Commentary – Federal Reserve System July 24, 2007
12 CFR Part 226
Regulation Z; Docket No. R-1286

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You have got to be kidding! Does anyone not remember that "Truth in Lending Act" is a short title for "**Consumer Credit Protection Act"** which is a sub-title of the **"CONSUMER PROTECTION ACT"?** There is no part of this regulation that even remotely supports the incredible interpretation that is now proposed. Please remember, the purpose for amending this act is to correct unfair and deceptive credit card practices, not enhance them. Contrary to the tearful and distortional testimony of the "industry representatives" it is not a distortion to disclose the Annual Percentage Rate (APR) according to Section 107 of the Consumer Credit Protection Act and Sections 226.5, 226.14 and Appendix F of the FRB's Regulation Z. It is a distortion and it is very much misleading to imply that Interest Rate and Annual Percentage Rate are equivalent values as you are doing with the Schumer Box. Disclosing the true cost of a credit card account as an annualized rate is telling the truth in a consistent comparable manner and that is why it is called the "Truth in Lending Act".

THE ANNUAL PERCENTAGE RATE AND THE INTEREST RATE ARE NOT SYNONYMOUS if there are other costs and/or fees involved.

I typed "annual percentage rate" into a Google search window. The results are astounding!

Examples:

From www.mtg-net.com:

"What is an Annual Percentage Rate (APR)? The annual percentage rate (APR) is an interest rate that is different from the note rate. It is commonly used to compare loan programs from different lenders." "The APR is a very confusing number! Even mortgage bankers and brokers admit it is confusing. The APR is designed to measure the "true cost of a loan." It creates a level playing field for lenders. It prevents lenders from advertising a low rate and hiding fees." "If life were easy, all you would have to do is compare APRs differently! Right? Wrong!" "Unfortunately, different lenders calculate APRs differently!" " The reason why APRs are confusing is because the rules to compute the APR are not clearly defined."

From Wikipedia, the online encyclopedia at http://en.wikipedia.org:

"**Annual Percentage Rate** (APR) is an expression of the effective interest rate that will be paid on a loan, taking into account one-time fees and standardizing the way the rate is expressed. In other words the APR is the total cost of credit to the consumer, expressed as an annual percentage of the amount of credit granted. APR is intended to make it easier to compare lenders and loan options." **"Despite repeated attempts by regulators to establish usable and consistent standards, APR does not represent the total cost of borrowing nor does it really create a comparable standard.** Nevertheless, it is considered a reasonable starting point for an ad-hoc comparison of lenders." "**Does not represent the total cost of borrowing" "Credit card holders should be aware that most US credit cards are**

quoted in terms of nominal APR compounded monthly, which is not the same as the effective annual rate (EAR). Despite the "Annual" in APR, it is not necessarily a direct reference for the interest paid on a stable balance over one year." "Not a comparable standard." "Even beyond the non-included cost components listed above, regulators have been unable to completely define which one-time fees must be included and which excluded from the calculation. This leaves the lender with some discretion to determine which fees will be included (or not) in the calculation." "Non-repeatable" "Two lenders with identical information may still calculate different APRs. The calculations can be quite complex and are poorly understood even by most financial professionals."

And finally the following from http://www.**federalreserve**.gov/Pubs/shop/:

(Remember, these interpretations are from the keepers of our national monetary policy and the authors of all banking regulations.)

"What are APRs?" The annual percentage rate—APR—is the way of stating the interest rate you will pay if you carry over a balance, take out a cash advance, or transfer a balance from another card. The APR states the interest rate as a yearly rate." "Multiple APRs" "A single credit card may have several APRs." "How is the finance charge calculated?" "The finance charge is the dollar amount you pay to use credit. The amount depends in part on your outstanding balance and the APR." "How will you use your credit card?" "If you sometimes carry over a balance from month to month, you may be more interested in a card that carries a lower interest rate (stated as an annual percentage rate, or APR)." "If you expect to use your card to get cash advances, you'll want to look for a card that carries a lower APR and lower fees on cash advances. Some cards charge a higher APR for cash advances than for purchases."

