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November 20, 2009

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

Re: Docket No. R-1370  
Proposed Changes to Regulation Z  
Truth in Lending Act  
74 *Federal Register* 54124, October 21, 2009

Dear Madam:

This letter provides comments of the undersigned concerning the proposed changes to Regulation Z (the "Proposed Rule") described above which was published by the Board of Governors of the Federal Reserve System (the "Board") in the *Federal Register* on October 21, 2009. We are partners in the law firm of Davenport, Evans, Hurwitz & Smith, L.L.P., and our law firm represents various financial institutions regulated by the Board, as well as a number of national banks and state-chartered non-member banks, that would be significantly impacted by the Proposed Rule.

I. Introduction

In accordance with the mandates of the recently enacted Credit Card Accountability Responsibility and Disclosure Act of 2009 (the "Card Act"), the Board has proposed to amend Regulation Z to establish fair and transparent disclosure practices pertaining to open-end consumer credit plans, including credit card accounts. While we strongly support Congress and the Board's efforts to provide consumers with adequate disclosures regarding their credit, we believe several provisions in the Proposed Rule are unclear and likely to confuse card issuers. Therefore, these comments are intended to identify provisions where we believe clarification is

Ms. Jennifer J. Johnson, Secretary  
November 20, 2009  
Page 2

needed to assist card issuers in complying with the changes to Regulation Z necessitated by adoption of the Card Act.

II. Clarification of the time frame during which notice of a change in terms may be sent to a consumer and considered timely.

Regulation Z Section 226.9(c)(2)(i), as proposed, requires at least 45 days prior notice with respect to a significant change in account terms or an increase in the required minimum periodic payment. However, neither this section nor the Official Staff Commentary (the "Commentary") provides guidance as to how far in advance the notice may be sent and still be considered timely.

The Proposed Rule amends Regulation Z to read as follows with regard to a change-in-terms notice:

(2) Rules affecting open-end (not home-secured plans).

- (i) Changes where written advance notice is required. For plans other than home-equity plans subject to the requirements of § 226.5b, except as provided in paragraphs (c)(2)(iii) and (c)(2)(v) of this section, when a significant change in account terms as described in paragraph (c)(2)(ii) of this section is made to a term required to be disclosed under § 226.6(b)(3), (b)(4) or (b)(5) is changed or the required minimum periodic payment is increased, a creditor must provide a written notice of the change at least 45 days prior to the effective date of the change to each consumer who may be affected. The 45-day timing requirement does not apply if the consumer has agreed to a particular change; the notice shall be given, however, before the effective date of the change.

Proposed Reg. Z § 226.9(c)(2)(i).

The proposed Commentary to Regulation Z provides the following guidance regarding the timing of an advance change-in-term notice:

2. Timing – effective date of change. The rule that the notice of the change in terms be provided at least 45 days before the change takes effect permits mid-cycle changes when there is clearly no retroactive effect, such as the imposition of a transaction fee. Any change in the balance computation method, in contrast, would need to be disclosed at least 45 days prior to the billing cycle in which the change is to be implemented.

Proposed Reg. Z Commentary § 226.9, § 9(c)(2)(i)-2.

As stated above, neither the proposed Regulation nor the Commentary thereto provide guidance as to how far in advance the written notice may be provided to the consumer. The card issuer may wish, for example, to notify a consumer that a particular fee will be increased as of

Ms. Jennifer J. Johnson, Secretary  
November 20, 2009  
Page 3

January 1 and a different fee will be increased as of June 1. Assuming the issuer meets the requirements as to disclosure of the consumer's right to opt with respect to such fee increases, could the card issuer disclose both of these changes in the same change-in-terms notice, which notice is sent at least 45 days prior to the January 1 change?

As the Board is aware, many card issuers are implementing a number of changes, both to meet the disclosure and systematic requirements of the Proposed Rule, as well as to reprice their credit products in a manner that complies with the rule. Further, a number of the required regulatory changes have different implementation dates, thus in some instances necessitating multiple change-in-terms notices.

