DISCOVER BANK

March 28, 2005

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20^{th} and Constitution Avenues
Washington, D.C. 20551

*Re: **Docket No. R-1217 – Regulation Z***
Comments of Discover Bank

Discover Bank submits these comments in response to the Board's Advance Notice of Proposed Rulemaking on Regulation Z's open-end credit rules.

Discover Bank, as one of the nation's largest issuers of consumer credit cards, is vitally interested in the requirements for consumer disclosures pertaining to the marketing and issuance of these cards. We are pleased that the Board is conducting a comprehensive review of the disclosures that consumers must receive under the Truth in Lending Act, and is seeking comments on the need for additional disclosures as well as simplification of those currently required.

As the features, pricing, and patterns of consumer usage of credit cards change over time, it important to regularly evaluate whether the disclosures consumers receive, and the way this information is presented, remain pertinent to the current marketplace and provide useful information to consumers. While this may entail crafting new or modified disclosures to address new fees or changes in credit pricing practices, it should also include repealing, or making less prominent, disclosures that may be of little interest or utility to most consumers. Information about card features or pricing that affects a relatively small number of consumers or applies only under special circumstances should be readily available to affected customers. But it is not appropriate to require it to be disclosed it to all customers on a regular basis in a prominent format, since this can contribute to information overload and lead some consumers to overlook more important information. Recommendations on targeting credit disclosures are discussed below.

Regulatory Flexibility

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Adjusting disclosure requirements through the rulemaking process allows the costs and benefits of individual requirements or proposed requirements - and the cumulative impact of the full range of required disclosures - to be evaluated in a deliberative and open manner. In addition, it allows changes to be made when appropriate. In contrast, statutory disclosure requirements that mandate the use of specific language or impose creditor duties may be devised in haste or remain in effect long after the specific practices they were intended to address have changed.[1] Regulation Z continues to provide a sound mechanism for adjusting consumer disclosures to reflect changes in the marketplace, and we encourage the Board to focus on changes that can be effected through the regulatory process without the need for legislative changes.

We also urge the Board to build on existing mechanisms that do not rely on Regulation Z disclosures for informing consumers about the costs and usage of credit. As the Board's ANPR notice observes, there are limits on the amount of information that can be effectively communicated through disclosures on periodic statements, credit card solicitations and applications, and consumers' ability to use the information is adversely affected as the volume of disclosures increases. Simplification and format changes are not likely to enhance consumer understanding if the volume of disclosure requirements continues to grow. Consumer education efforts delivered through multiple formats (public service announcements, classroom materials, brochures, Web-based educational materials, etc.) can be a far more effective means of communicating some information and targeting information to those most likely to benefit.

Impact of Technology on Consumer Access to Credit Cost Information

We urge the Board, in conducting its review, to be mindful of the impact that developments in information technology (such as computers and the Internet) and communications technology (e.g., e-mail) have had on users of credit cards and other forms of consumer credit. For example:

- Consumers who once compared credit cards by clipping advertisements from newspapers and magazines, picking up "take one" applications in bank branches and restaurants, or collecting offers to apply for credit cards that arrived in the mail, can now shop for credit over the Internet or compare "firm offers of credit" from lenders across the country.

- Customers with questions about account terms, pricing practices or other matters who may have once relied principally on the information printed on their

[1] For example, when the Truth in lending act was amended to mandate that specific items be prominently disclosed in credit card solicitations in the "Schumer Box", most credit cards carried an annual fee, and the statute required that the amount of this fee be disclosed. Today, more often than not, cards are offered without an annual fee, yet the statute has not been changed, and consumers must be advised of that fee (i.e., "none"). .

periodic statements, now have 24/7 access to detailed information via toll-free calls to customer service representatives or to Web sites with "Question and Answer" pages.

- Consumers who once rushed to the Post Office with payments, or mailed payments long before the due date, to avoid late fees can now accomplish this with on-line bill payments or preauthorized debit agreements. Internet bill payments have become increasingly popular and the percentage of credit card users who use this convenient means of remitting payments continues to grow.

Changes in disclosure requirements may be warranted to take into account developments that are rapidly changing the way consumers receive and store information. For example, the Board should consider allowing consumers to elect to access the Truth in Lending disclosures through the Internet, and receive simplified short-form periodic statements that are free of most or even all of this information. The short-form statement would notify consumers of the Web site where the disclosures information (e.g., billing error notices, Fair Credit Billing Act notice) could be found. The Board has asked for comments on an "abbreviated notice" approach with respect to the balance calculation method disclosure (in Q30), but we think it should be explored as well with regard to the other required disclosures.

Targeted Disclosures

Changes in information technology might also provide an opportunity for Truth in Lending disclosures that address specific issues (e.g., fees for late payments) to be targeted to consumers who would most benefit from the disclosure because of the way they use their accounts. The same technology that has allowed card issuers to use information about customers' use of credit in developing products and making risk-based pricing decisions could be used to direct consumer disclosures to those who would benefit most.

