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March 28, 2005

VIA E-MAIL

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

Re: Truth in Lending: Advanced Notice of Proposed Rulemaking (Docket No. R-1217)

Ladies and Gentlemen:

We appreciate the opportunity to submit comments on the Board's advanced notice of proposed rulemaking to commence a review of the open-end (revolving) credit rules of the Board's Regulation Z (Truth in Lending), 12 C.F.R. Part 226.[1] As a financial services law firm, Schwartz & Ballen LLP provides advice to financial institutions concerning Regulation Z. Because our clients will be affected if the Board proposes to commence the proposed review, we believe it is appropriate to provide the Board with our views concerning the notice.

OVERVIEW

We applaud the Board for undertaking a review of Regulation Z. We believe, however, that that Board should conduct a review of the rule as part of a comprehensive rulemaking rather than on a piecemeal basis. This would avoid the possibility of consumer confusion as well as reduce the overall transition and implementation cost. We also believe that the Board should retain outside experts to assist it in determining whether proposed forms of disclosure will in fact prove meaningful to consumers.

[1] 69 *Fed. Reg.* 70925 (Dec. 8, 2004).

SPECIFIC COMMENTS

Our responses to the Board's questions are as follows:

Q1. The Board solicits comments on the feasibility and advisability of reviewing Regulation Z in stages, beginning with the rules for open-end credit not home-secured. Are some issues raised by the open-end credit rules so intertwined with other TILA rules that other approaches should be considered? If so, what are the issues and what other approach might the Board take to address them?

Comment: While the Board is to be commended for considering a review of Regulation Z, we are concerned that a multi-year review of the regulation in stages could prove burdensome to creditors and confusing to consumers. There simply is no compelling reason why Regulation Z need be reviewed in stages over a number of years. Such a review will undoubtedly prove disruptive to creditors as they will be required to retrain staff, modify operations, reprogram computers and revise forms each time the Board adopts changes. Consumers will be confused because there will be little basis for comparison among credit offers during the transition and implementation periods. We believe that the expense that will be incurred by creditors and consumers will far outweigh any marginal benefits that may be realized from a piecemeal review of Regulation Z. Accordingly, we believe that a better approach would be for the Board to take a fresh look at Regulation Z as a whole rather than approach it as a multi-year task.

Moreover, our experience suggests that it will prove difficult for the Board to consider open-end credit in isolation. Issues relating to the determination of finance charges and disclosure standards are integrally related to standards applicable to closed-end credit. Accordingly, we believe that a global, comprehensive approach to a review of Regulation Z is called for. Such a review should of necessity include revisions to the Official Staff Interpretations, Supplement I to 12 C.F.R. Part 226, and the Model Forms and Clauses, Appendices G and H to 12 C.F.R. Part 226

Q2. What formatting rules would enhance consumers' ability to notice and understand account-opening disclosures? Are rules needed to segregate certain key disclosures from contractual terms or other information so the disclosures are more clear and conspicuous? Should the rules require that certain disclosures be grouped together or appear on the same page? Are minimum type-size requirements needed, and if so, what should the requirements be?

Comment: We see no need to adopt rules to segregate disclosures from other information. Open-end credit card agreements are typically presented and captioned in sections. Regulation Z already requires the finance charge and annual percentage rate to be presented in a manner that is clear and conspicuous. Requiring additional segregation and minimum type-size requirements would reduce the relative importance of those terms and would serve very little purpose. The existing requirements of Regulation Z provide creditors with flexibility to design formats that provide information tailored to the credit

terms being offered to consumers. Application of rigid rules requiring segregation of information will not improve consumer understanding of the information presented, but will serve only to overload information disclosed to consumers.

Q3. Are there ways to use formatting tools or other navigational aids for TILA's account-opening disclosures that will make the disclosures more effective for consumers throughout the life of the account? If so, provide suggestions.

