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August 4, 2008

Via Electronic Mail and U.S. Mail

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

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attn: OTS-2008-0004

Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Federal Reserve System: Docket No. R-1314
Office of Thrift Supervision: OTS-2008-0004
National Credit Union Administration: RIN 3133-AD47

Dear Ms. Johnson:

Chase Bank USA, N.A. ("Chase"), the credit card bank subsidiary of JPMorgan Chase & Co., appreciates the opportunity to comment on the Board's Regulation AA Proposal published in the Federal Register on May 19, 2008 (the "UDAP Proposal"). These comments supplement the comments we made to the original (May 2007) and revised (May 2008) proposed revisions to amend Regulation Z, which implements the Truth in Lending Act ("TILA"), and the Regulation Z Official Staff commentary ("Commentary").

The UDAP Proposal is very broad, directly impacts significant aspects of Chase's credit card business and, if finalized as proposed, is likely to have profound effects on Chase's operations and financial results. We have substantial concern that these effects will ultimately work to the detriment of its consumers. As a result, Chase has a large number of comments regarding the UDAP Proposal. In order to convey the comments in an organized fashion, we have divided this letter into five parts: Part I addresses general policy considerations that we believe the Board should consider in acting on the proposal; Part II addresses particular concerns regarding the use of the Board's authority with respect to unfair or deceptive acts and practices; Part III proposes alternatives to the use of the UDAP authority; Part IV addresses the specific elements of the UDAP Proposal; and Part V addresses the timing of mandatory compliance with any final rule.

At the outset, Chase would like to emphasize its concerns with respect to proposed Section 227.24, which would prohibit, except in limited circumstances, changing the APR applicable to outstanding credit card balances. Chase appreciates the need for consumers to

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understand the terms of their accounts. In that regard, Chase would welcome the opportunity to comment upon suggested revised disclosures concerning change in terms issues, as such developments may well serve to enhance competition in the industry and promote consumer understanding. However, Chase strongly believes that proposed Section 227.24 is the wrong approach to this issue. Not only would the change disturb settled expectations on existing accounts, it would effect a fundamental change to the established history of credit cards and the basic pricing strategies used to offer cards. If enacted, it is likely to squelch the current availability of credit, resulting in: higher initial interest rates, the likely elimination of non-variable rate cards, lower approval rates, and lower credit limits. Chase urges the Board to factor these results into its analysis, and to consider the costs to consumers, the industry, and the economy overall.

I. INTRODUCTION AND OVERVIEW

A. Card products offer appropriate, risk-sensitive pricing to a wide audience of consumers.

As background to any rulemaking, we believe that it is important for the Board to consider the current credit card marketplace, and the developments over the past several decades. The GAO published a study requested by Congress in September 2006 (the "GAO Credit Card Report")[1] noting that in the 1980s only about 30% of the population possessed credit cards. By 2005, 75% possessed them. In 2005, consumers held a total of 691 million cards that generated transactions with a cash value of $2.1 trillion. The GAO Credit Card Report correctly attributes this democratization of credit cards to an increasing sophistication on the part of issuers in the management of the credit risk associated with the issuance of cards. The techniques in managing this risk lie largely in a complex interdependence of fees and pricing developed over time by issuers based on risk factors honed through hard experience. For example, as will be discussed later, issuers have determined by their own empirical data that being even 6-15 days late with a payment doubles the risk of that account ultimately being charged off.[2] Because they present a greater risk, such late-payers are properly assigned higher rates and/or charged fees. Being able to segregate and address such risks allows a credit card issuer to price credit appropriately, and to make credit available on more favorable terms to a broad range of customers.

To give a simple example of the way the system works, an applicant whose credit history is blemished and whose income is marginal might well have been denied a credit card altogether in the 1980s. However, that same applicant in 2008 might well have qualified for a card. This is largely because the issuer by 2008 had developed a pricing structure, combined with a responsible credit line assignment, that set the rate and fees at an appropriate level at issuance and, if the applicant failed to comply with the terms of the card agreement or the applicant's risk factors were to otherwise worsen, reserved the right to increase that rate and/or reduce the credit limit after issuance. That structure permits an issuer to offer credit to a greater range of consumers, and not only the best credit risks. Similarly, customers who begin as higher credit risks may be rewarded for consistently positive performance through a reduction in rates, and increases in credit limits.

[1] U.S. Gov't Accountability Office, Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers (Sept. 2006) (available at *http://www.gao.gov/new.items/d06929.pdf*).
[2] See description of Data Study in Part I. C. below.

There is an additional advantage of risk-based pricing that may not be obvious. It does, in fact, permit issuers to offer lower cost cards to the more creditworthy, commensurate with the risks posed by those borrowers. For example, according to Visa, USA, in the 1980s the average credit card bore an interest rate of over 18% and virtually all carried an annual membership fee, often as much as $25. Today's cards average an interest rate of 12.5% and generally do not have an annual membership fee. They are, therefore, cheaper as well as more available. This is because those that pose less credit risk are not asked to pay for those that do.

This progress is remarkable. It has taken a product that was once available only to higher income consumers, and made it available to the average consumer at an affordable cost. However, as noted, this opportunity for consumers exists only because of the flexible, risk-based pricing approach adopted by issuers. Making elements of that approach difficult or impossible to implement, or artificially raising issuers' costs, will have a direct and negative affect on both the cost and availability of credit to consumers. As a result, the UDAP Proposal will reduce consumer liquidity just when it is most needed. Chase's comments below are made in that context.

B. Credit cards offer short-term flexibility to consumers and issuers.

A fundamental aspect of the credit card relationship is that it is terminable at will, by either party. The cardholder is free to repay or refinance the debt at any time, without penalty. Likewise, the issuer reserves the right to terminate the card (subject to legal restrictions such as the Equal Credit Opportunity Act) at any time. Thus, although the terms of the account may permit a balance to be paid over a longer term, the right to terminate renders the arrangement in essence a constantly renewing, short-term borrowing relationship.

This short-term nature of the relationship is reflected in the interest rates charged. Issuers, because they have to constantly offer attractive terms to their customers who are free to leave for competitors, must offer the most attractive, short-term interest rates to their consumers. They can only do this, however, if they have the flexibility to change rates over time. An issuer cannot extend credit at short-term rates when it risks being locked out of the ability to change the rate due to changed circumstances.

Changing this flexibility, therefore, is likely to significantly impact the economics of the card business and, therefore, the terms and credit availability that can be offered to consumers. This will ultimately cause a detriment to consumers, who will have to shoulder increased costs and who will be deprived of features and options available today.

C. Comments on secondary markets, economic impacts, overdraft proposal.

Chase also believes that the UDAP Proposal will have a negative impact on the credit card asset-backed securities market ("ABS"), reducing the amount of secondary market capital, creating liquidity and capital issues for financial institutions, and exposing both issuers and secondary market investors to significant risk with respect to existing loans. More specifically, investors in the credit card ABS market supply the capital needed to make credit card loans that might not otherwise be available. The ability of credit card issuers to sell loans in the secondary market both increases the credit available to lend and lowers borrowing costs that can be passed on by banks to consumers in the form of more loans and better rates. To date, the credit card ABS market has been relatively stable. Secondary market investors in credit card receivables are

reassured by the underwriting practices of card issuers, including the ability to adjust pricing on consumer accounts for changes in consumers' risk profiles. The impact of the UDAP Proposal will likely increase the costs and risks for such investors that will necessarily be passed on to consumers. The UDAP Proposal will affect securities that have been previously issued, as well as the willingness of investors to participate in future ABS offerings. Due to reduced revenue streams and higher risks caused by the UDAP Proposal, investors may pay less for them or not purchase them at all. A reduction in the ability of creditors to access the ABS secondary market would decrease available credit and increase borrower costs. Any such impact would increase a bank's on-balance sheet assets, would require additional capital and, thus, has the potential to create a liquidity issue for banks by forcing them to raise capital at the worst possible time. With respect to these secondary market issues, we understand that these concerns will be more thoroughly described in a written comment letter submitted to the Board by the American Securitization Forum.

Additionally, we believe the UDAP Proposal will affect the availability and cost of credit for individual consumers and will have broad impacts on the economy in general. In order to better document these consumer and economic impacts, we participated in a study with various other banks whereby historical data on credit card accounts issued by the participating banks was collected on a confidential basis by the law firm of Morrison & Foerster LLP. Morrison and Foerster employed Argus Information and Advisory Services, LLC, a data processor, to analyze the data to determine the potential impact of certain aspects of the UDAP and Regulation Z Proposals on the accounts studied. We believe these impacts generally are representative of the impacts on the credit card industry and cardholders. We refer to this study elsewhere in this letter as the "Data Study". We provide some data on those impacts in this letter, which we understand will be more thoroughly described in a written comment letter to be submitted to the Board by Morrison & Foerster.

JPMorgan Chase & Co., Chase's parent company, will be submitting a separate comment letter regarding the Regulation AA and Regulation DD proposals regarding overdraft services.

II. TREATMENT OF PRACTICES AS UNFAIR AND DECEPTIVE UNDER FTC ACT

A. The proposed restrictions are unprecedented and will adversely affect consumers and the economy.

Many of the practices that would be prohibited or regulated have been directly authorized or sanctioned for many years by federal and state law, as well as the Board and other financial institution regulators. In reliance on such authority and guidance, creditors have engaged in these practices in good faith with the understanding that they are legal and appropriate. Many are essential to risk-based pricing. Creditors for years refined their risk-based pricing in the belief that they were acting in accordance with safe and sound banking principles and furthering the goal of providing credit on a widely available basis. Creditors were not aware that such practices would be viewed as unfair or deceptive. There have been no enforcement actions of which we are aware involving the practices contained in the UDAP Proposal, nor any prior guidance by the bank regulators indicating these are suspect practices (save for the OTS's ANPR published in August 2007, which listed payment allocation practices involving savings associations). It is unprecedented that the Board, given this long history, is proposing regulations that would suddenly convert these long-established and accepted practices into unfair

or deceptive practices.[3] We suggest that the Board consider the form of its approach. As explained later, there are alternatives that we believe will accomplish the laudable goals being pursued without diminishing the benefits being given to consumers and severely disrupting creditors' credit card programs.

There are numerous examples of current laws and regulations that authorize the practices that would now be banned under the Board's UDAP Proposal. For example, the National Bank Act authorizes national banks (such as Chase) to charge interest at the rates allowed by its home state, and this includes the provisions of home state law regarding the ability to change rates.[4] The laws of Chase's home state (Delaware) and many other states expressly permit card issuers to change the rates applicable to outstanding credit card balances.[5] Proposed Section 227.24 would override these federal and state laws. Similarly, as discussed more fully below, TILA and Regulation Z,[6] either currently or under the amendments proposed by the Board, regulate changing terms on existing balances, payment allocation practices, disclosures for firm offers of credit, the time required to mail billing statements prior to the due date, and the two-cycle balance calculation method. Further, firm offers of credit have long been heavily regulated under Regulation Z, as well as the FCRA and the FACT Act.[7] All of these would now be ruled illegal under the UDAP Proposal.

An abrupt abolition of long-established practices under a vague unfairness standard makes little sense.

The breadth of the proposed restrictions will have extraordinarily adverse impacts on consumers, the economy, and the credit card industry. Consumers face the loss of now common benefits such as low rate promotional offers, may be subject to higher initial costs or lower credit lines, and may not have the ability to obtain new accounts. These changes are likely to occur as creditors are forced to consider other means to price for risk, such as setting higher APRs for lower risk customers to compensate for the delayed ability to offset increased losses from higher risk customers, setting higher initial APRs for higher risk customers because of the inability to price the risk through later adjustments based on actual performance, imposing tighter credit standards generally, or any combination of the above. In short, the credit card industry may be forced to return to the practices common in the 1980s, depriving many consumers of a valuable product and the economy of a principal source of growth.