We believe it would enhance consumer understanding if the number of change-in-terms notices applicable to an account could be kept to a minimum. One way to achieve this is to combine notices in a single letter or notification form. Thus, we believe guidance as to the time frame during which a change-in-terms notice may be given to a consumer and still considered timely would assist card issuers in providing comprehensive notices that are easier for the consumer to understand.

III. Clarification that an increase in the annual fee does not constitute an increase to a fee based solely on a protected balance even if the cardholder does not subsequently use the card.

In general, under the proposed Regulation Z § 226.55(a) a card issuer may not increase an annual percentage rate or certain fees or charges on a credit card account under an open-end consumer credit plan. However, under proposed Regulation Z §226.55(a), a card issuer may increase a rate or fee if, provided that the increase does not occur during the first year after the credit card account is opened and the increased rate or fee does not apply to transactions that occurred prior to provision of the notice or to transactions that occurred prior to or within 14 days after provision of the notice.

The proposed Commentary to Regulation Z provides as follows with regard to increased fees and charges:

Once an account has been open for more than one year, § 226.55(b)(3) permits a card issuer to increase a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) after complying with the applicable notice requirements in § 226.9(b) or (c), provided that the increased fee or charge is not applied to a protected balance. A card issuer is not prohibited from increasing a fee or charge that applies to the account as a whole or to balances other than the protected balance. For example, after the first year following account opening, a card issuer may add a new annual or a monthly maintenance fee to an account or increase such a fee so long as the fee is not based solely on the protected balance.

Ms. Jennifer J. Johnson, Secretary  
November 20, 2009  
Page 4

Proposed Reg. Z Commentary § 226.55, ¶ 55(c)(1) (emphasis added).

We believe that the Board should clarify that an annual fee, or other periodic fee, would be regarded as a fee “that applies to the account as a whole.” The confusion with respect to this matter arises because some consumers who have not opted out of the fee increase may wait for some period, and in some instances an extended period, before using their card. In such instances, the only balance on the card would be the “protected balance.” However, we believe that the intended interpretation of the proposed regulation is that it is permissible to impose the increased annual fee on such an account because it is a fee that “applies to the account as a whole.” However, without further clarification, when an increased annual fee is applied to an account on which no new charges are made (despite the cardholder’s ability to make new charges at any time), this could arguably be regarded as an increase in a fee “based solely on the protected balance.” Due to this possible confusion, we believe further clarification should be added with respect to this provision to clarify that if an annual fee, or other periodic fee on an account, is increased with appropriate notice, and a cardholder does not opt-out of such increase, the increased fee may be applied to the account and will be regarded as a fee applicable to the account as a whole, even in those instances in which the cardholder does not make further charges to the account.

IV. Clarification of underwriting requirements when assessing ability to pay.

Under the Proposed Rule, Regulation Z Section 226.51 states that a card issuer must not open a credit card account, or increase any credit limit applicable to such account, unless the card issuer considers the ability of the consumer to make the required minimum periodic payments, based on the consumer’s income or assets and the consumer’s current obligations. However, the Proposed Rule does not provide sufficient guidance with respect to these underwriting requirements, particularly when applied to consumers with a negative credit history or consumers with little or no prior credit history. We believe the Board should provide additional explanation as to the requirements of the Proposed Rule regarding these requirements. We further believe the Board should provide clarification as to what constitutes a “current obligation.”

Based on this language, it appears that card issuers could satisfy the Proposed Rule by obtaining information directly from the consumer or by using information in a consumer report.

However, the Proposed Rule requires card issuers to evaluate the consumer’s ability to pay based upon both the consumer’s income or assets and current obligations. The Commentary to the Proposed Rule provides in relevant part:

1. Consideration of additional factors. Section 226.51(a) requires a card issuer to consider a consumer’s ability to make the required minimum periodic payments under the terms of an account based on the consumer’s income or assets and the consumer’s current obligations.

The card issuer may also consider credit reports, credit scores, and other factors, consistent with Regulation B (12 CFR part 202).

....

