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August 4, 2008

Jennifer J. Johnson
Secretary of the Board
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention: Docket No. R-1314
regs.comments@federalreserve.gov

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: OTS-2008-0004
http://www.regulations.gov
(Federal eRulemaking Portal)

Re: Federal Reserve Board Docket No. R-1314
Office of Thrift Supervision OTS-2008-0004

Unfair or Deceptive Acts or Practices

Ladies and Gentlemen:

This letter is submitted by American Express Travel Related Services Company, Inc., on behalf of itself and its U.S. affiliates (collectively "American Express"), in response to the proposed rule on unfair or deceptive acts or practices ("UDAP") in connection with consumer credit card accounts and deposit account overdraft services published in the Federal Register on May 19, 2008 by the Board of Governors of the Federal Reserve System (the "Board"), the Office of Thrift Supervision ("OTS"), and National Credit Union Administration (collectively, the "Agencies").[1]

INTRODUCTION

American Express appreciates the Agencies' hard work in developing the proposed UDAP rule and the opportunity to comment on it. The proposed rule's credit card provisions are of particular interest to American Express due to our extensive credit card businesses. Accordingly, they will be the focus of our comments.

[1] American Express has addressed our comments to the Board and OTS only, because they currently regulate American Express entities and the National Credit Union Administration does not. However, our comments apply equally to the rule as proposed by the National Credit Union Administration.

American Express supports the goals of the proposed UDAP rule's credit card provisions and believes that, on the whole, these provisions will address many of the concerns that have been expressed about credit card practices. However, there are aspects of the proposed rule that are likely to have adverse consequences for consumers, including increasing the cost of credit and curtailing the availability of credit, even for consumers without credit problems.

We believe a few changes to the rule would help address the most serious of these concerns while preserving the intent and scope of the rule. The changes would also ensure the proposed rule strikes the right balance between protecting consumers and allowing issuers to prudently manage risk.

Our concerns are:

1. **Rate Increases on Existing Balances.** The restrictions on the repricing of existing credit card balances in proposed **§ ___.24** address many legitimate concerns that have been raised about credit card practices, particularly when interest rates are changed on an existing balance based on conditions outside the control of the consumer and without prior notice. However, the provision is drafted in such a far-reaching way that it will not allow repricing an existing balance based on the consumer's higher risk behavior on the account in question, and it will interfere with prudent risk management practices employed by card issuers. Card issuers will not be able to charge interest rates that accurately reflect the higher cost of doing business with customers who fail to pay their accounts in a timely way or act in a manner that presents heightened risk on the account. Broad limitations on risk management practices will increase costs for ***all*** consumers, the overwhelming majority of whom pay their bills on time. Ironically, this means that consumers who meet their obligations will be hurt by the proposal. Card issuers will also be forced to reduce credit availability, even for many consumers without credit problems.

   Recommendation: The proposal should be modified to allow for the repricing of outstanding balances when the consumer has prior notice of the conditions for repricing, those conditions relate to the account in question and are within the control of the consumer, and the behavior triggering a higher rate is a clear indication of greater risk. Specifically, we propose that credit card issuers retain the right to increase interest rates on both new and existing balances if the consumer pays late two or more times in a 12-month period or if the customer makes a payment that is returned for insufficient funds. The consumer would be notified of these conditions at the time the card is offered, at account opening, and on every monthly statement. In addition, our experience indicates clearly that these behaviors are significant predictors of increased risk on an account. These behaviors, as well as the 30-day late payment trigger already set forth in the proposal, should be a permissible basis for applying an interest rate increase to outstanding balances. The rate increase in these instances should be permitted to go into effect in the billing period in which they occur.

2. **Payment Allocation.** The payment allocation rules for credit card accounts with multiple interest rates in proposed **§ ___.23** will lead to severe reductions of – if not the elimination of – low rate promotional offers that are beneficial to consumers.

   Recommendation: The Agencies should include a fourth permissible method allowing issuers to allocate payments to promotional rate balances first, provided they then follow a mandatory high rate to low rate allocation for other balances.

3. **Effective Date.** The effective date for the final UDAP rule must take into consideration the extensive time and effort that will be required of card issuers to develop and test systems, materials, and business processes to make the necessary changes required by the rule. This is particularly true of the proposed payment allocation rules and restrictions on interest rate increases on existing balances, which present complicated systems issues. This challenge will be compounded by the simultaneous burden of implementing the Board's comprehensive overhaul of Regulation Z's open-end credit rules.

   Recommendation: We urge the Agencies to establish an effective date that recognizes the difficulty and complexity of this work and provides card issuers with sufficient time to implement the changes. We believe it is vital to adopt an effective date of at least 18 - 24 months from the date the final rule is published.

4. **Reputational Risk.** The proposed UDAP rule will cause issuers to face unwarranted reputational and litigation risks. The rule may be used opportunistically to bolster an otherwise baseless claim that current card practices – which to this point have been considered lawful and appropriate by legislators, regulators, and the industry – are now "unfair or deceptive."

> **Recommendation**: We believe that it is incumbent upon the Agencies to supplement the proposed rule with a strong, unequivocal, and formal statement that the rule reflects the Agencies' evolving views of certain longstanding industry practices and is not intended to rebrand those practices retroactively as unfair or deceptive.
>
> American Express also wishes to go on record as stating that no past or current practice of ours affected by the proposed UDAP rule is unfair or deceptive. Our practices to date have been developed in good faith reliance on applicable statutes, regulations, and both formal and informal guidance from our regulators, including both the Board and OTS. We also believe our practices are among the best and most consumer-friendly in the credit card industry. Although we are prepared to and will, of course, modify our practices if and as eventually mandated by the Agencies, we will do so in the firm and justifiable belief that the practices subject to modification are not and never have been unfair or deceptive in either the legal or common sense meaning of those terms.

We discuss in detail below each of these four primary concerns, as well as several other concerns, and our recommended revisions to the rule.

DISCUSSION

Set forth below are American Express' comments and concerns about various credit card provisions in the proposed UDAP rule. The discussion addresses various provisions as they would be added to the current UDAP rules of the Board, 12 C.F.R. § 227 (Regulation AA), and OTS, 12 C.F.R. § 535. For simplicity of reference, we use only the subsection citations common to each in a manner similar to that employed by the Agencies in the supplementary information accompanying the proposed UDAP rule.

1. RATE INCREASES ON EXISTING BALANCES

American Express has significant concerns about proposed **§ ___.24**, which would prohibit interest rate increases on existing balances except in very limited circumstances. Unless those circumstances are expanded as we recommend, proposed **§ ___.24** will seriously compromise prudent and legitimate risk management practices in the credit card industry.

The development and growing sophistication of risk management practices by credit card issuers in recent years have led to lower credit card costs and greater credit availability for the vast majority of consumers. A 2006 report to Congress by the Board found that "improvements over time in risk-screening technology and account management techniques, such as controls on credit limits, appear to have helped offset the credit risks related to wider access to revolving credit."[2] If adopted as is, this proposal will transfer costs from those consumers who fail to pay on time to the general consumer population, the overwhelming majority of whom pay their credit card accounts on time.