The Truth in Lending Act and Regulation Z were adopted at a time when credit card users were a far more homogeneous group than today, and credit products tended to be offered on a one-size-fits-all basis. While it made sense in the 1970's to provide all consumers with essentially the same disclosures, the ability of card issuers today to have current data about how individuals use their accounts might provide an opportunity to allow issuers to provide some Regulation Z disclosures only to a defined segment of their cardholders. Consumers who never or rarely make delinquent payments receive little or no benefit from more prominent late fee disclosures; "convenience users" who pay their full account balance each month receive little benefit from enhanced disclosures about the APR or fees that they never incur; and consumers who never utilize balance transfer offers receive little benefit from payment allocation disclosures.

Particularly with respect to disclosures that address fees, practices or consumer behavior (e.g. exceeding credit limits) that do not affect the majority of borrowers in a portfolio, the Board should consider allowing credit card issuers to target disclosures to individuals most likely to benefit from them. Individual disclosure requirements could be subjected to different rules, with the disclosure obligation "triggered" by appropriate levels of consumer behavior and exposure to a specific practice. Differences in the circumstances under which an issuer could elect to target disclosures might depend on such factors as whether the disclosure addresses behavior that can impair an individual's credit score (e.g., delinquent payments) as opposed to fees that do not (e.g., balance transfer fees).

Testing the Benefits of Proposed Disclosures

Finally, before the Board approves the addition of new disclosure requirements to Regulation Z, we suggest that it explore the feasibility of "real world" testing of the impact of any proposal on actual credit card users. The ANPR explores the addition of about 20 new disclosures. While the Board may contemplate the "testing" of some or all of these proposals through consumer surveys, focus groups, or notice-and-comment proceedings, such studies tend to examine individual disclosures in isolation or use other techniques that may not replicate the experience of actual credit card users exposed to the full array of disclosures that accompany solicitations or appear on periodic statements. And no such test, no matter how well conceived, can accurately evaluate the extent to which the disclosure will benefit consumers by motivating them to use credit cards in a manner that would reduce borrowing costs, improve creditworthiness, avoid penalty fees, or avert delinquency or default.

The best way for the Board to evaluate the true impact of a proposed disclosure on consumers would be to work with card issuers on tests that would involve furnishing proposed disclosures to a sample of current or (with respect to solicitation and application disclosures) prospective card users, and measuring their responses to the disclosures over a reasonable period of time. For example, this would allow the Board to evaluate whether consumers who have habitually made only minimum payments on their accounts, or who repeatedly incur late fees, begin to make larger or full-balance payments, and start making timely payment, after receiving new minimum payment or late fee disclosures. Testing disclosures in a real life setting would also allow proposed disclosures that are intended to educate or inform consumers who engage in specific behavior (e.g., regularly make balance transfers, overlimit purchases, or obtain cash advances) to be sent only to consumers who engage in such behavior.

This approach would provide the Board with demonstrable evidence of the efficacy of a proposed disclosure before the proposal became a mandate. On the other hand, it would provide a sound basis for abandoning or rethinking a proposed disclosure if it demonstrated that the consumers who had been exposed to it did not change their behavior.

The following responses address specific questions raised in the Notice.

Q2. Formatting Rules for Account-Opening Disclosures

The Board seeks comment on whether formatting rules are necessary with respect to account-opening disclosures. We do not believe that there is a need to require format changes. Two thirds of consumers responding to the Board's 2002 Consumer Advisory Council (CAC) study found these disclosures "very easy" or "somewhat easy" to use.[2] In response to the Board's point that many consumers also consider these disclosures complicated,[3] we believe the Board should keep in mind that open-end credit by its nature, and by virtue of the common credit practices (default rates, payment allocation, two-cycle billing, etc.) requires complex disclosures. No change to formatting or type size requirements will ever make account-opening disclosures uncomplicated.

Requiring increased font sizes for account-opening disclosures or mandating special formatting would not work. Banks are understandably reluctant to make TILA disclosures more prominent than others because doing so invites litigation over whether the other disclosures have thereby been rendered inconspicuous. Disclosures required by the Fair Credit Reporting Act, the Gramm-Leach-Bliley Act, the Fair Credit Billing Practices Act, the USA PATRIOT Act and various state laws are all important, as are fundamental contract terms (reward/rebate terms, mandatory arbitration provisions, etc.). Banks would therefore tend to make the same font and formatting changes throughout the account-opening disclosure documents. This would significantly increase the total size of the disclosures, without making the TILA disclosures any more conspicuous relative to the others.

Changes to disclosure requirements are also likely to lead to years of wasteful and expensive litigation as plaintiffs' attorneys take issue with banks' interpretation of the rules and attempt to extract nuisance settlements. Changes should be made only for the most compelling of reasons. They do not exist in this case.

