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HSBC

By electronic delivery

August 4, 2008

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-1314

Dear Ms. Johnson:

This comment letter is submitted by HSBC Bank Nevada, National Association ("HSBC") in response to the proposal issued by the Board of Governors of the Federal Reserve System ("Board") to exercise its authority under section 5(a) of the Federal Trade Commission Act to prohibit unfair and deceptive acts or practices ("Proposed Rule"). HSBC is part of the HSBC Group, one of the largest financial services organizations in the world which serves over 125 million customers worldwide. In the United States and Canada, HSBC Group businesses provide financial products to nearly 60 million customers. HSBC is a top ten issuer of general purpose and private label credit cards, with 37 million active accounts and managing over $48 billion in gross receivables. HSBC appreciates the opportunity to provide its comments on the Proposed Rule to the Board.

HSBC appreciates the complexity posed by the Board's current review of a variety of credit card practices. While a great number of credit cardholders have benefited from industry advancements, HSBC is cognizant that credit card products have become more complex, and disclosures under antiquated rules have become more challenging. As noted in its response to the Board's June 2007 and May 2008 Regulation Z proposals, HSBC supports nearly all of the Board's initiatives aimed at better informing consumers. However, the Regulation AA Proposed Rule would represent a significant change in direction with respect to the regulation of the credit card business. Rather than cultivating the informed use of credit through timely and meaningful disclosures, the Proposed Rule would take the dramatic step of labeling existing credit card practices, including perfectly compliant billing and risk mitigation practices, as "unfair."

In general, HSBC finds the Proposed Rule puzzling in its effort to regulate prevalent practices under Regulation AA. If the Board determines a need to reform the credit card industry practices assessed in its Proposed Rule, it may do so just as effectively by promulgating amendments to Regulation Z. As detailed below, Regulation Z currently regulates subject matter addressed in many of the proposals, and is suitable for regulating others under the Board's broad authority. In addition to avoiding any need to justify such reforms under a heavily fact-reliant unfairness analysis, such rulemaking would not stigmatize credit card issuers as wrongdoers merely for engaging in industry standard and accepted practices and acting in reliance upon existing law and regulation. Furthermore, as again more fully detailed below, HSBC believes promulgation under Regulation AA could unnecessarily expose financial institutions to litigation risks, when such exposure can be avoided through Regulation Z rulemaking.

Introduction

The Federal Trade Commission Act (FTC Act), enacted in 1914, was the original federal statute prohibiting unfair and deceptive business practices. As described in the Federal Trade Commission's (FTC) *Policy Statement on Unfairness*[1], the current standard for unfairness is the result of an evolutionary process. As the FTC further noted, the FTC Act was enacted deliberately broad, "since Congress recognized the impossibility of drafting a complete list of unfair trade practices that would not quickly become outdated or leave loopholes for easy evasion."

This evolutionary process resulted in a standard codified by Congress under 15 U.S.C. 45(n), whereby an act will be enforced as unfair only if: (1) It causes or is likely to cause substantial injury to consumers; (2) the injury is not reasonably avoidable by consumers themselves; and (3) the injury is not outweighed by countervailing benefits to consumers or to competition.

While the FTC has no direct authority to regulate banks,[2] the FTC Act is enforceable by a bank's regulator under supervisory powers.[3] Historically, banking regulators have taken a measured approach in utilizing FTC Act authority, either when prescribed by Congressional Acts, or in isolated instances when the specific acts of a regulated bank were determined, upon assessment, to meet the elements of an unfair practice.

In a 2002 Financial Institution Letter, the Federal Deposit Insurance Corporation (FDIC) advised its regulated institutions that it intended to enforce the FTC Act, noting "[w]hile the Federal Trade Commission has adopted policy

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[1] FTC Policy Statement on Unfairness (Dec. 17, 1908); Letter to Senators Wendell H. Ford and John C. Danforth

[2] 15 U.S.C. § 45(a)(2).

[3] Under section 8 of the Federal Deposit Insurance Act, 12 USC 1818, the OCC and FDIC may take appropriate enforcement actions against national banks and their subsidiaries for violations of *any* law or regulation.

statements on unfairness (FTC Policy Statement on Unfairness, December 17, 1980) and deception (FTC Policy Statement on Deception, October 14, 1983), most unfair and deceptive trade practices have been defined in fact-specific, case-by-case adjudications. The FDIC anticipates that additional guidance will be provided in similar fashion going forward."[4]

Also in 2002, Board Chairman Alan Greenspan authored a letter to Representative John LaFalce of the Committee on Financial Services, following a request that the Board consider promulgating a rule to prohibit unfair acts. Mr. Greenspan responded:

> Your letter also suggests that the Board consider adopting a comprehensive rule that sets forth principles for defining unfair or deceptive behavior and that provides specific examples of unlawful practices. I understand the FTC has issued statements setting out the principles for determining what acts and practices violate the FTC Act. As to specific examples, because a determination of unfairness or deception depends heavily on the facts of each individual case, the Board believes it is effective for the banking agencies to approach compliance issues on a case-by-case basis. The agencies have a number of supervisory tools to address these situations.[5]

The Board reiterated its position regarding targeted FTC Act authority during 2007 testimony, when it noted "[b]ecause a determination of unfairness or deception depends heavily on the facts of an individual case, the Board has not issued other rules under this provision."[6]

In August of 2007, the Office of Thrift Supervision (OTS) published an advance notice of proposed rulemaking, seeking comments regarding its intent to regulate unfair acts in a variety of ways. The FTC provided comment, recommending against using FTC Act authority to prohibit particular acts and practices, suggesting "[t]he FTC uses case-by-case enforcement and carefully crafted rules to accomplish these goals. The Commission staff recommends that the OTS consider the FTC's experience applying its current legal standards in determining whether to impose rules prohibiting or restricting particular acts and practices of financial institutions."[7]

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[4] FIL-57-2002, May 30, 2002.

[5] Letter from Alan Greenspan, Chairman of the Federal Reserve Board, to The Honorable John J. LaFalce, May 30, 2002.

[6]Sandra F. Braunstein testimony before the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, U.S. House of Representatives, March 27, 2007.

[7] Federal Trade Commission, Public Comment, OTS-2007-0015

In summary, HSBC believes the Proposed Rule represents a dramatic shift from prior regulation of unfair practices committed by financial institutions, is contrary to the Board's articulated policies in this area, and deviates from the FTC's own use and recommendations regarding this authority.

HSBC's Proposed Rule Comments

We have divided the next portion of our letter into six sections, each devoted to a credit card practice addressed by the Proposed Rule. In part A of each of the six sections (Sections I-VI), we explain why the particular credit card practice discussed fails to meet the 15 U.S.C. 45(n) "unfairness" standard utilized by the Board (the "Unfairness Standard"). Many of the Board's analyses lack sufficient factual support of harm, or consideration of case-by-case factors which might make a noted harm reasonably avoidable. Further, the Board does not appear to have assessed countervailing factors, such as benefits received by the majority of consumers, or increased competition. We further believe the fact that many of the practices addressed in the Proposed Rule are expressly or implicitly permitted under current law and regulation prevents any finding of unfairness under the Unfairness Standard.

In part B of Sections I -VI, we suggest alternatives to the proposed promulgation under Regulation AA. Largely, HSBC suggests any credit card industry reform with respect to the practices targeted by the Proposed Rule, be accomplished through the Board's broad authority to regulate credit card practices under Regulation Z. Under Section 105 of the Truth in Lending Act (TILA), the Board is directed to "prescribe regulations to carry out the purposes of this title."[8] The stated purposes of TILA are defined in Section 102 of that statute, and include "protect[ing] the consumer against inaccurate and unfair credit billing and credit card practices."[9] Therefore, it seems logical that any practice reform deemed necessary by the Board be addressed through the Board's broad authority to regulate credit card practices under TILA. Also within Section B, HSBC will respond to specific questions posed by the Board, and offer any additional suggestions related to the specific proposal.