Further, certain of the disclosures that would result from the UDAP Proposal – particularly the puzzle-like disclosure about when changes in interest rates will become effective, what balances the rates will apply to, and how payments will be allocated to different rate balances after a change – will be complex and confusing to consumers.

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[3] This should be contrasted with the history of UDAP enforcement against banks, which has focused on marginal practices generally used by subprime lenders, and not on mainstream, long accepted practices. *See, e.g.*, Julie L. Williams and Michael S. Bylsma, "On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks," 58 Bus. Law. 1243 (May 2003) (discussing history of banking agencies' exercise of UDAP authority).

[4] 12 U.S.C. § 85.

[5] 5 Del. Code § 952. See also Official Code Ga. § 7-5-4(c), S.D. Codified Laws § 54-11-10, Utah Code § 70C-4-102(2), and NYS Banking Law § 105.

[6] Truth in Lending Act ("TILA"), 15 U.S.C. § 1601 *et seq.*; Regulation Z, 12 C.F.R. Pt. 226.

[7] Fair Credit Reporting Act ("FCRA"), 15 U.S.C. § 1681 *et seq.*; Fair and Accurate Credit Transactions Act ("FACT Act"), 117 Stat. 1952, Pub. L. 108-159 (Dec. 4, 2003).

The impact to the economy due to the restrictions in credit availability and reduced spending will be severe. The systems and development work, implementation and operational support for these restrictions will be an enormous task and an ongoing drain on financial institution resources. In light of these drastic and perhaps unintended consequences, we urge the Board to carefully evaluate the need and appropriateness of the various elements of the UDAP proposal, and to consider certain alternatives as described in this letter.

B. The rulemaking process undertaken by the Board cannot support the proposal, especially when compared to the procedural safeguards generally required by Congress under the FTC Act.

We firmly believe that the Board, notwithstanding its focus group testing and consideration of the input it has already received, has not established a sufficient basis to support a conclusion that the practices identified in the UDAP Proposal are unfair or deceptive. As a result, the limitations in the proposal should not be adopted as rules under the Board's UDAP authority. While we support the goal of fair treatment of consumers and applaud the Board for taking the initiative in examining the practices in question, we respectfully suggest the means chosen to do that are misplaced.

This is the first time that the Board has exercised its independent authority to adopt a trade practices rule under Section 18 of the FTC Act.[8] The Board's only prior rulemaking under Section 18 was the existing Credit Practices Rule in Regulation AA, but that was taken from a Federal Trade Commission ("FTC") rulemaking. We suggest that the Board, in exercising this authority, should do a more robust and considered study of the issues to be addressed beyond the efforts it has made to this point. Notably, the FTC devoted substantial work over a long period toward the adoption of the Credit Practices Rule. The effort spanned nearly a decade, involved an extensive survey conducted by the National Commission on Consumer Finance, and an investigation of the consumer finance industry conducted by the Bureau of Consumer Protection. The UDAP Proposal concludes that a number of credit card practices are unfair or deceptive, based on limited quantitative or qualitative study, what appears to be only brief consideration of the economic impact on consumers and the economy, and limited consumer or industry feedback regarding any countervailing benefits that might outweigh the effect of the alleged unfair practices. The Board needs to follow a reasonable standard in determining whether there is substantial evidence to support the treatment of these practices as unfair or deceptive. This can only be done by analytical rather than conclusory reasoning. Further, we are concerned that the broad justification used to support the treatment of these practices as unfair or deceptive is so general that the very same justification could be used to attack any number of commonly accepted and appropriate practices within the consumer credit industry.

1. <u>FTC process is the appropriate standard</u>. Congress has established a hybrid standard for judicial review of FTC rules. FTC factual findings may be set aside if they are not supported by substantial evidence in the rulemaking record taken as a whole.[9] Generally, the substantial evidence test is met if the record contains "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion."[10] The FTC, in examining its own responsibilities, itself has commented on the record it believes is necessary, noting that Congress

[8] Federal Trade Commission Act, 15 U.S.C. § 41 *et seq.*
[9] 15 U.S.C. § 57a(e)(3)(A); *see Pennsylvania Funeral Directors Ass'n, Inc. v. FTC*, 41 F.3d 81, 85 (3d Cir. 1994).
[10] *Id.*

imposed a "high standard" for FTC findings being supported by substantial evidence as a "greater procedural safeguard" because of the "potentially pervasive and deep effect" of FTC rules.[11] The FTC has stated that it takes seriously its responsibility to determine if there is a preponderance of substantial reliable evidence to support a proposed rule, and to see that such evidence is clearly recorded.[12]

A notice of proposed rulemaking should only be issued if there is reason to believe that the alleged unfair or deceptive practices that are the subject of the proposed rulemaking are prevalent.[13] An examination of the procedural histories surrounding the adoption of various FTC trade rules demonstrates that for recently promulgated rules, the FTC engaged in extensive investigations and examinations before adopting any new regulations. For example, during the promulgation period for the Rule Concerning Preservation of Consumers' Claims and Defenses, FTC-requested studies were performed over a period of almost 10 years, comprising 59 separate projects and involving 32 states. The FTC has stressed the importance of sound qualitative studies as substantial evidence. The FTC further believes it is important to determine whether: the act or practice is prevalent; a significant harm exists; the proposed rule will reduce that harm; and the benefits of the rule exceed its costs.[14]

These concerns and attendant procedural safeguards should inform the Board's UDAP rulemaking procedures, even if the same technical requirements of the statute are not applicable to the Board. In light of the broad effect of the UDAP Proposal if it were enacted, we urge the Board to promulgate any such rule only after it has determined that there is a preponderance of substantial reliable evidence to support such a rule. Until a fairness determination is made following reasonable procedures, the Board should not regulate these practices under the FTC Act.[15]

2. Board's process and record should be more robust. We believe that the Board has not developed an adequate record to support regulation of these practices using its FTC Act rule-writing authority, for the following reasons:

a. *Need Empirical Studies.* The Board should conduct empirical studies on the issues underlying its proposed unfairness determinations. In many instances, its conclusions have been reached summarily without studies to back up the conclusions. For example, the Board has conducted no studies of the impact of the proposal on the availability or cost of credit, or the effectiveness of alternatives. It has not conducted a study of alternatives for prohibiting increases on existing balances, such as requiring consumer opt-out rights or allowing broader exceptions from such a prohibition. The Board cites various general articles, reports or statements made by others about the credit card industry on which it has relied to draft the UDAP Proposal, particularly in support of the proposed rule to restrict raising APRs on

[11] Credit Practices Rule, 49 Fed. Reg. 7740, 7742 (March 1, 1984).
[12] *Id.*
[13] 15 U.S.C. § 57a(b)(3).
[14] 49 Fed. Reg. at 7742.
[15] The Board has stated that it will follow FTC substantive precedent on unfairness determinations, but that it will not follow the special procedures in the FTC Act designed to ensure fair hearing on unfairness questions because they are expressly applicable only to the FTC. See 73 Fed. Reg. at 28907. We believe any process for determining a practice to be unfair or deceptive must involve at least some of the safeguards used in the process that the FTC has followed in adopting its 15 trade practices rules. Such safeguards would include publishing a notice of proposed rulemaking; allowing interested persons to submit written data, views, and arguments, and make all such submissions publicly available; providing an opportunity for an informal meeting with the Board to discuss the issues; and issuing a final rule based on the materials in the rulemaking record.

outstanding balances. However, it is not clear whether these studies are relevant to the issues at hand, or that they provide any reliable support for the Board's proposed conclusions.

In addition to the limited input it has received from consumer and industry groups, the Board relies on the Macro International consumer testing conducted for the May 2007 Regulation Z Proposal. However, that report was very limited. In the first of two phases, Macro conducted four focus groups (of eight to thirteen people in each group) and one round of nine one-on-one cognitive interviews. In the second phase, Macro conducted additional rounds of interviews with 33 participants. Focus group testing, while useful, is not an in-depth analytical approach to determining unfairness practices. By comparison, the very small number of people examined in this singular study is a far cry from, for example, the 59-project/32-state studies performed at the FTC's request during the promulgation period for the Rule Concerning Preservation of Consumers' Claims and Defenses.

b. *Longer Comment Time Needed.* The 75-day notice and comment period was not sufficient to allow the banking industry to fully analyze, consider and respond to this wide-reaching proposal. In contrast, the FTC's notice and comment periods for its trade practices rules have ranged from over 120 days in total to well over two years. We suggest that the Board's process is likely to achieve better results if the comment period were extended to a year and if the Board were to hold hearings and accept such testimony as may be offered by consumers themselves and the industry. This is a topic that it is essential to address adequately and such a process would allow for a full vetting of it. In addition, the Board has indicated that it would like to publish the final version of the rule later this year. The fastest FTC adoption process described above still took at least three years from inception to completion, and the longest took over a decade. The very breadth of the UDAP Proposal, and its effect of upending settled practices, counsels in favor of substantially more time for comment and consideration.

c. *Need More Thorough Discussion.* The Board conducted limited information gathering from consumer, industry and focus groups. We believe more thorough discussion should be held on the unfairness issues. Under FTC procedures, hearings allow industry representatives the ability to present evidence on relevant factual issues and rebut evidence provided by other parties. The adoption processes of all of the FTC trade practice rules described above involved public hearings over several days in multiple cities, resulting in a plethora of comments and in many instances transcripts and records amounting to many thousands of pages. While we believe the type of hearings used by the FTC for unfairness determinations are not necessary, more informal meetings and discussion are warranted.

d. *Need Studies Specific to UDAP Proposal.* The Board is attempting to rely on certain studies and congressional testimony that were not developed in the context of the issues at hand, or in a manner calculated to inform the issues specific to the UDAP Proposal. Virtually all the consumer testing was conducted as part of the aforementioned Macro International study to determine the effectiveness of various forms of consumer disclosures in connection with the May 2007 Regulation Z proposal; none of it specifically considered the issues presented in the UDAP Proposal. While those other studies may well serve to inform the Board on issues that could be addressed through rulemaking, they are no substitute for targeted studies designed to produce reliable evidence with respect to the specific proposals (and alternatives) to be included in a final rule.

e. *No ANPR.* The Board did not issue an Advance Notice of Proposed Rulemaking, as the FTC is required to do, and as the Board generally has done in connection with major rulemakings in the past (*e.g.*, the re-write of the open end credit rules under TILA).[16]

3. UDAP is the wrong tool. We also urge the Board to reconsider the effect of deciding, under the FTC Act, that certain practices are unfair or deceptive. There is a significant difference between enacting new disclosure rules, and even enacting new substantive rules to govern conduct, as contrasted to regulation through the labels of unfairness and deception. The former create new rules, to which private parties can adjust their conduct. The latter, however, imposes a judgmental standard on conduct; it uses blunt labels ill-suited to this context. Moreover, it creates a risk that conduct that occurred prior to the rulemaking will be called into question. As a result, the Board should consider other alternatives to further its aims.

In summary, we urge the Board not to regulate these practices as unfair or deceptive practices under the FTC Act. They have not been adequately evaluated to be, nor is there substantial evidence to support the treatment of the targeted practices as, unfair or deceptive.