(*NOTE: Obviously the folks who wrote this are too young to fully comprehend the thorough and complex methodologies elaborated by their predecessors at the Federal Reserve for disclosing the true cost of credit.)*

Let's put that interpretation into the proper context of the regulation: What are APRs? The annual percentage rate—APR—is a way of stating **the total finance charges** you will pay if you carry over a balance, take out a cash advance, or transfer a balance from another card. **The APR is a measure of the cost of credit expressed as a yearly rate**. (It is **NOT THE INTEREST RATE OF CHARGE**!) Multiple APRs: A single credit card account may have several **INTEREST RATES** that are used in addition to card fees to calculate the total finance charge and THE APR. "How is the finance charge calculated?" The finance charge is the total dollar amount you will pay to use your credit card. (Per section 106 of the Consumer Credit Protection Act, the amount of the finance charge in connection with any consumer credit transaction shall be determined as the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit. The finance charge does not include charges of a type payable in a comparable cash transaction.) The amount depends in part on **how your outstanding balance is calculated**, the **interest rates charged** and the **fees imposed**. " How will you use your credit card?" If you sometimes carry over a balance from month to month, you may be more interested in a card that carries **lower interest rates and a lower APR**. If you expect to use your card to get cash advances, you'll want to look for a card that **carries lower interest rates and lower fees** on cash advances. Some cards charge a higher **INTEREST RATE** for cash advances than for purchases.

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Determination of annual percentage rate:

Section 107 (a) of the Consumer Credit Protection Act states: The Annual Percentage Rate applicable to any extension of consumer credit shall be determined, in accordance with the regulations of the Board, in the case of any extension of credit under an open end credit plan, as the quotient (expressed as a percentage) of the total Finance Charge for the period to which it relates divided by the amount upon which the Finance Charge for that period is based, multiplied by the number of periods in a year.
Section 226.14 (a) of FRB Regulation Z states: The Annual Percentage Rate is a measure of the cost of credit, expressed as a yearly rate.
Section 226.14 (b) of FRB Regulation Z states: Where one or more Periodic Rates may be used to compute the Finance Charge, the Annual Percentage Rate(s) to be disclosed for purposes of Sections 226.5a, 226.5b, 226.6 and 226.16 shall be computed by multiplying each periodic rate by the number of periods in a year.
Section 226.2 defines **Periodic Rate** as a rate of **Finance Charge** that is or may be imposed by a creditor on a balance for a day, week, month or other subdivision of a year. **Note: Before we delve further into disclosures it is important to attempt to disclose A MAJOR FRB MISINTERPRETATION about the term "Periodic Rate" in the calculation of the Annual Percentage Rate (APR). *PERIODIC RATE* IS NOT A RATE OF INTEREST!**

***PERIODIC RATE* IS A RATE OF FINANCE CHARGE!**

Section 226.4 of FRB Regulation Z defines **Finance Charge** as the cost of consumer credit as a dollar amount. **Finance Charge** includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit. It does not include any charge of a type payable in a comparable cash transaction. (It includes interest charges, balance transfer fees, cash advance fees, service fees, transaction fees, etc.)
(Example: Annual Interest Rate = 5.25%, Cash advance of $1,000.00, Cash Advance fee of 3.00%, Period of one month. Interest charge is $4.38 + Cash advance Fee is $30.00 = Finance Charge of $34.38 for a Periodic Rate of .03438%. The APR would be 41.2560% (.03438 times 12).

Examples for a Credit Card Account that separates purchases, balance transfers and cash advance charges. Assume an annual interest rate of 14.25% for purchases, annual interest rate of 0.00% plus a 3.00% balance transfer fee for balance transfers and an annual interest rate of 23.25% plus a 3.00% cash advance fee ($5.00 minimum) for cash advances. Also assume a $100.00 day one balance for each category with previous balances of zero.
The Purchase APR would be: The interest charge would be $1.19, the total Finance Charge would be $1.19 and the Periodic Rate is .01875% times 12 equals an APR of 14.25%;
The Balance Transfer APR would be: The interest charge of $0.00 plus the fee of $3.00 for a total Finance Charge of $3.00 and the Periodic Rate is .0300% times 12 equals an APR 36.00%;
The Cash Advance APR would be: The interest charge of $1.94 plus a minimum fee of $5.00 for a total Finance Charge of $6.94 and a Periodic Rate of .00694% times 12 equals an APR of 83.28%; and,

The Credit Card Account APR would be the total interest charges of $3.13 plus the total fees of $8.00 for a total Finance Charge of $11.13, for a total Periodic Rate of .0371% times 12 for a Credit Card Account APR of 44.52%.