4. Income, assets, and employment. Any current or reasonably expected assets or income may be considered by the card issuer. For example, a card issuer may use information about current or expected salary, wages, bonus pay, tips and commissions. Employment may be fulltime, part-time, seasonal, irregular, military, or self-employment. Other sources of income could include interest or dividends, retirement benefits, public assistance, alimony, child support, or separate maintenance payments. A card issuer may also take into account assets such as savings accounts or investments that the consumer can or will be able to use.
5. Current obligations. A card issuer may consider the consumer's current obligations based on information provided by the consumer or in a consumer report.

Proposed Commentary to Reg. Z § 226.51(a) (emphasis added).

Further, the Supplementary Information to the Proposed Rule provides that “[w]hen considering a consumer’s income or assets and current obligations, a creditor would be permitted to rely on information provided by the consumer or information in a consumer’s credit report.” 74 Fed. Reg. 54124, 54127 (October 21, 2009).

The foregoing provisions create confusion as to whether a creditor must obtain information regarding income or assets and current obligations directly from the consumer, or whether the creditor may instead rely on information in the consumer’s credit report. While the Supplementary Information states that a creditor would be permitted to rely on the credit report with respect to both “a consumer’s income or assets and current obligations,” the proposed Commentary refers to credit reports as an additional factor to be considered. However, the Commentary also states that with respect to current obligations, the card issuer may consider the consumer’s current obligations based on information provided by the consumer or in a consumer report. Thus, we believe the Board should provide further guidance reconciling these provisions and, in particular, clarifying whether reliance on a consumer report is sufficient with respect to “income or assets,” as well as with respect to current obligations.

We also believe the Board should provide additional guidance as to the underwriting that must be conducted by card issuers. We believe that traditional underwriting, such as the use of standard debt-to-income ratios, may not be indicative of a consumer’s ability to repay, particularly with respect to accounts with relatively low credit lines and thus low minimum periodic payments. Further, we believe guidance should be provided as to whether or not a

Ms. Jennifer J. Johnson, Secretary  
November 20, 2009  
Page 6

creditor may rely solely on the consumer's credit score, as well as whether a creditor may rely solely on such creditor's internal scoring model. Finally, we believe guidance should be provided as to whether, in evaluating the ability to repay with respect to a credit line increase, the card issuer may limit the underwriting to an evaluation of the cardholder's performance on accounts with the card issuer, or whether the card issuer must also consider information from the consumer or other sources, as discussed above.

V. Clarification regarding early compliance with the Proposed Rule.

While the Proposed Rule discusses implementation in stages, the Proposed Rule does not provide a clear safe harbor for card issuers who comply with the provisions of the Proposed Rule before the February 22, 2010 effective date. The Board should clarify that card issuers are compliant with federal law if their materials and disclosures are drafted in accordance with the Proposed Rule even if the applicable sections of the Proposed Rule have not yet become effective.

As a result of the many amendments that have been made to Regulation Z over the past several years, there is some confusion as to which version of various Regulation Z provisions are currently applicable. Further, there is no straightforward provision in either the January 2009 Regulation Z Final Rule or the Proposed Rule that provides that if an issuer implements various provisions prior to such provisions' effective date, the issuer will be in compliance with the Truth in Lending Act and Regulation Z, even if the disclosures used by the issuer do not comply with Regulation Z as it is in effect today. A prime example of such an instance is an issuer who adopts the new format and terminology for tabular disclosures under Regulation Z § 226.5(a). The format and terminology of the tabular disclosures changed significantly under the Final Rule, and these changes were carried forward to the Proposed Rule. A tabular in compliance with those new provisions would, in some instances, violate Regulation Z in its current form. This is also true with respect to the Regulation Section §226.6 account-opening disclosures, as well as the Regulation Z Section 226.7 periodic statement disclosures, as both of these latter items require that certain items be labeled as "finance charges," terminology which is abandoned in the Final Rule and the Proposed Rule.

The Board's January 2009 Regulation Z Final Rule does address prospective application and implementation in stages, stating as follows:

Prospective application of new rules. The final rule is prospective in application. The following paragraphs set forth additional guidance and examples as to how a creditor must comply with the final rule on the effective date.