III. ALTERNATIVES TO UDAP REGULATION

In view of the fact that a UDAP rulemaking is ill suited to addressing the practices identified by the Board, we urge the Board to consider alternatives to address concerns about practices in the credit card industry. In particular, we urge the Board to consider using its authority under TILA to amend Regulation Z to include provisions addressing certain practices. It is instructive that members of Congress are proposing changes similar the UDAP Proposal by amendments to TILA, not through a UDAP law.[17] And, if the Board decides to issue final amendments to Reg. AA, we urge the Board to consider changes to the manner of exercising its UDAP authority.

A. Alternative #1. Address practices under TILA/Regulation Z.

The UDAP Proposal addresses certain practices that are already regulated or proposed to be regulated under TILA and Regulation Z, specifically: changing terms on existing balances, payment allocation practices, disclosures for firm offers of credit, time required to mail billing statements prior to the due date, and the two-cycle balance calculation method. Barely a year ago, the Board proposed changes to Regulation Z that would address these practices through enhanced disclosures. We concur with the Board's assessment then that this is the proper way to benefit consumers and allow risk-based pricing and other practices to continue to bring them its benefits. Other practices that we believe are best addressed by enhanced disclosure should be addressed in TILA/Regulation Z, specifically: fees for exceeding credit limit caused by credit holds and security deposits, and fees for the issuance or availability of credit. We believe that a practice that complies with detailed disclosure requirements that could be set forth in Regulation Z, such as the practices described above, should not be irrebuttably presumed to be deceptive or unfair. In this regard, many of the practices identified by the Board as matters of concern are better addressed via enhanced disclosures or other solutions under TILA/Regulation Z, as opposed to a regulation promulgated under the FTC Act. The Board has broad authority under TILA to alter the coverage and requirements of TILA, through Regulation Z.[18] The Board has

[16] The OTS did issue an ANPR for its credit practices rule. However, banks subject to Regulation AA should not be expected to comment on regulations that apply to savings associations and not banks.
[17] See HR5244, Credit Cardholders Bill of Rights Act of 2008, and S.3252, Credit Card Accountability Responsibility and Disclosure Act of 2008 (pending in the current Congress).
[18] *See, e.g.*, 15 U.S.C. § 1604(a), (f), & § 1637(c)(5).

already chosen to rely on this authority in the May 2007 and May 2008 Regulation Z Proposals to provide for improved minimum payment and "time to repay" disclosures on billing statements, and improved purchase grace period disclosures in tables such as used in applications and solicitations. We believe the Board should also use its authority to address enhanced disclosures for the practices listed above.

Addressing these alleged UDAP practices under TILA/Regulation Z is particularly appropriate given the manner and extent to which they are already regulated under that authority. In fact, Congress anticipated the need for such actions by the Board when it originally enacted TILA. See Sections 102(a), 105(a) and 105(d) which reflects the authority under TILA for the Board to promulgate regulations involving unfair or deceptive credit card practices. There is simply no need for a separate UDAP rule. Further, it is the proper and time-honored approach to address long-standing practices in the credit card industry. The blunt tool of UDAP authority is ill-suited to the purposes of the current rulemaking. It is illogical that a practice that was not an unfair trade practice the day before the UDAP Proposal was issued is suddenly proposed to be unfair or deceptive. But Regulation Z presents an established way to change – prospectively – the rules applicable to credit card practices. We also support enhanced disclosures, either in Regulation Z or another regulatory approach as suggested in this letter, as a way to minimize consumer confusion yet address the Board's concerns. We would be delighted to work with the Board, either by helping to facilitate further studies or focus groups, sharing our experience in dealing with customers, helping to craft improved disclosures, or otherwise assisting the Board in a manner it would find useful to develop improved disclosures.

Below we address specific instances in which Regulation Z could be amended to address the practices mentioned in the Board's UDAP Proposal.

1. Changing terms on existing balances. Regulation Z, Comment 226.9(c)-2, expressly provides that state or other applicable law controls issues such as the types of changes creditors can make and how changed terms affect existing balances. Delaware law clearly authorizes banks to amend terms on existing balances.[19] The Board in Regulation Z has deferred to state law on the matter of changing terms on existing balances, and banks have adhered to that authority for many years. The credit card industry, as noted, has built its risk-based pricing strategy on the possibility of changing rates. We urge the Board to reconsider its proposal. Furthermore, we believe that it is inappropriate, and directly in conflict with Regulation Z, for the Board to now declare that such reliance is unfair, and prohibited by the FTC Act. If any change were required here-- and there is no record to suggest that it is -- the Board should consider instead enhanced disclosures as part of Regulation Z. In the May 2008 Regulation Z Proposal, the Board has addressed enhanced disclosures for various change in terms scenarios created by the proposed UDAP restrictions on repricing existing balances. We believe the proper alternative, as discussed in more detail below, is to further regulate change in terms disclosure and practices as part of Regulation Z.

2. Payment allocation. The Board has proposed extensive payment allocation disclosures in application and solicitation tables as part of the May 2007 Regulation Z proposal in proposed Section 226.5a(b)(15).[20] This Proposal is a refinement to the guidance issued by the Office of the Comptroller of the Currency (the "OCC") to disclose payment allocation terms on

[19] 5 Del. Code § 952(a)
[20] 72 Fed. Reg. at 33047.

the front page of cover letters for direct mail solicitations offering promotional rates.[21] National banks like Chase have adhered to this guidance for several years. In light of the OCC's actions, and the established payment allocation methods used in the industry, the Board should not now deem past payment allocation practices to be unfair. This proposal would also interfere with the statutory authority of the OCC to regulate national banks. We believe the proper alternative, as discussed in more detail below, is to further regulate payment allocation practices through enhanced disclosure as part of Regulation Z.

3. Firm offers of credit. Similar criticism applies to the part of the UDAP Proposal requiring disclosure of the types of criteria used to determine an APR or credit line in a firm offer of credit with multiple possible APRs or credit lines. Firm offers of credit have long been regulated under Regulation Z (in the Schumer box rules), as well as the FCRA. These types of consumer credit offers are among the most heavily regulated today. TILA was amended in 1988 under the Fair Credit and Charge Card Disclosure Act,[22] with supplementing amendments to Regulation Z in 1989, requiring extensive disclosures as part of such offers. The FCRA substantively limits firm offers, and imposes additional disclosure obligations. Most recently, as part of the FACT Act, the Board and the FTC are also proposing a risk-based pricing notice to implement Section 615(h) of the FCRA. This FACT Act notice relates to the very same type of offer (a firm offer of credit containing multiple APRs or credit lines) that the Board seeks to regulate as part of its UDAP Proposal. Again, it is inappropriate that the Board would determine that the disclosures for such offers are deceptive, notwithstanding the extensive regulation of these offers in the Board's Regulation Z and under the FCRA for many years. We note that the Board's proposed "cure" for this alleged UDAP practice is a single additional sentence in firm offers of credit. Since the Board's own solution to this practice is enhanced disclosure, we believe the proper alternative as discussed in more detail below is to require this disclosure as part of Regulation Z, rather than in a UDAP regulation.

4. 21-day rule for mailing of statements. Regarding the proposal to mail statements 21 days in advance of a payment due date, Congress, after a series of hearing and much deliberation, has already deemed that billing statements should be sent 14 days in advance of the payment due date for purposes of accruing finance charges.[23] We urge the Board to give credence to that process. If after such deliberation the Board does feel that present circumstances may warrant a change, we suggest that the Board hold hearings and collect its own present day data to support its belief. We are confident that the presentation of that data to Congress would result in an expeditious change to TILA that could be incorporated into Regulation Z. Absent that process, we are reluctant to endorse the Board's proposal given the enormous operational changes and very significant extra cost it would entail. The Board's approach to changing the Congressional 14-day rule is to require a different mailing rule for other purposes (providing a reasonable time to pay to avoid late payments). It makes little sense to require a longer time to make a minimum payment (to avoid incurring late fees or penalty interest) and a shorter time to pay the full balance owed (to avoid accruing interest). We also believe the Board has failed to provide any valid evidence to justify a conclusion that the current practice of mailing statements in accordance with TILA's 14-day requirement is an unfair practice. It did not rely on any data to reach its conclusion and, instead, apparently based this rule on an uninformed understanding about how long it takes for consumers to receive statements and make payments in the mail. For

[21] Office of the Comptroller of the Currency, "Credit Card Practices," Advisory Letter 2004-10 (Sept. 14, 2004).
[22] The Fair Credit and Charge Card Disclosure Act ("FCCCDA"), Pub. L. No. 100-583, 102 Stat. 2960, amending 15 U.S.C. § 1637.
[23] 15 U.S.C. § 1666c(a).

this particular practice, we believe the existing Federal law states Congress's intent on this issue. Further treatment of this issue under the Board's UDAP authority directly conflicts with TILA.

5. Two-cycle balance calculation method prohibition. Finally, with regard to the two-cycle balance calculation method, the Board has addressed this method as part of Regulation Z disclosure requirements for many years.[24] Chase no longer uses the two-cycle billing method; however, for those creditors that continue to use it, we believe the proper alternative would be for the Board to address that method under Regulation Z.

B. Alternative #2. Clarify that any limits are imposed to prevent unfair or deceptive acts.

As explained above, Chase believes that amendments by the Board to Regulation Z are far more appropriate than relying on the Board's rule-writing authority under the FTC Act. Using Regulation Z as the tool to further address the practices in the UDAP Proposal is much more consistent with the past treatment of these issues by the Board, and the expectations of consumers and the credit card industry. More importantly, as proposed, the UDAP Proposal will expose banks to unwarranted litigation based on their past, previously authorized and accepted practices that now will be tainted with the unfairness label. Such litigation benefits class action practitioners and not consumers, while potentially costing the credit card industry huge sums of money. It is unprecedented that federal bank regulators including the Board (along with the Office of Thrift Supervision and National Credit Union Administration as) are proposing regulations that would put the financial institutions they regulate in this precarious position.

An alternative that is inferior to moving any enhanced regulation of these practices into Regulation is as follows. To the extent that the Board determines that certain limitations on credit card practices must be adopted under Regulation AA, the Board should expressly state that it is adopting the limitations as a prophylactic measure to prevent unfair or deceptive acts and not because it has found the specific acts to be unfair or deceptive.

Given the limited nature of the Board's factual investigation into the impact that the practices under consideration actually have on consumers, industry participants and the economy generally, as well as into the effectiveness of different alternatives available to address the Board's concerns, the Board should not conclude that the practices are in fact unfair or deceptive. Nor is such a conclusion a precondition for enacting a rule. Section 18(f) of the FTC Act, 15 U.S.C. Section 57a(f), gives the Board regulatory authority to establish "requirements prescribed for the purpose of preventing [unfair or deceptive] acts or practices" (emphasis added). Thus, the Board is not required to conclude that a particular practice is in fact unfair or deceptive to proscribe it under Regulation AA; it may proscribe conduct to prevent (or that may lead to) unfair or deceptive acts.

Lesser factual record needed for preventative measures. The Board's proposal in several instances indicated that the Board was in the process of attempting to determine whether the acts and practices under consideration were unfair or deceptive under the FTC's applicable standards. If the Board desires to determine whether these acts are actually unfair or deceptive, the Board should extend the fact-finding procedures involved with its rulemaking in order to allow an appropriate consideration of the relevant information that is needed to support such a

[24] *See* 12 C.F.R. § 226.5a (g)(2).

determination. As noted above, determinations of unfairness or deception in FTC rules involve factual considerations that are much more extensive than the sparse undertakings by the Board in this rather expedited rulemaking effort. Among other things, the Board should offer an opportunity to rebut any evidence presented in support of the proposed limitations. On the other hand, such extensive fact-finding is not required to support new disclosure rules under Regulation Z. And, a less substantial factual record arguably would be sufficient to conclude that restricting an act or practice may "prevent" unfair or deceptive conduct. We urge the Board to consider these alternatives, and to clarify that it has not undertaken to determine, and has not determined, that the practices identified in the UDAP Proposal are unfair or deceptive.