The Agencies acknowledge that "if institutions are prohibited from increasing rates on existing balances, they may charge higher rates or set lower credit limits initially or curtail credit availability to higher risk consumers,"[3] but we are concerned that the Agencies have seriously underestimated the potential impacts on consumers and the economy. Among the reasons for this may be the absence of solid empirical data on the importance of penalty pricing, and assigning the related costs to those few consumers who drive the increase in costs. We address this below by sharing data from our own recent analyses on penalty pricing.

In addition, we believe the Agencies' unfairness calculus overestimates the difficulties consumers face in avoiding penalty pricing. Again, data from our own analyses show that consumers are acutely aware of payment due dates and that, contrary to the Agencies' conclusion, a consumer's failure to pay by the due date is "reasonably avoidable." The same is true of payments with insufficient funds which, as shown below, are also a key indicator of risk.

In the sections that follow, we discuss in more detail our data and analyses of: (A) the importance of penalty pricing; (B) how late payments, as well as insufficient fund payments, are "reasonably avoidable;" (C) the adverse impacts of proposed **§___.24** on the costs and availability of credit; and (D) how our recommended revisions to the provision can preserve its intent and scope while containing these impacts.

[2] Board of Governors of the Federal Reserve System Report to the Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and their Effects on Consumer Debt and Insolvency, June 2006 at p. 10.
[3] 73 Fed. Reg. 28919 (May 19, 2008).

A. Economics of Penalty Pricing.

Over the past several months American Express has conducted several detailed analyses regarding the economics of penalty pricing, which show that restrictions on it will pose significant costs on issuers and, ultimately, consumers. Key findings are:

- Accounts that pay late present significant risks and costs.
- Penalty pricing does not cause any appreciable increase in write-offs.
- Accounts placed in penalty pricing are not profitable over the next 24 months.

Accounts that Pay Late Present Significant Risks and Costs.
The Agencies propose that a penalty rate cannot be applied to existing balances unless and until the account fails to pay the minimum due by the payment due date and *30 days later* still has not paid the minimum due. The Agencies assert this will permit issuers to conduct effective risk management. This view misreads the need for prompt action right after an account does not pay on time – not 30 days later. Figure 1 below clearly shows that accounts[4] that do not abide by the terms of the account agreement impose significantly greater risk and costs on issuers. Figure 1 specifically illustrates that, in each case over the 24-month period following the default event:

[4] Unless otherwise stated, data regarding accounts are based upon proprietary American Express® Cards issued to consumers in the U.S.

- Accounts that fail to pay on time will write-off at 5 times the rate of average accounts.
- Paying late twice in a 12-month period increases this risk of write-off to 8 times the rate of average accounts.
- Bouncing a check, or having a payment dishonored by the consumer's bank, increases this risk of write-off to 12 times the rate of average accounts.
- Accounts that still haven't made the minimum payment 30 days after the due date write-off at a rate of 28 times the rate of average accounts.

Account Write-off Compared to Average Accounts

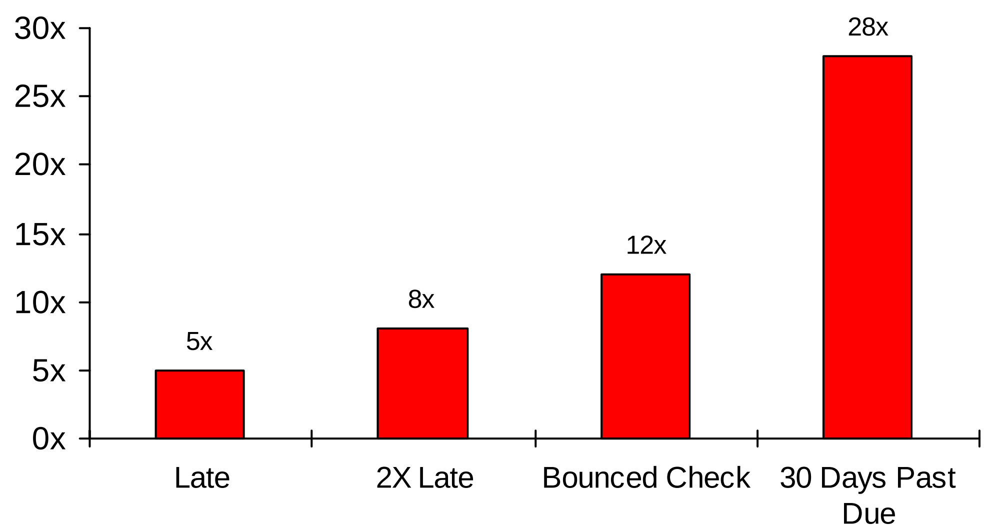

Figure 1

Penalty Pricing does not cause Write-Offs.

Some argue that the imposition of penalty pricing is the final straw that pushes an already teetering account into write-off. Testing we conducted shows that underlying risk factors – not penalty pricing – lead to write-offs. Specifically, our data show that penalty pricing has minimal impact on write-off rates when compared to a test group of accounts that exhibited similar account performance but were withheld from penalty pricing. Figure 2 below illustrates the virtually identical write-off experience of both the test and control groups.[5]

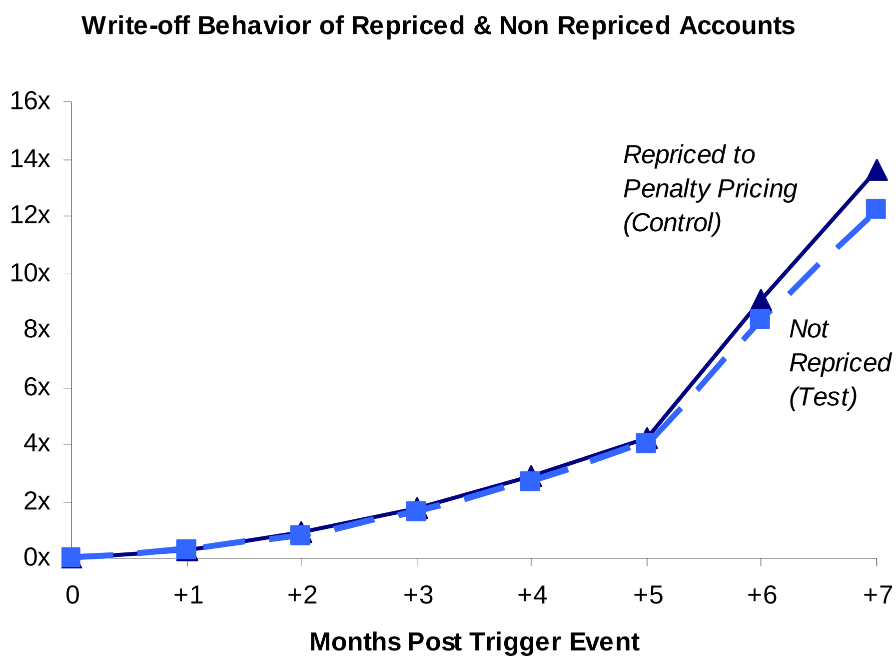

Figure 2

[5] The test group consisted of accounts which exhibited performance that otherwise would have resulted in being placed in penalty pricing. When compared to accounts placed in penalty pricing, the test group had substantially similar write-off behavior over the following months. Figure 2 illustrates this, using an index of 1 as the portfolio average write-off rate.