Q3. Formatting Rules for the Life of an Account

The Board seeks comment on whether formatting rules are needed to make disclosures more effective during the life of an account.

We believe that allowing card issuers to have the flexibility to design appropriate disclosure formats is preferable to a regulatory mandate. There are enough differences among card products, fees and issuer policies that attempts to design a format suitable for the entire industry would be difficult. For example, if all issuers were required to use the same captions, or make disclosures in the same order, there would be a significant

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[2] Thomas A. Durkin, Consumers and Credit Disclosures: Credit Cards and Credit Insurance, Federal Reserve Bulletin (April 2002), p. 205, Table 5.

[3] ANPR at 10.

number of blank spaces (or entries that read “none” or “not applicable”). The result could be disclosures that consumers might find more confusing than helpful.

A focus on the format of account-opening disclosures probably overemphasizes how consumers use this information. Like the owners’ manuals that accompany appliances and other consumer products, account-opening disclosures are probably read on receipt by few consumers, but rather put aside for future use. Some consumers may never have occasion to read TILA disclosures over the life of the account. Others, as the Board has noted, may refer to the information long after the account was opened to learn about a practice or fee that their card usage has triggered.

Moreover, the account opening disclosures are only one of the sources of information about accounts that the consumer may choose to use. Issuers, including Discover Bank, make plain-English explanations of important account terms and requirements available in other formats: 24-hour customer service centers with representatives trained to explain terminology and answer questions; Web sites with “FAQ” pages; and even customer service via e-mail. Consumers may elect to obtain information from these sources because they are more convenient or when the account-opening disclosures are inaccessible (e.g., if the customer is traveling).

Q4. Additional Disclosures on Periodic Statements Regarding Payment Due Dates

The Board seeks comment on lenders’ disclosures of payment due dates on periodic statements and the need for an additional disclosure on the front of statements. Discover Bank discloses a single “payment due date” on its statements. Disclosing two due dates for payments (the grace period or the “actual” due date, in addition to a “please pay by” date) is likely to confuse consumers as to which date to rely upon, and will likely result in increasing the number of late payments by consumers who decide to use the former date and do not send payments early enough. The resulting late fees, increased interest rates, dissatisfaction and complaints will not serve consumers well.

Q5. Formatting of Fee Disclosures

The Board requests comments on whether lenders should group fees together on monthly statements. We believe it is more clear and informative to consumers when fees are shown chronologically, so that consumers can better understand the sequence of events which triggered a fee. Listing an ATM fee adjacent to the ATM transaction, for example, or disclosing fee credit adjacent to the listing of the fee itself is easier to understand than disclosing the fees separately on the statement. Grouping of fee might also confuse some consumers who might think that the fees were being charged twice. The Board has not identified, nor do we see, any particular benefit to consumers of grouping fees together.

Q6 Periodic Statement Formats

The Board seeks comment on whether formatting rules or mandatory navigational aids are necessary with respect to periodic statements. Card issuers have a marketplace incentive to make their periodic statements understandable and easy to use. Indeed, sometimes the readability of statements is used as a competitive tool. While the task of simplifying the period statement becomes more complicated with the addition of new disclosures and placement mandates (e.g., the new minimum payment disclosure that soon must appear on each statement) flexibility in designing the format makes the task easier.

We are not aware of any evidence that consumers find periodic statements difficult to use, or hard to navigate, or would be materially benefited by new format requirements. Changes may be disorienting to customers who have become accustomed to finding the information they need in the same place each month. Statement format changes can also be expensive for creditors, and occasion wasteful nuisance lawsuits.

Q7 Schumer Box Formatting

The Board seeks comment as to the formatting of the "Schumer box." We believe the current formatting rules work, as evidenced by the Board's CAC study results. However, the Board should consider whether the box currently addresses fees and charges most important to consumers. For example, as noted earlier, annual fees or their equivalent are not as commonplace as in the past, lenders who do not impose such fees should be permitted to omit them from the Schumer box.

Q8 - Including Transaction Fees within the Schumer Box

The Board seeks comment as to whether lenders should be required to disclose balance transfer fees and cash advance fees within the Schumer Box. We believe the existing requirement that these balance transfer fees be disclosed "clearly and conspicuously" is sufficient. These fees affect only those customers who choose to use balance transfers or cash advances, and often vary during the life of an account due to special promotions (e.g., "No fee with this offer"). In addition, Discover reminds its customers of the applicable fees at the time they receive a balance transfer offer. We do not think consumers are ill informed about balance transfer fees, and do not think there is a need to elevate the prominence of the disclosure of these fees.

Q.9. Linking Account-Opening Disclosures with Convenience Checks and Balance Transfer Checks

The Board asks whether formatting tools or navigational aids 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. We do not believe there is any evidence that the disclosures currently provided by lenders on these promotional checks are inadequate or confusing, and do not believe any rule change is required.