Preventative measures reduce confusion related to enforcement of state statutes. Taking action under Regulation AA on the basis that the Board is attempting to "prevent" unfair and deceptive conduct also may minimize the risk of unintended consequences of any new requirements. The Board has recognized that any changes to Regulation AA should have an effective date in the future that will allow banks to change their practices in an orderly manner after any modifications are made to the rules. Enforcement would apply to future conduct subject to the new rules, not prior conduct before the effective date. While the Board has authority to impose the requirements prospectively as a matter of federal banking law, there may be confusion regarding whether state statutes prohibiting unfair or deceptive conduct (especially those states that look to the FTC Act, and rules promulgated under the FTC Act, to determine what is unfair or deceptive) will likewise be applied prospectively. To the extent that the National Bank Act does not preempt any such state laws, the risks of such confusion should be reduced by clarifying that the acts or practices are designed to "prevent" unfairness and deception. The state statutes typically proscribe conduct only if it is actually unfair or deceptive.

Express statement regarding prospective effect in relation to state laws. To further mitigate this risk of confusion, the Board also should expressly state in any rule adopted under Regulation AA that the Board intends for state law to be used (if at all) only to enforce requirements under Regulation AA with respect to conduct occurring after the effective date of amendments to Regulation AA. The risk of such unintended consequences under state law should be mitigated if the Board adopts a clear statement that it would be inconsistent with (and frustrate the intent of) federal law to allow state laws to be used to enforce the federal requirements before the effective date established by the Board, or for any determinations of unfairness or deception under state law with respect to conduct before the effective date of any Regulation AA changes.

Paucity of factual record favors preventative measures. Finally, refraining from an express determination that certain practices are unfair or deceptive under Regulation AA is consistent with the well-advised approach of determining whether a practice is unfair or deceptive only in the context of all of the particular facts and circumstances that may be presented. In a letter to Representative La Falce, dated May 30, 2002, then-Chairman Greenspan indicated correctly, "because determinations of unfairness or deception depend 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." Chairman Greenspan also said that "[i]n the absence of specifics generated in case-by-case complaint and enforcement approach, . . . it is difficult to craft a generalized rule sufficiently narrow to target specific acts or practices determined to be unfair or deceptive, but not to allow for easy circumvention or have unintended consequences of stopping acceptable behavior." Those considerations are especially appropriate in this instance where, as noted above, there is an under-developed factual record, the practices at issue have

been expressly or impliedly approved by federal and state law in the past, and virtually none of the practices at issue have been the subject of prior enforcement actions.

C. Alternative #3. Adopt requirements based on reasonableness with safe harbors.

For the reasons set forth above, Chase believes that Regulation Z rulemaking is more appropriate than a UDAP rule. However, to the extent that the Board decides to enact a UDAP rule, in addition to considering the matters set forth in Part III. B. above, we urge the Board to consider adopting a rule that requires "reasonable" policies addressing the issues identified in the UDAP Proposal, and then grants more specific safe harbors. This is the approach already taken by the proposed rule on time for making payments, where the requirement references reasonableness and there is a defined safe harbor.

The merit of this approach is that it avoids labeling practices as unfair or deceptive without considering the complete facts and circumstances under a fully developed record. That determination would be left to future decisions by regulators or courts. At the same time, creditors would benefit from having bright-line safe harbors. Given the need to preserve the possibility for future innovation in the card industry, and in light of the sparse factual record developed to date, such an approach has much to recommend it.

IV. FURTHER COMMENTS ON SPECIFIC PRACTICES

In the context of the general comments set forth above, Chase also has specific comments with respect to a number of the elements of the UDAP Proposal.

A. Proposed Section 227.22. - Time to make payments.

As discussed earlier, Congress in TILA provided that statements should be sent 14 days in advance of the due date for purposes of the grace period. The UDAP Proposal (providing a safe harbor only if the creditor sends bills at least 21 days in advance for purposes of late payment) expands the specific time allowed by Congress. Since this means a consumer has to pay only the minimum payment during the proposed longer time period, rather than the full balance owed during the currently required shorter time period, we do not believe the Board can substantiate that the current practice of mailing statements in accordance with 14-day requirement under existing Federal law is an unfair practice. Further, this rule should not be necessary, and clearly should not be an unfair practice, in light of the data discussed below.

1. Data does not support 21 days. The Board's logic supporting the 21-day rule is as follows: 7 days for the billing statement to be received by the consumer, 7 days for the consumer to review it, and 7 days for the payment to be received by the issuer.[25] The Board appears to base its conclusion of a 7-day mail time on a single disclosure it observed from a card issuer urging a consumer to pay 7 days in advance of the payment due date. A UDAP rule should not be based on such a single, isolated observation, and that helpful guidance to a consumer is certainly not the "substantial evidence" that should be required to support a finding of an unfair practice – indeed, it is no evidence at all of the actual time required for mail to be processed.

[25] 73 Fed. Reg. at 28913.

Rather, Chase's data shows that 14 days advance billing is ample time for consumers to receive statements and make payments. Mailed statements are delivered on average in less than three days. Mailed payments, similarly, are delivered on average within the same time – less than three days. This information is derived from a USPS software product that tracks the delivery of mail to and from consumers. Thus, under the 14-day rule, and assuming that creditors allow only that minimum period, consumers should have on average eight days to review their statements and put in the mail a payment back to Chase. This is more than enough time under the logic adopted by the Board, even assuming that consumers should have a week to review their statements and send payments. The data is even more convincing since an increasing number of consumers make payments electronically (over 50% of Chase credit card customers) which reduces the times that are the basis of the Board's proposed rule, and further lengthens the amount of time that consumers have to review their statements and make a payment. We also note that an increasing number of consumers have their statements delivered electronically, which speeds up the delivery of statements and further lengthens the statement review time for such consumers. Chase credit card customers who sign up as online users, even if they do not request *only* electronic delivery of statements, can obtain their statements online within one day. Also, Chase permits customers to pick their own due date for billing statements so they know when to expect to receive their credit card bills each month. Finally, the adequacy of existing rules is demonstrated by the fact that the overwhelming majority of cardholders are currently able to make on-time payments.

Other Chase data indicates that its current practices allow for sufficient review and payment by consumers. A review of customer complaint data shows that a very small number of inquiries were related to the time to make payments after statements were received. Given that the issues raised by customers could cover a broad range of topics related to the timing, mailing and receipt of statements, there does not appear to be statistical evidence that indicates customer dissatisfaction on this topic.

Chase, like many issuers, typically offers cardholders a longer grace period than the 14-day rule requires. However, this is not a basis for altering and lengthening the legal requirement. As discussed below, there are operational requirements why a longer rule can create havoc in particular situations. And, as a matter of consumer protection, the 14-day rule is entirely adequate. To the extent that there are abuses (or violations) of the current rule, those abuses rather than the general rule should be targeted for enforcement or change.

2. Possible consumer confusion. Under the Proposal, creditors could have 2 payment due dates (one for any purchases grace period, and one for late payments) which would be confusing to consumers. Creditors could have one payment due date for the purchases grace period based on the current TILA 14-day rule, and another payment due date for a late payment based on the 21-day rule in the UDAP Proposal or other more restrictive mailing requirement the Board may adopt. We believe one due date, based on the current 14-day rule, will keep the due dates disclosures simple and understandable for consumers.

3. Operational limitations. In order to appreciate the operational consequences of the proposal, it is important to bear in mind that the UDAP Proposal's 21-day rule is measured as calendar days, but banks are restricted when mailing statements since the U.S. Postal Service does not mail on Sundays and federal holidays. This is particularly a problem with Federal holidays, and can impact the timely release of statements into the mail stream. The complexity of billing statement production will be further increased due to the many new disclosures that

will be required under the proposed Regulation Z billing statement requirements, including additional data feeds that will be needed to supply the necessary disclosures. Further, there can occasionally be delays in being able to mail statements that are beyond the control of the creditor, such as a disruption of postal service caused by bad weather, and this favors some extra time after any cycle closes to ensure creditors have enough time to meet their regulatory requirement. Any delays, combined with a rule longer than the current 14-day rule, could require an issuer to move due dates into the next billing cycle. That is problematic from a disclosure and systems perspective, as well as from a consumer relations perspective (as timely payments might not be reflected on the next statement). Further, increasing the length of interest-free grace periods involves a cost to creditors that will likely be passed on to consumers in the form of higher rates and fees. The Board needs to balance the benefits to consumers (in this case, having enough time to make payments) against the costs and operational complexity of mailing millions of billing statements each day to consumers. For these reasons, we also believe the current 14-day rule continues to be adequate and appropriate.

4. Board requested input. The Board also asked for certain specific input about this proposed rule.

- The Board asks whether additional days should be allowed after the payment due date in which a payment that is received would not be not deemed late. We believe that no additional time is needed. One reason for this is that the vast majority of our customers (about 92%) pay on or before the due date. Further, for purposes of simplicity and clarity, the due date should mean what it is - the date the payment is due.
- Another question was whether consumers should be permitted to instruct banks how to allocate payments. We do not believe that is appropriate. Chase cannot develop the complex systems and related operational support that would be needed to accommodate every type of payment allocation request that could be made by consumers.
- The Board also asks whether 14 days is an appropriate amount of time to allow between providing notice to consumers of an increased APR, and beginning to segregate the new balances to which that APR will apply. Chase believes that 14 days is a more than an adequate amount of time. As noted above, mail is typically delivered in three days, giving consumers at least eleven days on average to act on such a notice.

5. UDAP standard not met. Finally, regarding the Board's analysis of this rule as an unfair practice, since there is reasonable time to pay under the current 14-day rule, any increased cost to the consumer is clearly avoidable. Under the FTC standard, the alleged "harm" to the consumer must be unavoidable for a finding that a particular practice is unfair. As a result, we do not believe this rule should be part of a UDAP regulation because the legal standard for unfairness is not met and there is an existing Federal statute that provides 14 days is a reasonable time to mail statements. We urge that this proposed rule be withdrawn.

B. Proposed Section 227.23 - Allocation of payments

As stated earlier, payment allocation practices are clearly disclosed to consumers in accordance with existing OCC guidelines. Further, the Board has proposed enhanced payment allocation disclosures under its proposed Regulation Z revisions. Such disclosures made by creditors in reliance on existing authority support the view that the current practices should not be found to be an unfair practice. Further, the currently common payment allocation rules (pay lower APR balances first) are fair because they offset the cost of funds to creditors of making promotional low rate APR offers.

