BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

Docket No. R-1217

COMMENTS OF THE MINNESOTA ATTORNEY GENERAL ON THE ADVANCED NOTICE OF PROPOSED RULE-MAKING FOR PART B OF REGULATION Z

The Attorney General of Minnesota submits these brief Comments in connection with the Federal Reserve Board's review of the open-end credit rules under Part B of Regulation Z. The Board's commitment in the advanced notice of proposed rule-making to conduct a thorough review of its rules on consumer credit is commendable and appropriate. These rules are in need of a comprehensive overhaul to protect consumers and the marketplace from serious problems of consumer confusion and misunderstanding in the use of open-end credit.

I. INTER-RELATED PROBLEMS OF CONSUMER CREDIT FRAUD

During the past two years, the Minnesota Attorney General's Office has taken numerous actions against fraudulent purveyors of foreclosure rescue schemes. Preying on desperate homeowners in foreclosure, these companies and individuals take title to homes in foreclosure and strip the remaining equity for their own gain, typically depriving the foreclosed homeowner of his or her last remaining asset. This Office also has aggressively pursued companies engaged in other predatory lending practices in Minnesota, especially with home mortgages.

One striking aspect of these cases is that many homeowners' financial problem can be tied directly to massive credit card debt, often as a result of disability or illness but compounded by credit card fees and charges. The primary sales pitch by predatory lenders is that the consumer can achieve lower overall payments by refinancing significant, high-cost credit card debt in a home refinancing loan. Simply turn on the television and one can observe multiple mortgage lenders promising consumers a happier life without the burden of high credit card payments. It is not unusual to observe refinancing loans in which a consumer traded manageable mortgage payments for a higher-cost mortgage loan that increased the consumer's potential for financial disaster on the occurrence of a job loss or unexpected expense. Sometimes, debt collectors for credit card issuers and predatory home mortgage lenders have joined forces in persuading consumers to exchange their high-cost, but unsecured debt, for lower cost mortgage debt that often imperils the consumer's ownership of the home. At root, the problem of predatory home lending is substantially inter-twined with the problem of excessive credit card debt.

Credit card debt also drives other pressing consumer protection concerns. For example, several state Attorneys General filed lawsuits against Ameridebt and related entities. Ameridebt promoted itself as a nonprofit corporation that could assist consumers in managing debts. The lawsuits alleged that Ameridebt misused its nonprofit status and made other misrepresentations that often sunk consumers further in debt. Again, the primary sales pitch by the company was high consumer credit card debt.

Revising Regulation Z obviously will not solve excessive credit card debt, predatory lending or related problems. The existing open-end credit rules, however, do far too little to assist consumers in understanding or managing credit. This brief comment will suggest some guiding principles for revising the open-end disclosure rules and will propose some other specific areas for revision of the regulations.

II. PRINCIPLES FOR ADEQUATELY PROTECTING CONSUMERS IN REVISIONS TO REGULATION Z OPEN-END DISCLOSURE RULES.

The Minnesota Attorney General proposes the following three principles as guideposts for re-drafting open-end disclosure requirements:

1. Disclosures should be easily understood by average consumers.

2. Important items should be disclosed with equal prominence to marketing claims.

3. The content of disclosures and corresponding consumer rights should be directly related to the action facing the consumer at the time the disclosure is required to occur.

These principles are directed at making disclosures meaningful to a significant number of consumers.

Current open-end disclosure requirements are focused on the amount of information disclosed, the precise meaning of important terms like "finance charge" and "APR" and when the disclosures must be made in the solicitation, initiation and billing process. These concerns are not meaningful unless the rules also address the three above-listed factors that make the disclosures useful to the average consumer.

A. *Disclosures should be easily understood by less sophisticated consumers.*

Many of the mandated open-end disclosures in Regulation Z as it now exists probably are fully meaningful only to a few thousand lawyers and others who work in the consumer credit field. It is almost certain the distinction between a "finance charge" and "other charge" is of little or no consequence or concern to almost any consumer. Pages 10 and 11 of the ANPR correctly identify a fundamental problem with current disclosures, which need to be "clearer, simpler, easier to understand, written in lay terms, or in large print." From the point of the view of the average consumer, there is essentially no difference between a disclosure buried in the fine print and no disclosure at all. Disclosures based on revised requirements should be test-marketed with groups of less sophisticated consumers to ensure that everyone is capable of and likely to comprehend the information.