<u>Accounts Placed in Penalty Pricing are not Profitable over the Next 24 Months.</u>
It has been asserted that issuers seek to reap windfall profits by repricing accounts to inordinately high penalty rates. This is not the case at American Express. In assessing the potential impacts of the proposal, we analyzed a group of accounts that were increased to our highest penalty interest rate in 2006 due to late or missed payments. We then assessed the profitability of those accounts over the following 24 months. As indicated in Figure 3, during that timeframe these accounts are not profitable, losing 3 cents for every dollar of revenue generated.

In today's environment, we can minimize this loss and maintain it at an acceptable level. Incremental finance charges help to mitigate the loss, but do not completely offset the higher write-offs and increased costs associated with these accounts. We use penalty pricing to manage the inherent risks of these accounts by keeping this unprofitability at an acceptable level, not to extract profits. If applying penalty pricing to existing balances were restricted as proposed, our ability to minimize the losses from accounts placed in penalty pricing would change drastically.

Figure 3 shows that if these accounts were not put into penalty pricing, they would become *25 times more unprofitable*. The loss would escalate to over 75 cents per dollar of revenue generated.

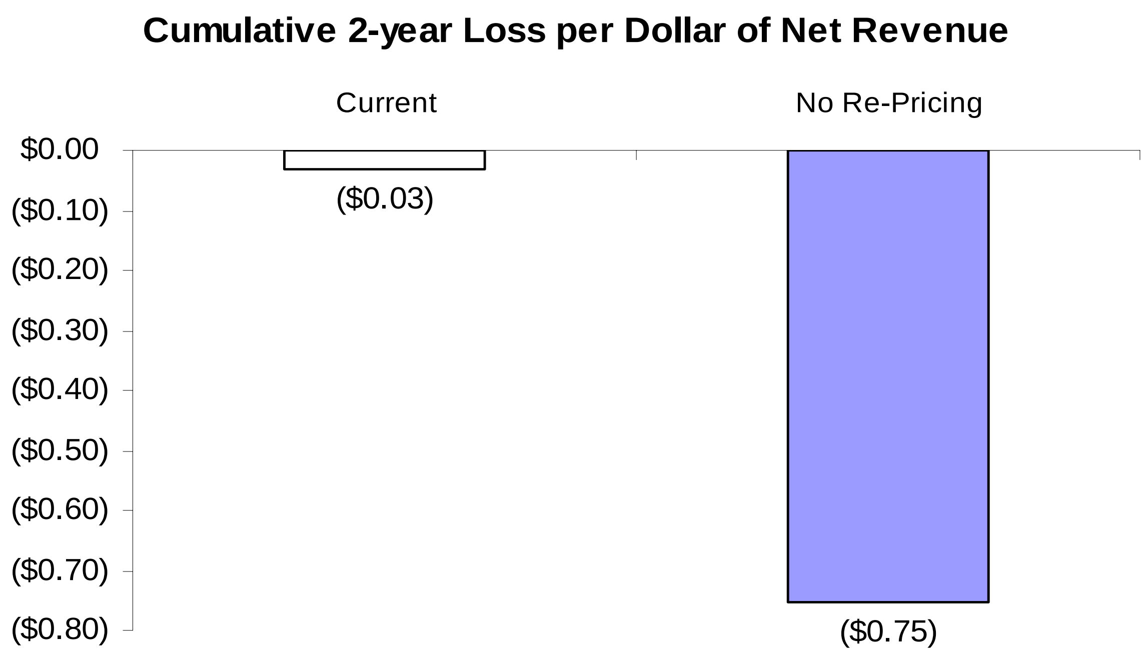

Figure 3[6]

B. Payment Behaviors that are Reasonably Avoidable.

The proposal explicitly states that consumers are able to reasonably avoid paying late or bouncing a check by taking reasonable precautions. Nevertheless the agencies conclude that "it appears that the event [paying late or bouncing a check] may not be reasonably avoidable."[7] No supporting objective or empirical data are provided. Rather, this conclusion is supported only by an observation that even when consumers understand the rules and are given sufficient time to pay, "there may be other reasons why consumers pay late or miss a payment."[8]

Our concern is that the Agencies appear to interpret "reasonably" as meaning "absolutely" in assessing whether a practice or behavior is avoidable. This approach, combined with the lack of supporting data, leads to an overly broad reading of the

[6] Losses equal revenues net of write-offs and operating expenses.
[7] Regulation AA (Federal Trade Commission Act) Unfair or Deceptive Acts or Practices (proposed May 2, 2008)(to be codified 12 C.F.R. pt. 227) Regulation AA, Docket No. R-1314, p. 36.
[8] 73 Fed. Reg. 28918 (May 19, 2008).

Unfairness Doctrine[9] and the characterization of certain practices or behaviors as "unfair" when in fact they are reasonably avoidable.

Paying Late is Reasonably Avoidable.

The Agencies assert that consumers cannot "reasonably avoid" paying late. This rests upon a view that consumers are not aware of when payments are due, and should in effect be granted a 30-day grace period beyond the due date. Empirical data do not bear this out.

Consumers are well aware of when the payment due date falls, and understand that to avoid being late they must pay by the due date. This is demonstrated by the payment behavior on accounts with different payment due dates. We compared payment behaviors and the dates on which payments are made for a group of credit card accounts with a 20-day payment period, and a group with a 25-day payment period. We then compared the proportion of accounts that make payments on each day in the billing cycle, leading up to and after the payment due date.

Figure 4 illustrates that in each case, a very high percentage of consumers pay shortly before the due date, a percentage pay several days in advance of the due date, and a very small percentage pay after the due date. Figure 4 shows that consumers act rationally when making payments. Regardless of whether a due date is on day 20 or day 25, a very large proportion of consumers make payments just before the due date. The same percentage pay on time whether the due date is 20 or 25 days. This proves that consumers know when the due date falls, and they manage their payment behavior rationally. Consumers also have a growing number of tools to help them maintain their accounts in good status, including access to account alerts which notify consumers when their due date is approaching and when they are nearing their credit limit. At American Express, consumers can access their accounts 24 hours a day, schedule payments in advance to ensure that their account remains current, and make payments online or by phone, all at no additional charge. These tools help consumers avoid triggering penalty interest rates on their account.

