regulation Z.

The ABA brings together all elements of the banking community to represent the interests of this rapidly changing industry. Its membership – which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies, and savings banks – makes ABA the largest banking trade association in the country.

**Section 226.6 Initial Disclosure Statement
6(b) Other charges.**

The staff have proposed additional guidance on the status under Regulation Z of two fees charged to consumers in connection with open-end credit plans: fees imposed for expedited payment and fees imposed for expedited mailing of a credit card. The proposal excludes fees for expedited payment from the definition of finance charge, but adds them to the list of fees considered "other charges" which must be disclosed in the initial disclosure. However, the proposal excludes from the change-in-term notice requirements changes to expedited payment fees.

ABA greatly appreciates the Board's and Board staff's efforts over the last several years to meet with the ABA and review our recommendations to clarify treatment of these two fees under Regulation Z. Card issuers have been frustrated with guessing how to treat and disclose fees for new optional services and products. The lack of guidance or predictability leaves them vulnerable to liability after the fact for good faith interpretations and further hinders addition of new services.

Generally, we believe that the overall result is manageable, but suggest that the final Commentary take a broader approach and provide clearer guidance on the definitions of finance charge and "other charges" for open-end credit as well as closed-end credit so that creditors are better able to analyze how a particular fee will be treated under Regulation Z. We agree that expedited payment fees are not finance charges, but submit that they are also not other charges, whether for open or closed end credit. We also agree that fees for expedited delivery of cards are neither finance charges nor other charges. If staff declines a broader inquiry at this time, staff should make clear that neither fees are finance charges nor "other charges."

The Supplementary Information acknowledges that the existing regulation and Commentary have been unclear about the status of these fees. We request that staff further explain in the final Commentary that creditors could reasonably and in good faith have concluded that such fees could have been classified differently than the final Commentary provides. This may help avoid liability for good faith, reasonable interpretations of an unclear regulation.

As we have previously submitted, we believe that the critical test for finance charge classification is whether a fee is required by the creditor in connection with the extension of credit. Fees for optional services should not be considered finance charges. For the same reasons, fees for optional services should not be considered other charges. The primary distinction between the finance charge and "other charges" for open-end credit is whether it is appropriate to include the fee in the annual percentage rate ("APR") so that the disclosed APR is useful and meaningful to understand the cost of credit and compare credit terms.

Under Section 226.(4)(a) of the regulation, finance charge includes "any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or condition of the extension of credit." The common meaning and use of the term "imposed" means required. Simply put, a fee for an optional service is not a fee required or imposed in order to gain access to credit. Otherwise a host of various fees for optional services and products would fall under the definition. For example, fees for a duplicate statement or copy of a convenience check would arguably become finance charges.

In addition, treating such fees as finance charges to be calculated into the APR would grossly distort the APR, misleading consumers shopping for credit and misteaching them about the terms of credit. To illustrate, a consumer who has contracted for a 12% APR and one month opts to pay a fee for expedited payment would likely be shocked to see on the periodic statement an APR in the triple digits. Based on this disclosure, the consumer may be very tempted to accept an offer of credit boasting a 21% APR, believing that to be a better deal. In fact, it most likely would not be a better deal.

To avoid calls from aggravated and confused customers as well as the compliance and operation burdens of including fees for optional service in the APR, credit card issuers would simply eliminate or never offer these services, to the detriment and inconvenience of customers. For example, elimination of the expedited payment option would expose customers to late payment fees and derogatory remarks on their credit report. Card issuers would also be reluctant to add other optional valuable services, notwithstanding consumer demand for the service or product and the willingness to pay for the service or product.

The Board would retain discretion to specifically include particular fees in the finance charge, but a clearer general principle will assist card issuers in compliance and avoidance of potential liability for good faith interpretations of the regulation.

ABA also recommends that staff clarify the definition of "other charges" by explaining that "other charges" only covers fees required for the extension of credit and excludes fees for optional services. A more definitive principle will assist creditors in analyzing and determining how fees for optional services should be treated under Regulation Z. The Commentary should specifically exclude fees for expedited payment from the definition of "other charges."

According to the statute and regulation, "other charges" refers to any charge which "may be imposed as part of the plan." As explained earlier in the discussion of the definition of finance charge, we submit that "imposed" means required. Thus, in order to fall within the category of "other charge," the fee must be required as a condition of the plan.

The distinction between optional service fees and "other fees" currently delineated in the Commentary, such as payment fees and over the limit fees, is that the latter are intended to discourage certain behavior and the consumer does not make a conscious choice to accept the fee at the time it is charged. In contrast, consumers make a conscious choice and specifically request and initiate optional services such as expedited payment or expedited delivery of a credit card.

It can also be argued that certain fees are charged pursuant to an agreement separate from the credit card "plan" and therefore are not "other fees . . .imposed as part of the plan." For example, card holders can agree to a charge for expedited payment or expedited delivery of a card at the time they make the request. This agreement would be subject to usual contract law and would be considered separate from the plan.

If staff declines to address the broader issue of guiding principles for defining finance charge and "other charge" as suggested above, we encourage it to specifically add to the list of fees excluded from other charges both fees for expedited payment and expedited delivery of credit cards. We agree with the proposal that a fee for expedited delivery of a card is not an "other charge" because, as the Supplementary Information explains, "the card is also available to consumer by standard mail service without paying the fee."

Similarly, a fee for expedited payment is not an "other charge" as it is possible "by standard mail service without paying the fee." The Supplementary Information notes that the expedited payment allows the cardholder to avoid a late payment, but this does not change the fact that the consumer has the choice to send payment by standard mail without charge, albeit to avoid the late fee, payment must be sent in a timely fashion to arrive by the due date. It is tempting to conclude that the consumer has no choice when faced with paying by standard mail and incurring a fee and paying for expedited payment. However, the consumer had the choice upon receipt of the statement. That the consumer has delayed payment does not negate the fact the consumer had the opportunity to pay by standard mail in a timely fashion without charge and did not. Accordingly, fees for expedited payment should be excluded from other charges.