Q10 - Existing Model Forms and Clauses

The Board seeks comment as to whether existing model forms and clauses should be revised to improve their effectiveness. We see no need to change the existing model forms or clauses.

Q11 - Additional Model Forms and Clauses

The Board seeks comment as to whether additional model clauses or forms would be helpful. We believe additional model forms or clauses would be helpful specifically to address the increasingly common practice of credit card issuers of offering cards with a range of possible purchase rates (e.g., "a rate between 8.99% and 11.99 %"), the actual rate being determined after a review of the applicant's credit.

Q13 - Characterization of Fees as Finance Charges

The Board requests comment on whether, or when, fees on an open-end credit account should be characterized as "finance charges." We believe that only those fees that are periodic and vary according to the balance owing should be deemed "finance charges." Our experience has been that consumers have great difficulty distinguishing between "finance charges" and "interest" and that eliminating the distinction will make disclosures far easier to comprehend, and much more meaningful.

Transaction fees, in particular, would be excluded under this definition since they are not periodic. Transaction fees, when amortized over a single billing period, and in particular if there is a small balance, often cause APRs to be enormous and, at best, uninformative. It is far simpler and more helpful to simply leave those fees disclosed as a dollar amount.

Q14 - Disclosure of Fees for Services

The Board requests comment as to how consumers learn about fees that will be imposed in connection with services related to an open-end account, and any changes in the applicable fees. Discover Bank discloses such fees in its Cardmember Agreement, and again at the time the service is requested, unless it is waived (e.g., pay-by-phone, overnight replacement card deliveries, etc.). In the Agreement, each fee has its own boldface and all-capitals heading (e.g., "**PAY-BY-PHONE FEE**") and is listed in a table of contents at the front of the Agreement. Any changes are clearly identified in a change-in-terms notification with clear and prominent headings.

Q15 - Significance for Consumers of the Label "Finance Charge"

The Board requests comment as to what significance consumers attach to the label "finance charge," as opposed to "fee" or "charge." As stated in response to Question 13, our experience has been that consumers equate "finance charges" with "interest." We believe consumers consider "fees" or "charges" to be amounts charge either on a one-time basis, or in an amount that does not vary depending on the balance owed.

Q16 - Classifying Fees as Finance Charges Only If Required to Obtain Credit

The Board requests comment on suggestions that fees be classified as finance charges only if payment of the fee is required to obtain credit. As explained above in response to Question 13, we believe a better rule is that fees are finance charges only if they are periodic and vary according to the balance owing. If the Board does not adopt this approach, however, we agree that the next-best alternative would be a rule based on whether the fee is required to obtain credit. The rule should specifically exclude fees for participation in a credit plan (e.g., annual fees) because those fees are generally imposed regardless of whether one has borrowed. To remove any possible doubt, the rule should also exclude the other fees itemized in Section 226.4(c) (late fees, overlimit fees, etc.) since they are not required as a condition of obtaining credit.

Q17 - Classifying Fees as Finance Charges Based on Whether They Affect the Amount of Credit Available or the Material Terms of the Credit Plan

The Board requests comment on suggested rules that would classify a fee as a finance charge based on whether the fee affects the amount of credit available or the material terms of the credit plan. We find this suggestion very unclear, and hesitate to comment on it in the absence of a specific proposal and examples of which fees would be covered and which would not. A rule that contained only a general standard could result in years of uncertainty, litigation, and additional rulemaking.

Q18 - "Significant" Charges

The Board requests comment on the staff commentary to the effect that only "significant" charges need be disclosed under TILA. The commentary is helpful, but we believe that it would be useful to specify that fees charged for optional, non-credit services provided for the customer's convenience need not be disclosed under TILA. Examples of such fees would include fees for expediting delivery of cash advance checks, and fees for providing copies of account records.

Q21. – Over-the Credit-Limit Fees: Inclusion in Finance Charge

The Board requests comments on whether there is a need for guidance on including overlimit fees as a component of the finance charge, such as when the customer incurs such fees "on a continuing basis." We do not think that there is a need for additional guidance on this issue, and in particular do not believe that Regulation Z should be amended to require the inclusion of such fees in the finance charge.

All borrowers can avoid overlimit fees, and most borrowers incur these fees rarely if ever. These fees should not be considered a component of the finance charge for consumers whose account utilization behavior results in their imposition. We are aware of no indication that consumers who incur these fees do so because they are unaware that their account carries a spending limit or that a fee will be charged for exceeding it. We do not believe that requiring the fee to be annualized, as a component of the finance charge, would result in a change in payment behavior of affected credit card users.

The issue of the imposition of overlimit fees on a continuing basis has been addressed in the FFIEC Guidance on "Credit Card Lending - Account Management and Loss Allowance" (January 3, 2003). The Guidance observed that the failure to adequately provide for "timely payment of over-limit accounts" (particularly subprime accounts) might significantly increase an institution's risk. It requires credit card issuers to avoid "liberal overlimit tolerances and inadequate repayment requirements" for these accounts and directs that overlimit authorization should be "restricted." Thus, the Guidance provides adequate restraint on the assessment of these fees on a continual basis.