Comment: We believe that it is not desirable for the Board to specify formatting tools and navigational requirements for account-opening disclosures. Depriving creditors of flexibility in the manner in which information is presented will not serve consumers and could result in less meaningful disclosures. If the Board wishes to consider formatting tools and navigational aids, it may wish to present them in the context of revisions to the Model Forms and Clauses.

Q4. Format rules could require certain disclosures to be grouped together or appear on the same page where it would aid consumer's understanding. . . . Is such a rule desirable? Are there other disclosures that should be grouped together on the same page?

Comment: Attempting to determine when it may be beneficial to group certain disclosures together is a very complex issue. It requires a comprehensive review of how consumers perceive and interpret disclosures presented to them. We suggest that the Board consider conducting a study to determine how consumers process disclosures. In any event, we suggest the Board propose revisions to its Model Forms and Clauses rather that establish a rigid rule based upon intuition that may prove to be of little benefit to consumers.

Q5. Could the cost of credit 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? Are there other approaches the Board should consider? If so provide suggestions.

Comment: We do not believe that the presentation of the cost of credit will be enhanced if less emphasis is placed on how fees are labeled or if all fees were grouped together on the periodic statement. Requiring such labeling or grouping will stifle creativity and reduce flexibility with very little, if any, benefit to consumers. Again, it may be appropriate for the Board to consider this proposal in the context of revising the Model Forms and Clauses.

Q6. How could the use of formatting tools or other navigational aids make the disclosures on periodic statements more effective for consumers?

Comment: We do not believe that the use of formatting tools or navigational aids will result in more effective disclosures for consumers. Indeed, there is little evidence that

consumers have difficulty in understanding periodic statements they receive from creditors. In the absence of such support, we believe that requiring formatting tools or navigational aids is unwarranted.

Q7. Is the "Schumer box" effective as currently designed? Are there format issues the Board should consider?

Comment: We believe the Board should propose eliminating the requirement currently set forth in § 226.5a(b)(1) of Regulation Z that the annual percentage rate for purchases be in at least 18-point type. As the Board recognizes, this is the only instance in which Regulation Z specifies a type size. It is inconsistent with the approach the Board has taken to provide flexibility to creditors to determine the manner and context in which disclosures may be made. Accordingly, we believe that no specific type size should be mandated.

Q8. Given the prevalence of balance transfer promotions in credit card applications and solicitations, should balance transfer fees be included in the Schumer box?

Comment: Regulation Z permits a creditor to disclose balance transfer fees inside the Schumer box or clearly and conspicuously elsewhere on or with the application. We believe that it would be a mistake to reduce the flexibility Regulation Z currently provides to creditors by requiring that balance transfer fees be included in the Schumer box.

Q9. Are there formatting tools or navigational aids that could more effectively link information in the account-opening disclosures with the information provided in subsequent disclosures, such as those accompanying convenience checks and balance transfer checks?

Comment: We believe that mandating formatting tools or navigational aids will reduce the flexibility that is currently found in Regulation Z. Such requirements will serve only to confuse consumers and reduce the likelihood that consumers will receive meaningful, understandable information about their accounts and account terms.

Q10. Should existing clauses and forms be revised to improve their effectiveness?

Comment: We believe the Board should focus its attention on revising existing forms and clauses. Given the changes that have occurred in the types and range of credit offerings, existing model clauses and forms are sorely outdated and in need of revision. At this stage of the proceeding, it would not be practical to specify the model forms and clauses that should be revised. Accordingly, we recommend that the Board conduct a study of forms and clauses that are currently being used by creditors and factor its findings into a proposal that can be considered by the industry and consumers.

Q11. Would additional model clauses or forms be helpful? If so, please identify the types of new model clauses and forms that the Board should consider developing.

Comment: The Board should consider adopting new model forms and clauses. A survey of forms and clauses currently in use would provide the Board with a great deal of information regarding what new model forms and clauses may be desirable.

Q12. Is there additional information on the navigability and readability of different formats, and on ways in which formatting can improve the effectiveness of disclosures?

