

October 12, 2007

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

RE: Comments on Docket No. R-1286; Regulation Z (Open-End Credit)

Dear Ms. Johnson:

I am writing on behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions (FCUs), in response to the Board of Governors of the Federal Reserve System's (Board) request for public comment regarding its proposed rulemaking regarding Regulation Z, which implements the Truth in Lending Act (TILA), and the official staff commentary to the regulation. The proposed rule would amend TILA's rules for open-end (revolving) credit that is not home-secured.

Specifically, the Board has proposed changes to the format, timing, and content requirements for the five main types of open-end credit disclosures by Regulation Z: (1) credit and charge card application and solicitation disclosures; (2) account-opening disclosures; (3) periodic statement disclosures; (4) change in terms notices; and (5) advertising provisions. The proposed rule would also make changes to disclosures and implement protections involving multi-featured open-end credit plans, checks that access a credit card account, credit insurance, debt cancellation, and debt suspension coverage.

NAFCU would like to commend the Board for its significant efforts in working to update and improve the open-end credit rules. NAFCU recognizes that this comprehensive and thorough review of Regulation Z was a tremendous undertaking for which the Board and its staff should be praised. NAFCU would also like to applaud the Board for its efforts to encourage public participation in the rulemaking process by means of two prior advance notices of proposed rulemaking (ANPR) and through consumer focus group testing. NAFCU strongly encourages the Board to continue to integrate focus group testing into the regulatory process.

NAFCU, however, has significant concerns with some of the proposed amendments, particularly the changes affecting multi-featured open-end lending and change in terms notifications. We elaborate on these concerns and provide additional comments below.



General Comments

Before addressing the specifics of the Board's proposed amendments, NAFCU would like to take the opportunity to provide some general comments about the effectiveness of the open-end credit disclosures required under Regulation Z. NAFCU and its member credit unions are firmly committed to fostering the responsible and informed use of credit by ensuring that American consumers are provided with meaningful disclosures. However, NAFCU continues to hear concerns from our member credit unions that, with the number of consumer protection disclosures becoming increasingly copious, consumers are becoming overwhelmed by "information overload." Simply put, NAFCU is concerned that consumers are not reading or not fully comprehending, the litany of complex disclosures that are being provided to them. Clearly, the benefits of disclosures are negated if the information is not being utilized by consumers.

NAFCU would also like to express concern about the significant regulatory burden imposed by the proposed rulemaking. The proposed amendments create substantial compliance and financial burdens for federal credit unions. For example, establishing toll-free numbers and modifying disclosures, periodic statements, and marketing materials will prove costly for financial institutions, particularly smaller institutions. NAFCU strongly believes that whenever it amends any of its regulations, the Board should remain cognizant of the significant regulatory burden that is involved.

Today's complex financial marketplace is highly regulated. With the myriad existing compliance responsibilities, all federal depository institutions, especially smaller institutions, face a heavy regulatory burden. As NAFCU has expressed in prior discussions with Federal Reserve and Department of the Treasury officials, federal credit unions are feeling significantly taxed by the weight of this burden.

According to NAFCU's June 2007 *Flash Report* data, nearly all respondents (97percent) indicated they are spending more staff time on regulatory compliance issues than five years ago. In addition, almost all respondents (95 percent) said they do not expect to spend less time within the next 12 months. When asked how much time was spent on compliance issues, the median percentage value was 5 percent, with 25 percent of the survey respondents indicating they spent more than 50 percent of their staff time on regulatory compliance. 42 percent of the credit unions participating in the *Flash* survey said they were approached by small credit unions (less than \$100 million in assets) for compliance assistance, with 34 percent providing such assistance. The Bank Secrecy Act (BSA) in particular remains a significant compliance concern among NAFCU members. Indeed, among all regulations, an overwhelming majority of the *Flash* participants indicated that BSA was considered the most burdensome regulation (91 percent). However, Regulation Z was the next most common response (3 percent).