With that as an overview, the following are HSBC comments on the various topics addressed within the Proposed Rule.

I. Providing reasonable time to make payments

As proposed in § __.22(a), the Board would prohibit institutions from treating a payment as late for any purpose unless the consumer has been provided a reasonable amount of time to make that payment. In addition,

[8] 15 U.S.C. § 1604
[9] 15 U.S.C. § 1601(a)

§ __.22(b) provides a safe harbor for institutions that have adopted reasonable procedures designed to ensure that periodic statements specifying the payment due date are mailed or delivered to consumers at least 21 days before the payment due date.

HSBC believes the analysis using the Unfairness Standard does not support the regulation of this practice under Regulation AA. The advance billing requirement is currently regulated within §226.5(b)(2)(ii) of Regulation Z, and there is no compelling rationale to begin regulating this topic elsewhere. As to the question of whether customers reasonably require 21 days advance notice to make a monthly payment, HSBC believes the existing 14-day requirement is sufficient for the vast majority of consumers.

A. Unfair practices analysis

i. <u>The Board's analysis must balance public policy considerations.</u>

The 21-day advance billing requirement should not be considered an unfair and deceptive practice for public policy reasons. As provided in the Federal Reserve's Examination Procedures, "[P]ublic policy, as established by statute, regulation, or judicial decisions may be considered with all other evidence in determining whether an act or practice is unfair. For example, the fact that a particular lending practice violates a state law or a banking regulation may be considered as evidence in determining whether the act or practice is unfair. *Conversely, the fact that a particular practice is affirmatively allowed by statute may be considered as evidence that the practice is not unfair*. Public policy considerations by themselves, however, will not serve as the primary basis for determining that an act or practice is unfair." [Emphasis added]

HSBC's current practices are compliant with standards established by the Federal Reserve through its promulgation of Regulation Z, § 226.5(b)(ii), which provides:

> "The creditor shall mail or deliver the periodic statement at least 14 days prior to any date or the end of any time period required to be disclosed under section 226.7(j) in order for the consumer to avoid an additional finance charge or other charge."

In the context of this particular rule, where the delivery of statements and payments, in many cases, has only become faster, we do not agree that it is unfair to require payment within a two-week period. Given the complexity of consumer lending, financial institutions are heavily reliant on pragmatic standards established by the Board. Thus, we would submit that it is unreasonable and contrary to public policy for banks to be exposed to litigation and reputational risk for actions taken in reliance upon current regulations, such as the current Board standard set forth in § 226.5(b)(ii) of Regulation Z.

ii. <u>The existing 14-day billing requirement does not cause substantial consumer injury.</u>

HSBC believes most customers are being given adequate time to pay under existing advance billing requirements contained in § 226.5(b)(2)(ii) of Regulation Z. Like other monthly expenses, payments owed on a revolving credit card account should be reasonably anticipated by consumers, and therefore should not require significant advance notice. The Board's assessment that cardholders generally require 1-week to review new charges seems excessive in most instances, and this review period is already available today for all consumers, who may take advantage of the ability to pay by phone or electronically. In the event a particular charge is not recognized and requires research, applicable law and regulation already provides a remedy that prohibits creditors from penalizing customers for non-payment upon notice of an unauthorized or disputed item.

The Board also suggested that delinquency credit reporting is a further substantial consumer injury which results directly from the existing 14-day advance billing requirement. HSBC does not agree that a 21-day advance billing requirement would have any impact on delinquency reporting to credit bureaus. HSBC's practice, which it believes to be common within the industry, is to report an account as delinquent only after payment becomes 30 days *contractually* delinquent, which is a full 30 days following the due date. It is HSBC's further understanding that the three major credit bureaus treat any delinquency of less than 30 days as "current." Therefore, the existing 14 day advance billing requirements should not be determined to cause significant consumer injury.

iii. <u>Any customer injury is reasonably avoidable.</u>

HSBC believes the existing 14-day standard provides even greater protection to consumers today than it has historically, as payment alternatives and technology continue to develop. In fact, roughly 31% of HSBC's customers made their monthly payments using on-line payment technology in 2007, and an additional significant number make payments by telephone. The percentage of consumers who take advantage of an ability to remit payments on-line has increased in recent years, as this figure was 21% during the final 3 quarters of 2005 [when HSBC began tracking this number], and increased to 25% in 2006. There is every reason to believe this upward trend will continue. Alternative payment methods should allow sufficient time to review a statement and remit timely payment even when individualized circumstances make the mailing of timely payments difficult. Such alternative expedited payment methods are frequently communicated by credit card companies on statements. Customers are also frequently encouraged to request payment reminders via email, and to set up automatic payments debited from a personal account to assist their ability to consistently make on-time payments.

B. Requests for comment and HSBC suggestions

Based upon the above analysis, HSBC believes a consideration of all relevant elements of the Unfairness Standard does not support a finding that existing billing practices are "unfair." In general, HSBC believes this proposal would provide limited benefit to most consumers, while increasing the cost of lending, which would likely be passed along to all consumers. Having noted that concern, HSBC would not oppose the promulgation of revised billing standards under Regulation Z, if the Board concludes such revision is necessary. Again, based upon Congress' broad grant of authority to the Board to "protect the consumer against inaccurate and unfair credit billing and credit card practices," coupled with the fact the Board currently regulates advance billing requirements under Regulation Z, we believe Regulation Z is the proper regulatory vehicle to effectuate any changes with respect to this credit card practice.

HSBC offers the following additional comments and suggestions:

i. <u>HSBC practices.</u>

Within its proposal, the Board has elicited specific information as to existing issuer processes. While HSBC continues to advance its delivery of electronic periodic statements, it currently delivers 3% of its statements solely through this channel. HSBC expects its delivery of electronic statements to continue to expand over time. HSBC credit cardholders have the ability to take advantage of online account management tools, and today approximately 37% of HSBC cardholders have done so and are able to review their monthly statements on-line immediately once their account cycles, even before their statements are delivered by mail.

ii. <u>A mandated grace period.</u>

The Board has specifically requested comment as to whether it should adopt a rule that prohibits institutions from treating a payment as late if received within a certain number of days after the due date and, if so, the number of days that would be appropriate. Effectively, this would create a mandated grace period for all institutions.

HSBC is opposed to the adoption of any rule which would prohibit institutions from treating a payment as late if received within a specified number of days after the due date. Such a mandated grace period would effectively preclude a Bank's ability to react to risky behavior, even when it has given a reasonable advance notice of a due date. Such a rule would have a particularly material impact to lenders which currently allow 21 or more days between time of billing and due date. For example, a lender that already provides 21 days after advance billing would be forced to recognize a mandated grace period on top of the “reasonable” duration already allowed. The Board’s Proposed Rule would already allow banks to consider any grace period they provide consumers, so long as payments are not treated as late if received within 21 days of billing, with 21 day advance billing merely being a safe harbor rather than a mandate. In summary, mandating a grace period would (1) encourage consumers not to pay by a due date and limit a bank’s ability to react to risky behavior, and (2) penalize those banks that allow 21 days between time of billing and due date today.

iii. A mandated consumer dispute process.

The Board has asked whether it should adopt a rule that requires institutions, upon the request of a consumer, to reverse a decision to treat a payment mailed before the due date as late and, if so, what evidence the institution could require the consumer to provide (*e.g.*, a receipt from the U.S. Postal Service or other common carrier). HSBC is opposed to a mandated dispute process, as such a process would be highly manual, and HSBC would not expect a consumer to frequently be in possession of a receipt from the Postal Service showing when an envelope was mailed. Such a process would assuredly increase a bank’s operational costs, and those increased costs would be passed along to all customers. Further, consumers can and do dispute payment process issues today, and HSBC believes that institutions deal with late payment matters fairly when unique situations arise. For example, HSBC waives approximately 15% of late payment fees each month in response to concerns and requests.