Comment: We agree that the Board should make use of consumer focus groups and other research. We also suggest that the Board retain consultants who possesses expertise in graphic design and consumer perceptions. This is an area in which many firms possess extensive experience, and the Board should be prepared to use resources that are available in the marketplace to the fullest extent possible.

Q13. How could the Board provide greater clarity on characterizing fees as finance charges or "other charges" imposed as part of the credit plan? What fees should be excluded from the finance charge and why? How would these fees be disclosed to provide uniformity in creditors' disclosures and facilitate compliance?

Comment: The current approach regards a fee as a finance charge if it is an incident to or a condition of the extension of credit. Because the rules for open-end credit provide no tolerance for errors in disclosing the finance charge, creditors are at risk if they inadvertently characterize the charge as an "other" charge. This places creditors in an untenable position. We believe that treating as a finance charge a fee that is required as a condition of obtaining credit is a better approach that should be considered by the Board. Such an approach would provide a greater degree of clarity than is currently the case and reduce risk exposure for creditors.

Q14. How do consumers learn about the fees that will be imposed in connection with services related to an open-end account, and any changes in the applicable fees?

Comment: Consumers become aware of fees and changes in fees in several ways. Fees are disclosed in the Schumer box as well as in the account agreement. Consumers also are made aware of changes in fees through the use of change-in-terms notices which are sent to or otherwise made available to them by creditors. Finally, fee changes are often delivered to consumers with or on periodic statements.

Q15. What significance do consumers attach to the label "finance charge" as opposed to "fee" or "charge"?

Comment: We believe that consumers view a finance charge as interest, whereas they regard other fees and charges as additional expenses they may incur as a result of their other actions (*e.g.*, late payment). This suggests that fees that are incident to the extension of credit should not be regarded as finance charges, but rather as other fees.

Q16. Some industry representatives have suggested a rule that would classify fees as finance charges only if payment of the fee is required to obtain credit. How would creditors determine if a particular fee was optional? Would costs for certain account features be excluded from the finance charge provided that the consumer was also offered a credit plan without that feature? Would such a rule result in useful disclosures for consumers? Would consumers be able to compare the cost of the different plans? Would such a rule be practical for creditors?

Comment: We believe that consistency and certainty of outcome is the preferable approach. Regardless of what approach is deemed appropriate, similar charges should be treated similarly. The result should not be dependent upon whether the context of the transaction is open-end credit or closed-end credit. For example, a fee for expedited payment is not a finance charge in the context of open-end credit. However, it is not readily apparent whether this is the case in the context of closed-end credit. We suggest that the Board adopt an approach that enables creditors to readily determine what constitutes a charge imposed as a condition of the extension of credit and eliminate the incidental test. This would provide a greater degree of certainty and consistency to creditors. It would also prove far more meaningful to consumers, who will be in a better position to compare the cost of various options offered by creditors.

Q17. Some industry representatives have suggested a rule that would classify a fee based on whether the fee affects the amount of credit available or the material terms of credit. How would such a standard operate in practice?

Comment: We do not believe that such an approach provides the degree of certainty creditors desire, nor does it facilitate the ability of consumer to compare credit offerings.

Q18. TILA requires the identification of other charges that are not finance charges and may be imposed as part of the plan. The staff commentary interprets the rule as applying to "significant charges" related to the plan. Has that interpretation been effective in furthering the purposes of the statute?

Comment: We believe that the staff commentary has provided useful guidance to the industry and to consumers. While we believe that it may be helpful to provide additional guidance in the form of a list of factors to take into account, this interpretation has not generally been one that creditors find difficult to apply.

Q19. What other issues should the Board consider as it addresses these questions?

Comment: In considering changes to Regulation Z, the Board should strive to propose and adopt changes that simplify and clarify the rule, facilitate compliance by creditors and improve the ability of consumers to understand and compare credit offerings.

Q20. How important is it that the rules used to classify fees for open-end accounts mirror the classification rules for closed-end loans?