1. UDAP standard not met – there are countervailing benefits and any "injury" is reasonably avoidable. The current payment allocation rules (generally, pay lower APR balances first) permit important consumer benefits like promotional low rate offers that permit consumers to borrow money at below-market rates: issuers can extend these important consumer benefits, knowing that they will be repaid first, while giving the consumer flexibility to incur additional charges. Further, notwithstanding the current payment allocation methods, consumers are provided a real economic benefit because the overall cost of credit on their account is lower as a result of such offers. The effective or "blended" rate that factors in both the promotional rate while it is in effect and the non-promotional rates on the account represent substantial cost savings to consumers. Data about the economic impact of this benefit is an important countervailing benefit that the Board should take into account with regard to this proposed rule and the determination whether it is an unfair practice. Imposing a payment allocation requirement on such offers means they will make substantially less economic sense for creditors, and will likely cause a significant reduction in, or shorter duration of, promotional low rate offers; promotional APRs and fees may be increased; or such offers may be eliminated altogether. Creditors will need to reduce or eliminate promotional rate offers because they cannot price such offers below their costs of funds without the current payment allocation, and also because the proposed allocation options (*e.g.*, highest APR paid first) will accelerate the payment of higher APR balances. The net effect of the proposed rule, therefore, is likely a loss of consumer benefits in the form of a higher cost of borrowing. Further, consumers can easily avoid the effect of payment allocation methods by maintaining only a small balance at a non-promotional rate, by paying in full each month, or by using one card account for promotional balances and another card account for non-promotional balances.[26]

We reiterate from our comments regarding the revised Regulation Z Proposal that changing the payment allocation (paying the lower APR balances first) will lead to curtailing promotional low rate offers and will have a negative impact on consumers and on the economy. Based on the Data Study, we estimate that the participating banks have, as of April 2008, about $150 billion in outstanding promotional low rate balances. Since this potential impact is only for a select group of banks, the potential total industry impact could be much higher. We conservatively estimated that industry impact to be $225 billion in our comment letter to the Board for the additional proposed revisions to amend Regulation Z. These balances reflect a high level of consumer spending that will likely be greatly reduced or removed from the market if the Regulation Z and UDAP Proposals are adopted in their current form. At the same time, these balances represent significant cost savings to consumers by providing a low cost of borrowing. Given that the effect of the proposed changes will be to restrict the volume of these low rate offers or to increase their rates, the cost to consumers and the economy will be significant. This proposal would directly impact the risk-based pricing structure described earlier. The consumer benefits from additional liquidity being afforded to them from credit cards would diminish substantially. One industry analyst, Meredith Whitney of Oppenheimer Funds, has estimated that $2 trillion in liquidity would be withdrawn from the economy.[27] This will hurt not only the consumer sector

[26] The Board criticizes the use of a card solely to carry the promotional balance because it is not the traditional model of open-end credit. However, this ignores the fact that the card continues to offer the flexibility to incur additional charges at the option of the cardholder – whether before or after the repayment of the promotional balance.

[27] As quoted in an unofficial transcript of the interview held in New York between Meredith Whitney, an analyst at Oppenheimer and Co., and Bloomberg's Carol Massar and Margaret Popper, published by Bloomberg.com (Bloomberg L.P.) on May 27, 2008.

that relies on credit in these difficult times, but may impede a U.S. economy that is already struggling from the effects of the constriction of available credit. The Board should weigh the economic impact of its Proposals both from a consumer and monetary policy standpoint.

Chase data indicates that its current practices for payment allocation related to its low rate promotional offers are not objectionable to our customers. A review of customer complaint data shows that a very small number of inquiries are related to payment allocation. There does not appear to be statistical evidence that indicates customer dissatisfaction on this topic.

2. Purchase grace period. In addition to affecting payment allocation rules for promotional rate balances, this rule will change the purchase grace period and average daily balance calculation. As written, it would prohibit requiring payment of promotional rate balances that are part of the total prior balance (if that is the balance required by the creditor) to get a grace period on new purchases. Grace periods on new purchases are not required to be offered by creditors, but have been provided as a consumer benefit for many years. Although an interest-free grace period is valuable to consumers, it is also a significant cost (*i.e.*, a subsidized loan) for creditors. As noted above, low rate promotional offers, another important consumer benefit offered by creditors, are also costly and not economically viable to creditors with respect to higher risk consumers. We urge the Board, if it enacts this Rule, to withdraw the payment allocation requirement involving the grace period for new purchases. The cost effect on creditors is magnified if the rule affects both the payment of promotional rate balances as well as new purchases that are not subject to the promotional rate offer. Such cost impact will increase the likelihood that creditors will be forced to restrict or eliminate either low rate promotional offers, a grace period on new purchases, or both. Given the long-standing practice of offering a grace period on new purchases, we believe at a minimum that the Board should not enact a rule that will jeopardize that consumer benefit.

3. Alternatives. Further, as suggested earlier, an alternative to the rule in the UDAP Proposal is enhanced disclosure under Regulation Z. Such enhanced disclosure could include practical examples that improve consumer understanding of payment allocation methods. Given that Chase data suggests there is little customer confusion in this area, relevant examples can address any potential issues that require further clarification. We also urge that the Board permit as an additional alternative method the "first-in, first-out" (*i.e.*, FIFO method) in appropriate circumstances. For instance, such a method may be appropriate in new account offers because it is reasonable to expect a consumer to satisfy an initial debt before repaying new debt incurred as part of the ongoing relationship. In other words, it directly connects the timing of specific transactions with the payment of those transactions, and therefore may be clearer to consumers. We also urge that the final rule be flexible enough to include an exception where a creditor can offer a new product with a payment allocation method that may vary from one of the recognized methods, provided the consumer expressly consents to that feature. This is important to permit product innovation that will provide value to consumers. For example, creditors may wish to offer a product that permits customers to select the priority and timeline for repayment. An inflexible rule as to payment crediting may prevent this option from even being considered. Rather, an affirmative consent by consumers (*e.g.*, an opt in) after appropriate disclosures are made would seem to be a preferable option for both consumers and creditors.

Existing balance exemption needed, systems concerns and other clarification. We also believe it is important that, if specific and multiple payment allocation rules are mandated in a final rule, it be made clear that creditors are given the flexibility to choose the rule that they believe is

appropriate for any particular account or segment of accounts. Further, creditors should be permitted to use only one of various options on any particular account or segment of accounts, since they may have operational or systems constraints that prevent them from supporting multiple allocation methods at the account or segment level. We also urge the Board to clarify the disclosure requirements to consumers related to the various payment allocation options available to them. Payment allocation methods are very complex, involving many different elements in a full payment hierarchy to account for all the balances that must be satisfied. We urge the Board not to require creditors to disclose detailed payment allocation methods to consumers, either in the consumer account agreements or otherwise, because such disclosures will be confusing and meaningless to consumers. Rather, we suggest the Board may want to consider disclosure of only the name of payment allocation, perhaps with a short explanation that the Board could provide in the form of a model disclosure. Alternatively, the Board could require no specific disclosure to consumers regarding the various payment allocation methods. Further, it should be clarified that regardless of which method is applied, it is permitted to apply payments first to fees and interest before applying them to principal. In addition, we urge that, since systems are already programmed for existing allocation methods, any final rule have prospective effect on new balances incurred only after the effective date of the rule. The current rates and fees on existing balances were premised on the existing payment allocation process, with rates and terms predicated on expected payment allocation sequencing. It is both unfair and an unsound business practice to require financial institutions to effectively change their allocation process for those balances. Otherwise, the Board should permit creditors to close accounts and let existing balances be paid under the existing allocation method, either because they cannot apply systematically a new payment application for existing balances or it is economically impractical to do so.

C. Proposed Section 227.24 - Application of increased APR to outstanding balances.

As indicated above, we believe this rule is unprecedented and unwise, and raises substantial safety and soundness concerns. We urge the Board to consider the multiple problems inherent in this rule. Set forth in greater detail below are broad concerns about this proposal, as well as more specific comments.

1. Need to maintain risk-based pricing. As noted earlier, the right to change pricing on all balances on an account is one of the central pillars of risk based pricing. Creditors grant credit and set credit limits in the expectation that they can address added risk displayed by consumers in the future by adjusting the pricing assigned to that consumer accordingly. Denying that right to creditors is very likely to force them to revert to an old system in which credit worthy customers bear the burden for those that are not or that will make it impossible for a great number of consumers to obtain credit at all. In addition, as a matter of safety and soundness, creditors need to be able to adjust to changing circumstances that affect risk exposure and operating costs for open-end credit agreements that can continue indefinitely. Bank regulators have sanctioned the use of risk-based pricing for years as sound account management practice. The benefits to consumers of risk-based pricing includes the fact that financial institutions can offer credit to an expanded universe of consumers including higher risk consumers, as documented in the GAO Credit Card Report.[28]

[28] GAO Credit Card Report, at 29.

2. Importance of enforcing penalty rates. Chase agrees with Julie Williams, Counsel to the OCC, in her following statement:

> The risk mitigation tools used by credit card lenders to address changes in the credit risk profile of customers may include freezing or reducing credit lines, closing accounts, shortening account expiration dates, and "re-pricing" (changing the rate of interest charged) for outstanding balances on an account. Changes in a customer's creditworthiness and other factors affect credit risk assumed by credit card lenders for both existing balances that a customer has not repaid, as well as for future transactions by the customer. In other words, when a credit card customer does not pay his or her balance in full, that action by the customer creates risk to the lender for the unpaid balance as well as any future charges.
>
> As 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.[29]

Within the context of risk-based pricing, the use of penalty rates to assign higher rates to borrowers who demonstrate riskier behaviors is particularly important. Regulation Z has regulated penalty pricing for years. Events of default that triggered rate increases have not heretofore been regulated. Events of default used by creditors are critical in managing risk because they are predictive of possible consumer charge-offs and losses. To the extent that the issue that is problematic is penalty rates imposed as a result of a default by the consumer with respect to another creditor (*i.e.*, so-called universal default), then Regulation Z should be amended to eliminate that practice as a permitted event of default. We note that Chase does not engage in these practices. However, we believe that it would be a mistake to preclude creditors from imposing an increased APR (such as the penalty APR) where such terms have already been disclosed to consumers and are part of their account terms. Consumers already will have been informed many times of the conditions that trigger any penalty APR before it is imposed: in ads before the account is open; within the account agreement; as part of promotional offers, and each month as part of the new "late payment" warning on billing statements. The penalty APR will be even more clearly disclosed under the revised solicitation table and new account opening table in the May 2007 Regulation Z Proposal. Creating restrictions on imposing the penalty APR would not only upset this expectation, but may have adverse financial consequences for most consumers.

3. Exceptions to the prohibition should be expanded. The UDAP Proposal provides exceptions to the ban on raising APRs for: 1) a variable rate adjustment tied to a variable rate

[29] *See*, Statement of Julie L. Williams before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit (Apr. 17, 2008), available at http://www.occ.treas.gov/ftp/release/2008-45a.pdf (discussing importance of risk mitigation, including repricing accounts based on changes in cardholder risk).

index; 2) balances at promotional APRs; and 3) any balances if creditors do not receive payments within 30 days of the payment due date. Although these exceptions are helpful, they do not go far enough to protect against the risk of non-payment. Based on the Data Study mentioned earlier in this letter, the cumulative impact of the UDAP Proposal for those banks participating in the Study potentially is at least $10.6 billion in annualized interest lost. If the participating banks were to offset that loss by changing only one of the following elements, the potential impact is estimated to be as follows:

- Changing Purchase APRs – Purchase APRs would increase by almost 12%, bringing the average purchase APR to 16.58%.
- Reducing Existing Credit Lines – $1.1 trillion in outstanding available credit would be removed.
- Tightening Underwriting Standards – 3.36% of new accounts with the highest risk of default, representing $11 billion in new credit lines each year would no longer be booked.

Since the potential impacts described above are only for a select group of banks, the potential total industry impact would be much higher. Generally, we estimate the tightening of credit standards will affect approximately 45 million consumers nationwide. Specific comments and recommendations regarding these exceptions appear later in this Part of the letter.

4. Restricting APR changes under Regulation AA conflicts with 12 U.S.C. Section 85. The Board should not adopt proposed Section 227.24 because it conflicts with the interest rate provisions of the National Bank Act.[30] The conflict is legally objectionable, interferes with the intent and purpose of Section 85, and should be avoided.