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In summary, HSBC is mindful of the harms identified by the Board, and the reasons for contemplating an increased advanced billing requirement. However, HSBC believes that adherence to the current 14-day advance billing requirement provided in Regulation Z, §226.5 cannot reasonably be classified as an unfair practice under the Unfairness Standard. As a matter of public policy, a financial institution’s adherence to standards promulgated previously by the Board should weigh heavily in any analysis of whether this practice is declared to be unfair or deceptive under other federal law. If, upon receipt and review of comments to the Proposed Rule, the Board nevertheless determines that current advance billing regulatory standards no longer provide adequate protections to consumers, we strongly urge that rather than declaring current practices as unfair, the Board effect any reform through amendment of Section 226.5(b)(ii) of Regulation Z.

II. Allocation of payments

Proposed § __.23(a) would establish a general rule governing payment allocation on accounts that do not have a promotional rate balance or a balance on which interest is deferred. The agencies propose three alternatives for allocation of excess payments, and would deem any other allocation which is less favorable to consumers an unfair practice. Under the Proposed Rule, a creditor would retain the right to apply a minimum payment in its sole discretion. In the event an account is comprised in part of promotional balances, proposed § __.23(b) would establish special rules requiring that non-promotional balances be paid in full before payments in excess of a minimum payment are allocated to those promotional balances. As with § __.23(a), creditors would retain sole discretion over the allocation of minimum payment.

In contrast, within the June 2007 Regulation Z proposals, the Board had suggested enhanced disclosures which would notify cardholders of how payments would be allocated. For the reasons discussed below, HSBC believes the Board should reconsider the new proposals, and pursue those proposed within the June 2007 proposals. If the Board nevertheless concludes it necessary to issue a final rule that prescribes the manner in which payments are allocated, HSBC strongly urges the Board to provide that such rule applies only to accounts originated after the effective date thereof.

A. Unfair practices analysis

i. <u>Injury is outweighed by countervailing benefits.</u>

In her testimony before the U.S. Representatives subcommittee on Financial Institutions and Consumer Credit, Julie Williams, the OCC's Chief Counsel and First Senior Deputy Comptroller, noted:

> "Credit card lenders compete for new customers by offering temporarily low interest rates on balance transfers, and many consumers who receive meaningful disclosures can benefit – sometimes substantially – by lowering their borrowing costs when they transfer credit balances to a lower-cost account. If restrictions are imposed on payment allocation methods, instead of addressing these issues through enhanced consumer disclosures, the likely consequences will be reduced lender competition, fewer low-rate promotional programs that benefit customers, and changes to the way credit cards are priced – including the re-imposition of annual fees. These are examples of the trade-offs that should be considered in

connection with requiring the approach to payment allocation that would be dictated by this section."[10]

HSBC agrees with this analysis. Today, customers enjoy many promotions which offer reduced APRs on a variety of transactions. Generally speaking, consumers receive significant value from these promotions, and HSBC expects these to be offered less frequently, and for shorter durations, if the promotional balances are segregated for purposes of payment allocation.

B. Requests for comment and HSBC suggestions

i. Deferred Interest Balances

The Board has requested comment as to the need for the exception regarding deferred interest balances in proposed §__.23(b)(1)(ii). More specifically, the Board would like comments as to whether a deferred interest exception should apply during the last two billing cycles of the deferred interest plan, or during a different time period.

HSBC believes an exception for deferred interest balances is necessary. These promotions offer significant economic value to consumers, who may delay full payment on a purchase for 12-24 months [or longer] and avoid paying any finance charges whatsoever for such purchase so long as the purchase is paid in full pursuant to the terms of the promotion. Pursuant to disclosed promotion terms, if these purchases are not paid in full by the expiration of the promotional period, the creditor will often bill finance charges calculated from the date of the transaction. Applying payments to all other balances before applying payments to these promotional balances will hurt consumers by making these same as cash promotions very difficult, if not impossible, to manage to a consumer's reasonable expectation. HSBC believes this to be so significant a problem that it could result in elimination of deferred interest promotions to consumers.

In response to the Board's second question as to whether an exception should be limited to the final two billing cycles of such a promotional plan, HSBC is skeptical that this would fix the problem discussed above. This "final two cycles" concept may be beyond a typical cardholder's understanding, regardless of how it is disclosed. For example, if a cardholder has the ability and desire to pay in full a deferred interest promotion at any point prior to the suggested 2-month window due to her specific circumstances [e.g. upon receipt of a tax refund], that money would be allocated to other balance types, contrary to the

[10] Office of the Comptroller of the Currency testimony before the U.S. House of Representatives Subcommittee on Financial Institutions and Consumer Credit, in reference to Section 3(f) of HR 5244 "Pro Rata Payment Allocations," which would require a pro rata allocation of payments among outstanding balances. (April 17, 2008).

customer's desire. Such an allocation could perhaps leave the cardholder without sufficient additional funds with which to pay off the promotional balance before the promotion expires, resulting in a requirement to pay retroactive finance charges, which, in turn, would cause the consumer substantial injury.

Further, as many of these promotional purchases are for large ticket items (e.g., washers, dryers, other appliances, furniture), allowing excess payments during only the final two billing cycles may leave the cardholder insufficient time to pay such purchases in full prior to promotion expiration. Not only would this requirement take away the consumer's flexibility to manage the repayment of the promotional balance in accordance with her unique financial circumstances, it could impose a burden on consumers to build a separate repayment fund over time, and to then appropriately time the remittance of the lump payment until the final two billing cycles, so as to ensure intended allocation to the promotional balance prior to the expiration date. For all of the foregoing reasons, HSBC believes these promotions provide such value to consumers that a full allocation exception is necessary and reasonable.

ii. Customer directed payment allocation.

The Board requested comment on the question of whether consumers should be permitted to instruct the institution regarding allocation of amounts in excess of the required minimum periodic payment. Presumably, this could be an alternative way to managing customer expectations with respect to the repayment of deferred interest promotions. HSBC is strongly opposed to this as a general concept, as this would inevitably become a manual and burdensome process for banks to manage, and it would be difficult to conceive of every possible customer preference which may be requested. Creating the complex infrastructure needed to support every cardholder's ability to direct how his/her payments are allocated would require significant cost and resources which are difficult to estimate. Further, HSBC believes such a concept would be highly confusing to consumers, since this concept would presumably give discretion only as to excess payments, and consumers have not historically been asked to give this direction when remitting payments.

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In summary, HSBC believes consideration of the countervailing benefits of offering transactions at a variety of rates, including promotional offers, must be more thoroughly considered before a rule is adopted prescribing payment allocation methods. We believe that the Board should reconsider deviating from the approach it suggested in June 2007, under which banks would be expected to disclose in greater detail how they intend to allocate payments. That such a disclosure may be challenging to formulate should not lead to the prohibition of a practice. If, however, the Board concludes practice limitations are needed, then any requirements pertaining to the allocation methods a bank may utilize, and how such methods should be disclosed to consumers, should be addressed in the Board's proposed amendments to Regulation Z. Specifically, the Board had suggested § 226.5a(b)(15) in its June 2007 proposals. Additionally, we ask the Board to consider that any significant limits on how banks may manage promotional rate offers will likely result in reduced availability of such promotions to consumers. While allocating payments to promotional balances does reduce the maximum value customers could possibly receive, these promotions nonetheless provide significant value to consumers. We therefore strongly urge the Board to adopt an exception concerning the repayment of promotional purchases, particularly those which defer interest obligations. Finally, HSBC suggests that any requirements concerning a bank's allocation of payments should be prospective in nature and affect only accounts originated after the effective date of any final rule.

