



July 18, 2008

Via E-Mail (regs.comments@federalreserve.gov)

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

Re: Docket No. R-1286

Dear Ms. Johnson:

Discover Bank submits this comment letter in response to the proposed rule published by the Board of Governors of the Federal Reserve System ("Board") to revise those portions of Regulation Z regulating open-end credit products ("Proposed Rule"). Discover Bank, as one of the nation's largest issuers of consumer credit cards, the Discover® Card, is vitally interested in the requirements for consumer disclosures pertaining to the marketing and issuance of credit cards. Discover Bank also plans to submit a comment letter with respect to the Board's Regulation AA proposals and respectfully requests that consideration be given to ensure that both the Regulation Z and Regulation AA proposals are consistently applied and aligned. We are pleased that the Board is conducting a comprehensive review of Regulation Z and appreciate the opportunity to provide our comments on the Proposed Rule.

In General

Discover Bank continues to support the Board's efforts to improve the effectiveness of disclosures. We believe consumers should be presented with clear, easy-to-understand disclosures. For these reasons, we support many of the Board's proposals. For example:

- We support the Board's clarification that certain disclosures that are not required to be in writing may be provided electronically without regard to the notice and consent provisions of the E-sign Act.
- We support the Board's proposal to add a de minimus dollar amount trigger of \$1.00 for disclosing minimum finance charges. We agree that consumers do not tend to choose a credit issuer based on this amount and reducing unnecessary disclosures will lead to more clear and effective disclosures.
- We support the Board's proposal to include foreign transaction fees in the application disclosure box as we believe there should be consistency between the application disclosure box requirements and the account-opening summary table proposed by the Board in its June 2007 proposal.

However, while we believe many of the Board's proposals will improve disclosures, Discover Bank does have concerns regarding two of the proposals. Specifically, Discover Bank believes that a cut-off time for mailed payments prior to 5 p.m. is reasonable. We believe there are many practical operational reasons as to why cut-off times are imposed and believe that the manner in which Discover Bank and many other creditors process mailed payments benefits consumers in more ways than would the proposed elimination of the cut-off time. In addition, while we support the guidance the Board has provided on the interplay between the 45-day notice period and Regulation AA, we believe there needs to be further clarification to avoid inconsistencies. We discuss these aspects of the Board's proposal in more detail below. We look forward to continued dialogue with the Board on these and other aspects of this proposal as well as its proposal under Regulation AA.

A. An Issuer Should Be Allowed to Set a Reasonable Cut-Off Time For Payments Received by Mail. (12 C.F.R. § 226.10(b)(2)(ii))

Section 226.10(a) of Regulation Z generally provides that a creditor must credit a payment to the consumer's account as of the date of receipt, except when a delay in crediting does not result in a finance or other charge. Section 226.10(b) further provides that a creditor must provide such same-day credit if the consumer follows the requirements in making payments specified on or with the periodic statement. For over 25 years, the Commentary to Regulation Z has recognized that creditors are not required to provide same-day credit pursuant to Section 226.10(b) for payments received after a reasonable cut-off time established by the creditor.

The proposal would reverse this longstanding accepted practice with respect to payments received by mail and replace it with a requirement that creditors provide same day credit for all payments received by mail before 5 p.m. Since 5 p.m. is generally the end of the business day, the Proposed Rule effectively would preclude creditors from having a cut-off time for mail payments. For the reasons stated below, we urge the Board to retain the existing practice set forth under the Commentary and allow reasonable cut-off times for mail as well as other forms of payment.

Discover Bank offers many payments options for its customers. Discover Bank provides same-day credit for telephone and online payments received by 5 p.m. because we are able to process these payments almost instantaneously. We also offer options such as a direct payment plan automatic withdrawal as well as walk-in and pay services at Sears and other third-party facilities, all of which receive same-day payment effective dates as well. However, Discover Bank requires more time to process payments received by mail. Even though a very high percentage of mail is made available by the post office to Discover Bank at various agreed upon pick-up times throughout the night and morning, Discover Bank requires an early afternoon cut-off time in order to complete the manual processing of all such payments received in order to update the customer's account and accurately reflect the customer's available credit to accommodate any next day purchases.

The Board has stated that its intent is to afford customers a sufficient time to make timely payments and avoid late fees. To help meet the Board's intent, Discover Bank and many other card issuers have already voluntarily adopted "shadow" grace periods of a day or more that

effectively reduce the impact of a cut-off time on the relatively few customers that might otherwise be affected. It is common for card issuers to treat a payment as late for purposes of the imposition of late fees or penalty pricing only if received after the “shadow” grace period. Thus, even assuming a cardholder’s payment is received after a reasonable cut-off time and before 5 p.m., Discover Bank customers will not incur any late fees or default pricing as a result. Discover Bank submits that the Board should not adopt a one-size fits all payment posting rule for all creditors. Different creditors have different operational limitations and requirements within which they structure their payment posting policies. The reasonableness of a cut-off time should be measured in the context of these individual operations.