B. *Important items should be disclosed with equal prominence to marketing claims.*

The ANPR requests guidance on the "format" of the disclosures. This concern should extend not only to the appearance of the disclosures, but to the relative prominence of the disclosures. Segregated, carefully grouped disclosures that appear on the back of page four of a six page solicitation are highly unlikely to be read. Revised Regulation Z should require that the key disclosures appear on the first page of written or internet solicitations or are on a separate piece of paper that is either the first or second page in any multi-page mailing. Similarly, these disclosures should be provided promptly as part of an oral (inbound or outbound) telemarketing solicitation.

Prominence, however, should also be judged relative to the marketing claims of the potential creditor. The current advertising requirements of section 226.16 use the trigger term concept to mandate the disclosure of substantial amounts of information, but allow this information to be disclosed in any manner that is deemed clear and conspicuous. Fine print disclosures that flash on the screen at the end of television ads, ten-point type footnotes in mailers or the like are not useful to consumers.

Instead, the Minnesota Attorney General proposes that the "equal prominence" concept, such as in section 213.7 of Regulation M, be employed with open-end credit disclosures. If the creditor advertises no annual fee, all other required fees should be disclosed *with equal prominence.* If the creditor advertises an APR but has alternative APRs that it knows a substantial number of consumers will ultimately pay, the alternative APRs should be disclosed *with equal prominence.* This would include the penalty rate APR or that the APR can be changed in the sole discretion of the creditor at any time.

Credit cards and other open-end credit arrangements are complex. Allowing creditors to highlight certain benefits without equally prominently disclosing directly related terms that limit or condition that benefit has led to consumers accepting open end credit on terms that they did not understand.

C. *The content of post-sale disclosures and the corresponding method of effectuating consumer rights should be directly related to the action facing the consumer at the time the disclosure is required to occur.*

Finally, disclosures should be tied to forms, web-links or the like that allow the consumer to easily effectuate his or her rights. Given the complexity of the transaction and regulations for the average consumer, disclosing to the consumer rights that may exist on the contingency of future events is of substantially less value than clear, prominent disclosures that occur at the time the future event becomes the current reality.

For example, the right to contest a charge or disclosure should be prominently disclosed with each credit card bill. While the right to contest a billing error under section 226.13 has seeped into the broader public consciousness, very few consumers understand the far more powerful, if more limited in scope, rights under section 226.12. A prominent disclosure on the front page of the bill might indicate to consumers that an explanation of all billing rights is on the back of the bill, such as: **"If you have a dispute about the merchandise listed as purchased on this statement, or questions about the accuracy of this bill, look on the back for an explanation of your rights to dispute the charge. Or visit (targeted Board website address)."** The statement of billing rights set forth in Appendix G-3 and G-4 should be modified to put the section 226.12 rights first and re-title the section from "Special Rule For Credit Card Purchases," to "Right to Withhold Payment."

III. RECOMMENDATIONS FOR IMPROVED CONSUMER PROTECTIONS

More important than improved disclosures are substantive limits, consistent with the purpose of the Truth in Lending Act, on the ability to unfairly change the terms of credit card transactions. The Minnesota Attorney General proposes at lease three revisions to remedy the unequal bargaining power in favor of card issuers that is inherent with credit card transactions: (1) improved protections with change in terms; (2) a new consumer right to cancel within ninety days of card issuance; and (3) consistent and fair standards for crediting of payments. We also hope the Board will consider other similar protections for consumers facing the complex credit decisions required when dealing with open-end credit.