Because federal credit unions are member-owned not-for-profit cooperatives, any adverse economic impact on a credit union is ultimately felt by its members. Thus, unnecessary regulatory burdens also create indirect harms for consumers by raising the cost of services that credit unions provide. For example, increased compliance and operational costs could lead to



higher fees, loan rates or lower share savings rates, as well as reduce the availability of reasonably priced financial products and services. In some circumstances, compliance costs may be so cost-prohibitive as to deter some financial institutions from offering certain products and services altogether. Regulatory burdens must therefore be minimized in order to ensure that consumers continue to have access to the high-quality products and services provided by credit unions. NAFCU therefore urges the Board to fully and carefully contemplate how the total regulatory burden on federal depository institutions ultimately impacts the overall financial quality of life for America's consumers.

Finance Charge

Currently, under §226.4(a), the definition of "finance charge" does not include any charge of a type payable in a "comparable cash transaction." The staff commentary to this provision, comment 4(a)-1, states that in determining whether a charge associated with a credit transaction is a finance charge, the creditor should compare the credit transaction with a "similar" cash transaction. The Board is proposing to revise comment 4(a)-1 to adopt a new interpretive rule that all transaction fees on a credit card plan would be considered finance charges.

NAFCU strongly opposes this proposed change. Unlike other federal depository institutions, federal credit unions are subject to a statutory usury limit, currently set at 18%. *See* 12 USC §1757(5)(vi). The National Credit Union Administration (NCUA) generally looks to Regulation Z for guidance on what constitutes a finance charge for the purposes of the statutory interest rate cap. *See* NCUA Legal Opinion Letter 00-12-17 (January 25, 2001).

Considering all transaction fees as finance charges would likely cause the annual percentage rate to exceed this usury ceiling. For example, even charging a nominal cash advance fee at an automated teller machine (ATM) on a low-balance account could easily cause the APR to go above the 18% cap. Thus, federal credit unions will be unfairly penalized if this proposed amendment is adopted.

Application and Solicitation

Regulation Z currently requires credit and charge card issuers to provide disclosures about key costs and terms with their applications and solicitations in a standardized table—commonly referred to as the "Schumer box." The proposed rule would adopt new format and content requirements for the Schumer box.

NAFCU generally supports the proposed amendments to the tabular disclosure for credit card applications and solicitations. We believe the proposed modifications to the Schumer box provide material information to consumers in a clearer, more meaningful way. In particular, we believe that the inclusion of information regarding penalties inside the Schumer box will help to ensure that consumers are aware of the penalty APR and the events triggering penalties. NAFCU also believes that the proposal's approach to simplify disclosures about variable APRs



is appropriate. The modifications to the Schumer box should serve to improve awareness and promote consumer understanding of key terms among a broad spectrum of financial literacy levels.

NAFCU would like to reiterate our concern, however, that consumers are overwhelmed by the amount of information being provided in disclosures. While the proposed amendments appear to be consumer-friendly, NAFCU would like to emphasize that only the most pertinent information about the key costs and terms of credit should be included inside the tabular disclosure. In short, the requirements for the Schumer box should be minimized to the greatest extent possible.

Payment Allocation

The Board has proposed to add a new disclosure to the Schumer box alerting consumers of the creditor's payment allocation methods when payments are applied entirely to transferred balances at low introductory APRs. NAFCU would like to note that most financial institutions generally allocate payments to balances at the lowest APR first. The low introductory APR, however, is not necessarily the lowest.

Account Opening Disclosures

The Board has proposed two noteworthy revisions to account-opening disclosures for open-end credit plans. Generally, the rule would require a tabular summary of key terms, substantially similar to the "Schumer box," to be provided before an account is opened, and change the manner and timing of cost disclosures.

Tabular Summary

NAFCU generally agrees with the proposal's approach to account-opening disclosures. NAFCU believes that highlighting critical terms in a tabular format will better ensure that consumers are aware of the key terms associated with their account. Consistency with the organization and format of the Schumer box should also result in greater effectiveness.