III. Application of increased APRs to existing balances.

Proposed § __.24(a)(1) would prohibit institutions from increasing the annual percentage rate (APR) applicable to any outstanding balance on a consumer credit card account, except in the circumstances set forth in proposed § __.24(b). These three exceptions include (1) variable index movement, (2) contractual loss of promotional rate, (3) penalty pricing, but only if a customer is at least thirty days contractually late. Proposed § __.24(a)(2) defines "outstanding balance" as meaning the amount owed on a consumer credit card account at the end of the fourteenth day after the institution provides a notice required in the Board's June 2007 Regulation Z proposals.

HSBC believes the Board's unfairness analysis does not consider the net effect of a bank's ability to price its accounts using risk-management tools, including the benefits received by the majority of consumers through the use of established risk-based practices. Further, HSBC believes the Board should give significant weight to existing consumer protections, such as advance notice and ability to opt out of risk-based pricing term changes. Finally, HSBC believes weight must be given to the fact that federal and state laws specifically authorize current practices. Nevertheless, should the Board conclude additional risk-based pricing limitations are necessary, HSBC strongly urges the Board to address such limitations through amendment to Regulation Z and to provide that such limitations apply only to accounts originated after the effective date of such rule.

A Unfair practices analysis

i. <u>Any injury is reasonably avoidable.</u>

The Board has requested comment as to whether there are other appropriate means of protecting consumers from application of increased rates to existing balances. HSBC believes advance notice and opportunity to opt out provide such reasonable protections for consumers. Perhaps as a result of the existing commentary under §226.9(c)(2) of Regulation Z, granting deference to state law, many states have enacted provisions providing specified consumer protections when a bank exercises its right to change account terms on existing balances. Such states typically provide a period of time within which consumers may opt out of the change in terms resulting from risk-based re-pricing [i.e. not default pricing], without penalty, and pay off an existing balance under terms previously in effect. HSBC currently provides 30 day advance notice and opt-out rights for consumers before adverse risk-based re-pricing terms may be applied to an existing balance.[11] HSBC believes this opt-out right does provide sufficient protection to consumers and, to the extent there is any injury, it is reasonably avoidable by the consumer's ability to exercise her right to accept the change or close the account under the existing terms.

In June 2007, the Board proposed increasing advance notice to consumers, and providing very conspicuous disclosure on monthly statements. Implicitly, the Board's proposal would allow consumers a reasonable time to move a balance to another account before new terms would be applied. HSBC encourages the Board to reconsider that proposal, as this would serve as a secondary safeguard to existing opt-out protections. HSBC believes the June 2007 proposals were generally well founded, offered significant additional protection to consumers, and should be given an opportunity to function.

ii. Any consumer injury is outweighed by countervailing benefits.

In her testimony before the U.S. Representatives subcommittee on Financial Institutions and Consumer Credit, the OCC's Julie Williams noted the unique nature of the credit card product, and the need for credit card issuers to constantly track each customer's credit profile as ongoing extensions of credit involve no new credit underwriting. Ms. Williams noted the various risk management tools used by credit card issuers, such as credit line management, closing of accounts, use of account expiration dates, and "re-pricing" of outstanding balances on an account, concluding that, "[a]s a fundamental safety and soundness matter, given the nature of unsecured, revolving, open-end credit, credit card lenders need to be able to respond to changing circumstances that affect their risk exposure and operating costs. And, because the nature and degree of these risks can differ on an account-by-account basis, they need to be able to employ appropriate risk mitigation options, such as those described above, to address these risks."[12]

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[11] N.R.S. 97A.140

[12] Office of the Comptroller of the Currency testimony before the U.S. House of Representatives Subcommittee on Financial Institutions and Consumer Credit, in reference to Section 2 of HR 5244 Section 2: "Credit Cards on Terms Consumers Can Repay," which would limit a bank's right to increase APRs on outstanding balances. (April 17, 2008).

These OCC comments regarding the unique nature of credit card lending, and the need to mitigate risk with respect to such lending using available methods, are echoed by HSBC. HSBC believes that any restriction of a credit card lender's ability to manage the risks associated with revolving debt will invariably result in either cross-subsidization by non-risky customers, or credit simply being offered to fewer consumers, at a higher cost.

Furthermore, HSBC believes that any unfair acts analysis by the Board must contemplate the benefits provided to the majority of consumers, which result from ever developing risk management procedures. As noted by the FTC in its Policy Statement on Unfair Acts,

> "Most business practices entail a mixture of economic and other costs and benefits for purchasers. A seller's failure to present complex technical data on his product may lessen a consumer's ability to choose, for example, but may also reduce the initial price he must pay for the article. The Commission is aware of these tradeoffs and will not find that a practice unfairly injures consumers unless it is injurious in its net effects."[13]

HSBC believes the Board, too, must consider the net effect of current risk management tools utilized by banks. Consumers who maintain favorable credit profiles should not be required to pay more for the credit they are extended, merely to promote the ability for consumers who present more credit risk to pay less.

For example, in 2006, the Government Accountability Office (GAO) provided a Senate subcommittee an in-depth review of credit card practices, and offered recommendations for noted weaknesses.[14] Notably, the report indicated that the average APR for cardholders had been roughly 20% for decades following the introduction of credit cards. Over time, APRs have steadily decreased for most credit card accounts, as card practices have shifted the cost of credit to those who pose the most credit risk.[15] According to the top 6 card issuers providing data to the GAO, 80% of cardholders as of December 2005 had APRs below 20%, and roughly 40% had APRs below 15%. Nearly half of all cardholders did not pay a finance charge in at least 10 months of 2005.[16] Despite this general reduction in APRs to the majority of cardholders, the GAO report concluded that:

[13] Federal Trade Commission Policy Statement on Unfairness (Dec. 17, 1980)
[14] U.S. Gov't Accountability Office, Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers (Sept. 2006) (''GAO Credit Card Report'') (available at http://www.gao.gov/new.items/d06929.pdf).
[15] GAO Credit Card Report, Figure 3 on page 16.
[16] GAO Credit Card Report, p.32

> "With the profitability of the largest card issuers generally being stable over recent years, the increased revenues gained from penalty interest and fees may be offsetting the generally lower amounts of interest that card issuers collect from the majority of their cardholders. These results appear to indicate that while most cardholders likely are better off, a smaller number of cardholders paying penalty interest and fees are accounting for more of issuer revenues than they did in the past. This further emphasizes the importance of taking steps to ensure that all cardholders receive disclosures that help them clearly understand their card costs and how their own behavior can affect those costs.[17]

HSBC finds it compelling that, given all of its analyses, the GAO did not recommend that evolved bank practices be prohibited. Instead, the GAO recommended that "the Federal Reserve should ensure that such disclosure materials more clearly emphasize those terms that can significantly affect cardholder costs, such as the actions that can cause default or other penalty pricing rates to be imposed."[18]

iii. <u>Public Policy must be given weight in the Board's analysis.</u>

In addition to the reasoning set forth above, the application of new terms to existing balances should not be considered an unfair and deceptive practice for public policy reasons. As noted above, Examination Procedures of the Board provide that "the fact that a particular practice is affirmatively allowed by statute may be considered as evidence that the practice is not unfair." Section 226.9 of Regulation Z establishes procedure for instances where account terms under an open lending plan are changed. In commentary to 226.9(c)(2), the Board provided:

> 2. *State law issues.* Examples of issues not addressed by § 226.9(c) because they are controlled by state or other applicable law include:
> - The types of changes a creditor may make.
> - How changed terms affect existing balances, such as when a periodic rate is changed and the consumer does not pay off the entire existing balance before the new rate takes effect.

HSBC submits that it is contrary to public policy to conclude that a bank has acted unfairly for adhering to state laws, as prescribed within Regulation Z.