....

Implementation in stages. As noted above, commenters indicated creditors will likely implement the final rule in stages. As a result, some disclosures

may contain existing terminology required currently under Regulation Z while other disclosures may contain new terminology required in this final rule. For example, the final rule requires creditors to use the term “penalty rate” when referring to a rate that can be increased due to a consumer’s delinquency or default or as a penalty. In addition, creditors are required under the final rule to use a phrase other than the term “grace period” in describing whether a grace period is offered for purchases or other transactions. The final rule also requires in some circumstances that a creditor use a term other than “finance charge,” such as “interest charge.” As discussed in the section-by-section analysis to § 226.5(a)(2), during the implementation period, terminology need not be consistent across all disclosures. For example, if a creditor uses terminology required by the final rule in the disclosures given with applications or solicitations, that creditor may continue to use existing terminology in the disclosures it provides at account-opening or on periodic statements until July 1, 2010. Similarly, a creditor may use one of the new terms or phrases required by the final rule in a certain disclosure but is not required to use other terminology required by the final rule in that disclosure prior to the mandatory compliance date. For example, the creditor may use new terminology to describe the grace period, consistent with the final rule, in the disclosures it provides at account-opening, but may continue to use other terminology currently permitted under the rules to describe a penalty rate in the same account-opening disclosure. By the mandatory compliance date of this rule, however, all disclosures must have consistent terminology.

74 Fed. Reg. 5244, 5389-90 (January 29, 2009).

While the foregoing clearly anticipates that issuers will implement the various changes required under the Final Rule, and accordingly the changes under the Proposed Rule, in stages, and states that issuers may comply with some of the new requirements, but need not comply with all, prior to the effective date, the foregoing does not include a straightforward statement that compliance with any revised section of Regulation Z prior to the implementation date constitutes compliance with the Truth-in-Lending Act and Regulation Z as it stands today. We would therefore recommend that a straightforward early compliance provision, addressing the foregoing, be added to clarify this matter.

VI. Delayed effective date for other Regulation Z amendments.

In the Supplementary Information accompanying the Proposed Rule, the Board discussed retaining the original mandatory compliance date of July 1, 2010, consistent with the effective date the Board adopted when the January 2009 Regulation Z Final Rule was issued, with respect to those provisions of the January 2009 Regulation Z Final Rule that are not directly affected by the CARD Act. The applicable section of the Supplementary Information is set forth below. As

Ms. Jennifer J. Johnson, Secretary  
November 20, 2009  
Page 8

discussed below, we would strongly recommend that the Board retain the July 1, 2010 effective date with respect to the changes in question.

The Supplementary Information accompanying the Proposed Rule provides as follows with regard to the effective date of certain proposed changes to Regulation Z:

As noted above, the effective date of the Board's January 2009 Regulation Z Final Rule is July 1, 2010. However, the effective date of the provisions of the CARD Act implemented by this proposal is February 22, 2010. Many of the provisions of the CARD Act as implemented by this proposal are closely related to provisions of the January 2009 Regulation Z Final Rule. ... In order to implement the CARD Act in a manner consistent with the January 2009 Regulation Z Final Rule, the Board intends to make the effective date for the final rule pursuant to this proposal February 22, 2010. The Board is considering whether this effective date should apply to both the provisions of the January 2009 Regulation Z Final Rule that are not directly affected by the CARD Act that are included in the proposed rule as well as new and amended requirements proposed pursuant to the Card Act.

The Board recognizes that there are certain provisions of the January 2009 Regulation Z Final Rule that impose substantial operational burdens on creditors that are not directly required by the Card Act. For such provisions, the Board is considering retaining the original mandatory compliance date of July 1, 2010, consistent with the effective date it adopted when the January 2009 Regulation Z Final Rule was issued. In particular, the Board is considering whether the original mandatory compliance date of July 1, 2010 would be appropriate for certain tabular or other formatting requirements applicable to account-opening disclosures under § 226.6(b), portions of the periodic statement under § 226.7(b), disclosures provided with checks that access a credit card account under § 226.9(b)(3), change-in-terms notices provided pursuant to § 226.9(c)(2), and notices of a rate increase due to a consumer's default, delinquency, or as a penalty pursuant to § 226.9(g).