Q22. Over-the-Credit-Limit Fees: Disclosures

The Board seeks comments on whether there is a need for additional disclosure on how overlimit fees are calculated when they are imposed. Discover explains both of these to its Cardmembers, and we do not believe that there is a need to require additional disclosure. Overlimit fees are incurred by a relatively small percentage of consumers, so additional or more prominent disclosures would not benefit most card users. Again, it is not at all clear that consumers who incur these fees are unaware that they exist or how they can be avoided. The credit limit typically is disclosed on each periodic statement. Consumers who want information about their current limit or account balance prior to the receipt of their monthly statement can receive this information via telephone or the Internet.[4]

As the Board has observed, technical limitations and practical considerations often do not allow the merchant or creditor to determine at the moment of the transaction that a

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[4] Discover Card users with Internet access can sign up for e-mail reminders that alert them when they are nearing their credit limit, when a purchase would cause them to exceed the limit, or when their account balance exceeds a specified dollar amount.

particular charge will cause the customer to exceed the account spending limit. Indeed, Discover does not impose an overlimit fee at the time of a specific account transaction, but makes this calculation at the end of the billing cycle. As a result, payments received before the end of the cycle will offset charges that might otherwise have caused the credit limit to be exceeded. The Discover Cardmember Agreement advises card users that an overlimit fee will be imposed if:

> *"at the close of a billing period, your outstanding Account balance exceeds your Account credit limit"* (emphasis added).

With regard to the circumstances under which overlimit fees may be imposed, Discover specifically advises its card users that an overlimit fee may be imposed notwithstanding the fact that transactions that may have caused the consumer to exceed the limit were approved at the time of the transaction. The Cardmember Agreement also informs consumers that interest and fees are included in the calculation of the spending limit. It states that an overlimit fee may be charged:

> *"even if the transaction which causes you to exceed your Account credit limit is authorized by us or if you exceed your Account credit limit due to the posting of Finance Charges or fees to your Account."*

Discover makes additional overlimit fee disclosures to customers who use balance transfer checks or authorize balance transfers over the telephone. The Cardmember Agreement discloses that if a balance transfer check would cause the account's credit limit to be exceeded, *"we will lower the transfer amount to your available credit."* If a customer makes a balance transfer request by telephone that would cause the account to exceed the preauthorized limit, the customer service representative warns the customer *"you may be at risk of receiving an overlimit fee on your next statement."* The representative also suggests that the customer lower the amount of the requested transfer to avoid the overlimit fee.

Even if there were no technical or practical problems with providing an overlimit fee disclosure at the time of other transactions, it is unlikely that most consumers would want to receive this information. A disclosure in a retail checkout line or at a table in a restaurant that "if you use this card, and do not make offsetting payments before the end of the billing period, an overlimit fee will be imposed" is more likely to be perceived as an embarrassment or an annoyance than as a helpful disclosure. And it would be unlikely to change consumer behavior. Given a choice of (1) having all transactions that exceed the spending limit declined, (2) receiving a point-of-sale "warning" similar to the above, or (3) having over-the-limit transactions approved without a contemporaneous fee notice, most consumers would probably prefer the third option (i.e., current industry practice).

Q23 Usefulness of the Historical APR Disclosure

The Board seeks comment as to the usefulness of the historical APR disclosure. As suggested by our response to Question 13, we do not believe that these disclosures are helpful. Indeed, we believe they actually cause confusion. Transaction fees, when amortized over one billing period, grossly distort APRs, particularly if there is a small balance. We question whether the disclosure has been of practical significance to consumers. For example, consumers who make $50 cash advance withdrawals from ATMs are told that they incurred a very high APR. Is there any evidence that this information results in changes in future ATM usage (e.g., fewer withdrawals or larger ones)? If not, what is the value of the historical APR disclosure?

Q24 - Improving Consumers' Understanding of the Effective APR

The Board seeks comment on ways to improve consumers' understanding of the effective APR. We suggest that a revised definition of "finance charge," as discussed above, is the best way to improve customers' understanding of the effective APR.

Q25 - Alternative Frameworks for Disclosing the Costs of Credit

The Board requests comment as to alternative frameworks for disclosing the costs of credit on periodic statements. Again, we believe that a revised definition of "finance charge," as discussed above, is the best way to improve customers' understanding of the costs of credit.