In addition, we suggest that the final Commentary delete the proposed condition for exclusion, "provided that method of payment was not established as the regular payment method for the account." Our concern is that the language is susceptible to interpretation. It is not clear when a method would be "established . . . as the regular payment method." Is it when the customer has made a series of payments in a particular fashion? Is it what was established in the written contract?

Accordingly, we suggest that the phrase read, "provided that the consumer may avoid the charges through another reasonable payment method." It should also be made clear that the "reasonable payment method" may not deliver the payment as quickly and may not avoid any late fee. The Commentary could provide as an example the U.S. Postal Service.

In the alternative, the Commentary could read, "[c]harges imposed for expediting a consumer's payment provided that method of payment was not established in advance under the plan as the regular payment method." This may help make clear how the method is established.

Finally, with regard to the proposal to specifically exclude from "other charges" fees for expedited delivery of cards, the final Commentary should omit any repetition or reference to the statement in the Supplementary Information to the proposal, "[W]here a creditor merely passes through a third party delivery charge. . . the fee is not a finance charge or other charge." It contradicts the proposal, raises additional questions, and creates ambiguities. Moreover, it is not always possible to ascribe a particular fee to a individual customer. Payment schedules for courier services can vary depending on a variety of factors, including volume. For example, one rate might apply for the first lot of deliveries and a lower rate for the second lot, and so on.

Section 226.12 Subsequent Disclosure Requirements
12(a) Issuance of Credit Cards

Section 132 of TILA, implemented by Section 226.12(a) of Regulation Z generally prohibits creditors from issuing credit cards except in response to requests or applications for cards. Section 132 explicitly exempts from this prohibition credit cards issued as renewals of or substitutes for previously accepted credit cards. Comment 12(a)(2) - 5, the "one-for-one rule," interprets these provisions by providing that in general, a creditor may not issue more than one credit card as a renewal of or substitute for an accepted card. An exception is provided for accepted credit/debit cards replaced by separate credit and debit cards.

The Supplementary Information notes that advances in technology now offer cards in different sizes and formats. However, merchant card readers may lack the capability to read all types of credit cards. For example, card issuers have recently issued cards smaller than the standard card which are suitable for key rings. Card issuers seek guidance on how they can issue such cards which are intended to supplement rather than replace an existing card.

To address this matter, comment 12(a)(2)-6 would be revised to provide that card issuers may replace an accepted card with more than one renewal or substitute card on the same account where the consumer's total liability for unauthorized use with respect to the account does not increase. In addition, any replacement cards must access only the account of the accepted card and all cards issued under the account must be governed by the same terms and conditions.

Comment is requested on whether it is appropriate to apply this view to additional cards issued for an existing account on the conditions specified in the proposal even when there is no renewal of or substitution for the cardholder's existing card. We strongly recommend that the final comment extend this common sense approach to additional cards.

We appreciate the Board staff's willingness to address this issue and its recognition of the evolution of the credit card, but believe that the Commentary should be more permissive than proposed and allow card issuers to provide additional cards to existing cardholders, whether the card is being renewed or not, without violating the prescription against sending unsolicited cards. Excepting additional cards from the prohibition will encourage development and adoption of new convenient services that pose no potential harm or negative element to consumers.

As the staff notes in the Supplementary Information, the prohibition against unsolicited cards was passed in response to the practice of mailing unsolicited credit cards to consumers. Critics of these practices were concerned that the cards would encourage some consumers to spend beyond their means, were inconvenient to dispose of, and were too easily stolen in the mail. In addition, though consumers were not responsible for unauthorized transactions, they would still suffer the inconvenience of refuting unwarranted claims of liability.

Sending an additional card to a customer who has already requested and received a prior card prompts none of these concerns. Providing an additional card presents no greater risk than sending the first -- which the customer has requested. Also, there is no greater risk sending an additional card than sending a renewal card. Consumers, as a practical matter, do not know when to expect a renewal card: they are often unconscious of the expiration date, especially if they hold several cards which most cardholders do, and the card often arrives well in advance of the renewal to ensure that the card arrives prior to the expiration date. Moreover, as staff notes, security practices and features have greatly improved to reduce the risk of an interceptor's use of a card, e.g., requiring cardholders to call in order to activate the card, a common practice, and sending subsequent notices alerting customers that the card was sent earlier and requesting that they contact the issuer if it wasn't received.

Moreover, mailing an additional card is akin to allowing access to the account through alternate means, no different than using the account numbers for phone, mail, and internet transactions. Arguably, the latter are more significant with regard to the usability of the account than an additional card, yet the ability to use the account numbers to access the account does not require the specific consent of the customer.

Restricting additional cards will deprive consumers of creative and valuable conveniences which we do not believe Congress intended. For example, the value of the key ring card is obvious. Because of its intended attachment to a key ring and its size, it may be easier to carry without losing and easier to locate. Already key ring size cards have proven very popular with frequent buyer programs. Constraints in distributing the card will artificially delay acceptance of the card, risking its abandonment.

We can identify no negatives for the consumer as the Commentary makes clear that the terms and conditions remain intact and liability for unauthorized use does not increase.

Card issuers should not have to wait until the current card expires or send out a replacement standard card with the additional card, when the existing card is perfectly good. Such waste and cost is simply not justified, given the added consumer convenience and lack of consumer harm. The regulatory restriction will also inhibit innovation, to consumers' detriment.

Because sending an additional card poses none of the dangers that prompted Congress to prohibit the issuance of unsolicited credit cards and because consumers may be deprived of valuable convenience, we urge staff to expand the proposal to also except from the prohibition, additional cards sent to existing accountholders, whether as at the time of renewal or not, subject to the same condition as proposed.

"Bounce Protection."

The Board is also requesting information on "bounce protection" programs associated with transaction deposit accounts. Questions have been raised about whether there are circumstances in which such services might be covered by TILA and Regulation Z.

As the Board describes these programs, the institution generally reserves the right not to pay particular items under these programs, but typically establishes a dollar limit for the account holder and then "routinely" pays overdrafts on the account "without a case-by-case assessment." Account holders pay a fee for overdrafts that are paid, usually the same amount as for an overdraft item that is returned unpaid.