Section 85 allows "a national bank based in one State to charge its out-of-state credit-card customers an interest rate on unpaid balances allowed by its home State…."[31] The intent of Section 85, as understood by more than one hundred twenty-five years of Supreme Court jurisprudence, is to grant national banks "most favored lender" status, with the ability to rely on the state law interest terms made available to any competing lender in the state.[32]

The OCC, the agency charged with interpreting Section 85, has long interpreted Section 85 to refer not only to the numerical interest rates allowed by a bank's home state law, but also any provisions of home state law "material to the determination of the interest rate." This necessarily includes provisions of state law that govern a lender's ability to change interest rates.[33] The ability to change an interest rate is "material to," and indeed inextricably intertwined with, the setting of the rate. There is a vast difference between a state usury law that permits state banks to charge up to 25% with no ability to change, and a state usury law that sets the same limit of 25% but with the ability to change the rate over time.

Effectively, the right to change rates over time permits lenders to give their borrowers the benefit of short-term interest rates – something they can do only because they know they can re-price if interest rates (or the lender's or borrower's circumstances) change. Absent the ability to change rates over time, lenders will have to calibrate all of those possibilities (*i.e.*, risks) into

[30] 12 U.S.C. § 85.
[31] *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299, 301 (1978).
[32] *Tiffany v. Nat'l Bank of Mo.*, 85 U.S. (18 Wall.) 409, 412 (1874).
[33] *See* OCC Letter No. 354, 1985 OCC Ltr. LEXIS 30 (Rel. Jan. 1986) (§ 85 encompasses a state law "provision governing rate-change frequency").

determining the initial rate. Thus, it is clear that the ability to change rates under state law is part of the body of law that Section 85 incorporates, and authorizes national banks to charge. Chase is located in Delaware. Delaware's banking statutes expressly permit state banks to change credit card interest rates over time by following the procedure outlined in the statutes.[34] This provision is incorporated into Section 85, and forms part of the body of interest rate laws that Chase is permitted to rely upon in setting its rates to borrowers nationwide.

Proposed Section 227.24 would prohibit Chase, in most circumstances, from changing the interest rate on an outstanding credit card balance. This creates a direct conflict with the power granted by Section 85. The Board should not enact a rule that creates such a conflict, for at least six reasons.

First, it is clear that Congress has specifically legislated – in Section 85 – with respect to the interest rates that national banks are permitted to charge. The Board ought not disturb that specific authorization from Congress through a rule enacted under the FTC Act. To the extent that a national bank's Congressionally created exportation authority is to be changed, that change should come from Congress rather than a rulemaking. Moreover, there is no indication in the Board's rulemaking authority under the FTC Act that the Board has the authority to override other federal statutes.

Second, the National Bank Act confers upon the OCC the power to make rules and regulations under Section 85. There is a long history of the OCC's interpreting Section 85, and of determining the interest rate authority available to national banks. The OCC has enacted a regulation concerning the scope of Section 85, 12 C.F.R. Section 7.4001, and has issued numerous interpretive letters and opinions concerning Section 85. This includes the letter cited above. Other agencies, including the FDIC, have historically deferred to the OCC's interpretation of Section 85 in interpreting similar provisions in other banking statutes. Against this regulatory framework, and given the experience and expertise of the OCC, the Board should not lightly embark on its own new restrictions regarding banks' interest rate authority.

Third, the essence of the "most favored lender" doctrine is that Section 85 incorporates the rate authority allowed under state law. Thus, instead of a uniform federal interest rate cap, the National Bank Act has long looked to each state's law to determine what a national bank located in that state can charge. As noted above, Delaware and numerous other states have determined that lenders in those states can change interest rates, and apply the changes to outstanding balances. The Board should not now substitute its FTC Act power for this established reliance on state law standards, and effectively override the state law rules that have long governed.

Fourth, and more generally, the long and established history of Section 85 counsels against a new scheme of federal regulation of banks' interest rate powers. Section 85 was enacted in the Civil War years, and has governed national banks for well over a century. It has served as a key part of the legal foundation on which the national banking system has developed and grown. This established and time-tested framework should not be revised absent compelling reason. And the rulemaking process concerning proposed Section 227.24 has not identified any such reason. Rather, the record in support of this proposal is virtually non-existent. Particularly lacking is any real attempt to compare the purported benefits of the proposal with the costs – including the costs to the banks for modifying their businesses to account for the proposal, as

[34] *See* 5 Del. Code § 952.

well as the substantial costs on consumers in the form of higher initial interest rates and, in all likelihood, a decreased ability to provide flexible credit terms or to provide credit at all.

Fifth, the Supreme Court has confirmed that special rules enacted for national banks under the National Bank Act survive later enacted federal statutes of more general applicability. In *Radzanower v. Touche Ross & Co.*, 426 U.S. 148 (1976), the Court ruled that a venue provision in the National Bank Act – providing that a national bank could be sued only in its home district – prevailed over the more general venue provision of the Securities Exchange Act of 1934 that would have allowed the claim to be brought elsewhere. The same conclusion should be reached here. The interest rate authority given to national banks under Section 85 should not be subsumed by a rulemaking under the more general FTC Act.

Finally, it is an established rule of statutory construction that "statutes must be read to give effect to each if such can be done by preserving their sense and purpose."[35] The Board's proposed Section 227.24 would turn this rule on its head by adopting an interpretation of the FTC Act – defining a practice as unfair – that creates a direct conflict with another federal statute, Section 85. Rather than adopt such a rule, the Board should instead shape an interpretation that gives effect to both statutes. That can easily be done by not adopting a rule that conflicts with another statute.

In short, proposed Section 227.24 would interfere with the operation of Section 85, and should be rejected for that reason.

5. <u>UDAP standards not met</u>. The Board's justification for disallowing a creditor's ability to increase APRs on outstanding balances lacks a logical grounding. Any "injury" is clearly reasonably avoidable by consumers. The Board indicates disclosures are not adequate to enable a consumer to avoid a rate increase, yet Regulation Z for years has required advance disclosure regarding the amount and triggering conditions of penalty APRs. Indeed, as even the Board admits, it has proposed to enhance these disclosures in the proposed revisions to Regulation Z, adding a new notice for when the penalty is triggered.[36] The Board also suggests "[c]onsumers may ignore the disclosures because they overestimate their ability to avoid the penalty triggers."[37] Not only do consumers (not the creditor) control whether or not consumers ignore the multitude of Regulation Z required disclosures regarding penalty rate triggers, this position ignores long established law reinforcing that consumers are responsible to read their consumer credit ads, contract terms and change in terms notices.[38] It also ignores consumers' ability, in the current marketplace, to swiftly and easily transfer balances if they can obtain better terms elsewhere.[39]

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[35] *Blackfeet Indian Tribe v. Montana Power Co.*, 838 F.2d 1055, 1058 (9th Cir. 1988).

[36] See Chase's comment letters submitted with respect to the Board's Regulation Z proposals regarding its objection to such a notice requirement.

[37] 73 Fed. Reg. 28918

[38] *See, e.g., Walther v. Sovereign Bank*, 386 Md. 412, 429, 872 A.2d 735, 745-46 (2005) (cardholders were presumed to read credit card agreement, and were thus bound by its terms); *Grasso v. First USA Bank*, 713 A.2d 304, 311 (Del. Super. 1998) (terms of agreement put cardholder "on notice that (1) [the agreement] could be amended and (2) any amendment would include unpaid balances.").

[39] Contrary to the Board's discussion, the fact that some consumers cannot find better terms elsewhere is not an indication that a penalty APR is unfair. Rather, it is an indication that it is appropriate to reprice the consumer given the risk presented.

The Board also asserts that, with respect to interest rate changes other than penalty rates, consumers lack control over the circumstances in which creditors will raise APRs or when such increases will occur. Such changes cited by the Board would be examples of: 1) economic necessity on the creditor's part; or 2) actions taken for safety and soundness reasons. For Chase, such changes would require a prior notice and opt out right by the consumer under state law. Thus, there is clearly an opportunity for consumer control without enacting a complete ban on such changes.

The Board states a particular concern with APR increases that may be due to reasons unrelated to performance on the account for which the APR is raised, such as "off us" default or a drop in the consumer's credit score. As stated above, Chase does not engage in these practices. However, for those creditors that do, this concern about so-called "universal default" provisions being used by a creditor as a penalty APR trigger should be addressed by a rule specifically addressing that practice, rather than transforming that targeted concern into a justification for a much broader ban on raising APRs on outstanding balances. Regarding credit scores, the FCRA provides mandatory free credit reports and numerous credit reporting disclosures to consumers that should make consumers very aware of the importance of credit scores on loan interest rates. Chase, like many issuers, provides educational information on this topic on its website, and refers its customers to such information from time to time. Chase also provides 24-hour access to customer service advisors, 365 days of the year, to answer any questions of this nature.

The Board further asserts that many issuers raise rates for reasons that do not violate account terms, such as consumers with balances close to their credit limit or who make minimum payments for several consecutive months – there is, however, no factual support in the record for this contention. Chase is not aware which creditors engage in such practices but, again, any such increase in APR would likely require a prior notice and opt out by the consumer, or the Board could ban that specific set of practices only.

The Board continues its justification by saying that APRs are currently subject to increase because of a consumer default, and that consumers may not reasonably avoid such default because consumers may inadvertently exceed the credit line based on delayed restoration of "open to buy" after a payment, or because of funds availability policies by depository institutions. The consumer knows what events trigger penalty APRs since these events have been disclosed to them multiple times under current Regulation Z disclosure requirements, and consumers – not creditors – are in control of whether they satisfy their obligations. The delayed restoration by Chase of a consumer's "open to buy" is an important anti-fraud and risk management practice. This practice is *only* employed with respect to certain payment patterns indicative of consumers who attempt to obtain credit before their payment checks have cleared. This is a safe and sound banking practice that generally affects the authorization of new transactions and, as implemented by Chase, will not cause an overlimit condition. Further, consumers should know when the funds are available in their checking or other deposit accounts because regulations already require that any policies related to funds availability by depository institutions be clearly disclosed to them. These policies are outside the control of card issuers. For these reasons, we believe the increase of APRs is avoidable by consumers, and does not justify a treatment as an unfair practice.

The Board also indicated its preliminary determination that countervailing benefits do not outweigh the costs of allowing increased APRs on outstanding balances. The Board reached this conclusion notwithstanding that the effect of the proposal on consumers will be higher initial

APRs, less credit availability (fewer new account originations and lower credit lines on existing accounts, which reduces consumer liquidity), as well as a reduction of low rate promotional financing offers. This determination belies reliance on an objective standard of fairness, and instead reduces the proposal to a naked imposition of price controls. Practically, by curtailing risk-based pricing, creditors must raise rates and fees on a far broader population of consumers. Approximately 92% of Chase customers have the same or better APRs at the end of the year as they have at the beginning of the year. Even though relatively few consumers experience a significant decline in their credit scores that merit rate increases, for those that do, their entire balance is at risk of repayment. To mitigate this risk, creditors will be forced to raise rates more broadly. Further, one justification for the Board's determination (that creditors can hedge funding costs with variable APRs on consumer accounts), misses the fact that many accounts now have regular "fixed" APRs that are not tied to a variable rate index. Therefore, once this restriction would apply, creditors imposing such fixed rates will be prevented from changing them to variable rates to hedge funding costs.

The Board also rejects the idea of using consumer opt outs in lieu of a broad ban on increasing APRs. It is simply not true, however, that "few" consumers exercise such rights. For Chase customers notified of a potential APR increase, a significant number of them choose to opt out, close their account, and pay the balance at the old rate. Further, contrary to the Board's position,[40] we believe that it is rational for consumers to choose not to opt out of a higher rate. Consumers choose to accept higher rates for the convenience of credit card use, to earn rewards related to their card use, and simply because they want to keep their cards for possible future use. There is no substantiation for the Board to suggest that such a notice and opt out would create "burdens for institutions and consumers".[41] It is far more a burden on consumers if an environment is created were consumers will pay higher APRs, have lower credit lines generally, and do not receive low rate promotional offers which lowers the cost of borrowing. The Board has not adequately evaluated the countervailing benefits of this rule, and those benefits clearly outweigh the alleged harm. Therefore, the UDAP standard for finding an unfair practice is not met.