A. *Consumers should have improved protections for change in terms and costs of card use.*

Credit card charges are among a group of areas that consistently generate a large number of consumer complaints to the Minnesota Attorney General's Office. One of the primary complaints to this Office is that credit card companies seemingly arbitrarily change the terms and costs associated with the card agreement. The consumer, for instance, believes that he or she has a 4.9% rate, but is sent a bill or notice with a rate of 22.9%. Or, the consumer's credit limit is drastically lowered. In many cases, these changes are because of "trip wires," such as penalty rate pricing, including universal default provisions, that are unlikely to be known to the consumer.

The Minnesota Attorney General recommends that the Board delete the provision in section 229.9(c) that excludes from the change-in-term notice requirements when "a periodic rate or other finance charge is increased because of the consumer's delinquency or default." While such an increase could vary from the issuer's representations and advertisements or solicitations such that it violates state consumer protection statutes, any change in the cost of credit, whether it is due to the sole discretion of the issuer, as a result of the consumer hitting a trip wire, or for any other reason, should also be treated as a change in terms under TILA.

We further suggest that the Board require 90 days notice before any change in terms becomes effective, and allow the consumer a right to cancel the card and pay off the existing balance under the old terms. The right to cancel should be accompanied by a simple form for that purpose that could be checked-off and sent in by the consumer.

B. *Consumers should have a ninety day right to cancel with all fees and non-interest charges refunded.*

A fundamental problem with current credit card solicitations is that consumers are given solicitations that promise tempting benefits but deliver much less; in other words, bait and switch is rampant in this industry. For instance, many subprime risk consumers are sent credit cards that offer a credit limit of $500-$5,000, or the like. In reality, almost everyone receiving this offer will get a card with a $500. Worse, the $500 limit comes burdened with high initial fees that immediately put the consumer in jeopardy of unknowingly exceeding the credit limit and then spiraling down with over-limit fees and other card-issuer charges. Lower risk consumers

experience a version of the same problem. For instance, some issuers offer bonus airline "miles" at X miles to the dollar. The reality of the offer, buried in the disclosures, is a complex system that makes it unlikely that many of the offered consumers would ever see mile accumulation at this level.

The Minnesota Attorney General suggests a 90 day right to cancel during which the consumer could cancel the card and receive a credit of all fees imposed by the card issuer. This change would not only protect the reasonable expectations of the consumer, it would create an incentive for the issuer to more carefully consider the initial terms it offers to consumers. Consumers would have a reasonable period to experience the real terms of the offer before becoming obligated to pay the fees and costs associated with the card.

C. *Consistent and fair standards for crediting of payments.*

Another area of consistent consumer complaints with credit card companies is the imposition of late fees due to creditor's failure to promptly credit payments. Given the proliferation of penalty rate pricing and the extraordinary rise in the amount of late fee charges, this issue is of great importance to consumers. We make two suggestions in this regard.

First, credit card statements prominently feature a date by which the consumer must make payment to avoid a late fee. The fine print on the back of the bill, however, often sets a time of day on the due date after which payment received is considered untimely. *See* Staff Commentary to section 226.10(b) (permitting such cut-off hours). Again, this is just a trap for the ordinary consumer. Almost no one would understand that, for instance, January 21st means 10a.m. on January 21st. Or that payment in person must be made by 10:00 a.m. while mail must be received by noon. Section 226.10 should be revised to require that payments are timely if received by midnight on the date shown on the periodic statement.

Second, creditors should be required to accept as timely any payment for which the consumer could provide proof that the payment was sent under circumstances that the consumer could reasonably expect would result in timely payment. For U. S. Mail, a five day postal rule, or the like, would be appropriate. Card users are particularly upset when they act reasonably in making payment and the issuer claims that the payment just did not arrive on time. For some consumers, it is critical that a payment be timely in a given month. The proposed rule would provide assurance that these consumers have a means to guarantee that such payments be credited as timely.

CONCLUSION

The Board should be commended for taking a comprehensive approach to the amendment of Regulation Z open-end credit rules. The current rules are woefully inadequate to provide meaningful assistance or protections to consumers in credit transactions. Managing credit card purchases, in particular, have become a central part of the financial lives of American consumers. An amended Regulation Z should focus on helping to protect average consumers, the overwhelming majority of whom do not read or understand dense disclosures before making every-day decisions about their use of credit cards.