Comment: We believe that it is very important that the rules used to classify fees for open-end accounts mirror the classification rules for closed-end loans in order to achieve consistency and predictability among credit offerings. It is very difficult to explain to clients why some items are treated one way for open-end credit and another way for closed-end credit. We believe the Board's endorsement in 1998 of an "all required fees" approach for closed-end mortgage credit is inconsistent with the Board's approach to fees associated with open-end credit and should be reconsidered in light of changed circumstances.

Q21. Is there a need for guidance with respect to fees imposed for exceeding a credit limit, for example, when the creditor does not require the consumer to bring the account balance below the originally established credit limit, but imposes an over-the-credit-limit fee each month on a continuing basis?

Comment: Additional guidance may be appropriate in this area in order to achieve consistency, certainty and predictability.

Q22. How do card issuers explain to consumers their practice of approving transactions that might result in the consumer's exceeding the previously established credit limit for the account and being charged an over-the-limit fee? The Board specifically requests comments on whether additional disclosures are needed regarding the circumstances in which over-the-credit-limit fees will be imposed.

Comment: Our experience is that consumers do not wish to have their purchases denied on the basis that the charge will exceed their established credit limits. Consumers wish to avoid the embarrassment of having their transactions declined, and generally prefer to incur an over-the-credit limit charge because it results in their obtaining goods and services they desire. It would be extremely unusual for a consumer to complain to a creditor that they should have declined approving the consumer's purchase. Indeed, we find that consumers are grateful when their purchases are approved notwithstanding the fact that they will exceed their credit limits. Accordingly, we do not believe that additional disclosures are needed at this time.

Q23. Have changes in the market and in consumers' use of open-end credit since the adoption of TILA affected the usefulness of the historical APR disclosure?

Comment: It has been our experience that consumers generally do not understand how the historical/effective APR differs from the APR based on a periodic interest rate. We suggest that the Board conduct consumer studies to determine whether the historical/effective APR continues to serve any meaningful purpose. If it does not, we recommend that the Board propose to eliminate the disclosure.

Q24. Are there ways to improve consumers' understanding of the effective APR, such as by providing additional context for the disclosure?

Comment: We recommend that the Board conduct studies of whether the effective APR has any meaning for consumers. If the studies indicate that it is of little value to consumers, the Board should propose eliminating it as a required disclosure.

Q25. Are there alternative frameworks for disclosing the costs of credit on periodic statements that might be more effective than disclosing individual fees and the effective APR?

Comment: We believe that the existing framework for disclosure of individual fees is meaningful to consumers and satisfactory to creditors.

Q26. Is mailing a notice 15 days before the effective date of a change in interest rates adequate to provide timely notice to customers?

Comment: We believe that the 15-day prior notice requirement is effective and satisfactory to consumers. Accordingly, we recommend that no change be made in this area.

Q27. How are account-holders alerted to increased interest rates due to consumers' default on this account or another credit account?

Comment: Consumers are advised about increases in rates due to defaults in their account agreements and in periodic statements.

Q28. How significantly does the balance calculation method affect the cost of credit given typical account use patterns?

Comment: As indicated in the Board's notice, the balance calculation method may have a significant impact on the cost of credit.

Q29. Do consumers understand that different balance calculation methods affect the cost of credit, and do they understand which balance calculation methods are more or less favorable for consumers?

Comment: We believe that consumers generally understand that different balance calculation methods affect the cost of credit, and that certain balance calculation methods are more or less favorable. To the extent that consumers are sensitive to this issue, they are provided considerable information to compare credit offerings.

Q30. Should the Board permit more abbreviated descriptions [of balance calculation methods] on periodic statements along with a reference to where consumers can obtain further information about the calculation method, such as the credit agreement or a toll-free telephone number?

Comment: We believe it would be useful for the Board to permit abbreviated descriptions of balance calculation methods on periodic statements. If consumers are interested in additional information, they can always call a toll-free number or request a copy of their credit agreement.