This comparison in Figure 4 shows that consumers can reasonably avoid paying late, and they do so by making the rational economic decision of paying just as the due date approaches.

[9] The Unfairness Doctrine, codified in 15 U.S.C. § 45(n), deems a practice unfair if it causes substantial injury which is not reasonably avoidable by consumers and not outweighed by countervailing benefits to consumers or competition.

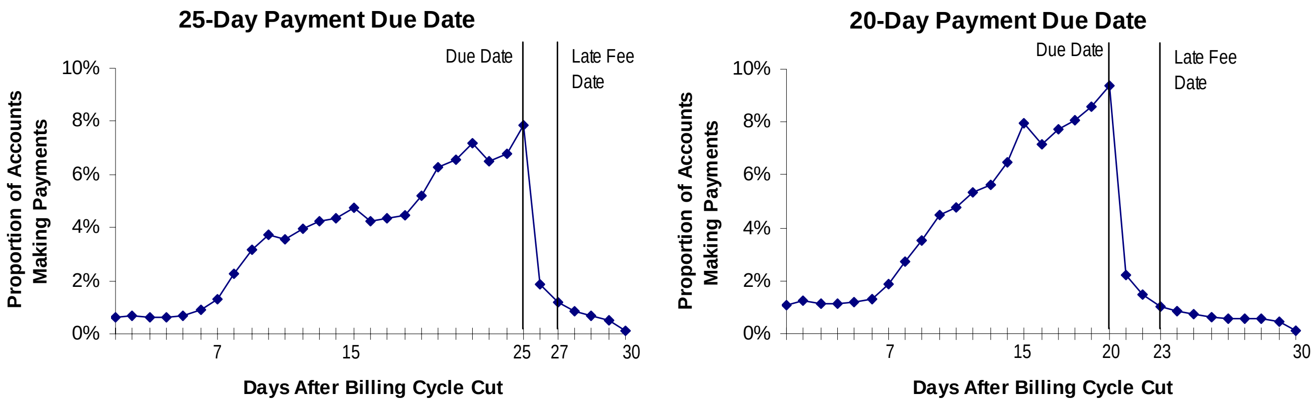

Figure 4

<u>Checks Drawn on Accounts with Insufficient Funds are Reasonably Avoidable.</u>
Making a payment that is returned for insufficient funds is also reasonably avoidable. As a general matter, tracking checking account status and activity is readily manageable by consumers. Consumers also have a growing number of tools to help maintain their accounts and to avoid drawing a check on accounts with insufficient funds. Access to account information online and by telephone facilitates the informed and responsible use of checking accounts by consumers. The Agencies' rationale that "consumers lack sufficient information about key aspects on their accounts, including how holds will affect the availability of funds" is unpersuasive. As shown in Figure 1, accounts that exhibit this behavior are 12 times more likely to write-off. This in and of itself demonstrates that bouncing a check presents real increased risk (as opposed to consumers merely losing track of their available funds). As the Agencies point out, by carefully tracking account status and activity, consumers can "reduce the risk of making a payment that will be returned for insufficient funds." In fact, by using ordinarily available means, consumers can reduce the risk to the point where it is reasonably avoidable.

<u>C. Impacts and Reactions.</u>

The proposed restrictions on repricing existing balances will exacerbate every facet of managing the risks and costs imposed by accounts that do not pay in accordance with terms. The magnitude of the potential impact on revenues (as demonstrated by Figure 3 and related discussion) leaves issuers no choice but to take remedial and compensating action. Two primary reactions, which are already being seen, are:

- Interest rates will increase on all accounts, even those that pay on time.

- Availability of credit will decline. As issuers reduce line sizes and become more selective about underwriting, consumers with good credit performance will have difficulty accessing credit.

Restricting the ability to reprice existing balances will have a significant impact on card issuers' revenues. Extrapolating our analysis to consumer credit cards generally, the magnitude of that impact, and its significant and adverse effect on revenues, will leave issuers no choice but to compensate by making up these revenues from other sources. The overwhelming majority of consumers who manage credit responsibly and pay their credit card bills on time will face rate and fee increases, as issuers are forced by the proposal to transfer to them the costs imposed by the small percentage of customers who don't pay on time.

Restricting the use of legitimate and prudent risk management tools will drive issuers to cut back on the number of consumers to whom they offer credit, and to decline more applications from consumers seeking credit. As underwriting practices are modified to take into account the proposed restrictions on penalty pricing, issuers will decline to grant credit to many consumers who previously would have qualified for credit.

Based on our internal assessment, we estimate that between 9.1 and 21 percent of consumers solicited today would not be solicited to apply for a credit card if the proposed rule were adopted as written. This would result in fewer new accounts being opened, and less credit being granted to creditworthy consumers. This in turn suppresses consumer spending – according to one analyst, the proposal would reduce consumer purchasing power by $2 trillion by 2010.[10]

As has been widely reported, issuers including American Express have already begun to reduce credit lines on credit cards in response to economic conditions. The proposed restrictions will accelerate this trend, as issuers reduce access to credit for many borrowers. This will put even more downward pressure on credit availability and consumer spending on credit cards.

D. Recommended Revisions

To mitigate or avoid these results, the final rule must strike a more appropriate balance between the legitimate need to protect consumers from unfair interest rate increases that impose a "costly surprise," and the equally legitimate need for prudent and sound risk management. We have three suggested revisions to proposed **§ ___.24** that will lessen the

[10] *See* Meredith Whitney, et al. "Far From Over: We Believe the Credit Crisis Will Extend Well Into 2009". Oppenheimer & Co., Inc., May 19, 2008.

impacts to consumers, issuers, and the economy while achieving the Agencies' objectives in this rulemaking. They are:

- Revise **§ ___.24(b)(3)** to permit penalty pricing of existing balances for "on-account" triggers, specifically a payment drawn on insufficient funds or paying late twice within a 12-month period.
- Retain the proposal's limits on "off-account" repricings to protect consumers from "costly surprises."
- Redirect the discussion of the current exception from the number of days late to paying late twice in a 12-month period.

Adopting this approach would lessen, but not eliminate, impacts on risk management and the cost and availability of credit. Our projections indicate that, even with our recommended revisions included in the final rule, the loss in revenues would be substantial. And, while not insignificant, it would not impose the severe impact that the proposal certainly would. Extrapolating this projection to credit card issuers generally, this negative contribution would still have impacts, but not on the same draconian scale of **§ ___.24** as proposed**.**

Permit Penalty Pricing of Existing Balances Based on "On Account" Triggers.

The Agencies should refine **§ ___.24(b)(3)** to permit interest rate increases on existing balances in cases where (1) the consumer has bounced a check or otherwise had a payment dishonored, or (2) the consumer has paid late twice within a 12-month period, in addition to the 30-day late payment trigger already proposed.