The Board notes that such fees may or may not meet the definition of finance charge and seeks more information on how "bounce protection" services are designed and operated and how they should be treated for purposes of Regulation Z.

Generally, we believe that most automated bounce protection programs do not merit Regulation Z coverage. Most are simply the automation of banking's long tradition of paying overdrafts under certain circumstances and charging a fee for the overdraft, whether the overdraft is paid or not. The automation of this historical practice reduces costs associated with manual intervention and ensures consistent treatment for all customers. Any concerns about unclear disclosures or deception should be addressed by other appropriate regulations and laws. As one banker noted, "There are enough regulations to go around." If Regulation Z is amended to cover such programs, many banks, to avoid compliance costs and complications, will be compelled to return *all* overdrafts, to the great cost and aggravation of customers.

Banks use a variety of programs and practices in handling overdrafts. Under the long established traditional treatment, banks manually review overdrafts and decide to return or pay based on a variety of factors. Factors include the history and age of the account, the amount of the overdraft, the tendency of the individual branch, and the personal relationship with the customer. The same factors may be used to determine whether to waive the overdraft fee.

For some years, the trend has been to automate this practice, using algorithms to minimize risks and identify those accounts most likely to be brought to positive balance. Automation of the practice offers, 1) significant reduction in costs by eliminating expensive manual intervention and review by staff and 2) more consistent and fair application so that some customers are not inadvertently favored based on inappropriate factors.

For large institutions, the systems are often fairly sophisticated and based on actual experience. The parameters are usually not disclosed.

Smaller institutions have more recently installed automated bounce protection systems for handling overdrafts. However, rather than being developed internally, many have purchased systems from various third party vendors. In some cases, the product is simply a software package. In others, the vendor continues to be involved in the program in some fashion. In addition to the software to establish the parameters for paying overdrafts, the vendors may provide legal and compliance guidance, risk management, monitoring capabilities, and customer communication tools such as formatted and tailored response letters.

While the criteria for the vendor solutions may be less complicated than those developed by individual institutions, they allow small institutions to automate a traditional practice, thereby reducing costs and ensuring more consistent application.

Typically, under these programs, banks disclose that they *may* pay overdrafts, usually between $100 and $500, depending on the customer, under certain circumstances. (See attached examples.) The main difference between the traditional practice and the newer programs, is that the criteria are disclosed to the customer.

Examples of typical criteria for eligibility for the service include:

- Monthly deposit of $300 or more
- Periodic direct deposit
- No outstanding debts to bank
- Account opened for at least 30 days.

Usually, the feature is available to all those eligible to open an account. There is no "creditworthiness" test as there is for overdraft lines of credit. A flat fee is charged, regardless of amount.

If any negative balance is not brought to a positive status, e.g., within 15 days, letters are sent advising the customer to bring the balance to a positive position. Reminders and requests continue for 30 to 40 days after which time the account is closed. A few institutions offer the customer the option to repay the overdraft through an installment loan (subject to Regulation Z) if the customer has difficulty in paying the lump sum.

Under the programs, whether to pay an overdraft remains discretionary on the banks' part. Disclosures provide that the bank "may" pay the overdrafts and outline the parameters. However, banks reserve and exercise the right not to pay any particular overdraft notwithstanding that the particular overdraft otherwise fits within the disclosed parameters.

Banks may choose not to pay an overdraft that otherwise fits within the disclosed criteria for a variety of reasons. For example, banks may choose to return an overdraft if: several checks deposited into the account have been returned unpaid; the balance is already in a negative position; periodic deposits have ceased; the customer has had multiple overdrafts in a single month. In addition, overdrafts would not be paid if there are reasons to suspect fraud, either by the customer or the payor of a check deposited into the account.

Bounce protection products are popular with consumers for a number of reasons. Paying an overdraft can save the customer fees imposed by the recipient of an unpayable check, such as a merchant or creditor. It might also save them additional interest and late payment fees. They also avoid adverse reports to credit bureaus and databases of bad check writers. Consumers avoid the embarrassment as well as the hassle and time wasted to straighten out the transaction involving a returned check.

These programs contrast with overdraft lines of credit, which are subject to Regulation Z, in a number of ways.

Overdraft line of credit	**"Bounce protection" program**
Written agreement.	No written agreement.
Bank obligated to pay overdraft. No discretion. While bank may not pay if fraud is suspected, threshold is higher because of contract and liability for failure to pay.	Bank retains discretion to pay or return any overdraft. Threshold for not paying due to fraud suspicions is lower.
Potential bank liability for failure to pay overdraft.	No liability for failure to pay overdraft.
Overdraft may be repaid over time and in installments.	Entire overdraft must be repaid in short period.
Consumer must meet creditworthiness standard to obtain product.	Consumer need only meet eligibility standard for opening the account.
Interest charged for overdrafts. May be per item, application, or annual fee.	No fees other than flat per item overdraft fee, unrelated to the amount of the overdraft.

Some consumers prefer the bounce protection programs to the overdraft lines of credit. For example, the line of credit requires more time and paperwork to initiate. Consumers do not expect to overdraw other than on an occasional basis and do not want the temptation of a line of credit. More customers are eligible for the bounce protection programs than for a line of credit, which has stricter eligibility criteria.

The Board notes that questions have been raised about whether such programs may be covered by TILA and Regulation Z. We believe that generally they should not, assuming that they meet the criteria currently outlined in Regulation Z for excluding overdraft fees from Regulation Z. Any concerns about misleading or confusing messages should be addressed under other appropriate regulations and laws. The Board should not try to artificially force these programs into Regulation Z. It will only result in vagueness, uncertainty, confusion, and unnecessary compliance headaches, as well as the elimination of the practice of paying *any* overdrafts except for select customers.

Comment 4(b)(2) to Regulation Z provides that a checking account charge imposed with a credit feature is only a finance charge to the extent it exceeds the charge for a similar account without credit features. Comment 4(c)(3) further explains:

> A charge on an overdraft balance computed by applying a rate of interest to the amount of the overdraft is not a finance charge, even though the consumer agrees to the charge in the account agreement, unless the financial institution agrees in writing that it will pay such items.