6. Applying new restrictions to existing balances would be unfair and raise serious Constitutional concerns. If the Board determines to adopt a restriction on the ability of credit card issuers to change the APR on outstanding balances, it is imperative that any such change applies only prospectively after an effective date in the future, and not with respect to credit that has already been extended.

Banks have extended billions of dollars of credit in reliance on the ability to change APRs. And that reliance was justified: the cardholder agreements provided for such changes, and federal and state laws have always permitted it. Neither the Board nor any federal banking regulator has given advance warning that regulatory limitations on the ability to change interest rates on outstanding balances might be imposed. Indeed, the extraordinary proposal from the Board to limit rate changes on outstanding balances is fundamentally inconsistent with the historic nature of a credit card account: an open-end relationship in which consumers can terminate relationships and move balances without pre-payment fees and lenders reserve the right to change interest rates on an account that can remain open indefinitely. It was entirely unforeseeable that the Board would now use Regulation AA to regulate interest rates on credit cards.

[40] 73 Fed. Reg. at 28919.
[41] *Id.*

The Board's proposal, if applied to balances outstanding on the effective date, presents extraordinary safety and soundness considerations for banks that have extended the credit on these accounts. The banks' pricing decisions were made on the basis that they would be able to change the APR in the manner permitted by applicable law at they time the loans were made. Banks have priced credit card accounts on the assumption that APRs could be changed on existing account balances. Many banks have responded to consumer demand to offer APRs that do not automatically vary with external interest rate indices on the assumption that they would have the ability to change interest rates if conditions changed, such as a change in the credit risk presented by an accountholder. Banks undoubtedly will suffer otherwise avoidable losses if the Board prevents them from exercising risk-based re-pricing practices that were developed to be applied in connection with the interest rates that were offered consumers.

Indeed, any attempt to apply limits on the ability to change interest rates on existing balances is flatly inconsistent with a wealth of precedent under usury laws. It is self-evident that changes in usury laws imposing new restrictions on interest rates apply only prospectively.[42] This tenet recognizes that the permissibility of an interest rate under usury laws is determined at the time the loan is made, as well as basic principles of fairness that prevent a more restrictive interest rate limit being imposed on a loan retroactively after the credit has been extended. A lender that makes a loan based on its assessment of the creditworthiness of the borrower and relevant economic considerations should not be forced to reduce that interest rate after the loan is made without being able to reconsider the factors that went into setting the interest rate. The same applies here: it is fundamentally unfair for the Board to prevent banks from changing interest rates on loans that have already been made when the loan contracts provide for such changes and such changes were permissible and commonly made at the time the loan balances were incurred. It would defeat the settled expectation that rates could be changed based on changed circumstances.[43]

The elimination of the right to change APRs on existing balances also raises serious issues under the Takings Clause of the U.S. Constitution. Congress has "considerable leeway to fashion economic legislation, including the power to affect contractual commitments between private parties."[44] However, federal legislation has been declared unconstitutional where its impact on private contract rights is excessive or unjustified.[45] To determine a violation of the Takings

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[42] *See generally* 47 C.J.S. Interest & Usury § 82, at 91-92 (2005) ("Where the parties to a contract have stipulated for the payment of a specified rate of interest, lawful at the date of the contract, such contract rate will not be affected by a subsequent statute … changing the rate permitted to be contracted for…."); 44B Am. Jur. 2d Interest & Usury § 8, at 33-34 (2007) ("a subsequent statute affecting the rate of interest recoverable will not ordinarily apply when there is an existing contractual obligation … fixing the rate of interest"); 4 A.L.R.2d 932 (1949), "Retrospective application and effect of statutory provision for interest or changed rate of interest."

[43] This is more than a matter of simple fairness, as there are also constitutional dimensions to a change that disturbs settled contractual expectations. *See* 47 C.J.S. Interest & Usury § 82, at 92 (2005) (applying new usury law to existing contract "would amount to an impairment of the obligation of the contract"); 87 A.L.R. 462 (1933), "Statutes in relation to interest as obnoxious to constitutional provision against impairing obligation of contracts." As Congressman Barney Frank (D-Mass.), Chairman of the House Financial Services Committee said, in the context of enacting legislation that would preclude mortgage lenders from exercising contractual rights of foreclosure: "I don't think that's appropriate. I don't think it's constitutional … to abrogate contracts." CNBC, July 25, 2008 Interview with Congressman Frank (video available at http://www.cnbc.com/id/15840232?video=803555368&play=1).

[44] *E. Enters v. Apfel*, 524 U.S. 498, 528 (1998).

[45] *See, e.g. Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935) (invalidating federal legislation that eliminated judicial foreclosure remedies for mortgage lenders).

Clause, the U.S. Supreme Court has set forth a three-part balancing test that considers: (1) the character of the governmental action; (2) the economic impact of the regulation; and (3) the extent to which the regulation interfered with distinct investment backed expectations.[46]

Cienega Gardens v. United States, 331 F.3d 1319 (Fed. Cir. 2003), is instructive on the Constitutional issues presented by the Board's proposal. In that case, borrowers obtained HUD-insured mortgage loans with respect to which HUD imposed limits on the use of the property securing the loans that applied during the 40-year loan term (e.g. required rental to low-income tenants at below market rates). The mortgage contracts with private lenders allowed the borrowers to pre-pay the mortgage loans after 20 years, and thereby terminate the property use requirements. After the borrowers obtained the loans, Congress enacted legislation that required HUD-approval for pre-payments after 20 years and thereby allowed HUD to continue to require use of the property for purposes of providing low-income housing. Applying the three-part test in *Penn Central*, the court found the application of the new regulations to existing loans violated the Takings Clause.

Cienega Gardens noted that the first element of the *Penn Central* test requires a review of the purpose and importance of the public interest in regulatory imposition, and found that the government had a legitimate interest in promoting low-income housing, but that the effect of the legislation was to impose that burden on the borrowers with HUD-insured loans.[47] The second element requires there to be a serious financial loss (so to ensure that not every restraint is covered by the Takings Clause), which the court also found to occur.[48] Application of the final element, the court indicated, required an objective consideration of whether the plaintiffs would reasonably have expected the government to nullify the twentieth-year prepayment right.[49] The court rejected the government's argument that the borrower's investment-backed expectations could not be reasonable because they were operating in a highly regulated environment and should have expected that the regulations might change, noting that even if the expectations should be reduced in such fields, they are not eliminated.[50]

If the Board applied a limitation on changing APRs on outstanding balances in effect at the time the regulation went into effect, there would be a taking insofar as the Board would be requiring banks to give up existing property rights to increase interest rates for the purported public good of giving the borrowers with such balances a new federal right to pay off those balances on existing terms. The Board should not be using its authority under Regulation AA to make such an economic reallocation of contractual rights and obligations between lenders and borrowers. Moreover, applying the *Penn Central* test, the government's interest in providing a rate cap to borrowers is limited at best, especially since these borrowers entered into loan contracts that expressly provided that the interest rate could be increased. In contrast to emergency situations (such as war time emergency), the Board has produced no evidence of the need to provide borrowers with the proposed rate protection. In addition, the potential financial loss to banks in not being able to raise interest rates on existing balances is likely to cause a substantial financial loss; for example, the imposition of a rate cap likely will substantially decrease the value of loans if banks want to sell them. And finally, the banks have a very reasonable investment-backed expectation that the government would not impose interest rate limits on loan balances after the

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[46] *Penn Central Transp. v. New York City*, 438 U.S. 104, 124 (1978).
[47] *Id.* at 1338-39.
[48] *Id.* at 1345.
[49] *Id.* at 1346.
[50] *Id.* at 1350.

loans were made. As noted above, the federal government has not previously regulated the ability to increase interest rates on credit cards, which have had such features since they were first introduced, and new restrictions in usury laws are seldom, if ever, applied to existing loan balances.

In sum, principles of bank safety and soundness, traditional usury law, basic fairness, and even Constitutional law compel the conclusion that any limit on the ability of banks to increase APRs be applied only to balances incurred after the effective date of any new regulatory requirements. In that regard, any effective date should be sufficiently in the future to allow banks to consider the new limitations on their ability to re-price and implement any re-pricing that is appropriate before they become subject to the new limitations.

7. Comments to specific portions of the UDAP Proposal. As described above, we believe the Board is restricted with regard to its authority to limit a creditor's ability to raise interest rates on outstanding balances in accordance with the terms of private contracts banks have with their customers. However, in the event that the Board was to proceed to finalize a rule with such limitations, we provide these additional comments. We provide comments below with respect to the exceptions contained in the UDAP Proposal, as well as additional exceptions that should, if any form of this rule is finalized, be added.

a. *Variable rate exception.* We agree the variable rate adjustment at proposed Section 227.24(b)(1) is an important exception.

b. *30-day delinquency exception.* Regarding the 30-day delinquency exception at proposed Section 227.24(b)(3), the data shows that a 30-day delinquency exception is too narrow an exception for consumer defaults to prevent significant credit losses. Customers who are even 6-15 days late pose twice the risk of charge-off than those who are not. Customers who exceed their credit limits pose, surprisingly, the same amount of risk.[51] Other events of default (such as making payments using checks that are not honored by the consumer's bank) and changes in consumer credit report information are also predictive of charge-offs and losses. If this rule is enacted, we believe the delinquent payment exception to raising APRs should be changed to permit increasing APRs where a payment is not received by the creditor within two days of the payment due date. In addition, the permitted exceptions should include any time a consumer exceeds his or her credit limit or provides a payment check, draft or transfer that is returned unpaid.

c. *Promotional APR balance exception.* We fully support a broad exception for balances at promotional low rate APRs in proposed Section 227.24(b)(2). The Board was very insightful to include this exception for such balances, in that it will help to preserve this important benefit for eligible consumers (although other elements of the proposal threaten it nonetheless). Supplementing the comments in our comment letter to the May 2008 Regulation Z Proposal, we believe that the exception should permit an increase in the APR at the end of the promotion, as well as where the promotional rate is lost because of a consumer default, as long as the rate that will apply upon the loss or expiration of the promotional APR has been disclosed to consumers. Excepting such balances from both a requirement to provide prior notice of a rate increase *and* any restriction to raise promotional rates balances on accounts in default will help creditors to price for its risk in making these low cost loans. Without such a broad exception, such offers will make substantially less economic sense for creditors. There will likely be a

[51] This conclusion is based on data from the Data Study.

significant reduction in, or shorter duration of, promotional low rate offers. Alternatively, promotional APRs may be increased or such offers may be eliminated altogether. The net effect of the proposed rule without a broad exception, therefore, is likely a loss of consumer liquidity and a higher cost of borrowing. As a result, we strongly encourage the Board to retain this exception.

As we stated elsewhere with respect to the payment allocation rules, curtailing promotional low rate offers will have a negative impact on consumers and on the economy as well. These balances reflect a high level of consumer spending that will likely be greatly reduced or removed from the market if the Regulation Z and UDAP Proposals are adopted in their current form. At the same time, these balances represent significant cost savings to consumers by providing a low cost of borrowing. Given that the effect of the proposed changes will be to restrict the volume of these low rate offers or to increase their rates, the cost to consumers and the economy will be significant. This will hurt not only the consumer sector that relies on credit in these difficult economic times, but also can hinder the U.S. economy that is already struggling from the effects of the constriction of available credit. The Board should weigh the economic impact of its Proposals both from a consumer and monetary policy standpoint, and retain and expand broad exception in the rule.