Q31. Is it appropriate for the Board to consider whether Regulation Z should be amended to require (1) Periodic statement disclosures about the effects of making only the minimum payment; (2) account-opening disclosures showing the total of payments when the credit plan is specifically established to finance purchases that are equal or nearly equal to the credit limit (assuming only minimum payments are made)?

Comment: We believe that the issue of disclosures relating to the effects of making only the minimum payment are complex. It can be exceedingly difficult to make the calculations that would be required by such a disclosure requirement. While disclosure of total payments are more manageable when the credit plan is specifically established to finance purchases that are equal or nearly equal to the credit limit, such plans are not consistent with the way in which open-end credit plans are actually used by consumers. Moreover, it is not entirely clear what consumer benefits are realized by requiring such disclosures. In our view, such disclosures are of little practical value to consumers.

Q32. Is information about the amortization period for an account readily available to creditors based on current accounting systems, or would new systems need to be developed?

Comment: We have been advised that information about the amortization period for an account is not readily available to creditors based on current accounting systems. We also understand that new and expensive programming would be required to make such disclosures.

Q33. Is there data on the percentage of consumers, credit cardholders in particular, that regularly or continually make only the minimum payments on open-end credit plans?

Comment: We have been advised that data indicate that the turnover period for open-end credit accounts is less than three years. This suggests that only a small portion of cardholders regularly make only the minimum payments on open-end plans.

Q34. What are common methods of payment allocation and how much do they affect the cost of credit for the typical consumer?

Comment: We understand that payment allocation methods generally are determined by state law.

Q35. Do creditors typically disclose their allocation methods and, if so, how?

Comment: It is our understanding that creditors typically disclose allocation methods in their credit agreements.

Q36. Is it appropriate for the Board to consider whether Regulation Z should be amended to require disclosure of the payment allocation method on the periodic statement?

Comment: We believe it would be inadvisable to require disclosure of the payment allocation method. Such an additional disclosure would serve only to make what is already an exceedingly complex set of disclosures even more difficult for consumers to comprehend. Consumers who have an interest in the payment allocation method used already have the ability to obtain such information from creditors.

Q37. What [numerical] tolerances should the Board consider adopting for purposes of TILA?

Comment: Current law requires numerical tolerances be narrow enough to prevent misleading disclosures. We anticipate that the existing standard should be acceptable to most creditors.

Q38. In considering changes to the disclosures required by Regulation Z, the Board seeks data relevant to the costs and benefits of the proposed revisions.

Comment: It will prove very difficult for creditors to estimate the cost associated with proposed revisions to disclosure requirements. Nonetheless, it is readily apparent that expenses associated with reprogramming, training and preparation of new forms will be quite high for each creditor and for the industry as a whole. Accordingly, the Board should carefully balance the additional cost burden imposed on creditors against the benefits before proceeding with proposed revisions.

Q39. Are there 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?

Comment: We believe it would be a mistake for the Board to propose additional disclosure requirements for particular types of open-end credit accounts. The disclosure requirements already in effect are quite complex. Additional disclosures will prove confusing, serve no useful purpose and would be of little benefit to consumers.

Q40. Are there additional issues the Board should consider in reviewing the content of open-end disclosure?

Comment: We believe the Board's notice discusses all of the important issues raised by this matter.

Q41. Are there classes of transactions for which the Board should exercise its exemption authority under 15 U.S.C. 1604(a) to effectuate TILA's purpose?

Comment: We do not believe that there are classes of transactions that the Board should exempt from Regulation Z.

Q42. Should the Board exercise its authority under 15 U.S.C. 1604(g) to provide a waiver for certain borrowers whose income or assets exceed specified amounts?

Comment: Because disclosures in connection with credit card accounts are typically preprinted on application forms, we do not see any practical way in which such an exemption could be implemented.

Q43. The Board solicits comments on whether there is a need to revise the provisions implementing TILA's substantive protections for open-end credit accounts.