Thus, under existing Regulation Z, the fees under bounce protection programs are not subject to Regulation Z if: 1) the fee is imposed whether or not the bank pays the overdraft; and 2) the bank does not agree in writing that it will pay such overdrafts.

Tampering with the writing requirement risks recreating regulatory chaos. There will be constant challenges questioning whether the bank has "agreed" to pay such overdrafts.

In addition, most financial institutions make clear that the institution "may" pay the overdraft under certain circumstances. Use of the term "may" is sufficient. "May" does not mean "will." However, if the agreement otherwise implies that the institution *will* pay such items, then the program may be subject to Regulation Z. As discussed earlier, financial institutions generally do reserve the right not to pay an item and indeed exercise that right. That the process has been modernized for efficiency and fairness through automation should not alter the analysis. To insist that decisions be made on a "case-by-case" basis to avoid Regulation Z treatment relegates financial institutions to inefficient and outdated systems.

Any distinction between the historical manual practice of paying overdrafts and automated systems will be artificial and unclear. To avoid significant risks of violating an unclear distinction, financial institutions will have to choose 1) to comply with Regulation Z, or 2) to pay no overdrafts except for select customers. Compliance with Regulation Z would certainly chill any automated systems: Regulation Z compliance is complicated, expensive, and burdensome, and financial institutions risk bumping up against usury laws because overdraft amounts are typically small relative to the fee. Financial institutions would have to choose between denying a valued and popular service to all but select customers and the perils of Regulation Z compliance.

Any concerns about programs related to confusion or deception about the terms and conditions should be addressed under other appropriate regulations and laws. For example, it has been suggested that the literature describing some programs are contradictory or misleading in that they promise to pay certain overdrafts in one place, but retain discretion not to pay in another place. We do not believe that this is a Regulation Z issue unless it is clear that the institution will pay the overdraft, as explained above. Rather, such literature, as the OCC has stated in Interpretive Letter #914, September 2001, may violate the Federal Trade Commission Act, which prohibits deceptive acts or practices. Contradictory or misleading messages are more appropriately addressed under that Act, not Regulation Z.

Further, the Truth in Savings Act and Regulation DD address disclosures related to checking accounts. They require that at account opening, institutions disclose, "The amount of any fee that may be imposed in connection with the account . . and the conditions under which the fee may be imposed." (Section 230.4(b)(4)). In addition, Section 230.6(a)(3) requires that any fees debited to the account during the statement period be disclosed on the periodic statement. Section 230.3 requires that these disclosures be made "clearly and conspicuously in writing and in a form the consumer can keep."

We believe that clear communication of fees is critical and that the requirements of Regulation DD are sufficient to alert consumers to any overdraft fees, whether the check is paid or not. We also believe that customers are informed and understand that the overdraft fee will be imposed. Even if some customers overlook the fee in the initial disclosure, the periodic statement will certainly alert them. Those with low or overdrawn balances are most likely to notice this charge and question it if it is incorrect. In any case, the first overdraft charge certainly alerts consumers to potential future overdraft charges.

Conclusion.

Generally, ABA supports the approach the proposed Commentary has outline with regard to treatment of fees for expedited payment and expedited delivery of credit cards. However, we strongly recommend a broader review to clarify principles for establishing whether fees related to credit accounts are considered finance charges, "other charges," or neither. If staff declines to address the broader issue at this time, it should exclude both from finance charge and "other charge."

In addition, we recommend that the Commentary extend the proposed section regarding credit card issuance to card issuers to send additional cards, whether provided at the time of renewal or not, without violating the general prescription against sending unsolicited cards.

Finally, we have provided general descriptions of various bounce protection programs. We strongly believe that these programs are not covered by Regulation Z. Any concerns relating to unclear or deceptive materials should be addressed under other appropriate regulations and laws.

The ABA appreciates the opportunity to comment on these important matters and is happy to provide additional information or comments.

Regards,

Nessa Eileen Feddis

AMERICAN BANKERS ASSOCIATION®

World-Class Solutions, Leadership and Advocacy 1875-2000

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January 9, 2002

The Honorable Edward Gramlich
Governor
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Governor Gramlich,

Over the last two years, members of the American Bankers Association's Card Policy Council and other members of the credit card industry have been discussing the treatment of certain credit card fees under Regulation Z (Truth in Lending Act). Unfortunately, we have been unable to agree on a resolution. Accordingly, we request a meeting with you at your convenience to discuss our concerns about this important issue.

As the attached memorandum from Nathaniel E. Butler and Ralph J. Rohner to the Card Policy Council explains in greater detail, our concern is that including fees for optional services related to credit card accounts in the finance charge and annual percentage rate ("APR"), as the Board Staff suggests, will: 1) distort the APR and mislead consumers, 2) reduce consumer choices and conveniences, and 3) impose unnecessary compliance costs. We appreciate your attention to this matter and look forward to meeting with you. I will call your office in the near future to follow up on our request.

Sincerely,

James D. McLaughlin

Attachment
cc: Dolores S. Smith
Director, Division of Consumer and Community Affairs

January 9, 2002

TO: Card Policy Council

FROM: Nathaniel E. Butler and Ralph J. Rohner

DATE: January 4, 2002

The purpose of this memorandum is to outline the discussions and issues between the credit card industry and the Federal Reserve Board Staff concerning the Truth In Lending Act (the "Act") and its implementing regulation, Regulation Z, and whether the charge for providing special, expedited treatment for a customer's payment is a finance or other charge under the Act and Regulation Z. Typically this type of charge is incurred at the direction of the customer and is for the customer's convenience, i.e., when a customer calls the creditor to request expedited treatment for his payment in order to avoid finance and delinquency charges. The industry consensus is that this is a charge incurred by the customer for special services outside the credit plan disclosed to the customer. The Staff's view is that any charge related to the plan, including an optional charge, is deemed to be imposed by the lender, and, therefore, is a finance charge. Under the Act and Regulation Z, to be a finance charge, the charge must be "incident to the extension of credit" and "imposed" by the creditor.