Reiterating the point from our comment letter to the May 2008 Regulation Z Proposal, we believe it is in the industry's and consumers' best interests for creditors to be able to make properly disclosed promotional low rate offers to qualified consumers while giving consumers appropriate notice of the adverse consequences of any default on their part. To strike a fair balance between the risk of loss creditors must take into account in making low rate promotional offers, and providing adequate notice to consumers of the consequences if they were to lose such promotional rates, we support an exception that allows for creditors to include a disclosure of any conditions on the offer that will cause a consumer to lose the promotional rate (either in the account agreement or in the promotional offer itself), and that would require that the increased APR be no greater than the non-promotional APR in effect at the time the consumer loses the promotional APR. In other words, a consumer's applicable non-promotional APR would apply if he or she loses the promotional APR.

As we also explained in our comment letter to the revised Regulation Z Proposal, a consumer's effective non-promotional APRs may change during the period of a promotional offer. For example, a consumer may convert his or her account to a different account with the same creditor with different rewards and different non-promotional APRs, and the balances from the old account (including the promotional rate balances) are transferred to the new account. Also, consumers may request and be granted by the creditor lower non-promotional APRs on their existing accounts, or a creditor may implement a change in terms to raise non-promotional APRs subject to any opt out rights required by state law. Further, a consumer may already have a penalty rate in effect on the account when he or she accepts a promotional offer, and that is now the standard APR for the account. We urge the Board to permit sufficient flexibility to accommodate such situations. The exception as currently drafted in proposed Section 227.24 is unclear about what rate "would apply after the expiration of the promotional rate." One example in the rule suggests that rate cannot be a penalty rate, but as described above, even a penalty rate can be the rate in effect when the promotional rate would expire and may have been in place for a substantial time. We believe the Board could provide that promotional rate balances are exempt from any prior notice requirement in the event of any loss or expiration of the promotional rate, provided that the non-promotional rate that would apply has already been

disclosed to the consumer and that non-promotional rate is the APR in effect at the time the consumer loses the promotional rate.

d. *Economic Necessity.* In addition, any rule limiting the ability to increase rates should allow exceptions for economic necessity. There are many examples of economic necessity that could dramatically affect a creditor's risk and/or costs, so any rule could only provide a representative list of such exceptions. However, the examples would include an increase in costs of funds, new legal or regulatory requirements, significant increases in credit losses, increases in third-party vendor or network costs, acts of war or terrorism, or natural disaster. Another example is that creditors should be permitted to protect against funding risks with existing balances at fixed interest rates, so changing terms on existing balances to variable rates should be allowed.

8. Operational effects. This proposed rule will also lead to changes in APRs on different balances and transactions during a billing cycle, with the result that potentially the number of APR and balance disclosures shown on consumers' billing statements will more than double. This is particularly problematic with consumers taking advantage of multiple promotional offers with different beginning and ending dates. In addition to the confusion this may cause, we also point out that it would be critically important for the Board to make this rule, if enacted, take effect at least 24 months after any final rule is effective. Creditors today do not have systems built that track separate balances tied to the 14-day, 30-day, and 45-day rules that are contained in the Regulation Z and UDAP Proposals, as it would need to do to be able to comply with these rules.

Again, as with the other practices discussed above, a review of Chase customer complaint data involving Chase's current practices related to changing terms on accounts shows a small number of inquiries about those practices. Therefore, there does not appear to be statistical evidence that indicates customer dissatisfaction on this topic.

9. Alternatives. Chase, as a leader in consumer financial services, appreciates the concerns that have been expressed that consumers are charged higher APRs and fees for events of default. Although we believe such actions are justified in light of the risk mitigation practices Chase must adhere to for safe and sound lending purposes, we also believe improvements can be made in the industry that will help consumers be more aware of risk-based pricing and how to avoid it. See Chase's clear and simple website at *www.chaseclearandsimple.com*. Most issuers already provide important consumer safeguards such as providing consumer opt out rights to raise an APR. Further, over the past couple years, certain major issuers, including Chase, have advocated or taken substantial steps to address this issue. What Chase proposes is that the Board adopt what we believe are the best practices from the industry, and make the following part of a new regulatory scheme implemented under Regulation Z.

First, creditors should refer at appropriate times, such as part of advertising for new accounts or as part of the account agreement, to a creditor website or Board website that contains educational material which explains the risk-based pricing process to consumers. These references will supplement the "late payment" warning messages that will appear on billing statements.

Second, any change in terms involving increased APRs (except for those triggered by a default or a penalty APR) should be subject to consumer opt out. This is consistent with the approach today as described earlier in this letter, where the Board in Regulation Z provides that state law

controls the types of changes banks can make to revolving credit terms, and how changed terms affect existing balances. Many states (including Delaware, Chase's home state) provide consumer opt-out rights for APR increases.[52] With such opt out rights, consumers can always avoid such increased costs. Consumers who opt out in effect convert their balances to loans that they pay off under their current rates, so there is limited possibility for a further change in terms. As we stated previously, our data shows that consumers do read their change in terms notices, and they do opt out in significant numbers if they do not want to pay the higher rates. Consumers who do not opt out want the credit cards they have, even at the increased rates, such as for the convenience of credit card use or to accrue valuable rewards on their account transactions. Opt out is a widely used and accepted method to change terms, as we believe most major credit card issuers are located in states that require such opt out notices. Banks provide other important notices with opt out rights as well, in accordance with federal law. For instance, opt out is the accepted method to decide on important privacy, information sharing options under the Gramm Leach Bliley Act.[53] Also, there is a long history of case law upholding a change in credit terms with opt out as a viable approach.[54]

Third, other than when consumers are in default on their accounts, creditors should limit the number of times they raise APRs on any individual account to no more than once a year.

Fourth, creditors should permit with regard to any change in terms involving increased APRs, except for those triggered by a default or a penalty APR, written and telephone opt outs by consumers who want to reject an increase in APRs.

These options ensure that consumers are well aware of how risk-based pricing works, have options to reject an APR increase other than for default, and are not immediately or automatically penalized for a lower credit bureau score. Further, APR increases other than for default require prior notice and any consumer opt out rights allowed. This approach would strike a fair balance between limiting consumers' exposure to immediate increased rates due to a change in financial circumstances (as may be reflected in a credit score) but where no account default has occurred, but still allows creditors to manage the risk of repayment over the long life of an account. Also, limited exceptions should be allowed, such as when a creditor buys a credit card portfolio and needs to convert the credit card accounts to its own processing system, even if the seller already changed terms on such accounts within the prior year. With such flexibility as described above, consumers are better off and creditors can avoid drastic cutbacks in credit availability or increases in rates charged to consumers.

In sum, repricing terms on existing balances is not an unfair practice violation. Banks clearly disclose that terms can be amended, and also when default APRs apply. Under Regulation Z today the Board defers to state law regarding changing terms on existing balances, so it should not now be an unfair practice under a federal regulation. Increased costs from such changes can clearly be avoided by consumers after they receive their change in terms notices informing them of their new, higher APRs using the suggested alternatives above (provide references to

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[52] Any such rule would need certain minor exceptions from these opt out rights (e.g. fixed to variable rates, changes in balance methods, monthly to daily periodic rates). These exceptions generally do not involve adverse cost impact to consumers from the change being made, and are important to creditors to be able to convert portfolios they acquire to their existing systems, as well as to permit keeping uniform terms throughout the portfolio of accounts for easier account management and control.

[53] 15 U.S.C. § 6802(b); 12 C.F.R. § 216.10(a).

[54] See *Grasso v. First USA Bank*, 713 A.2d 304, 311 (Del. Super. 1998).

educational information about risk-based pricing practices, allow consumer opt out rights for APR changes other than for default, limiting the number of changes in terms, other than for default, to once a year, and allowing written and telephone opt outs). For a default APR, consumers can avoid the default event that triggers the higher rate. We urge the Board to further expand its exceptions from this proposed rule as suggested above, in exchange for stricter rules such as requiring consumer opt out rights for APR increases other than for default and limiting how often a creditor can change terms on an account for other than default by the consumer.

D. Proposed Section 227.25 – Fees caused by credit holds.

Restrictions on the ability to impose a fee or charge for exceeding a credit limit should be included under Regulation Z, which already addresses the treatment and disclosure of such fees. Chase also questions whether the practices addressed by this rule are actually sufficiently common in the credit card industry to justify a particular rulemaking.

E. Proposed Section 227.26 – Unfair balance calculation methods (Two-cycle billing).

Chase no longer uses the two-cycle balance computation method. However for any creditor that does, the Board might better address any perceived problems by better-crafted disclosures. For example, it could enhance the disclosures for this computation method currently provided for Regulation Z.[55] There are legitimate questions whether such a practice should be regulated under the Board's FTC Act rulemaking authority.

We also urge the Board to clarify the language in this section to provide that it does not affect a creditor's ability to impose finance charges for a transaction beginning on the date of the transaction, if the transaction date falls in a different billing cycle than the cycle in which the transaction posts. For example, if a cardholder has billing cycles that begin on the first of the month, a creditor should be able to begin accruing finance charges as of March 31 for a transaction that occurs on March 31.

F. Proposed Section 227.27 – Security deposits and fees for the issuance or availability of credit.

This section does not affect the products offered by Chase. Nevertheless, we believe that enactment of this rule would create a dangerous precedent for federal regulation of credit terms. The permissible amounts of fees and charges have long been left to the National Bank Act (and analogous statutes), and state law. Overlaying new fee regulations as a matter of UDAP rulemaking is a departure from long accepted federal practice of regulating credit disclosures. We urge the Board to consider adopting disclosure rules – such as those contemplated by the May 2007 Regulation Z proposal – rather than substantive restrictions on credit terms.

G. Proposed Section 227.28 – Firm offer of credit practices.

Chase believes that restrictions and disclosure rules applicable to firm offers of credit are far better addressed under Regulation Z and the FCRA, which already impose requirements on such offers. To the extent that additional disclosures are required – and the Board's proposed rule is only a disclosure rule – those requirements should be folded into Regulation Z or Regulation V.

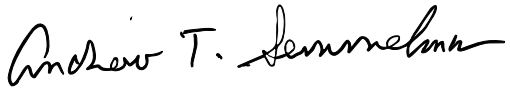
[55] 12 C.F.R. § 226.5a(g)(2).

V. TIME TO COMPLY

We also want to reiterate an important point from Chase's comments in response to the May 2008 Regulation Z Proposal and the May 2007 Original Regulation Z Proposal. The technological, systems, and operational effort to comply with the new requirements of the both the UDAP Proposal and the Regulation Z Proposals, if adopted, will be significant. We will need to conduct a comprehensive testing effort before implementing the changes. As a necessary precaution given the size of Chase's credit card portfolio with over 156 million cards issued, these changes should be implemented in phases (if at all) and not all at once. There will also be significant staffing and prioritization challenges to implement these changes on top of the normal conduct of the business. Some of the changes may also require amending the terms of customer agreements, or providing new disclosures. Therefore, we urge the Board to allow creditors at least 24 months from the effective date to comply with any new requirements, whether they appear in a Final UDAP Rule or an amendment to Regulation Z, particularly with respect to any rules involving payment allocation and the application of increased APRs to outstanding balances.

In conclusion, Chase appreciates the opportunity to comment on the UDAP Proposal. Please contact me with any questions about our comments using the contact information at the bottom of the first page.

Sincerely,



cc:
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