How much simpler can a Credit Card comparison disclosure be than to state the account APR? Actually, the creditor is allowed to show either individual APRs or a composite APR. If it were me, I would much rather show an account APR of 44.52% as compared to Purchase APR of 14.25% plus Balance Transfer APR of 36% plus Cash Advance APR of 83.28%!!

The Conus Fed Box

Annual Percentage Rate (APR) 44.52%	Periodic Finance Charge $11.13	Outstanding Balance $300.00	Total Amount Due to Pay Balance in Full $311.13
Minimum Payment Due	$12.00	Payment Due Date	7-15-07
12 Month Payment*	$28.00	Late Payment Date	7-26-07

*Payment amount required to pay off the balance in 12 monthly installments.

THE ANNUAL PERCENTAGE RATE AND THE INTEREST RATE ARE NOT SYNONYMOUS if there are other costs and/or fees involved.

General Disclosure Requirements:

Section 226.5 of FRB Regulations Z states that the creditor must make disclosures clearly and conspicuously in writing, in a form that the consumer may keep. It also states that the terms "Finance Charge" and "Annual Percentage Rate" when required to be disclosed with a corresponding amount or percentage rate, shall be more conspicuous than any other required disclosure. Certain required disclosures for credit and charge card applications must be provided in a tabular format or in a prominent location in accordance with the requirements of this section. (Note: Staff Commentary to this section instructs creditors that "The *clear and conspicuous* standard requires that disclosures be in a reasonably understandable form.)

Federal Reserve Board Chairman Bernanke stated in the May 23, 2007 Reg. Z commentary press release that "The goal of the proposed revisions is to make sure that consumers get key information about credit card terms in a clear and conspicuous format and at a time when it would be most useful to them."

In his statement to the Board, Governor Kroszner stated, "Better credit disclosure permits better-informed credit decisions and, hence, more effective competition among credit card issuers. In a nutshell, effective disclosure empowers consumers and enhances competition," and he concluded his statement with "The goal of the proposed revisions is to bring greater clarity of key terms on credit card accounts, to enable consumers to evaluate offers more easily and use their cards more wisely and enhance competition in the market."

With all due respect to Chairman Bernanke, Governor Kroszner and the "Reg. Z" staff at the Federal Reserve, your press release said you were listening to the people but the survey you refer to sure says that **YOU DID NOT HEAR US**!!!

The survey says that all the people in every market understand the fees they may have to pay and they understand when they may have to pay them. Again, The survey says that <u>all</u> the people in <u>every market</u> understand the fees they may have to pay and they understand when they may have to pay them. (*Did you know that there is very little in Regulation Z (Truth in Lending) about fee disclosure?)*

The survey also says, in the summary, in the testing, in the findings and in the conclusions that almost **all of the people** in all of the markets **DO NOT UNDERSTAND** the terms **Finance Charge, Periodic Rate** and **Annual Percentage Rate (APR).** They **also do not understand** the terms Penalty APR, Grace Period, Default APR, Effective APR, Nominal APR or Historical APR. **They Do Not Understand Finance Charge and Annual Percentage Rate!** Whole sections (107 and 108) of the Consumer Credit Protection Act were written about these terms! Whole sections of Regulation Z (226.4 and 226.14) were written about these terms! Appendix F was included to demonstrate how to use these terms to compute the Annual Percentage Rate (APR)! <u>Please go back and reread your survey!!!!!!!</u>
SectionS 226-5 and 226.7 **require** the disclosure of the **Periodic Rate, the Finance Charge and the Annual Percentage Rate**!! Please go back and reread Regulation Z!!! The people do not understand the terms Penalty APR, Effective APR, Nominal APR and Historical APR **because they are not a part of the Consumer Credit Protection Act or mentioned anywhere in Regulation Z!** Look for them in ANY section of either Act. They are not there! They are only a figment of your uninformed imagination! I even googled "Effective APR" and found NO DEFINITION. Google knows everything but it, like the people in the survey, did not understand that term. **That is because there is only <u>one</u> definition for Annual Percentage Rate. There cannot be a Prime APR, Standard APR, Fixed APR, Variable APR, Effective APR, Nominal APR or Historical APR. There is only ONE APR and it is the total Finance Charge expressed as a Periodic Rate (a percentage of the total outstanding balance) times the number of periods in One Year.** They are required to be disclosed in a clear and conspicuous manner in an understandable form that the customer may use.