Like a 30-day late payment, these two other events of default are so closely correlated with potential trouble on credit card accounts that they demand the card issuer to take prompt action on both existing and prospective balances. And, like a 30-day late payment, paying late twice within 12 months or having a payment returned for insufficient funds should trigger penalty pricing in the month in which the event of default occurs, without additional notice or waiting periods.[11] These triggers relate to the account in question and are within the control of the consumer. Together with the 30-day late payment exception, these two additional exceptions allow card issuers to retain core risk management practices and preserve the benefits of these practices for the majority of consumers.

[11] As described in our July 18, 2008 letter regarding the Board's proposed amendments to Regulation Z, § 226.9(g) of Regulation Z must align with §___.24(b)(3) of Regulation AA. This is best accomplished by revising § 226.9(g) to clarify that any increase under §___.24(b)(3) becomes effective in the billing period in which it occurs without additional notice or delay.

To implement the two exceptions, we recommend that proposed **§ ___.24(b)(3)** be amended with the underscored and bolded text shown below:

> **"(3) <u>A payment not being honored by the consumer's bank or financial institution</u>** or the bank not receiving the consumer's required minimum periodic payment: **<u>(1) by the payment due date for that payment twice within a 12-month period; or (2)</u>** within 30 days after the due date for that payment."

Our proposal would fulfill the Agencies' goals while mitigating undesirable side effects. First, it will protect consumers against the "costly surprise" imposed by rate increases triggered by external factors not directly related to the account in question. Second, it will increase clarity and transparency in pricing by encouraging the use of a limited number of crisply defined "on-account" triggers that are clearly disclosed and that are within the knowledge and control of the consumer. Third, it will preserve a prudent and legitimate risk management tool for credit card issuers by allowing timely actions following defaults that, in our experience, are the ones that point most strongly to increasing risk.

<u>*Safe Harbor Alternative.*</u>

An alternate approach to revising proposed **§___.24(b)(3)** would be to recast proposed **§ ___.24** as a safe harbor for repricing rather than a prohibition on repricing with exceptions. This would align with the principles set forth below, by stating a general rule that an outstanding balance could only be repriced based upon grounds that are "reasonable." Then, like the approach taken in proposed **§ ___.22**, a safe harbor section could be included to describe circumstances which would be deemed "reasonable." Commentary could be included to provide examples and elaborate on the factors and circumstances indicative of reasonableness.

> The safe harbor approach could be incorporated by revising **§ ___.24** to read as follows:
>
> **§ ___.24 Unfair acts or practices regarding application of increased annual percentage rates to outstanding balances.**
>
> <u>(a) Prohibition on Increasing annual percentage rates on outstanding balances.</u>
>
> (1) <u>General rule</u>. A bank must not increase the annual percentage rate applicable to any outstanding balance on a consumer credit card account unless the consumer has a reasonable opportunity to avoid such increase.

(2) Outstanding balance. For purposes of this section, "outstanding balance" means the amount owed on a consumer credit card account at the end of the fourteenth day after the bank provides a notice required by 12 CFR 226.9(c) or (g).

(b) Exceptions: Paragraph (a) of this section does not apply where the increase to an annual percentage rate is increased due to:

(1) The operation of an index that is not under the bank's control and is available to the general public; or

(2) The expiration or loss of a promotional rate, provided that, if a promotional rate is lost, the bank does not increase the annual percentage rate to a rate that is greater than the annual percentage rate that would have applied after expiration of the promotional rate.

(c) Safe Harbor. A bank satisfies the requirements of paragraph (a)(1) of this section if it increases the annual percentage rate applicable to an outstanding balance on a consumer credit card account if:

(i) The increase is based solely upon the consumer's performance on that particular consumer credit card account;

(ii) The events that trigger the increase are disclosed initially in the account agreement and in each periodic billing statement;

(iii) The events giving rise to the increase are within consumers' control and knowledge and consumers can reasonably avoid triggering the increase;

(iv) Consumers are provided an opportunity, by performing on that consumer credit card account in accordance with its terms for a specified time period, to have the annual percentage rate on the outstanding balance reset to a non-penalty rate.

Commentary:

(c) Safe Harbor.

(1) Reasonable opportunity to avoid the increase. Penalty pricing triggers indicative of a reasonable opportunity to avoid the increase include, but are not

limited to, two late payments on that account within a 12-month period or a payment not being honored by the consumer's bank or financial institution.

(2) Increases not reasonably avoidable. Penalty pricing triggers indicative of the absence of a reasonable opportunity to avoid the increase include, but are not limited to, the consumer's performance on another account with the same bank or another creditor; deterioration in the consumer's credit score; or an increase in the bank's cost of funds.

Retain Limits on "Off Account" Repricings to Avoid "Costly Surprises" to Consumers.

In our experience, penalty pricing works best when the rules are clear and understandable, consumers know what the rules are, and consumers can manage and control their payment performance to stay within the rules. According to a recent industry survey by the American Bankers Association, two-thirds of consumers agree that consumers who do not pay their monthly accounts on time should be treated differently than consumers who follow the rules. Consumers also believe that it is fair to raise interest rates on an outstanding balance in response to a consumer who makes multiple late payments on their account. In contrast, a separate industry survey conducted by the Financial Services Roundtable found that 69% of consumers consider it unfair to raise their rate based on a decline in credit score. And 76% said it would be unfair to raise rates based on late payments on other bills or on accounts with other lenders.

Of course, penalty pricing based on amorphous factors that are not intuitive to consumers and do not lend themselves to clear and transparent disclosures causes problems. Rate increases triggered by behaviors or factors not directly related to the account in question present consumers with a "costly surprise." Consumers do not expect, and cannot manage their accounts effectively to avoid, increases based upon deterioration in the consumer's FICO score, the consumer's performance on an account with the same issuer or an account with a different lender, or an increase in the issuer's costs of funds. Whether characterized as "universal default," "off us," or otherwise, these rate increases impose a costly surprise on consumers, and have been the basis for the overwhelming number of complaints to legislators and regulators.

In short, we believe that **§___.24** in its final form must retain its strictures on "off account" repricings and the "costly surprise" it imposes on consumers, while permitting "on account" penalty pricing triggers that fulfill what we believe are the basic principles of fair and transparent penalty pricing rules:

- The rules are communicated clearly to customers.

- The rules cover performance on the specific account in question and do not bring any "off account" behaviors or factors into consideration.

- The rules are intuitive and easy to understand.

- Consumers are in control of complying with the rules and can do so through reasonable effort, such as paying on time with good funds.

- Upon breaking a rule and being put into penalty pricing, consumers have an opportunity to perform their way back to non-penalty pricing.

- The rules serve a legitimate risk management or other business purpose.

