Docket No. R-1314
Meeting at the Federal Reserve Board on May 6, 2008

On May 6, 2008, several credit card industry representatives met with Governor Randall Kroszner and members of the Board's staff to discuss the Board's recently proposed rules under the Federal Trade Commission Act (Regulation AA), which address unfair or deceptive acts or practices in connection with credit card accounts.

The meeting was attended by Ken Clayton (American Bankers Association), Nessa Feddis (American Bankers Association), Oliver Ireland (Morrison & Foerster), Andy Navarette (Capital One), Greg Baer (Bank of America), and John Carey (Citibank). Also in attendance were Sandra Braunstein, Director of the Board's Division of Consumer and Community Affairs, and several members of her staff.

The discussion focused on the Board's proposal to restrict banks' ability to increase the interest rate on cardholders' existing balances. Industry representatives made the following points during the meeting:

- The proposal would prevent card issuers from adjusting the rate on the existing balance to reflect increased risk of consumer default. Because initial underwriting cannot identify the 5% of consumers who will eventually default on their accounts, issuers must continue to reevaluate the risk over time by, for example, looking at credit scores. Increasing the interest rate for these consumers does not lead to higher defaults; instead, some consumers charge less and pay off faster. When the interest rate is increased due to increased risk, additional revenue is earned from the majority who do not default, which is used to offset losses on the smaller number of accounts that go into default and will be charged-off.

- Allowing issuers to increase the rate only on new transactions is not sufficient because the greatest risk is on funds already extended. The proposed exception for accounts that are 30 days delinquent does not offer sufficient flexibility to tailor risk-based pricing to consumer characteristics. The majority of consumers who default are never 30 days late; instead, they make minimum payments for a period of time and then default.

- The proposal would lead issuers to raise rates and reduce available credit for all consumers rather than the small subset who present the greatest risk of default.

- Currently, card issuers can offer consumers the benefit of having a rate that is fixed for a period of time (possibly two or three years) because the issuer knows it has the ability to increase that rate after that period of time to achieve the expected return when there are market changes. The proposal would drive issuers to offer only variable rates, which would deny consumers the security of knowing their rate and payments will not increase for a set period.

- Rather than prohibiting rate increases on existing balances, the final rule should permit such increases if consumers also have the ability to opt-out of the increase by closing the account. If a rate increase accurately reflects the available market rates for that consumer, it is rational for a consumer to accept the increase and not opt-out because, if they close that account, the consumer may not be able to get a lower rate with another card issuer. The proposed rule assumes consumers cannot understand the opt-out, yet the Board's proposed TILA rules assume consumers will understand a 45-day notice of a rate increase on future transactions.

- Consumers have alternatives to accepting a rate increase – for example, ceasing to use the card or transferring the balance to another card.

- Card issuers fund their operations with securitizations backed by the credit card accounts. The proposal would affect securities that were issued based on the expectation that rates on existing balances could be increased. The proposal may also reduce investor confidence in future offerings, which will lead to less available credit.

- The proposal would adversely affect issuers' profits.

- The proposal could create liability under state laws.

Gov. Kroszner requested the industry representatives to provide any data that is available to support the points made during the meeting.