B. Requests for comment and HSBC suggestions

For the reasons noted above, HSBC believes an analysis of all relevant factors fails to support regulating this topic under Regulation AA. To the extent

[17] GAO Credit Card Report, p.79
[18] GAO Credit Card Report, study overview "What GAO Recommends."

commentary received by the Board supports such an undertaking, HSBC believes the appropriate location is Regulation Z, § 226.9, which currently addresses how terms may be changed for an open-end credit plan, including commentary addressing the very topic of application of changed terms to existing balances. Further, if the Board does prohibit a bank's ability to risk-based re-price existing balances, it should consider adopting the prevalent customer opt-out practice as an additional exception to those set forth in the Proposed Rule. Such an exception would effectively be a secondary consumer protection, as consumers could first evaluate an ability to transfer a balance, and utilize an opt-out right if transferring the balance is not possible.

Additionally, HSBC submits the following general comments:

i. <u>Delinquency Pricing.</u>

HSBC believes that allowing consumers to go 30 days contractually delinquent before delinquency pricing may be applied to existing balances would both foster unsafe account management by consumers, and create heightened credit risk for credit card issuers. HSBC's analysis of historic data indicates that once a cardholder becomes 30 days contractually delinquent, there is a greatly heightened chance that account will ultimately charge off as uncollectible. As the Board's proposal appears to be premised upon protection against isolated [non risk-indicative] events triggering default pricing, such as lost mail, HSBC believes there are suitable alternatives which both provide consumer protection and meet the needs of credit card issuers to react to displayed credit risk.

HSBC proposes the Board consider a framework whereby default pricing is not imposed unless a consumer submits a late payment twice within a rolling 12 month period. Such a concept may be further supported by a mechanism by which consumers may cure default, for example by remitting on-time payments over some established duration (e.g. six consecutive months), to regain non-default pricing terms. These would seemingly avoid instances where isolated, non-indicative default leads to application of delinquency pricing terms. Should such an alternative approach be adopted by the Board, HSBC anticipates its reduction in credit made available to consumers would be just 1/3 of the reduction anticipated under the Board's 30-day delinquency proposal.

ii. <u>Definition "outstanding balance."</u>

While HSBC understands the basis for the Board's proposal that balances not be considered new, and therefore subject to new terms, until some duration after notice of change in terms is delivered, HSBC believes 14 days it too long. HSBC believes such a delay in ability to impose new terms will encourage and allow cardholders to quickly utilize an open line under terms established when he/she had a different credit profile. HSBC suggests a short time which reasonably allows the customer to receive such notice, such as 5 days, but no additional time with which customers may be expected to accumulate new balances under prior account terms.

iii. Impact to securitization and portfolio sales.

The Board has specifically requested comment regarding the anticipated impact on securitizations. If the net effect of final rules results in the underlying business losing profitability, this would negatively impact the ability to securitize the credit card receivables product, as potential investors do look at the underlying portfolio and related business dynamics in assessing the desirability of investing in securities backed by such products. The potential effect for the underlying business is the product becomes more expensive for consumers, with a related decrease of available credit. HSBC believes this could lead to industry-wide market liquidity problems until investors become more comfortable predicting the performance of receivables under a materially changed product construct. It is feasible that the overall market will eventually adjust to these changes accordingly, and the products would again be able to be funded through securitizations, with securitization structures being designed to promote their marketability.

In regards to the sale of credit card portfolios, HSBC believes the inability for a purchaser of accounts and receivables to evaluate and price them in accordance with the purchaser's own underwriting models will have a chilling effect on such sales.

iv. Payment allocation to existing balances impacted by the Board's proposal

The Board has solicited comment as to whether additional or different approaches to the repayment of outstanding balances should be considered. If the Board issues a final rule similar to the proposal, HSBC strongly encourages the Board to create a payment allocation exception, allowing credit card issuers to more rapidly pay off prior credit extensions which presumed the bank's ability to re-price upon change in risk profile.

v. HSBC proposed exceptions.

HSBC believes there are additional alternatives which would balance protections to consumers with the need for a financial institution to remain safe and sound, considering the unique nature of unsecured and revolving credit card debt. One possibility is giving credit card issuers the ability to change terms as to an existing balance when the issued credit card comes up for renewal. HSBC submits that an expiration date is a reasonable indication to consumers when credit privileges can expire. HSBC proposes that the Board consider allowing credit card issuers the right to change the terms as to existing balances, upon providing applicable notice and opt out requirements, at such point in time an issuer renews an existing credit card account.

In addition, the Board has separately proposed amendments to Regulation Z that an issuer must place within the various disclosure boxes an APR which will apply to balances if account credit privileges are permanently terminated. HSBC believes this ability to apply a closed-account APR would be required as a specified exception to any regulation which limits this ability generally.

Another reasonable exception to any prohibition, contemplated currently within Regulation Z commentary §226.9(c)(1), is the instance where employment or affinity is a basis for preferential account APRs. In such instances, applicants are informed that the rate being offered is a preferential rate based upon employment or affinity, and is further informed that any termination of employment or affinity will result in non-preferential APRs being applied to the account. Given that this potential change in terms is conspicuously disclosed at time of application, HSBC believes it should be an additional exclusion to any broad rule prohibiting the application of new terms to existing balances.

Finally, HSBC proposes that any new risk based pricing rules should apply to accounts originated after the effective date of any final rule. Issuers that extended credit prior to any such rules would have done so in reliance upon an ability to change account terms as allowed under applicable state laws. Imposing prohibitions upon prior lending, underwritten using reasonable and compliant assumptions as to available risk management practices, creates very significant safety and soundness issues.

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In summary, HSBC believes an analysis of all relevant factors does not support regulating the application of new terms to outstanding balances under Regulation AA. First, any harm which may be caused to consumers is avoidable through provision and use of opt-out rights, and possibly advance notice protections, such as those proposed by the Board in its June 2007 Regulation Z proposals. Second, consideration of countervailing interests, including the impacts to customers who are benefited by existing practices, has a net effect of not supporting a finding of unfairness. Third, consideration must be given to safety and soundness impacts for this unique unsecured and revolving debt. Finally, public policy weighs against the classification of this practice as unfair, when credit card issuers have relied on applicable federal and state authority in regards to this practice.

To the extent comments received support further regulation of a bank’s right to change terms on a credit card account, HSBC submits this should be accomplished through amendment to § 226.9 of Regulation Z. Regulation Z already contains change in terms notice requirements, and the Board had previously proposed to amend those requirements to allow consumers to have greater opportunity to transfer balances, should they choose to do so, in the event of rate increases. Therefore, any new rules addressing rules on the ability to increase APRs on existing balances should logically be included with these existing or contemplated Regulation Z provisions.

As the Board has recognized, any final rule regulating the risk-based re-pricing of terms to existing balances should consider reasonable exceptions. HSBC believes the proposed 30-day delinquency requirement is excessive, and could serve to promote risky cardholder behavior. HSBC suggests the Board consider reasonable alternatives, such as two late payments within a rolling 12-month period, and ability for consumers to cure the default to regain non-default pricing terms. In addition, the Board should consider allowing terms to be changed when a card comes up for renewal, or when previously disclosed preferential pricing due to employment or affinity has ended. Further, the Board must create an exception to give effect to the Regulation Z proposal which explicitly allows the application of a closed account APR to outstanding balances when credit privileges are permanently terminated. Finally, HSBC suggests that any restriction of a bank's ability to change the terms of existing balances as currently allowed under applicable law should be prospective in nature and affect only accounts originated after the effective date of any final rule.

IV. Unfair balance computation methods.

Proposed §__.26(a) would prohibit institutions from imposing finance charges on balances on consumer credit card accounts based on balances for days in billing cycles preceding the most recent billing cycle. Proposed comment 26(a)-1 cites the two-cycle average daily balance computation method as an example of balance computation methods that would be prohibited by the proposed rule and tracks commentary under Regulation Z. The Board has proposed the following exceptions: (1) charging of deferred accrued interest under an unpaid promotion; (2) adjusting interest following a completed billing error investigation.