Q26 – Change in Terms Notices

The Board has asked for comments on whether Regulation Z's 15-day advance notice requirement for changes in account terms (12 CFR 226.9(c) (1)) is adequate to provide timely notice to consumers. We believe that the current requirement is adequate, and do not agree that in the case of a change that involves an increase in the APR consumers need more time to "shop for alternate financing." Because Discover Cardmembers who receive change of terms notices in this circumstance have the option of canceling the card and continuing to pay off existing balances at the current rate, all they need to do within the 15 day timeframe is to notify the card issuer of their election to cancel. There is no need to "refinance" the old balance with another lender to preserve the existing APR.

If the consumer wants to move the balance to a lower rate card, or find another card that will allow future purchases to be subject to a lower rate, the 15-day timeframe is adequate. Few consumers carry only a single credit card, so most typically shift old balances to another card and use that card for new purchases. If the consumer does not have another card, a competitive marketplace provides many options and multiple channels for opening accounts with little delay. Consumers can respond to preapproved offers, "take one" applications, and advertisements received in the mail or published in newspapers and periodicals. They can apply over the telephone or the Internet and may be able to receive "instant" approval. There does not seem to be a need to a regulatory delay in implementing rate changes to accommodate such customers.

Q27 – Changes in APRs under Default Rate Plans

The Board request comments on how consumers are alerted to changes in APRs that are made under the terms of a default-rate plan, and whether current notices are adequate. Discover advises consumers in its application disclosures and again in the account agreement of the types of APRs that can be increased in the event of delinquent payments, and of the type of delinquencies that can trigger an APR increase. Discover provides the following notice in its printed application:

> *"If you are late making a payment, any introductory/special rates terminates and the purchase APR will apply to purchase and balance transfers. Your purchase APR and cash advance APR will also be increased to a variable APR not to exceed the Prime Rate +10.99%. If you fall twice to make the required payment when due, or if you exceed your account credit limit twice, your purchase APR and cash advance APR will be increased to a variable APR not to exceed the Prime Rate+15.99%. If you fail 3 times to make a required payment when due or if you exceed your account limit 3 times, your purchase APR and cash advance APR will be increased to a variable rate not to exceed the Prime Rate + 19.99%. See Cardmember Agreement for details."*

Under the Discover plan, APR changes are triggered by the customer's payment history with Discover.[5] Because consumers are notified on their periodic statements when timely payments were not received, the customer should be aware that an APR adjustment might be made. Moreover, when an APR change occurs, the new rate information is included in the portion of the periodic statement that discloses the finance charge calculation. Customers who do not recall the basis for the change, do not understand default pricing, or believe that the increase should not occur are not hesitant to call a customer service representative with questions.

The purpose of the default pricing program is not to generate revenues from rate increases that the consumer does not notice, but to change customer payment behavior and reduce risk to the portfolio. Consumer responses to increases in APRs demonstrate that consumers are well aware when APRs increase. Discover customer responses include making larger payments, making future payments on a timely basis, and reducing new purchases to enable the balance to be paid down more rapidly. Some customers call with requests that the APR be reduced to its prior level. Others pay off the entire balance immediately.

The ANPR does not indicate the type of additional notice that might be contemplated for default-rate programs or the purpose of such notice. However, based on how consumers

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[5] This is not a so-called "universal default" plan that looks at delinquencies with other lenders.

react to APR increases under these programs, we believe that further disclosures are probably not needed.

Q31 – Minimum Payment Disclosure

The Board asks whether there is a need for a Regulation Z amendment to address the impact of making only minimum payments. The Bankruptcy Abuse and Consumer Protection Act of 2005[6] amends the Truth in Lending Act to require a periodic statement disclosure concerning the impact of making only minimum payments on a credit card account. The statutory language provides details about the disclosure that must be made, and establishes a mechanism for disclosing to consumers the length of time it would take to amortize the account balance if only minimum payments are made. There does not appear to be a need for further regulatory requirements.

Q32 – Availability of Account Amortization Data

The Board has inquired about the availability of "information about the amortization for an account" that would address the length of time it would take to pay off an account balance of a consumer who makes only minimum payments. There are a number of publicly available "minimum payment calculators" that consumers can access over the Internet. A number of institutions have developed proprietary systems (in anticipation of the implementation of California's minimum payment disclosure law).

To the best of our knowledge, all of these systems are based on a series of assumptions that are not reflective of consumers' real-world usage of credit card accounts and their minimum payment practices. Only a small percentage of consumers make only the minimum payment on any given month and few make only the minimum for months (and years) on end. However the minimum payment calculators must assume that: the consumer will make only the minimum payment on the account each month until the balance has been amortized; that the payment will be received on the same day each month (and will never be made late); that the interest rate on the account and the minimum payment will never change; and that no additional transactions (new purchases, fees or additional payments) will be added for the life of the account. The calculators also implicitly assume that lenders will not comply with regulatory guidance that discourages prolonged balance amortization. (See response to Q33). By incorporating assumptions like these, minimum payment calculation systems yield a "worst case scenario" disclosure of questionable utility.