In sum, we believe that creditors should continue to have the flexibility to establish reasonable cut-off times for posting payments received by mail to accommodate processing deadlines. The Board has not, to our knowledge, identified any reason why it is necessary to change established payment processing requirements in a way that will cause extensive operational issues and provide very limited benefits to only a small proportion of consumers. Instead, the Board should maintain the standard of reasonableness that the industry has relied on and that has worked successfully for the overwhelming number of consumers.

B. Issuers Should Be Required to Notify Consumers Only One Time Before Increasing Periodic Interest Rates as a Result of a Consumer’s Delinquency or Default (Comment 9(g)-1).

In its June 2007 proposal, the Board proposed to add a new Section 226.9(g), which would require that a creditor provide a consumer with an advance notice of 45 days (“Penalty APR Notice”) when a rate is increased due to delinquency or default on an account or as a penalty for one or more events specified in the account agreement, such as after a late payment or exceeding the credit limit (“Penalty APR”). In its Regulation AA proposal, the Board also proposed to prohibit the application of a Penalty APR increase to balances that are outstanding at the end of the fourteenth day after the notice is sent, unless the consumer fails to make the required minimum monthly payment within 30 days of its due date (“Trigger Event”). Discover Bank will not repeat its comments that were submitted on the Board’s Regulation Z proposal in June 2007, nor will we include in this letter comments on the Board’s Regulation AA proposal. However, we reiterate that Discover Bank does not support the Penalty APR Notice for imposition of Penalty APRs. In addition, we will be submitting a separate comment letter on our opposition to the proposed limitations on when the Penalty APR can be imposed on existing balances.

In this Proposed Rule, the Board proposes to add new illustrations to the Commentary to provide guidance on the interplay between the Penalty APR Notice and the substantive limits proposed under Regulation AA on the application of the Penalty APR to balances outstanding 14 days after the Penalty APR Notice is sent. Discover Bank supports the Board’s efforts to provide this guidance because the two sets of rules are extremely complicated and present significant opportunity for misunderstanding. Indeed, Discover Bank is concerned that the rules on Penalty APRs and imposition of such rates to outstanding balances under the Board’s recent proposals have become so confusing that they will be difficult for consumers to understand and creditors to implement.

Discover Bank also supports the proposed Commentary provision insofar as it makes clear that a creditor may send the Penalty APR Notice and inform the consumer in that notice of the possibility that the rate increase will apply to existing balances if a Trigger Event occurs prior to the effective date of the increase. We believe a creditor should not be required to wait until a Trigger Event occurs in order to be able to notify the consumer that the Penalty APR will be going into effect both with respect to future transactions as well as existing balances.

However, Discover Bank believes that the Proposed Rule does not appropriately address the situation in which the Trigger Event occurs after the 45-day notice period. The Proposed Rule provides that a second Penalty APR Notice is required to apply the Penalty APR to existing balances if the Trigger Event occurs after an initial Penalty APR Notice is provided in which the creditor informs the consumer that the Penalty APR will apply to future transactions. Discover Bank believes that when a Trigger Event occurs within twelve months of the creditor providing an initial Penalty APR Notice, a second notice is not necessary to improve consumer comprehension as to which balances will receive the Penalty APR.

In its June 2007 proposal, the Board is proposing to enhance the Penalty APR disclosures in the application disclosure box and the new account-opening summary table as well as add a late payment warning on statements that advises consumers each month that the Penalty APR will be a consequence of late payment. These disclosures sufficiently ensure that consumers are informed throughout the life of their account as to when and why Penalty APRs will be imposed (i.e. at application, account opening and monthly on their billing statement). Once a consumer actually triggers the Penalty APR, the Board's proposed initial Penalty APR notice will further satisfy the Board's intent to alert the consumer that the Penalty APR may apply to the consumer's existing balances. In fact, the Board's proposed notice set forth in Appendix G-21 demonstrates this. It states, in relevant part:

You have triggered the Penalty APR of 28.99%. Beginning 2/15/08, we will apply this Penalty APR to any transactions made on or after 1/15/08 and may keep the APR at that level indefinitely. Current rates will continue to apply to transactions made before 1/15/08. **However, if you become 30 days late on your account, the Penalty APR will apply to those balances as well.** [Emphasis added].

If you have any low promotional APRs, you will lose them on 2/15/08. At that time, we will apply standard rates to the existing promotional balances.