HSBC does not object to the proposed removal of the 2-cycle average daily balance method through amendment to § 226.5a(g) of Regulation Z. HSBC requests, however, that the Board consider unintended impacts from an overly broad proposal, and suggests that the Board simply eliminate a specific balance computation method if that is its intent.

A. Unfair practices analysis.

i. <u>Public Policy considerations must be given consideration.</u>

As noted above, the Federal Reserve's Examination Procedures provide that, "[p]ublic policy, as established by statute, regulation, or judicial decisions may be considered with all other evidence in determining whether an act or practice is unfair. For example, the fact that a particular lending practice violates a state law or a banking regulation may be considered as evidence in determining whether the act or practice is unfair. *Conversely, the fact that a particular practice is affirmatively allowed by statute may be considered as evidence that the practice is not unfair*. Public policy considerations by themselves, however, will not serve as the primary basis for determining that an act or practice is unfair." [Emphasis added] HSBC submits that any existing or prior uses of the 2-cycle average daily balance calculation method, was not only allowed, the specific wording disclosing this computation method was provided by the Board itself. Therefore, HSBC believes it is contrary to public policy to regulate this practice as one which is deemed unfair to consumers.

ii. <u>Any consumer injury is reasonably avoidable.</u>

HSBC submits that, to the extent consumer injury stems from this practice, it is readily avoidable. As noted by the GAO in its report to the Senate:

> "In our review of 28 popular cards from the six largest issuers, we found that two of the six issuers used the double-cycle billing method on one or more popular cards between 2003 and 2005. The other four issuers indicated they would only go back one cycle to impose finance charges."

Since this balance computation method is not prevalent in the credit card industry, HSBC believes cardholders can freely choose to do business with credit card issuers who do not employ that method.

iii. <u>General complexity of a practice should not be given significant weight.</u>

HSBC is concerned that the Board determined that difficulty in explaining a complex balance computation method to consumers may support a finding of unfairness. HSBC believes the Board's logic could be used to similarly criticize other balance computation methods deemed acceptable by the Board, which, like the double cycle average daily balance method today, are both complex and specifically permitted under Regulation Z § 226.5a(g). HSBC is concerned that the analysis used could open the door for unanticipated unfairness claims whenever a bank practice, including those expressly prescribed by the Board, requires sophisticated/technical knowledge beyond that of a typical consumer.

B. Requests for comment and HSBC suggestions

For the reasons stated above, HSBC believes an analysis of relevant issues does not support prohibition of a balance computation method under Regulation AA. To the extent comments received support the elimination of the

2-cycle average daily balance computation method, this should be accomplished through amendment of § 226.5a(g) of Regulation Z.

HSBC does have general concern regarding a blanket prohibition against the consideration of prior cycle transactions. The Board's proposal is worded much more broadly than merely prohibiting a 2-cycle average daily balance calculation. The Board has prohibited financial institutions "from imposing finance charges on balances on consumer credit card accounts based on balances for days in billing cycles preceding the most recent billing cycle." There are instances in which transactions technically occur late in one cycle, but for systems or other unavoidable delays, they do not post until the following cycle. One example of this is where a customer uses a check access device by depositing it into his/her bank account. While the cardholder obtains immediate availability of the cash advance, the transaction may not be systematically processed and posted to the credit card account until the check clearing process is completed. For these offers, the customer is informed that interest will begin to accrue from the date of the transaction, and the customer receives the benefit of that transaction in a prior cycle. Therefore, it is not categorically unfair to consider the actual transaction date when calculating finance charges from the actual transaction date.

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In summary, an analysis of all relevant factors does not support the prohibition of 2-cycle average daily balance computation method through Regulation AA. Primarily, this is because a majority of card issuers do not use this balance computation method, and therefore customer injury is easily avoided through consumer choice. In addition, public policy requires that a creditor must be able to reasonably rely upon permitted and specified computation methods provided by the Board in existing regulations. To be clear, HSBC does not object to the proposed removal of the 2-cycle average daily balance method through amendment to § 226.5a(g) of Regulation Z. HSBC requests, however, that the Board consider unintended impacts from an overly broad proposal, and suggests that the Board simply eliminate a specific balance computation method if that is its intent.

V. Deposits and fees impacting credit availability.

Proposed § __.27(a) prohibits institutions from financing security deposits and fees for the issuance or availability of credit during the twelve months following account opening if, in the aggregate, those fees constitute a majority of the initial credit limit. This proposal would not, however, apply to security deposits and fees for the issuance or availability of credit that are not charged to the account. Specifically, proposed § __.27(b) prohibits institutions from charging to the account during the first billing cycle security deposits and fees for the issuance or availability of credit that, in the aggregate, constitute more than 25 percent of the initial credit limit. The proposal would require that any additional security deposits and fees must be spread equally among the eleven billing cycles following the first billing cycle.

A. Unfair practices analysis.

i. <u>The net effect of these products may not indicate substantial consumer injury</u>

HSBC believes a case-by-case assessment of an institution's practices, which considers whether a credit product is appropriate for the credit profile being served, and how an institution informs its applicants about these fees, is needed to assess whether a bank's actions are causing substantial consumer injury.

ii. <u>Customer harm is avoidable.</u>

HSBC is concerned that the Board's proposals in this area deviate greatly from prior regulatory approaches, aimed at the conspicuous disclosure of account opening fees which materially impact an initial credit line.[19] HSBC believes enhanced disclosure, in the event fees materially impact initial credit availability, provides sufficient information to consumers, who then may accept or reject a credit offer.

B. Requests for comment and HSBC suggestions

HSBC submits that use of Regulation AA is unnecessary to effectively regulate when and how fees may be charged to an open end credit account. To the extent comments are received which indicate need for further regulation of fee products, including whether fees may or may not be allowed to revolve on a credit card account, the Board should address these matters within its ongoing efforts to amend Regulation Z, which currently includes proposals concerning credit products having material fees, and how customers may indicate acceptance or rejection of those fees.

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[19] See OCC Consent Agreement with Bank of Marin, N.A., which mandated conspicuous disclosure when customers may receive "little or no credit availability" at account opening; See FDIC consent agreement with Columbia Bank and Trust dated June 9, 2008, where the FDIC required offers with material fees to prominently disclose this fact.

VI. Firm offers of credit.

Proposal § __.28(a) would provide that, if an institution offers a range of multiple APRs or credit limits when making a solicitation for a firm offer of credit for a consumer credit card account, and the APR or credit limit that consumers approved for credit will receive depends on specific criteria bearing on creditworthiness, the institution must disclose the types of criteria in the solicitation. The disclosure must be provided in a manner that is reasonably understandable to consumers and designed to call attention to the nature and significance of the information regarding the eligibility criteria for the lowest APR or highest credit limit offered.

Under the Proposed Rule, an institution may use the following disclosure to meet these requirements, if it is presented in a manner that calls attention to the nature and significance of the eligibility information: "If you are approved for credit, your APR and credit limit will depend on your credit history, income, and debts."

HSBC believes there is no injury being caused in instances where customers have been predetermined to qualify, based on information currently available to a bank, for the best credit terms and credit line advertised. HSBC believes that, in the absence of misleading marketing, customers generally understand they are applying for all terms disclosed in the terms of an offer. Further, to the extent any injury may result from the fulfillment of terms less favorable than the most favorable terms disclosed, a consumer may freely reject the credit plan to avoid such injury. Finally, HSBC submits that it is contrary to public policy for the Board to conclude that failure to provide a disclosure, when practices are otherwise compliant with both Regulation Z and FCRA requirements, is unfair.