Q33 – Data on Consumer Minimum Payment Behavior

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[6] This measure has been approved by the U.S. Senate and the House Judiciary Committee, and awaits approval by the House of Representatives, which is likely to occur in April.

The Board seeks data on the percentage of consumers that regularly or continually make only the minimum payments on open end accounts.

Issues surrounding minimum payments were explored in depth during the development of the 2003 FFIEC Account Management and Loss Allowance Guidance. The Guidance warns about the dangers of negative amortization that can result from liberal minimum payment plans that delay the repayment of principal and can result in negative amortization particularly when the payment is inadequate to cover late or overlimit fees that were added to the account during the billing cycle. The Guidance expresses the expectation that lenders will "require minimum payments that will amortize the current balance over a reasonable period of time" while avoiding "prolonged negative amortization, inappropriate fees, and other practices that inordinately compound or protract consumer debt…."

The discussions surrounding the development of the Guidance led many lenders to reevaluate their minimum payment programs as well as the manner in which APR increases, late payment penalties, overlimit fees and other practices impact customers who make minimum payments. Discover has enhanced its efforts to contact consumers whose balances continue to grow because of nonpayment, or the making of only minimum payments in combination with incurring higher APRs or penalty fees. The purpose of these communications is to work out payment arrangements in which customers who agree to make regular payments in exchange for the elimination or reduction of fees and a reduced APR. The implementation of intervention programs by Discover and others in the industry make older information about minimum payment practices by consumers obsolete. While the percentage of consumers who occasionally make minimum payments may not have changed, the percentage that does so habitually has declined and is likely to continue to do so.

Q35 –Payment Allocation Methods: Current Disclosure Practices

The Board has asked if creditors typically disclose their payment allocation methods, and how the disclosure is made. Discover discloses this information in its printed and electronic account applications, in the Cardmember Agreement, and on materials accompanying convenience checks. We believe this practice is commonplace in the card industry.

The payment allocation disclosure accompanying Discover Card applications reads as follows:

> *"**Payment Allocation:** We apply payments and credits to balances with low introductory/special APRs (such as special balance transfer and purchase APRs) prior to balances with standard APRs. Therefore, your savings will be reduced by making additional transactions or having balances that are subject to standard APRs. In addition, the length of time the introductory/special APRs will apply to your account may be reduced by the amount of your payments."*

The disclosure accompanying balance transfer convenience check offers is similar:

> *"We apply payments to balances with low special/introductory APRs (such as special balance transfer and purchase APRs) prior to balances with standard APRs. Therefore, if you have existing balances or make additional transactions that are subject to standard APRs, your savings under this offer will be reduced. See Cardmember Agreement for additional information."*

The Cardmember Agreement's payment allocation disclosure is included in the "Monthly Payment Options" portion of the Agreement:

> *"We reserve the right to apply payments and other credits to Balances subject to lower Annual Percentage Rates, such as Special rate balance transfers, or other promotional rates, prior to Balances subject to higher Annual Percentage Rates."*

Q36 – Payment Allocation: New Periodic Statement Disclosure Requirement

The Board seeks comments on whether consumer confusion or misunderstanding would be avoided, or consumers otherwise materially benefited, if Regulation Z were amended to require a disclosure of the payment allocation method on the periodic statement.

We do not believe that consumers are currently confused about, or misunderstand, the manner in which payments are allocated or would receive a material benefit if another disclosure were added to the periodic statement. As noted above, Discover customers receive a disclosure about payment allocation when they apply for an account with an introductory APR or receive a low-APR balance transfer offer, and receive an additional disclosure in the Discover Cardmember Agreement. If a consumer enters into a transaction that results in multiple account balances that carry different APRs, the periodic statement will show this information, and when payments are made, it will show how they were allocated. Customers who do not understand how or why the payments were applied (because they did not read or understand the payment allocation disclosures they received when the account was opened or when they authorized a lower-rate transaction) can receive an explanation by calling a customer service representative. Discover receives relatively few customer service calls about how payments are allocated.

Information about payment allocation methods is available to Discover Cardmembers at any time. But inclusion of this information in account application and convenience check offers is perhaps most useful to consumers because it is presented – before the fact - at the time they are most likely to initiate a transaction (e.g., open an account with an introductory APR or initiate a balance transfer with a low APR) that could result in multiple APRs with different rates.

The Board has not indicated the purpose or content of a new payment allocation disclosure or whether it would be furnished to all consumers or only those who carry multiple balances. On the basis of the questions the Board has asked, the notice presumably would be an after-the-fact explanation of how payments were allocated to multiple balances that the consumer has previously incurred (as opposed to a notice about how payments would be allocated if, in the future, the customer adds multiple balances with different APRs).