The interpretation of the Staff is that charges made for optional goods or services are nonetheless imposed. This is the underlying basis of our disagreement. Imposed means the charge is compulsory in order to gain access to credit. As these changes are not required, but rather are incurred at the option of the customer for special services, they are not necessary in order to gain access to credit.

The scope of our disagreement is not limited to charges for expediting payments. In a similar context, if a customer requests copies of cash advance checks issued under the plan, is the charge for retrieving, copying and mailing the checks qualify as a finance charge? Credit is available under a credit plan, whether or not the customer obtains this service. Nevertheless, under the Staff's interpretation, the charge for the copies would be a finance charge. There are other examples. Consider the situation where a card issuer ordinarily sends periodic statements electronically, and charges extra for sending statements in paper as opposed to electronic form. Again, is the out-of-the-ordinary charge, initiated by the customer, a finance charge?

Today expedited payment charges are identified as a dollar amount. The result of the charge being disclosed under the Act is its inclusion in the APR calculation, which often results in a grossly distorted APR. Disclosure of a very high or other unusual APR is of no use to a customer. One purpose of the Act is to educate consumers about the cost of credit. The APR is one of its principal tools which, shown month after month, educates the consumer as to the cost of credit. An aberrational APR of 100% or more does not contribute to a consumer's understanding. It detracts from it.

Another goal of the Act is to encourage comparative shopping. A customer expecting to see a 14% APR (because that was the agreed contractual rate between customer and creditor) may see a triple-digit APR. This will not be a useful comparison in the consumer's search for a competitive rate.

If the charge is deemed to be an "other" charge, costly "Notice of Change in Terms" notices must be sent every time the amount of the charge is changed.

Under the standard industry convention for treating these charges, the ramification for the consumer would be loss of the charge being included in the calculation of the APR (which would distort the resulting calculation as described above) or receipt of a formal "Notice of Change in Terms." The expedited payment charge is, and would continue to be, displayed and properly identified on the customer's next statement.

More important, under the Staff's interpretation, is the potential loss of the service. The charge for expediting payments runs from $5 to $15. Delinquency charges are typically $23 and finance charges can be far more. Expediting payments reduces revenue from these sources, and creditors may drop the service rather than comply with the Staff's approach. This would not only cost consumers money, but also would result in more derogatory information appearing on their credit reports.

AMERICAN BANKERS ASSOCIATION
World-Class Solutions, Leadership and Advocacy 1875-2000

1120 Connecticut Avenue, NW
Washington, DC 20036

TO: Dolores Smith
Adrienne Hurt
Federal Reserve Board

COPIES: Jim Michaels
Jane Ahrens
Federal Reserve Board

FROM: American Bankers Association Card Policy Council*

DATE: September 18, 2000

RE: Federal Reserve Board Staff Interpretation of Regulation Z

As a follow-up to our April 19, 2000 meeting with staff, this memorandum provides a more detailed analysis of the treatment of fees for certain services under Regulation Z ("Truth in Lending.") Specifically, we discussed whether a fee to expedite the delivery of a credit or charge card or a fee to expedite the handling of a payment on an open-end credit plan is a finance or "other" charge under Regulation Z. As you will see, we believe an affirmative answer that such fees are finance charges could cause many creditors to discontinue responding to customers' specific requests for services, and those creditors who do not offer these services would decide not to do so. Furthermore, we believe treatment of these fees as finance charges would represent a significant change to the Board's approach in evaluating whether fees for services are finance charges under Regulation Z. In light of the importance of this matter, we respectfully request that you consider addressing this issue in the forthcoming proposed update to the Official Staff Commentary to Regulation Z. Thank you in advance for your time and consideration of this issue.

* * * * *

Background

In response to explicit consumer requests, many credit and charge card issuers will send cards by expedited delivery, such as next-day delivery, rather than by normal mail. Consumers request expedited delivery of cards for a variety of reasons. For example, consumers who have lost their card may need a replacement more quickly than would be the case with normal delivery. Similarly, a consumer may request an additional card for a spouse or child, and need to

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* The members of the American Bankers Association ("ABA") Card Policy Council are: American Express Company, Bank of America, Capital One Financial Corporation, Chase Manhattan Bank, Citigroup, Discover Financial Services, Inc., First USA Bank, MasterCard International, MBNA, Providian Financial, and Visa USA Inc.

lost their card may need a replacement more quickly than would be the case with normal delivery. Similarly, a consumer may request an additional card for a spouse or child, and need to ensure that the person has the card before the start of vacation or return to school. For consumers who choose this service, delay in receipt of a card could impose great inconvenience or significant problems.[1] Fees are sometimes charged when a consumer requests this service.[2]

In addition to expediting the delivery of a credit or charge card, many creditors allow consumers to make an expedited payment on an open-end credit plan in response to the consumer's explicit request. For example, a consumer may telephone the creditor shortly before a payment is due, after realizing that a mailed payment will not reach the creditor in time to avoid a late payment fee. The creditor informs the consumer that, for a fee, by providing a deposit account number, the creditor can generate a check drawn on the consumer's account, and a timely payment can be made.[3] A fee is charged when a consumer requests this service.[4] This service enables the consumer to avoid the imposition of a late payment fee. In addition, it enables a consumer to avoid having the payment reported to the credit bureau as late.

Of course, regardless of the treatment of these fees under the Truth in Lending Act and Regulation Z, creditors will disclose to consumers the charges for these services. For contractual, practical, and other reasons creditors must disclose the amount of these fees on the periodic statement sent to the consumer for the billing cycle in which the service was provided. Thus, aside from how these fees should be treated under Regulation Z, consumers will be informed of the amount of these fees.

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[1] For example, most, if not all, car rental agencies require a credit or charge card to rent a car. In these and other circumstances, loss of a card without the ability to quickly obtain a replacement card could result in significant hardship for a consumer.

[2] Expediting the delivery of a card requires a creditor to perform a number of tasks and incur expenses not associated with the normal delivery of a card.