A. Unfair practices analysis.

i. <u>Such practices do not cause substantial consumer injury.</u>

Section 226.16(a) of Regulation Z prohibits a creditor from advertising credit terms unless such credit terms *are actually available*. The level of information known about the recipient of an advertisement arguably dictates whether the creditor is or should be aware that advertised credit terms will not actually be available to a targeted consumer. In other words, for a general solicitation or take one, a creditor may advertise a broad spectrum of credit terms, whereas marketing a broad spectrum of credit terms to a prescreened list could be deemed problematic under § 226.16, to the extent prescreen criteria is known to disqualify certain targeted consumers from receiving certain advertised terms.

The Board has requested comment as to "[w]hether consumers who receive firm offers of credit offering a range of or multiple APRs or credit limits *understand that there may be no possibility that they will be eligible for the lowest APR and the highest credit limit stated in the offer*." [Emphasis added] HSBC submits that any such hypothetical scenario arguably runs afoul of current advertising restrictions contained in § 226.16(a) of Regulation Z, as there must always be a possibility that targeted consumers may be eligible for both the lowest APR and highest credit line advertised.

While recent litigation has concluded that specific credit terms need not be disclosed for an offer to be considered "firm," as more thoroughly described below, the credit card industry has regularly disclosed significant terms to consumers on or with a credit application or solicitation in accordance with Regulation Z requirements, including those solicitations which are firm offers of credit under FCRA. In the event multiple credit terms are disclosed within the application disclosures for valid reasons, consumers should reasonably understand they are applying for all credit terms disclosed. If less favorable terms are offered in some instances, for example to those applicants who, at time of application, no longer meet predetermined criteria used to pre-qualify. HSBC believes this to be a reasonable practice which does not cause consumer harm or indicate unfairness.

In short, HSBC believes the Board is assuming that credit card issuers are targeting consumers for offers they could not possibly be eligible for, and has issued the Proposed Rule based upon that assumption. HSBC believes a case-by-case assessment of an individual institution's prescreen marketing practices is needed to determine whether that institution is acting in an unfair manner. Generally speaking, HSBC believes "up to" marketing concerning the highest possible credit line for an offer, and "as low as" positioning regarding multiple APRs, should not result in consumer confusion. Furthermore, HSBC submits some form of actual injury must result from any such practice, such as imposition of fees or obligation on a transaction, for such practices to be deemed to result in the "substantial" consumer injury under the Unfairness Standard.

ii. <u>Any consumer injury may be reasonably avoidable.</u>

As detailed above, the Board would need to first assess a specific institution's practices in order to determine whether consumer harm is being caused through its practices. Only then can the Board assess whether any such harm is reasonably avoidable. For example, to the extent an individual bank uses misleading marketing which suggests a customer will be approved for the most favorable terms, it would perhaps support a conclusion of unfair practices as to that bank's practices, which injury may reasonably be deemed unavoidable.

iii. <u>Consumer Injury is outweighed by countervailing benefits.</u>

As detailed above, the Board would need to first assess a specific institution's practices in order to determine whether consumer harm is being caused through its practices. Only then can the Board assess whether any such harm is outweighed by countervailing interests.

iv. <u>The Board must weigh public policy considerations in its analysis.</u>

Failure to provide a disclosure of the sort proposed by the Board should not be considered an unfair practice for public policy reasons. As noted, Examination Procedures of the Board provide that "the fact that a particular practice is affirmatively allowed by statute may be considered as evidence that the practice is not unfair." HSBC submits that its credit card offers, which are targeted to individuals who have in fact been predetermined to qualify for the most favorable terms being offered, which are compliant "firm offers of credit" under FCRA and which fully comply with §226.5a and § 226.16(a) of Regulation Z, should not be deemed unfair. It would be contrary to public policy to classify all practices in this area as unfair, based on omission of a disclosure not currently required, without a more specific assessment of a particular institution's practices, and an actual finding of unavoidable consumer harm. HSBC submits that any such unfairness conclusions would be highly fact specific.

Even while adhering to statutory requirements, the credit industry has been inundated with "firm offer of credit" litigation in the recent past. Predominantly, this litigation has focused on whether a bank's pre-screened solicitations constitute a "firm offer of credit" under FCRA. Many of these lawsuits have attacked the lack of specific credit terms a consumer had been prescreened to receive.[20] Recent court decisions have begun to stem the tide of these lawsuits, correctly concluding that any disclosure content and timing requirements pertaining to an offer of credit are contained in the Truth in Lending Act. One recent case held:

> "FCRA does not, however, require that the creditor include terms 'other than the pre-selection criteria.' *Sullivan,* 520 F.3d at 76; *Dixon,* 522 F.3d at 81 ('Congress's choice to omit from the FCRA any requirement for the inclusion of loan terms is properly interpreted to mean that Congress did not intend to require any such terms.'). Moreover, a different subchapter of the CCPA, the Truth in Lending Act (TILA), regulates the disclosure of loan terms. *See* 15 U.S.C. § 1601 et seq. TILA's extensive disclosure requirements and FCRA's paucity of them suggest that Congress intended for TILA to govern this aspect of the credit industry and that extensive disclosures are not required under FCRA."[21]

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[20] *Cole vs. U.S. Capital, Inc*., 389 F.3d 719 (7th Cir.2004)
[21] *Poehl v. Countrywide Home Loans, Inc.* 528 F.3d 1093 (2008).

In short, Courts that have correctly assessed the intent of Congress, as expressed through its enactment of FCRA, concluded that no disclosures, other than those specified within FCRA, were deemed necessary for an offer of credit to be deemed "firm." Although it does not appear to be the Board's intent, HSBC is concerned that any disclosure requirement for firm offers of credit, placed in a regulation other than FCRA, could serve to encourage the argument, and confuse judicial analysis, as to whether firm offer of credit requirements may be found in regulations outside of FCRA. Additionally, should a final rule make it an unfair practice to omit a disclosure in conjunction with a firm offer of credit, this could be misunderstood to expand the definition as to the requirements for an offer of credit to be deemed "firm."

HSBC is highly concerned with the Board's proposal, whereby perfectly compliant credit offers, many of which are tailored to avoid the consumer harms hypothesized by the Board within its analysis, would nonetheless be classified as unfair due to absence of a disclosure. HSBC believes any regulator-indicated shortcomings pertaining to "firm offers of credit" have the potential of exposing banks to material litigation risk, based on the recent past.

B. Requests for comment and HSBC suggestions

Having argued that the Board's analysis does not support regulation of firm offers of credit within Regulation AA, HSBC is not opposed to the Board tailoring existing regulations to curb any practices deemed unfair to consumers. As noted above, HSBC is of the opinion the Board has already prohibited the advertisement of unavailable credit terms through its prohibitions contained in § 226.16(a) of Regulation Z. To the extent the Board deems it necessary to modify this section of Regulation Z to capture perceived concerns involving prescreened solicitations, HSBC would not be opposed.

In addition to the noted Regulation Z protections, the Fair and Accurate Credit Transactions Act of 2003 (FACT Act) was signed into law on December 4, 2003. Section 311 of the FACT Act added a new section 615(h) to the FCRA to address risk-based pricing practices. The statute required the Board and the Federal Trade Commission to address in the implementing rules the form, content, timing, and manner of delivery of any notices pursuant to section 615(h), which would inform consumers that credit information will be used to determine account terms.

On May 19, the Board separately proposed disclosures to better inform consumers as to the fact that creditworthiness will be considered after an application has been submitted to a bank, and couples the application disclosure with a fulfillment disclosure which is provided to consumers who receive terms less favorable than the most favorable terms offered. That disclosure concept would appear to address similar consumer confusions being addressed by the

Regulation AA proposals, and could be coupled with time-of-application disclosures required by modification of Regulation Z.