<u>Problems with the 30 Days Late Trigger Cannot Be Solved by Changing the Number of Days Late; Adding a Twice Late in 12 Months Trigger is the Better Approach.</u>

We appreciate that the 30 days late standard proposed by the Agencies helps avoid the imposition of penalty rates on a "hair trigger" following a single late payment that narrowly missed the payment due date, and we agree that this is a valuable regulatory goal. In our view, the Agencies can better achieve this goal by (1) keeping the 30 days late standard as is, and (2) adopting our recommendation that permits repricing an existing balance if the consumer pays late <u>twice</u> within 12 months. Periodic statement or other notices associated with the first missed payment would help consumers avoid paying late a second time. While this approach would require issuers to forego a single late payment as a trigger for repricing an existing balance as is currently the practice, we think the approach is a reasonable compromise. It preserves relatively expeditious risk management responses by issuers while protecting consumers against "hair trigger" penalty pricing and providing them with a reminder that may help them avoid penalty pricing altogether.

Some take the position that proposed **§ ___.24(b)(3)** should be adjusted to substitute 30 days past due with a different number of days. This approach will only lead the Agencies further into the quagmire of trying to articulate how late is late – is an account late when the payment is not made within 30 days of the due date, 29 days, 28 days? And so on. This approach will ultimately end up where it started, with the Agencies defending a subjective redefinition of "late." We do not believe this is an effective approach. From a risk perspective, there is no clear "tipping point" at which the risk of write-off dramatically increases. As illustrated in Figure 5, the likelihood of write-off increases steadily and incrementally. Attempting to redefine a "late payment" as one that misses the issuer's payment due date plus a certain number of days is thus not only a subjective exercise but one that is contrary to the evidence that shows substantial and steadily growing risk from the moment a payment deadline is missed.

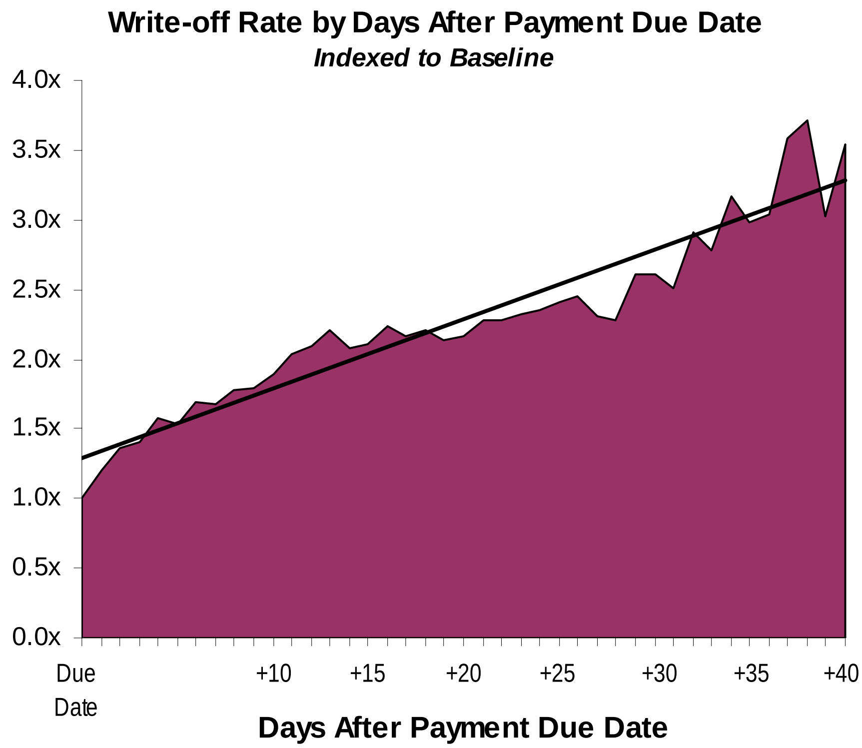

Figure 5

We believe the best resolution to resolve this tension is to adopt our suggestion that the Agencies not define "late" as a subjectively determined number of days, but instead link it to being late more than once in a 12-month period.

2. PAYMENT ALLOCATION

Proposed **§ ___.23** will change the fundamental economics of offering consumers low rate promotional and balance transfer offers. Unless the provision is modified, card issuers will curtail such offers drastically – if they continue to make them at all – effectively removing a valued consumer benefit.

American Express conducted analysis of our balance transfer offers for existing customers to simulate the economic effect of a high-to-low payment allocation method as permitted by proposed **§ ___.23** to determine how it would impact customers. The results were profound:

- 100 percent of customers would no longer receive our best balance transfer offer simply because the offer would no longer be economically viable. In anticipation of the final rule, we have already stopped these offers.

- 45 percent of customers would no longer receive any balance transfer offer at all.

- Response rates to new balance transfer offers by customers would decline by nearly 70 percent because the offers will be less compelling.

Proposed **§ ___.23** will have a significant effect on the ability to make low rate offers. Offers will have terms far less favorable to consumers than they are today, with the most prevalent likely to be balance transfer offers at standard purchase rates. Low rate promotional and balance transfer offers are important because they benefit consumers, support regulatory initiatives, and promote competition.

Low Rate Offers Benefit Consumers.

American Express' analysis shows that low-rate promotional and balance transfer offers provide substantial benefits to consumers. We studied the impact on a consumer's overall interest rate when he or she took advantage of a low rate promotional or balance transfer offer. We found that, on average, American Express® Cardmembers who took advantage of such offers (1) reduced their effective interest rates by nearly 280 basis points, and (2) had lower delinquency rates than other Cardmembers.

Low Rate Offers Promote Regulatory Initiatives.

Low rate offers work in tandem with other aspects of the Agencies' regulatory initiatives. These include the Board's Regulation Z proposals to establish a 45-day notice period prior to the imposition of a penalty interest rate and to increase the change in terms notice period to 45 days. They also include **§ ___.24** in the current proposal, which would restrict interest rate increases on existing but not on new balances.

Underlying all of these initiatives is the notion that, given enough time, a consumer can avoid an interest rate increase on a credit card account by opening a more favorable credit card account elsewhere (if he or she does not have the resources to pay down the account immediately). A consumer's ability to switch among card products depends to a great extent on an abundance of promotional and balance transfer offers. Without them, consumers would have much less opportunity to transfer a balance during the notice periods provided by the Board's Regulation Z proposal and to avoid rate increases that would still be permitted by **§ ___.24** of the current proposal.

Low Rate Offers Support Competition.

Low rate offers have been an engine for competition in the credit card industry. The industry has become extremely competitive because consumers can easily vote with their feet if a product no longer meets their needs. Over time, this competition may wane if the new payment allocation rule is not made more favorable to low rate offers. The end result will be higher costs of credit and fewer choices for many consumers. Promotional offers will dry up as a means of competition, and consumers will become more captive to their current credit card issuer as it becomes harder to move balances from one issuer to another.

Recommended Revision

Add Fourth Allocation Method to Preserve Low Rate Offers.

To preserve the availability of low rate offers, the Agencies should add a fourth payment allocation method to the three permitted in the proposal. This fourth method would allow card issuers to pay off promotional offers first, followed by a required high-to-low allocation for all other balances.