[3] This same service could be offered, pursuant to a consumer request, for a closed-end credit transaction. That is, we assume a creditor might similarly choose to accommodate a consumer's request to make an expedited payment during the term of a closed-end loan. This memorandum does not discuss the extent to which a fee to expedite the handling of a payment for a closed-end credit transaction may be excluded from the finance charge.

[4] Expediting a payment, like expediting delivery of a credit or charge card, requires a creditor to perform a number of tasks and incur expenses not associated with the typical receipt of a payment.

Treatment of Fees for Certain Services as Finance Charges under the Truth in Lending Act and Regulation Z

The Truth in Lending Act ("TILA") provides that the finance charge is the sum of charges "payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit."[5]

Regulation Z[6] closely parallels the language used in the TILA in providing that the term finance charge "includes any charge payable directly or indirectly by the consumer and <u>imposed</u> directly or indirectly by the creditor as an incident to or a condition of the extension of credit." (Emphasis added.) The Regulation also provides that finance charge "does not include any charge of a type payable in a comparable cash transaction."[7]

The Federal Reserve Board ("Board") has long recognized that not all fees paid by a consumer in connection with an open-end credit account are finance charges. For example, the Regulation excludes a number of fees from the finance charge, such as application fees (imposed on all applicants whether or not credit is actually extended) and participation fees (imposed in connection with open-end credit plans without regard to whether credit is actually extended during a particular period).[8] As the application and participation fees clearly illustrate, historically, the Board has recognized that, in determining whether a fee is a finance charge, it is appropriate to evaluate whether a creditor imposes the fee in connection with an extension of credit.[9] Neither the expedited delivery charge nor the expedited payment charge is related to a specific extension of credit. In fact, as with the participation fee, a consumer requesting next-day delivery of a card is charged a fee regardless of whether there are credit extensions under the credit card plan. Likewise, a consumer who requests an expedited payment is not requesting that service in connection with an extension of credit.

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[5] 15 U.S.C. §1605(a) (1998).

[6] 12 CFR pt. 226 (2000).

[7] 12 CFR pt. 226.4(a) (2000). This memorandum does not discuss the extent to which a fee to expedite the delivery of a credit or charge card or a fee to expedite the handling of a payment may be excluded from the finance charge under other provisions, such as the "comparable cash transaction" provision.

The regulation also provides that "[t]he finance charge includes fees and amounts charged by someone other than the creditor, unless otherwise excluded under this section, if the creditor: (i) requires the use of a third party as a condition of or an incident to the extension of credit, even if the consumer can choose the third party; or (ii) retains a portion of the third party charge, to the extent of the portion retained." 12 CFR pt. 226.4(a)(1) (2000).

[8] 12 CFR pt. 226.4(c)(1), (c)(4) (2000).

[9] See, for example, Staff Opinion Letter Number 643, issued November 2, 1972, noting that a charge for an amortization schedule not specifically requested by a consumer is a finance charge.

Similarly, the Official Staff Commentary ("Commentary") takes into consideration whether the creditor requires a service in determining whether a fee for a service is a finance charge and provides several examples of charges that are and are not finance charges. In general, the Commentary provides that fees for services required by a creditor are finance charges.[10] Neither the expedited payment or delivery fee is required by the creditor -- instead the fees are for services that are provided by the creditor as an accommodation to the consumer at the consumer's choice.

The Board has stated unequivocally when a disclosure requirement under Regulation Z applies to voluntary services as well as to required services. For example, in 1995, the Board amended Regulation Z, by adding section 226.33, which addresses reverse mortgages.[11] The amendments require creditors to disclose the total cost of credit, which includes "all costs and charges" to the consumer, including the costs of any annuity the consumer purchases.[12] In the final rule, the Board expressly noted that all costs and charges must be included in the disclosures, "whether or not the charge is deemed to be a finance charge[.]"[13] The Board further noted that any amount paid by the consumer for an annuity must be included "whether the purchase is mandatory or voluntary."[14] If a finance charge includes "voluntary" annuity purchases, the Board would not have found it necessary to state that the disclosure under section 226.33(c)(1) includes charges for both mandatory and voluntary annuities. That is, if a fee for voluntary annuities were a finance charge, there would have been no need to expressly state that the disclosure captures both voluntary and mandatory services.

In 1996, the Board amended Regulation Z to address the proper treatment of fees charged by creditors in connection with debt cancellation agreements.[15] The Board stated that fees for debt cancellation coverage are finance charges "because [such fees are] part of the cost of the credit."[16] The Board concluded that a fee for debt cancellation coverage is a finance charge, even though loans may be available without that feature, because coverage "alters the fundamental nature of the borrower's repayment obligation."[17] Thus, because debt cancellation

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[10] See, for example, comments 226.4(a) -1 (addressing required maintenance or service contracts), 226.4(a)(1)-1 (discussing required mortgage insurance), 226.4(a)(1)-2 (dealing with required annuities), and 226.4(b)(b)(7) and (8)-4 (addressing required hospitalization insurance) (2000).

[11] 57 Fed. Reg. 15463 (1995).

[12] 12 CFR pt. 226.33(c)(1) (2000).

[13] 57 Fed. Reg. 15463 (1995).

[14] 57 Fed. Reg. 15463 (1995).

[15] 61 Fed. Reg. 49239 (1996).

[16] 61 Fed. Reg. 49239 (1996).

[17] 61 Fed. Reg. 49239 (1996). The Board noted that it "has generally taken a case-by-case approach in determining whether particular fees are 'finance charges,' and does not interpret Regulation Z to automatically exclude all 'voluntary' charges from the finance charge." 61 Fed. Reg. 49239 (1996). The Board went on the note that most voluntary fees, such as fees for optional maintenance agreements,

services go to the heart of the payment obligations between the consumer and the creditor, a charge for these services is a finance charge.[18]

Courts also have evaluated the circumstances in which a fee for a service is a finance charge under the TILA and Regulation Z. These courts have concluded that a fee for a service is not a finance charge simply because the fee is paid in connection with a credit transaction. For example, in *Veale v. Citibank*, the Eleventh Circuit Court of Appeals held that a fee to expedite the payment of a prior loan was not a finance charge since the creditor did not require the service.[19]

At the very least, the 1995 and 1996 Board statements and court cases discussed above that have addressed whether a fee for a service is a finance charge stand for the proposition that not all voluntary services are finance charges. And we believe that those Board statements and court decisions support the proposition that a charge for a voluntary service is not a finance charge unless the service alters the fundamental nature of the borrower's payment obligations.