Some NAFCU member credit unions have raised concerns, however, about the redundancy costs of duplicative disclosures. Accordingly, NAFCU would like to emphasize our support of the option for creditors to mitigate their compliance burden by providing the more specific and inclusive account-opening table at application in lieu of the Schumer box otherwise required at application. *See 72 Fed. Reg. 32954 (June 14, 2007).*

How Charges are Disclosed

NAFCU supports the proposed inclusion of interest, minimum charges, transaction fees, annual fees, and penalty fees in the account-opening summary table. We agree with the Board's



contention that precisely specifying the charges that must be disclosed in the summary table will reduce creditor uncertainty while also increasing consumer awareness of these critical charges.

NAFCU is particularly supportive of the ability of creditors to disclose less critical charges orally or in writing. We feel it is appropriate to allow creditors the flexibility to orally disclose fees that are associated with optional and infrequently used services at a time that is most appropriate in the judgment of the creditor (i.e., when the service is requested, but before the consumer agrees to or is obligated to pay the charge).

Change in Terms Notification

Timing

The proposed amendments would increase the advance notice required before a changed term can be imposed from 15 to 45 days. NAFCU believes that requiring institutions to provide 45 days advance notice of a change in terms is unreasonable; we recommend that the Board adopt a shorter time period.

While NAFCU recognizes the need to allow consumers the opportunity to obtain alternative financing or to change their account usage before any adverse changes are imposed, NAFCU believes that this objective can be achieved with shorter notice. Because many credit unions mitigate costs and reduce call center volume by staggering their statement cycles or providing change in terms notices with monthly newsletters, in practice, members generally receive notice of changes to their account terms well in advance of 15 days. In fact, most NAFCU member credit unions indicate that they are currently providing change in terms notices at least 30 days in advance. Due to typical statement cycles, increasing the advance notice required would, as a practical matter, result in 60 days advance notice, or even as much as 90 days in some circumstances. Such a significant time period for advance notice would negatively impact institutions' ability to make timely changes based on overall market conditions.

Accordingly, we urge the Board to reduce the time required for advance notice of changed terms. NAFCU suggests that a shorter timeframe for change in terms notices, not to exceed 30 days, would strike a more appropriate balance between the need for consumers to have a reasonable opportunity to seek alternatives and the need for institutions to have sufficient flexibility to address material product changes.

Penalty Rates

The Board's proposal would also expand the events triggering advance change in terms notification to include higher penalty rates triggered by the consumer's default or deficiency. NAFCU requests that the Board clarify that merely imposing late payment or over-the-limit *fees* would not trigger the change in terms notification requirement.



Format

Under the proposal, if a change in terms notice accompanies a periodic statement, creditors would be required to provide a tabular disclosure of the key terms being changed on the periodic statement, directly above the transactions list.

NAFCU generally agrees with the tabular format; however, we recommend that institutions be provided with the flexibility to enclose the tabular disclosure of changed terms on a separate sheet as a statement insert. Statement formatting changes are very costly as they require extensive and time-consuming software modifications. Additionally, credit unions often rely on third-party software providers to perform these systems changes, which could cause implementation delays that would impact the institution's ability to timely impose changes to account terms. Having the option to include the tabular disclosure on a separate enclosure or insert would help to mitigate costs while still ensuring that consumers receive a clear and concise summary of the changes to their accounts.

Additionally, many credit unions disclose changes in terms in their newsletters, which may be enclosed with periodic statements to reduce mailing costs. NAFCU believes that institutions should be permitted to provide a tabular disclosure of changed terms on newsletters enclosed with periodic statements.

Periodic Statement

Effective APR

The proposed rule also modifies the format and terminology requirements for disclosing the "effective" or "historical" APR in an attempt to make it more understandable for consumers. For example, the proposal requires the effective APR to be referenced as the "fee-inclusive APR." However, because consumer testing demonstrated that consumers generally do not understand the effective APR, the Board has specifically solicited comment on whether this disclosure should be eliminated.

NAFCU encourages the Board to eliminate the effective APR disclosure. We believe that most consumers do not understand the effective APR and do not find this disclosure useful. Moreover, while the disclosure of the effective APR may be helpful in discerning the cost of credit for that particular billing cycle, it is uncertain whether the effective APR gives the consumer an accurate depiction of the cost of credit over more than one cycle.