Such a disclosure would be beneficial to consumers only if they notice and read it *and* use the information to reduce their costs (e.g., by paying off, or making larger payments on, higher-APR balances). We question whether more information about payment allocation practices would generate an interest in making larger payments to eliminate or rapidly amortize higher-APR balances. We are not aware of evidence suggesting that consumers who carry multiple balances have the additional resources necessary to make such larger payments, and would do so if they received more payment allocation disclosures than they currently receive. In the absence of reliable information demonstrating that a payment allocation disclosure on periodic statements is likely to motivate consumers to change their payment behavior, no such disclosure should be required.

Q46 – Issuance of Additional Cards on Existing Accounts

We support a revision of Regulation Z that would specifically authorize the issuance of additional cards on existing accounts. This would clarify issuers' ability to provide their customers with enhanced products and technology without having to cancel existing cards, or wait until the card's expiration date, and issue substitute or renewal cards. Regulation Z should facilitate, not hamper, the ability to provide credit card users with up-to-date products and services.

A card that does not involve a new extension of credit but merely gives the customer an additional means of accessing an existing credit line should not be treated as a "new" account. If the additional card is governed by the existing account terms, the consumer who receives the card is not exposed to a potential for increased indebtedness or other risk.

There is no need for an amended rule to require that cards sent to existing cardholders have new levels of security, such as a requirement that they be sent unactivated. As a practical matter, such cards are likely to be sent unactivated, or subject to additional security-related safeguards, because this is currently the best way that issuers have to protect themselves against exposure to fraud, theft or unauthorized use. (Consumers themselves are already protected from the risk of unauthorized use.) Thus, issuers have strong incentives to use the most effective security technology to prevent misuse of additional cards. A regulatory mandate requiring the use of a specific form of protection or security technology locks card issuers into current systems that may be superseded by more effective techniques or technology. Consumer interests would not be advanced by a prescriptive regulation.

Similarly, there is no need to require prior notification requirement before additional cards may be sent. Issuers have a financial and security incentive to advise consumers to "watch the mail" for the arrival of an additional card, because they hope that the cardholder will use the card and unauthorized persons will not. There is also a financial disincentive that prevents issuers from repeatedly sending additional cards that consumers may not expect to receive. While a prior notice might be of some utility in preventing fraud or unauthorized use, there is no evidence that this is the only or the best way of achieving this goal.

Q47 - Cut-Off Hours for Receiving Payments

The Board requests information about the cut-off hours that issuers use to determine when payments must be received. Discover's cut-off time for mailed payments is 1 p.m., Monday-Friday. Payments received by mail after 1 p.m., or during the weekend, are posted to the account as of the next business day

Q48 - Payment Cut-Off Times for Different Payment Methods

The cut-off time for phone payments is as follows: ACH payments received by 5:45 pm Eastern Time, and CTC payments received by 6:00 pm Eastern Time, are credited as of the date of receipt. Payments made over the Internet by 3:30 Eastern Time are credited as of the payment date. The differences in the time periods reflect the time (and staffing) required to process paper checks and different forms of electronic payments.

Q49 - Disclosure of Payment Cut-Off Hours

The Board inquires whether creditors clearly inform customers of the date and time by which payments must be received to avoid fees. For check payments, both the Discover Cardmember Agreement and the periodic statement disclose that payments must be received by 1 p.m. Monday-Friday to be posted as of that business day. For pay-by-phone, a disclosure is provided on both the automated voice system and by customer service representatives. The Discover Web site posts the cut-off periods for online payments.

With regard to the question of how payment disclosures might be improved, we note that the Bankruptcy Abuse and Consumer Protection Act of 2005 amends TILA to require a periodic statement disclosure. It includes the date on which a payment is due or, if different, the earliest date on which a late payment fee may be charged, and the amount of the late payment fee.

Q50 - Payments Processed by Third Parties

The Board requests information about the due dates and times for payments processed by third parties and whether creditors treat payments received by such processors as if they had been received directly by the creditor. Discover does not use third parties as agents to accept Discover Card payments. All Discover payments are mailed directly to Discover, and electronic receipts from payments made on the Discover Website are processed directly by Discover. The only exception is that Discover customers may make payments on their Discover bills in Sears stores. These payments are deemed to be received when received by the Sears store, not when the funds are received by Discover.

Q51- Crediting Payments on Date Received

The Board asks whether creditors should be required to credit payments as of the date they are received, regardless of the time of day they arrive. We do not think this would benefit consumers.

Cut-off times are imposed to allow incoming payments to be processed and the remittances deposited to the creditor's account. The effect of a date of receipt mandate would be that payments received by midnight would be credited as having been received on that date even though the payments were not actually processed or the incoming checks deposited until the following day. Finance charges could not be imposed on payments that were "deemed" to have been made but had not in fact been credited. This could be extremely costly and might force creditors to shorten grace periods, accelerate payment-due dates or find other means to recover the losses.

Discover Bank appreciates the opportunity to comment on the Advanced Notice. We would be pleased to provide additional information that would assist the Board in its review.

Respectfully submitted,

Discover Bank
By: Kathy Roberts
President