Analysis

Regulation Z provides that a finance charge is a fee "imposed" directly or indirectly by the creditor as an "incident to or a condition of the extension of credit."[20] "Imposed" is not specifically defined in the regulation, but is more generally defined as "[t]o enact or apply as compulsory[.]"[21] We believe the staff should not treat as a finance charge a fee for expediting delivery of a credit card and a fee for expediting a payment, when those services are provided at the express request of the consumer and as accommodation to the consumer. To conclude otherwise would be inconsistent with the definition of finance charge in the TILA and Regulation Z, previous Board statements, examples in the Regulation and Commentary, and court decisions. On the contrary, to exclude such service fees from the definition of finance charge would provide benefits to consumers, and would not compromise the value of the finance charge disclosure or the annual percentage rate ("APR") calculation.

In this regard, we believe there are at least two approaches that would enable the staff to appropriately characterize as nonfinance charges a fee for expediting delivery of a credit card and a fee for expediting a payment. First, we believe the staff could clearly distinguish fees for

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are excluded from the finance charge under the comparable cash transaction exclusion. 61 Fed. Reg. 49239 (1996).

18 Under the amendments, the Board provided that a charge for voluntary debt cancellation coverage is treated the same as a charge for voluntary credit insurance. Thus, a charge may be excluded from the finance charge if certain disclosures about the service are made to the consumer. 12 CFR pt. 226.4(d)(3) (2000).

19 85 F.3d 577 (11th Cir. 1996). See also the similar holding in *Great Western Bank v. Shoemaker*, 695 So. 2d 805 (Fla. Dist. Ct. App. 1997).

20 12 CFR pt. 226.4(a) (2000).

21 Webster's II New College Dictionary (1995).

these especially requested services from fees for certain other services paid in connection with a credit plan or a credit transaction. The expedited credit card delivery and payment fees are not imposed by the creditor as an incident to an extension of credit. That is, those services are not required by the lender to obtain the credit plan or to obtain a specific extension of credit. These service fees are easily distinguished from other types of charges that are appropriately treated as finance charges under the TILA, Regulation Z and the Commentary. For example, imposition of a fee to disburse construction loan proceeds or to prepare a Truth in Lending disclosure statement are treated as finance charges because a creditor would not make a specific advance or make credit available unless the consumer agreed to use those services. We believe not treating as finance charges fees for expediting delivery of a credit card and for expediting a payment on an account is consistent with the examples of finance charges in the Regulation and Commentary.[22] We also believe the analysis employed by, and the result reached by, the Board for debt cancellation agreements supports this approach.[23]

There is an alternative approach that would enable staff to characterize fees for expediting delivery of a credit card and for expediting a payment as nonfinance charges. Under this approach, the staff would treat a charge for a service as a finance charge unless the same credit terms can be obtained whether or not the consumer elects the service.[24] For example, under this approach, if the duration of a plan were related to a fee, say, a 2-year credit plan without a fee, but a 5-year plan with a fee, the fee would be viewed as a finance charge since the consumer could not obtain a 5-year plan without paying the fee. In contrast, fees for services wholly unrelated to the credit terms, such as a fee for expediting the delivery of a credit card, would not be viewed as a finance charge if the consumer requests the service and the consumer will receive exactly the same credit terms whether or not the service is obtained. This approach shows both that the fee is voluntary and that it has no real relationship to an extension of credit.

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[22] In fact, for analytical purposes, we believe a fee for expediting delivery of a credit card is the same as a fee for reinstatement or reissuance. Not only are reinstatement and reissuance fees excluded from the finance charge, these fees are excluded from the "other" charge. *See* 12 CFR pt. 226.6(b)-2 (2000).

[23] The Board made clear in its amendments to Regulation Z dealing with debt cancellation agreements that the charge is a finance charge because the service alters the "fundamental nature of the borrower's payment obligations." This clearly is not the case here. First, the expedited credit card and payment services do not in any way alter the obligations of the consumer, but simply provide an alternative way of receiving a credit card, or making a payment. Second, in the case of debt cancellation services, the approach taken by the Board treated those services in the same manner as credit insurance. Thus, if a creditor provides certain disclosures, the fee for debt cancellation coverage, like for credit insurance, is not a finance charge. The need to ensure equal treatment is not relevant in the present circumstances.

[24] This approach would enable staff, for example, to continue to characterize as a finance charge a fee paid prior to consummation in connection with a closed-end loan for an option to convert a variable rate mortgage to a fixed rate mortgage, since the consumer presumably could not obtain the conversion option without paying the fee. Moreover, this approach would not affect the comparable cash transaction analysis, or any other "exceptions" from the finance charge under the TILA and Regulation Z.

We believe that adoption of such an approach would provide valuable guidance to creditors on how to treat fees for services that are offered to consumers in connection with credit cards. These approaches also would provide a framework that would better enable creditors to evaluate whether certain fees are (or are not) finance charges, and might help reduce the risk and complexity of the finance charge determination, a problem the Board has recognized.[25] In addition, use of such a framework would likely help creditors gain a better understanding of why the types of charges specified in the Regulation and Commentary are and are not finance charges.

Policy Implications for Treating Fees for Certain Services as Finance Charges

There would be significant implications if a fee for expediting the delivery of a credit card or a fee for expediting the delivery of a payment were treated as a finance charge. Because the fee presumably would have to be included in the calculation of the periodic statement APR,[26] this could significantly skew the APR, especially when a modest or low balance is involved.[27] This would confuse consumers and undermine understanding of the APR, obviating its purpose. Reflecting these fees in the APR would likely impair consumer educational efforts about the APR, because the fees are unrelated to a specific extension of credit. Thus, including these fees in the APR would distort the APR, misleading consumers shopping for credit, and undermine efforts to help consumers better understand the APR.