The solution is so very simple. I am surprised that I am the only one who has thought of it! Although I think your surveyors were really trying to tell you BUT YOU DID NOT LISTEN! Remember, all of the people in all of the markets understand the fees they may have to pay and when they may have to pay them. The Fee Disclosure box works! So why not change the Interest Rates box? There is not a person in the world <u>who does not know</u> that the finance charge for an interest rate of 7.00% of $100.00 is $7.00. (There is not a person in the world <u>who knows</u> that an APR of 7.00% on $100.00 will yield a finance charge of $7.00!)
Change "APR" to "Annual Interest Rate" in every section of the Interest Rate Boxes of the Schumer Box: Interest Rate for Purchases; Interest Rate for Balance Transfers; Interest Rate for Cash Advances; Penalty Interest Rate; and, Interest-free Grace Period. That's it!!! Well almost!

You still need to disclose the Finance Charge and the Annual Percentage Rate. Regulation Z allows the disclosure of either separate APR's (APR for purchases, APR for balance transfers, APR for cash advances, etc.) or a combined account APR. Separate APR's are not really feasible. Purchases have their own interest rate but generally no other fees. But what if the credit card account has an annual fee or a set-up fee or a maintenance fee? Those fees would have to be allocated to the APR for purchases, but how? How do you also allocate those fees to Balance Transfers and to Cash Advances when they have their own separate fees as well? Again, there is really only one solution. The Conus Fed Box!

The Conus Fed Box

Annual Percentage Rate (APR)* 44.52%	Finance Charge* $11.13	Outstanding Balance* $300.00	Total Amount Due to Pay Balance in Full $311.13
Minimum Payment Due	$12.00	Payment Due Date	7-15-07
12 Month Payment**	$28.00	Late Payment Date	7-26-07
		Interest Free Due Date	7-15-07
*The Finance Charge is the combined total of your total interest charges plus your transaction fees (not including the penalty fees). The Finance Charge divided by the Outstanding Balance equals your Periodic Rate which is multiplied by the number of periods in one year (12) to equal your Annual Percentage Rate. The Outstanding Balance was calculated by using the average daily balance method.			

**Payment amount required to pay off the balance in 12 monthly installments.

Please note how this box contains all of the "material disclosures" mandated by Section 103 (u) of the Consumer Credit Protection Act and Sections 226.5a and 226.7 of Regulation Z. This Box should be located just above the Schumer Box.

The terminology in all of the disclosures should be totally consistent not only with that used in both the Consumer Credit Protection Act and Regulation Z, but also with the entire lending industry. For instance, the lending industry has created a definition for Fixed Interest Rate to mean that the Interest Rate and the Annual Percentage Rate (APR) cannot <u>ever</u> be changed for the life of the loan. (You are proposing "fixed" to mean for a fixed period of time. If it is fixed for 90 days and then changed for another 90 days, and then changed for another 90 days even though the original balance has not been paid off, is that really a "fixed" rate of interest?) The same industry defines Variable Rate of Interest as a rate of interest that is tied to an adjustable index (i.e. WSJ Prime Rate, LIBOR, etc.) and is changeable whenever the index changes. Grace Period is generally defined as "the additional period of time a lender provides for a borrower to make payment on the debt without penalty". (see Investorwords under Google) These definitions are used for personal loans, real estate mortgage loans and commercial loans. Why then should the credit card industry be any different? Actually, they are really taking advantage of the normal usage of these terms as defined by the primary lending industry to misrepresent the credit card rate structure to their consumers, in reality violating the Consumer Credit Protection Act and Regulation, which were both designed to provide comparable information to the consumer in order to make an informed decision. I suggest that you make a terminology change of the usage of "fixed" or any similar term to mean that rate will remain in effect unconditionally. Variable rate can continue to be described as a changeable rate for all of the conditions designed by the credit card industry. Grace Period needs to be defined as "Interest Free Grace Period" and "Late Payment Grace Period" and the final date for each should be disclosed.