Fees and Interest Costs

The Board's proposal includes a number of revisions to the periodic statement to improve consumers' understanding of fees and interest costs. For example, under the proposed rule, interest charges and fees would be grouped together and itemized by type. Total fees and interest imposed for the billing cycle and for the year-to-date would also be disclosed. NAFCU



generally agrees with this approach; however, we emphasize that implementation costs will be substantial, particularly for smaller credit unions. We also ask that adequate implementation time be given before compliance is mandatory, to allow institutions to complete all necessary modifications to internal software systems.

Minimum Payment Warnings

As mandated by the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* (Bankruptcy Act), the proposed rule would require credit card issuers to provide minimum payment information on periodic statements (i.e., minimum payment warning, hypothetical example, toll-free number). This general requirement can be met in several ways. However, to encourage credit card issuers to provide disclosures of actual repayment estimates on periodic statements, the proposal provides that if card issuers do so, they need not disclose the warning, the hypothetical example, and a toll-free number on the periodic statement (nor need they maintain a toll-free number for the actual repayment disclosure).

NAFCU is strongly supportive of this alternative. Although disclosures of actual repayment estimates on periodic statements would require significant system modifications and considerable upfront and ongoing implementation costs, NAFCU believes that the availability of this option will help to mitigate the significant compliance burden imposed by the Bankruptcy Act amendments, particularly the requirement to establish and maintain a toll-free number for repayment estimates. Providing actual repayment estimates on periodic statements would also be the most beneficial to consumers.

Multi-featured Open-end Lending Plans

The proposal would significantly modify the rules that apply to “multi-featured open-end lending” or open-end credit plans that include closed-end features, that is, separate loans or sub-accounts with fixed repayment plans. Amendments to comments 2(a)(20)-2 and 2(a)(20)-5 would specify that closed-end disclosures rather than open-end disclosures are appropriate when the credit being extended consists of individual loans that are individually approved and underwritten. The proposed commentary would also require that each advance or sub-account must be self-replenishing.

NAFCU is firmly opposed to the proposed amendments regarding multi-featured open-end lending plans and strongly urges the Board to reconsider its proposed revisions to the staff commentary to §226.2(a)(20).

Consumer Benefits

The changes to the staff commentary, as proposed, would have significant adverse implications for institutions that currently offer multi-featured open-end credit plans. Indeed, the proposed revisions would fundamentally limit the ability of such institutions to meet the convenience needs of its members and customers through multi-featured open-end lending.



Multi-featured open-end lending plans have been available in the marketplace, without controversy, for over 25 years. NAFCU is unaware of any consumer complaints about these products or any consumer harm that has resulted from this type of lending. In fact, we believe that multi-featured open-end credit plans have a strong record of performance and provide positive benefits for consumers. Such plans afford consumers greater ease, flexibility, and convenience in the lending process and ultimately, access to better rates. For example, the streamlined approval process and minimal paperwork associated with multi-featured open-end lending allows credit unions and other responsible lenders to match the convenience of point-of-sale (POS) financing, such as financing through an automobile dealer, while providing consumers with lower rates than the typical POS or dealer rate.

Multi-featured plans are also more conducive to remote lending than traditional closed-end lending. Multi-featured open-end lending allows consumers to make a single branch visit to complete one-time application procedures for most future loans. Thus, for many credit unions, particularly airline or military and defense credit unions, multi-featured open-end lending allows them to better serve their members, who may be geographically diverse, deployed overseas or stationed in remote locations around the globe.

Impact on Credit Unions

The proposed revisions would also present significant compliance challenges and impose considerable switching costs on those institutions that are currently operating in an open-end lending environment.

Credit unions in particular have invested heavily in multi-featured open-end lending and the industry as a whole would be severely impacted by the adoption of the proposed amendments. As member-owned not-for-profit cooperatives, these compliance and switching costs could ultimately result in economic harms to the American consumer.

Should the Board adopt the amendments to the staff commentary as proposed, institutions will essentially be forced to move from an open-end lending process to a closed-end lending process. This shift will require considerable costs for, among other things, staff retraining, modifications to existing forms and disclosures, IT systems enhancements and software reprogramming, and additional staff resources for managing added paperwork and increased in-person branch traffic.