Designing systems to reflect these fees as finance charges would impose significant costs and burdens on institutions. Faced with such costs, many institutions might choose not to make these services available to consumers. This is particularly true, as is currently the case, if a small percentage of consumers request these services. It is doubtful that many institutions could economically justify the significant costs of modifying their systems because relatively few consumers request such services. Accordingly, creditors would simply not offer the services.

An additional implication of treating such fees as finance charges is that this would trigger a "change-in-terms" notice.[28] This could be a significant concern for institutions. First, an increase in the price of these services would require institutions to send notices to all consumers, at great expense to institutions, even though only a few consumers request such

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[25] In a recent report to the Congress, the Board recognized the complexity and risk associated with the finance charge determination. In its report, the Board stated that the approach of treating "some fees in, some fees out" of the finance charge "makes it more complicated for creditors to determine whether a particular fee is a finance charge." Joint Report to the Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act, Board of Governors of the Federal Reserve System and Department of Housing and Urban Development, July 1998, pp. VIII, 12.

[26] 12 CFR pt. 226.14(c) (2000).

[27] For example, if the balance on an account were $1,000, for an account with an interest rate of 18.99% and a service fee of $15, the APR would be nearly 37%. If the balance on an account were $100, for the same interest rate and fee, the APR would be over 170%.

[28] 12 CFR pt. 226.9(c) (2000).

services. Second, because relatively few consumers request such services, the costs and burdens associated with this notice would likely greatly exceed the benefits of offering this service. That is, in light of the small number of consumers who currently request such services, many institutions may be unwilling to undertake these costs and to offer these services.

Of course, an institution could offer these services and have all customers absorb the costs associated with services for a few. But, we think most institutions are unlikely to adopt this approach. Such an aggregated pricing approach is an inefficient way of pricing services and would mean that nonusers are subsidizing users of the services. Furthermore, to the extent consumers increase their use of such services, this would increase the costs all consumers pay. And, even under this aggregated pricing approach, the problems identified earlier with respect to the change-in-terms notice would not be solved, since institutions would have to provide such notices for the general pricing charges necessary to support the availability of such services.

Another disadvantage of discontinuing the expedited payment service in particular is that institutions are likely to report more consumers as "late," since fewer consumers will be able to take advantage of such services.[29] This could result in institutions reporting more consumers as late to consumer reporting agencies or to others who may contact the creditor inquiring about the consumer's payment history. Of course, late payments can affect the ability of a consumer to obtain credit or other services, as well as the costs and conditions of that credit or those services.

Treatment of Fees for Certain Services as "Other" Charges Under the Truth in Lending Act and Regulation Z

The TILA also provides that a creditor shall disclose "other charges, which may be imposed as part of the [credit] plan. . . ."[30] Regulation Z closely tracks the TILA provision, and requires creditors to disclose "the amount of any charge other than a finance charge that may be imposed as part of the plan[.]"[31] The Commentary provides that "significant charges related to the plan" must be disclosed.[32] (Emphasis added.) The Commentary also provides examples of charges that are, and are not, "other" charges. For example, the Commentary provides that an other charge includes a fee for providing documentary evidence of a transaction requested under section 226.13.[33]

Taken together, the Regulation and the Commentary provide that only charges that are "imposed" by a creditor, and that are "significant" are deemed "other" charges. Given this

[29] Based on the experiences of the members of the ABA Card Policy Council, it would appear very unlikely for consumers to independently contact commercial next-day delivery services to avoid late payments.

[30] 15 U.S.C. §1637(a)(5) (1998).

[31] 12 CFR pt. 226.6(b) (2000).

[32] 12 CFR pt. 226.6(b)-1 (2000).

[33] 12 CFR pt. 226.6(b) -1 ii (2000).

result, we believe the two service fees discussed above are neither imposed by a creditor, nor are they significant. As discussed above, we believe that the creditor does not impose these fees. That is, the consumer may obtain all of the terms of credit and the plan itself, without obtaining either service. In addition, we do not believe the fees are "significant." As discussed earlier, these services are likely to be used by a small percentage of consumers and in the case of the expedited credit card delivery service, are unlikely to be used by a consumer more than once. It also is likely that a consumer who uses the expedited payment service will do so on an infrequent basis. Thus, these fees are not a significant part of the credit plan. In addition, in light of the nature of these services, we believe it is highly unlikely that any consumer will shop for these features or select a credit card or open-end plan based on the costs of these services.

The Commentary lists several fees that are excluded from the "other" charge disclosure, such as application fees, reinstatement and reissuance fees, and fees for documentary evidence of transactions (for income tax purposes). We believe the rationale for excluding these services applies to an expedited credit card delivery fee and to a fee for an expedited payment. And, as discussed earlier, we see no difference between a fee for expedited delivery of a credit card and a fee for reinstatement or reissuance. As with the fees excluded from the "other" charge in the Commentary, the expedited credit card delivery and payment fees are unlikely to be used on a recurring basis, and are unlikely to be considered by consumers in shopping for credit.

Requiring the disclosure of the fee for these services as an "other" charge on periodic statements would provide limited benefits to consumers. In addition, as discussed earlier, a significant implication of treating these services as "other" charges is that this would trigger a "change-in-terms" notice. The significant costs associated with the change-in-terms notices would discourage institutions from making these services available to their consumers.

Conclusion

In summary, we believe a fee to expedite the delivery of a credit card and a fee to expedite the handling of a payment on an open-end credit plan should not be viewed as a finance charge nor as an "other" charge for purposes of the TILA and Regulation Z. To conclude otherwise could effectively force creditors to cease making these services available to consumers, to the great detriment and inconvenience of consumers.

We believe it is important for the Board to provide greater guidance on these matters in the Official Staff Commentary. For the reasons stated above, we believe it would be helpful to creditors for the Board to clarify the approach used to determine whether fees for services are finance charges. Furthermore, providing a general statement of principal would enable creditors to more effectively determine which service fees should be treated as finance charges.

* * * * *

We hope that this information adds substantially to our earlier discussion. If we can provide any additional information please do not hesitate to contact Nessa Feddis at (202) 663-5433.