Comment: Generally, Regulation Z's provisions implementing TILA's substantive provisions are clear and well-understood by consumers and creditors. We believe there is little reason for the Board to propose substantive changes in this area.

Q44. Information is requested on whether industry has developed, or is developing, open-end credit plans that allow consumers to conduct transactions using only account numbers and do not involve the issuance of physical devices traditionally considered to be credit cards. If such plans exist, what policies do such creditors have for resolving accountholder claims when disputes arise?

Comment: We are aware of the existence of several open-end credit plans that do not involve the issuance of access devices. We understand that in connection with such

programs creditors use the same dispute resolution processes that currently apply to their credit card plans.

Q45. Have consumers experienced problems with convenience checks relating to unauthorized use or merchant disputes, for example? Should the Board consider extending any of TILA's protections for credit card transactions to other extensions on credit card accounts and, in particular, convenience checks?

Comment: We do not believe that it is appropriate to treat convenience checks in the same manner as credit cards with respect to disputes. To do so would force a creditor to assume merchant risk in instances where the creditor cannot, as a practical matter, require the merchant to accept a chargeback. Convenience checks are negotiable instruments. If a consumer asserts that a check is unauthorized, the creditor typically will credit the customer's account and return the item to the presenting bank as a forgery. However, if there is a merchant dispute, the creditor is not in a position to require the merchant or its bank to accept the return item. Under credit card rules, the merchant may be required to accept the return. It would be extremely difficult to harmonize check law with Regulation Z dispute resolution requirements, and the Board should avoid entering this area at this time.

Q46. Should the Board 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?

Comment: The Board should consider permitting creditors to issue additional credit cards on an existing account even when there is no renewal or substitution of a previously issued card if circumstances so warrant. Creditors could establish security devices, such as requiring a telephone call to activate the card, to reduce potential issues that could arise in connection with the issuance of additional credit cards.

[No comments on Q47 through Q51]

Q52. The Board invites the public to identify issues where they believe staff's informal advice should be formalized and addressed anew.

Comment: We believe that the current approach of updating the official staff commentary periodically and amending Regulation Z as needed is the appropriate approach. Given the enormous undertaking involved in revising Regulation Z, we suggest that for the foreseeable future, the Board concentrate staff resources on perfecting the existing rules and commentary.

Q53. Should *de minimis* amounts be adjusted, and if so, to what extent?

Comment: We think it is appropriate for the Board to consider adjusting the amounts considered to be *de minimis,* in particular because the amounts have not been reviewed in

years. We suggest that a review of the current levels will reveal that they should be adjusted to reflect intervening increases in price levels.

Q54. Improving plain language and organization.

Comment: The Board should proceed cautiously in this area. Creditors and consumers are familiar with the current language of Regulation Z and the official staff commentary. Changes, even those attempting to make the rules more easily understood, may have the unintended effect of confusing issues and making unclear that which was readily understood by creditors and consumers. In this regard, we are not aware of any significant or systemic misunderstandings with regard to Regulation Z and the official staff commentary.

Q55. Are any provisions of Regulation Z obsolete?

Comment: At this time, we are unaware of any obsolete provisions of Regulation Z that should be eliminated.

Q56. Recommendations for legislative changes.

Comment: We recommend that the Board seek authority to adjust dollar amounts established by TILA. The amount of such adjustments should be left to the Board's discretion.

Q57. Recommendations for nonregulatory approaches.

Comment: We believe that the Board should consider spending additional resources in developing model forms and clauses that creditors can readily use. Revised forms would be of enormous benefit to creditors and consumers.

Q58. Reviewing other aspects of Regulation Z.

Comment: We believe that the Board should be mindful that a piecemeal approach may result in inadvertent inconsistencies between rules applicable to open-end credit and those applicable to other types of credit. We suggest that the Board consider a more comprehensive approach towards revising Regulation Z.

We appreciate the opportunity to comment on the Board's proposal and look forward to the opportunity to consider additional proposals.

Sincerely,

Gilbert T. Schwartz