Given the savings these offers provide consumers, it is both fair and logical to allow priority pay down of the resulting balances as part of the overall offer. At the same time, consumers would benefit from the accompanying requirement that all other balances would be paid according to a high-to-low payment allocation.

3. EFFECTIVE DATE

American Express urges the Board to adopt an effective date for its proposed UDAP rule that is at least 18 - 24 months from the date the rule is promulgated. Whatever the final content of the rule, it will require costly and time consuming systems development and operational changes by card issuers. Implementing the payment allocation rules in proposed **§___.23** and restrictions on interest rate increases on existing balances in **§___.24** alone would require significant systems investment and work. Coupled with the challenge of simultaneously implementing the pending overhaul of Regulation Z's open-end credit rules, the challenges of implementing the UDAP rule will be formidable for even the largest and most sophisticated card issuers. An implementation period of at least 18 - 24 months is necessary for credit card issuers to plan, finance, and execute the required changes in their systems and operations.

Recommended Revision

We urge the Agencies to adopt an effective date for the proposed UDAP rule that is at least 18 - 24 months from the date the rule is promulgated.

4. REPUTATIONAL RISK

We are concerned about reputational and litigation risks that credit card issuers would face as a result of the proposed UDAP rule. We believe that it is incumbent upon the Agencies to supplement the proposed rule with strong, unequivocal, and formal statements that the rule reflects the Agencies' evolving views of certain longstanding industry practices and is not intended to rebrand those practices retroactively as unfair or deceptive. We believe these statements should include (1) a provision in the rule itself providing that it shall have prospective effect only, (2) commentary providing that past acts or omissions that complied in good faith with the law then in effect, including any rule, regulation, or interpretation by the Agencies, are not "unfair or deceptive," and (3) a finding in the supplemental information, similar to one made by the Board in its recently published HOEPA rule,[12] that the Agencies' ability to make the rule prospective only following an implementation period was integral to the

[12] See 73 Fed. Reg. 44523 (July 30, 2008) (discussing prospective application of rule on advertising and disclosure practices for higher-priced mortgages under the Home Ownership and Equity Protection Act).

Agencies' legal conclusion that the practices prohibited by the rule would be deemed "unfair or deceptive" from the effective date of the rule forward.

Recommended Revision

Accordingly, we urge the Board to add the following provision as a new **§ 227.1(e)** and to supplement it with the following commentary and supplemental information finding. We also urge the other Agencies to make parallel additions to their regulations, commentary, and supplemental information.

> **Rule:**
>
> (e) *Prospective Effect.* The provisions of subparts C and D of part 227 shall operate prospectively only and shall not be the basis of any liability for conduct predating the effective date of these regulations.
>
> **Commentary:**
>
> 1. The Board recognizes that these rules implement substantial changes in the manner in which banks must service and make disclosures related to consumer credit card and deposit accounts. The Board further recognizes that banks may have made pricing and other decisions based on accepted industry practice and prior Board regulations and commentary. The Board has considered, and has rejected, retroactive application of these rules. The final rule is effective on ________, _______.
>
> **Finding:**
>
> Compliance with these rules is not required before their effective date. Accordingly, nothing in these rules should be construed or interpreted to be a determination that acts or practices restricted or prohibited under these rules are unfair or deceptive before the effective date of these rules. Because broad regulations, such as the rules adopted here, can require large numbers of institutions to make major adjustments to their practices, there could be more harm to consumers than benefit if the rules were effective immediately. If institutions were not provided a reasonable time to make changes to their operations and systems to comply with these rules or were required to expend resources defending against claims brought against practices that were lawful prior to the effective date of these rules, they would either incur excessively large expenses, which would be passed on to consumers, or cease engaging in the

> regulated activity altogether, to the detriment of consumers. And because the Board finds an act or practice unfair only when the harm outweighs the benefits to consumers or to competition, the implementation period preceding the effective date set forth in the final rules and the prospective effect of the rules are integral to the Board's decision to restrict or prohibit certain acts or practices. For these reasons, acts or practices occurring before the effective dates of these rules will be judged on the totality of the circumstances under other applicable laws or regulations, and without regard to these rules or rulemaking or any preliminary proceedings or proposals undertaken or published in connection with these rules. Similarly, acts or practices occurring after the effective dates of these rules that are not governed by these rules will continue to be judged on the totality of the circumstances under other applicable laws or regulations.

5. ADDITIONAL CONCERNS

"Promotional Rate" Definition.

American Express believes that the definition of "promotional rate" in proposed **§ ___.21(d)** needs to be sharpened.

As proposed, the "promotional rate" definition uses vague language comparing a "low" annual percentage rate to a rate that will be "in effect" at the end of a specified period or for a particular type of transaction. Arguably, this language encompasses various rates in addition to "promotional rates" in the common sense meaning of that term. These other rates might include, for example, "standard" rates to the extent the rate "in effect" for purposes of comparison is a penalty rate; discounted rates given to a consumer as part of a work-out arrangement on a delinquent account; and even the rates on existing balances "grandfathered" by proposed **§ ___.24** and its restrictions on increasing interest rates on existing balances. Such a broad construction of the "promotional rate" definition would confuse and harm the proper interpretation of the proposed UDAP rule where the definition is critical. These include **§___.23** regarding payment allocation as well as **§___.24**.

Recommended Revision

To solve this problem, we recommend the addition of language to the proposed definition to clarify that the "base rate" to which the promotional rate is being compared is a "non-penalty" rate. This should preclude arguments that the definition includes standard rates in cases where a penalty rate applies to a balance. (We have not used the term "standard rate" itself because there can be more than one "standard" rate for a category of transactions. These might include, for example, cases in which a past rate is grandfathered for customer service reasons or due to a customer initiated transfer from one product to another.)

Our proposed modifications to the definition are set forth below as bold and underscored text:

(d) "Promotional rate" means:

(1) Any annual percentage rate applicable to one or more balances or transactions on a consumer credit card account for a specified period of time that is lower than the **non-penalty** annual percentage rate that will be in effect **for such balances or transactions** at the end of that period; or

(2) Any annual percentage rate applicable to one or more transactions on a consumer credit card account that is lower than the **non-penalty** annual percentage rate that applies to other transactions of the same type.

We further recommend the addition of commentary language that expressly excludes from the "promotional rate" definition any special rates that apply to account for other than marketing or promotional purposes. These should include discounted rates given to a consumer as part of a work-out arrangement on a delinquent account; "grandfathered" rates on existing balances under **§ ___.24**; rates that are grandfathered for customer service reasons, due to a customer initiated transfer from one product to another, or other operational reasons; and other special rates applied to an account for collections, legal, or operational reasons.

Time to Make Payment.