Now let's digress back to the APR and discuss the industry commenter's statements that the APR is misleading, exaggerates costs, and is shocking. That is codswallup, codswallup, and codswallup! When you state in your example that 54% APR is three times the 18.00% interest rate, it is because the

Finance Charge is three times the interest charge. (Your example shows $4.50 versus $1.50.) Remember, the purpose of these regulations is to promote the informed use of consumer credit by requiring disclosures about its terms and <u>costs</u>. Some in the industry have stated that time distorts and overstates the disclosure. Wrong again. We are looking at the total cost of a credit transaction. Does the creditor refund part of the fee if the credit is paid off early? The total Finance Charge is measured as an Annual Percentage Rate and when it is properly calculated with a Periodic Rate that equals the Finance Charge stated as a percentage of the outstanding balance multiplied by the number of periods in one year, it provides a meaningful and comparable disclosure of cost of consumer credit.

Imagine

Imagine® Mastercard® is the brand name of a bank credit card. Imagine® Mastercard® is the name of a Sub-Prime credit card. Look it up on Google! Under your current open-end credit disclosure rules it is allowed to advertise an Annual Percentage Rate of 19.75% for Purchases, a Cash Advance APR of 25.75% (why is Annual Percentage Rate spelled out for purchases and abbreviated for everything else in the Schumer Box?), a Cash Advance fee of 5.00% ($5.00 minimum), an annual fee of $150.00, a one-time processing fee of $4.95, and an account maintenance fee of $78.00 per year (billed monthly at $6.50 per month). The initial credit limit is $300.00!! This doesn't look to be too bad of a deal when detailed in the Schumer Box along side of other credit card disclosures. But let's transfer this information to the Conus Fed Box. Assume a zero first day balance, a $20.00 day one purchase and a $30.00 day one cash advance. The "purchase" interest would be $0.33, the cash advance interest would be $0.64, the cash advance fee would be $5.00, the annual fee is $150.00, the processing fee is $4.95 and the maintenance fee charge is $6.50. Total fees and interest combined equals a **Finance Charge of $167.42!**

The Conus Fed Box

Annual Percentage Rate (APR)* The cost of your credit as a yearly rate.	Finance Charge* The dollar amount your credit will cost you.	Outstanding Balance* The amount of credit provided to you or on your behalf.	Total Amount Due to Pay Balance in Full
334.84%	$167.42	$50.00	$217.42
Minimum Payment Due	??/??/??	Payment Due Date	8-15-07
12 Month Payment**	??/??/??	Late Payment Date	8-26-07
		Interest Free Due Date	8-15-07
*The Finance Charge is the combined total of your total interest charges plus your transaction fees (not including the penalty fees). The Finance Charge divided by the Outstanding Balance equals your Periodic Rate which is multiplied by the number of periods in one year (12) to equal your Annual Percentage Rate. The Outstanding Balance was calculated by using the average daily balance method.			

**Payment amounts were not disclosed in the advertisement.

I am starting my 40th year as a lender. During this time I have closed thousands of personal, commercial, real estate and open-end credit transactions. I have never had a customer walk away from my desk not understanding the difference between Interest Rate and Annual Percentage Rate. It is not a difficult task to explain when you lay it out in a proper definition. Would any of the current Imagine® Mastercard® customers have refused to open the account if they had been given the proper APR? I seriously doubt it. P. T. Barnum said "there is a sucker born every minute"! But, in America, even they are entitled to a proper disclosure of the cost of credit as mandated in the current Truth in Lending Act, the Consumer Credit Protection Act and the Consumer Protection Act.