These switching costs are even more pronounced in light of the Board's currently ongoing review of Regulation Z's closed-end credit rules. The Board has indicated that forthcoming amendments to the closed-end credit rules can be anticipated in the near future. Thus, credit unions and other institutions that are forced to incur costs for shifting to closed-end lending due to changes to the multi-featured open-end credit rules will need to contend with *more* implementation costs once the closed-end rules are amended. Accordingly, NAFCU requests that, should the Board move forward with its proposal, mandatory compliance with



regard to multi-featured open-end credit plans be delayed until the Board's revisions to the closed-end rules are finalized.

Changes are Unnecessary

NAFCU is not convinced that a new approach to multi-featured open-end lending is necessary. The preamble to the proposal notes that "The Board has received comments from time to time . . . that the definition of open-end credit permits creditors to treat as open-end plans certain credit transactions that would be more properly characterized as closed-end credit." However, mere "comments from time to time" that multi-featured open-end credit plans are improperly characterized do not demonstrate any tangible harm to America's consumers nor indicate any reason that these types of lending processes should be significantly limited or discontinued.

Absent any significant and compelling evidence of abuse or consumer harm, we believe that creditors should be permitted to continue providing consumers with the benefit of this lending option. NAFCU firmly believes that the availability of multi-featured open-end lending must be preserved; as such, we strongly urge the Board to withdraw the proposed amendments. At minimum, NAFCU encourages the Board to consider alternative approaches to ensure the continued viability of multi-featured open-end lending.

Additional Comments

Model Forms

The proposed rule includes model forms to illustrate the disclosures to be provided with applications and solicitations, at account opening, and on periodic statements. NAFCU would like to emphasize that providing financial institutions with model clauses not only assists institutions with compliance, but also helps consumers to compare different credit products because the language and format is the same.

Electronic Disclosures

Pursuant to the Electronic Signatures in Global and National Commerce Act (E-Sign Act), a creditor may provide any disclosures required under Regulation Z to be made electronically. *See* 15 USC § 7001 *et seq*; 12 CFR § 226.36. NAFCU would like to express our strong support of granting credit unions the ability to provide required disclosures via electronic communication, which is absolutely essential in an increasingly "paperless" business environment. NAFCU urges the Board to encourage electronic delivery of disclosures and to refrain from undue regulatory intervention. For example, NAFCU is supportive of the Board's recent move to withdraw provisions of interim final rules regarding electronic disclosure practices that may impose undue burdens on electronic transactions and commerce and that may be unnecessary for consumer protection. *See* proposed amendments to Regulations B, E, M, Z, DD, 72 Fed. Reg. 21125 - 21155 (April 30, 2007).



Effective Date

The regulatory revisions will require significant modifications on internal software systems. In many cases, credit unions will be forced to rely on third-party software providers for these systems changes. In establishing a compliance deadline, sufficient time must be allowed for institutions to work with third-party providers to implement any necessary technology enhancements and system reprogramming. Thus, NAFCU strongly encourages the Board to provide adequate time to ensure full and proper implementation of all necessary operational changes that will be required to comply with the new amendments to Regulation Z.

The amendments will also have a significant impact on forms, statements, and marketing materials as the format and content of the main types of open-end disclosures would be amended under the proposed rule. Compliance will require institutions to modify existing materials or purchase newly created materials. As such, NAFCU believes that the proposed amendments will impose a significant burden on credit unions, especially smaller institutions with limited resources. The impact of the revised regulations, however, could be mitigated by a longer implementation period to permit credit unions to deplete existing stocks of materials over time and to spread out the replacement costs over a longer fiscal period.

Accordingly, NAFCU recommends that a minimum of 18 months from the date of publication in the *Federal Register* be provided to allow credit unions sufficient time to implement and test system changes, and to exhaust existing supplies of forms, marketing materials, and disclosures.

NAFCU would like to thank the Board for the opportunity to comment on this important rulemaking. Should you have any questions or require additional information please call me or Pamela Yu, NAFCU's Associate Director of Regulatory Affairs, at (703) 522-4770 or (800) 336-4644 ext. 218.

Sincerely,



Carrie R. Hunt
Senior Counsel and Director of Regulatory Affairs

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