Set forth below are three technical changes we recommend to **§ ___.22** regarding time to make payment. First, however, we wish to point out and hope the Agencies recognize that the 21-day safe harbor for time to make payment that they are proposing would adversely affect many consumers. It is a well known and, as shown by our Figure 4 of this letter, empirically validated phenomenon that payments on credit card accounts cluster around the payment due date. The later the payment due date, the later the payments. To the extent the 21-day safe harbor lengthens the period before a payment due date, it would result in more interest being paid by consumers who revolve credit and carry balances on their accounts. Payment of additional interest by these consumers would offset the benefits of the later payment due date to consumers who would otherwise have been subject to a late fee or suffered other adverse consequence if the payment due date had been earlier. In other words, the 21-day safe harbor would not be an unalloyed benefit to consumers. It would harm some while helping others.

Proposed **§ ___.22** presumes that ordinary mail remains the predominant means for the delivery of billing statements and payments, and therefore 7 days must be allowed for the consumer to receive a statement, 7 more days for a consumer to consider a payment, and a final 7 days for a consumer to mail a payment. According to a recent survey, 62% of customers make payments online, and 82% visit their issuer's website to view their billing statements.[13] Accordingly, for the significant majority of consumers, the timing of mailed statements is not particularly relevant to how they manage their bills and payments. Moreover, for those consumers who continue to receive statements by mail, the pre-sorting of outgoing mail by card issuers, targeted delivery of that mail to specified U.S. Postal Service distribution centers, and similar techniques make the mailing of credit card statements, particularly from major issuers, much more efficient and expeditious than in years past. This too undercuts the continued validity of the "7-7-7" presumption.

Recommended Revisions

1. Additional commentary should be added to the safe harbor provision of proposed **§ ___.22(b)** to provide clarity on precisely when an issuer will be deemed to have "mailed or delivered" a billing statement for purposes of this section. Physical delivery to the U.S. Postal Service or private carrier will certainly qualify. But certain issuers expend additional time, effort, and expense to place items into the USPS with maximum efficiency. While physical delivery to the USPS may be later, pre-sorting, targeted distribution to specified USPS distribution centers and other steps performed by those issuers greatly facilitates mailing time. If the time spent on these functions were not captured, issuers who expend these efforts would be put at a disadvantage relative to issuers with less diligent mailing procedures. The additional commentary should provide that statements will be considered "mailed or delivered" at the point the issuer undertakes efforts that may be considered "mailing" functions if performed by the USPS directly. These efforts should include batching statements, pre-sorting statements, and bundling and distributing statements to specified USPS distribution centers.

2. Additional commentary should be added to the general reasonableness rule of proposed **§ ___.22(a)** to specify that a "reasonable amount of time to make payment" is to be determined on the totality of the circumstances, and that such circumstances should include services provided by the card issuer to the consumer at no extra charge to facilitate speedy electronic statement and payment procedures. These services should include: expedited payment options, such as paying by computer or pay by phone; expedited methods of obtaining periodic statements via e-mail or through an Internet link; and alerts or other communications, via e-mail or otherwise, reminding consumers the payment due date is approaching.

[13] The *J.D. Power and Associates 2007 Credit Card Satisfaction Survey*[SM]*, p. 29.*

This commentary also would have the added benefit of encouraging credit card issuers to provide expedited electronic statement delivery and payment options at no cost to consumers. Providing card issuers with an incentive to offer such options at no cost would likely broaden the base of consumers with access to such options and the extra time and convenience they provide in making credit card payments.

3. To qualify for the safe harbor in proposed **§ ___.22(b)**, billing statements must be mailed at least 21 days before the "payment due date." This term is not defined in either Regulation AA or Regulation Z. To remove any ambiguity arising from the use of the term, we recommend that it be dropped from proposed **§ ___.22(b)** in favor of a functional description of adverse consequences arising from late payment. Specifically, we recommend that **§ ___.22(b)** be revised to read as follows:

> (b) <u>Safe harbor</u>. A bank satisfies the requirements of paragraph (a) of this section if it has adopted reasonable procedures designed to ensure that periodic statements are mailed or delivered to consumers at least 21 days before any adverse consequences are imposed upon a consumer for failure to make a required payment on time.

<u>Adjustment Authority Should Be Expanded.</u>

American Express supports the $1 adjustment authority for all the payment allocation methods as set forth in proposed comment **§ ___.23-2,** because it is necessary to accommodate rounding. However, we urge the Agencies to consider an expansion of that adjustment authority to the greater of $1 or 1% of the total account balance. Although still relatively small, this greater adjustment authority would accommodate any number of other calculation decisions that might arise in implementing the various payment allocation methods. This includes tailor-made methods allowed by the proposal, provided they are "no less beneficial" to consumers than one of the specified methods. More flexible adjustment authority would help prevent unproductive litigation challenging reasonable approaches by card issuers to such decisions.

<u>Loss of Promotional Rate Should Be Clarified.</u>

Proposed **§___.24(b)(2)** permits an interest rate increase on an existing balance if it is due to the loss of a promotional rate, but only if the interest rate is increased to the standard rate that would have applied upon the expiration of the promotion. Although this is an appropriate exception, it presents ambiguity when the promotional rate is lost for an "on-us" default for which an interest rate increase to a penalty rate is permitted on existing balances under **§ ___.24(b)(3).**

Recommended Revision

Accordingly, we recommend an addition to the proposed commentary stating that a promotional rate may be increased to a penalty rate upon the occurrence of a triggering event encompassed by **§ ___.24(b)(3).**

Firm Offers of Credit.

American Express supports proposed **§___.28** requiring disclosure of the criteria used to determine the consumer's eventual interest rate and credit limit in credit card offers providing for multiple interest rates or credit limits. Our support is also based in substantial part on the clarity and brevity of the model disclosure language set forth in this section as proposed, which achieves the Agencies' purposes without unduly burdening credit card issuers. We urge the Agencies to retain the model language as is in the final rule.

Other Practices.

American Express notes that the Agencies' proposal does not address several practices that we believe should be prohibited. These include:

- **"Mid-cycle" overlimit fees**, which are charged to a consumer despite a payment that keeps the account within the credit limit by the end of a billing cycle. We believe that such fees serve as a trap for unwary consumers and are unnecessary for the prudent management of credit limits by card issuers. Mid-cycle control of transaction approvals and overlimit fees imposed at the end of a billing cycle are adequate for that purpose.

- **"Pay to Pay" Fees,** which are charges to a consumer for expedited means of paying an account by telephone or computer. We believe that such fees are inherently unfair and contribute to consumer complaints about not having enough time to pay. They force consumers facing a payment deadline to choose between mailing a check in hopes that it arrives early enough to avoid a late fee and penalty interest rate, and paying a hefty fee for an expedited payment method to ensure on-time payment. We do not think consumers should be placed in that position.

* * * * *

Once again, American Express thanks the Agencies for their work on this proposal and the opportunity to comment on it. We would also welcome the opportunity to discuss our comments further with the staff of any of the Agencies. Toward that end, any staff member should feel free to call me at any time at 212-640-5418.

Sincerely,

/s/

Thomas J. Ryan
Senior Counsel