The Board has also explained that the purpose for the Penalty APR Notice is to permit the consumer to take remedial action, such as shopping for alternative credit or paying off the balance, before a Penalty APR takes effect. The first Penalty APR Notice should accomplish this objective. The consumer is alerted of the Penalty APR and is provided with ample time to take measures to avoid it, having been informed that if the Trigger Event occurs in the future that the Penalty APR will apply to existing balances. Indeed, since the Penalty APR is already being

applied to balances incurred 14 days after the notice, the consumer should be considering remedial action at that point in time.

Requiring a second Penalty APR Notice when a Trigger Event occurs after the initial 45-day notice period will not only do little to further the Board's intent but may have the unintended consequence of requiring issuers to increase APRs for all consumers since they will not have the tools necessary to manage the credit risk of defaulting consumers in a timely manner. Moreover, such a notice may actually cause consumer confusion and aggravation as creditors will be forced to provide a notice each time a consumer pays late or otherwise triggers the Penalty APR in order to ensure that they will be able to invoke the Penalty APR on existing balances in a timely manner. For consumers who habitually pay late, but never more than 30 days, this could result in their receiving notices every month, but never triggering the Penalty APR on an existing balance.

If the Board still determines creditors will be required to provide a second Penalty APR Notice if a Trigger Event occurs after the initial 45-day notice period, Discover Bank urges the Board to reduce the notice period to (1) 15 days from the date of mailing, if the notice is mailed on a stand-alone basis, or (2) 1 billing cycle if the notice is provided with the cardholder's billing statement. As stated in our comment letter to the Board's June 2007 Proposal, creditors do not have the ability to impose rate changes at mid-cycle. Accordingly, the Board's proposed 45-day notice period is in effect a 60-day notice requirement.

Should the Board decide to retain the second Penalty APR Notice requirement, Discover Bank also recommends that the Board modify Illustration D as well as Comment 1 in the Commentary to Section 226.9(g). The Board should clarify that if a Triggered Event occurs after the initial Penalty APR Notice is provided, the creditor need not wait until the consumer is 30 days delinquent to provide a second Penalty APR Notice. For instance, Comment 1 provides that the Penalty APR Notice must be provided after the occurrence of the event that triggered the imposition of the rate increase. Additionally, in Illustration D, the creditor waited until the consumer was actually 30 days late before providing the second Penalty APR Notice. The combination of proposed Illustration D and Comment 1 could be interpreted to require creditors to wait until the consumer is actually 30 days late to provide the second Penalty APR notice. However, such an interpretation conflicts with the Board's proposed notice set forth in Appendix G-21 which permits a creditor to send a Penalty APR Notice when a consumer triggers the Penalty APR by paying late and advise the consumer in that notice that the Penalty APR will apply to their existing balances if they become 30 days late. If the Trigger Event occurs after the 45-day notice period, Section 226.9(g) should similarly be interpreted to permit creditors to provide a second Penalty APR notice when the consumer pays late and advise the consumer in that notice that if their payment becomes 30 days late, the Penalty APR will apply to their existing balances. Any interpretation to the contrary would require creditors to wait an unreasonably long period of at least 75 days after the original missed due date before the Penalty APR could be imposed on existing balances when a Trigger Event occurs after the initial 45-day notice period.

Discover Bank also believes the Board's application of the 45-day notice requirement should not apply to increases in promotional rates to a standard rate as a result of a consumer's

failure to comply with the terms of the offer. The loss of a promotional rate due to the consumer's failure to comply with the terms of the offer should not be considered a "penalty" to which the Penalty APR Notice applies. Consumers are informed at the time they take advantage of a promotional offer that the offer may end early under specified circumstances. Requiring a 45-day notice period after the consumer breaches the terms of the offer may have the unintended consequence of extending the promotional period for promotions which were set to expire prior to the end of the 45-day notice period. Moreover, if creditors are required to wait 45 days to terminate promotional offers, they may be forced to reduce the availability of such offers. While Discover Bank would have no objection to including a statement message advising the customer that their promotional rate has ended early due to their actions, it believes that the Penalty APR Notice is unwarranted in this circumstance.

Reasonable Implementation Request

Discover Bank respectfully requests that the Board provide for an implementation period of at least twelve months to support the significant systems and operational changes that would be required by the Final Rule.

Conclusion

Discover Bank appreciates the opportunity to provide the Board with comments on the Proposed Rule. It is our hope that the Final Rule will make the necessary changes to Regulation Z to improve consumer disclosures in a manner that balances costs and benefits appropriately. We would be pleased to provide additional information to assist the Board as it continues its deliberations.

Respectfully submitted,



Discover Bank
By: Christina Favilla
President