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In summary, HSBC believes the Board's analysis is too assumptive of industry practices, and therefore the legal analysis may often not be subjectively accurate. HSBC believes consumers generally understand they are applying for all credit terms disclosed in an offer, and are free to dismiss any offer which includes less appealing terms. Further, HSBC believes any consumer harm resulting from the fulfillment of less favorable terms is readily avoidable, as the consumer is under no obligation to utilize credit under that plan. Finally, HSBC believes public policy considerations must be given weight, as issuers have acted in reliance upon advertising limitations set forth in Regulation Z, and any specified firm offer of credit requirements contained in FCRA. In addition to the general litigation risk posed by adoption of the Proposed Rule, as detailed below, we believe there is heightened litigation risk with respect to this portion of the Proposed Rule in light of the recent flurry of FCRA litigation that resulted from judicial misinterpretation of a statutory definition.

HSBC proposes that the Board address any range-based pricing disclosure insufficiencies within its ongoing assessment to modify Regulation Z disclosures for credit card applications. HSBC further recommends that the Board amend existing advertising prohibitions contained in §226.16, to the extent it believes the existing prohibition against advertising of unavailable terms insufficiently regulates this practice.

Consideration of Litigation Exposure

As noted by bank regulatory agencies in recent years, bank practices may be considered unfair under both federal and state law. In 2004, the FDIC published FIL-26-2004, which guidance was titled "Unfair or Deceptive Acts or Practices by State-Chartered Banks." This guidance noted that "[a]cts or practices that are unfair or deceptive within the meaning of section 5 of the FTC Act may also violate other federal or state statutes. In AL 2002-3, the Office of the Comptroller of the Currency published guidance which noted that "A number of state laws prohibit unfair or deceptive acts or practices, and such laws may be applicable to insured depository institutions."[22]

Given the unprecedented nature of the Board's Proposed Rule, which would classify expressly or implicitly permitted practices as unfair under federal

[22] The OCC specifically cited Cal. Bus. Prof. Code 17200 *et seq*. and 17500 *et seq*.

law, HSBC can only look to state action which followed an FTC determination of unfair practices to illustrate our concerns. In these cases, FTC adjudication which resulted in findings of unfair practices was given retroactive effect by courts, who were considering disputes involving facts which arose before such FTC adjudication.

In *Schubach v. Household Finance,*[23] the plaintiffs asserted that filing of collection actions in inconvenient locations in order to obtain default judgments was unfair under the state UDAP. Although the relevant conduct occurred in 1974, the Court relied heavily on *Spiegel, Inc. v. FTC,*[24] a decision upholding an FTC order on the same issue. The court also relied on a 1975 F.T.C. cease and desist opinion ordering a defendant to cease and desist from instituting collection suits in any country other than that of defendant's residence.[25]

In *Gour v. Daray Motor Co., Inc.*,[26] an appellate court affirmed a prior determination that automotive practices which occurred in 1977 were unfair under Louisiana's Unfair Trade Practices and Consumer Protection Law.[27] The court gave weight to FTC adjudication from 1978, noting "[o]ur view is apparently shared by the F.T.C., which has brought another complaint against General Motors, based in part on its substitution of engines in the manner complained of in the present case. See In The Matter of General Motors Corp., F.T.C., No. 772-3031, decided June 21, 1978.

In *Williams v. Bruno Appliance and Furniture Mart*,[28] a consumer brought action under Illinois' Consumer Fraud and Deceptive Business Practices Act,[29] alleging unfair acts which occurred in March 1976. The Appellate Court of Illinois reversed a lower court's dismissal for failure to state a claim. In remanding, the court cited the Illinois' unfair acts statute which provided "[i]n construing this section consideration shall be given to the interpretations of the Federal Trade Commission and the federal courts relating to Section 5(a) of the Federal Trade Commission Act." However, in giving consideration the FTC's 1977 regulation regarding "bait and switch" sales tactics, this gave retroactive effect to FTC rulemaking concerning unfair practices.[30]

[23] 376 N.E.2d 140 (Mass. 1978). Despite the fact that conduct was both permitted by state law and had occurred in the past, the Court affirmed an interlocutory order denying Household Finance's motion to dismiss, giving weight to the fact that "[i]t is clear that the Federal Trade Commission (commission) regards the commencement of consumer collection suits in courts far from the consumers' homes as an unfair practice."
[24] 540 F.2d 287 (7th Cir. 1976)
[25] *See Schubach*, 376 N.E.2d at 141 (citing *In re Commercial Serv. Co.*, 86 F.T.C. 467 (1975)).
[26] 373 So. 2d 571 (La. Ct. App. 1979)
[27] LSA-R.S. 51:1401 et seq., 51:1402(10), 51:1405, subd. A.
[28] 379 N.E.2d 52 (Ill. App. Ct. 1978)
[29] Ill.Rev.Stat.1975, ch. 1211/2, par. 261 et seq.
[30] *See Williams* at 54-55 (quoting 16 C.F.R. sec. 238 (1977)).

While HSBC believes that any attempt to give retroactive effect to any final rule under Regulation AA would not have merit, financial institutions could not avoid the time and expense required to defend such claims. Furthermore, as is the case with any litigation, financial institutions would be at risk of misapplication of law, and the degree of inferences which might be given to the Board's choice to reform industry practices under Regulation AA, as opposed to implementing reforms under Regulation Z.

In light of the largely unquantifiable litigation risk, HSBC again requests the Board to reconsider the approach of regulating any credit card practice reforms under Regulation AA. It would seem these practices may be regulated, if deemed necessary, in conjunction with ongoing Regulation Z amendment proposals. This would appear to have no lesser regulatory effect, yet would nullify any exposure to banks that acted in reliance upon existing law and regulations. If any final rules are regulated within Regulation AA, HSBC strongly encourages the Board to do so in a manner which eradicates retrospective application of changed Board policies and positions.

State Exemption

In the Proposed Rule, the Board noted that the FTC's Credit Practices Rule includes a provision allowing states to seek exemptions from that rule if state law offers consumers greater or substantially similar protections. The Board appears inclined not to include a similar state exemption provision in the Proposed Rule and has requested comment on the subject. HSBC fully supports the Board's inclination in this regard and agrees that such state exemption is not necessary and would only serve to undermine the uniform application of federal rules

Conclusion

In conclusion, HSBC is very concerned that the Proposed Rule is overbroad in many cases and that the practices labeled as "unfair" do not meet this well-established legal standard described by the Board. HSBC fully supports disclosures that are clear and useful to consumers, and believes this approach to the regulation of practices would enhance competition in an already competitive industry. We also endeavor to, and do, provide much-needed credit to consumers with a very broad band of credit profiles. Thus, we encourage the Board to revisit its unfairness analysis in light of this letter and other industry commentary to ensure that the Board's assumptions reflect industry practice and the actual risk of "substantial injury" to consumers. Moreover, we would suggest great consideration be given to the reasonable reliance by lenders on existing rules issued by the Board and other agencies, which the Proposed Rule would now declare to be "unfair" to consumers. Once again, HSBC welcomes ongoing assessment of the subject matter analyzed in the Proposed Rules, but to the extent comments received indicate a need to modify credit card industry practices, such modifications should be effectuated through ongoing amendments to Regulation Z.

Effective Date

HSBC strongly urges the Board to provide card issuers with sufficient time to review and implement any Final Rule published as a result of this comment process. Any practice changes of the sort described in the Board's proposal will require significant systems work, operational revisions, and testing. We note that the Board granted creditors a year to implement the significant revisions to Regulation Z published in 1981 and has in other instance provided for a long implementation period. In light of the increased complexity of systems and products since 1981, we believe it would be appropriate to grant card issuers no less than 18 months to implement any final rule. Alternatively, the Board may wish to consider a phased approach which staggers the effective dates for various proposals base upon the impact to existing business, and need to modify existing technological systems. HSBC anticipates that any final rule creating advance billing requirements and requiring specific payment allocation techniques will require the most time allowance for compliance.

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Again, HSBC appreciates the opportunity to provide its comments on the Proposed Rule. Please do not hesitate to contact me at (952) 358-4847 or General Counsel Julie Davenport at (224) 544-2964 in connection with this comment.

Sincerely,

James S. Hanley
Senior Counsel