74 Fed. Reg. 54124, 54126 (October 21, 2009).

As noted in the foregoing, the cited provisions for which the Board is considering a July 1, 2010 effective date imposed substantial operational burdens on creditors and are not directly required by the CARD Act. The tabular disclosures, the account-opening disclosures, and the change-in-terms notices, and the notices of a rate increase due to a consumer's default, delinquency, or as a penalty, all represent provisions that require significant new or revised disclosures.

Accordingly, such significant additions and revisions require numerous changes to both consumer disclosures and the underlying processing systems. Adopting an earlier effective date will impose a substantial operational burden on many card issuers, and it is likely that the number of card issuers will simply be unable to comply in a timely manner, particularly given the limitations on changes being implemented by system processors. A rush to compliance will also likely lead to disclosures that are less straightforward and more difficult to understand than those that could be developed if the card issuer had sufficient time to properly implement the changes. Thus, for both the benefit of card issuers and consumers, we believe the Board should retain the original mandatory compliance date of July 1, 2010 for those provisions of the January 2009 Regulation Z Final Rule that are not directly affected by the CARD Act.

VII. Clarification that the limitations on fees do not include periodic finance charges.

Under the Proposed Rule, Regulation Z Section 226.52 contains a limitation on the fees a card issuer may impose during the first year after the account is opened, stating as follows:

(a) Limitations during first year after account opening.

(1) General rule. Except as provided in paragraph (a)(2) of this section, if a card issuer charges any fees to a credit card account under an open-end (not home-secured) consumer credit plan during the first year after the account is opened:

(i) The card issuer must not charge to the account during that period fees that in total constitute more than 25 percent of the credit limit in effect when the account is opened; and

(ii) The card issuer must not require the consumer to pay any fees in excess of the total amount permitted by paragraph (a)(1)(i) of this section with respect to the account during that period.

(2) Fees not subject to limitations. Paragraph (a) of this section does not apply to:

(i) Late payment fees, over-the-limit fees, and returned-payment fees;  
or

(ii) Fees that the consumer is not required to pay with respect to the account.

(3) Rule of construction. Paragraph (a) of this section does not authorize the imposition or payment of fees or charges otherwise prohibited by law.

Proposed Reg. Z § 226.52.

The proposed Commentary to Section 226.52 addresses various items that are included within the limitation (e.g., security deposits), as well as fees that are not subject to the limitations. However, neither the proposed Regulation nor the Commentary thereto address periodic finance charges (i.e., charges due to the application of an annual percentage rate to an outstanding balance). While we believe that a charge due to application of the annual percentage rate to an outstanding balance would not be regarded as a “fee” for purposes of Section 226.52,

Ms. Jennifer J. Johnson, Secretary  
November 20, 2009  
Page 10

we believe that the Board should clarify this fact to avoid alternate interpretations and confusion going forward. We therefore believe that the Board should add a straightforward provision under the Commentary to Section 226.52 stating providing that a charge due to application of an annual percentage rate to an outstanding balance does not constitute a fee for purposes of that section.

VIII. Clarification as to prospective application.

Under the Proposed Rule a number of sections were added under Subpart G, entitled "Special Rules Applicable to Credit Card Accounts and Open-end Credit Offered to College Students." Many of these provisions were contained in the earlier adopted amendments to Regulation AA and have now been moved into the aforementioned section of Regulation Z. We believe that it is imperative that the Board clarify that these provisions are prospective only and should not be interpreted as support for the position that past or current practices are impermissible or misleading, deceptive, or unfair simply because they are inconsistent with the proposed Regulation Z. We would therefore strongly recommend inclusion of a statement in the preamble, as was the case in the earlier revisions to Regulation AA, as to the prospective application of the newly added provisions.

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In closing, we would again commend the Board on its efforts to establish fair and transparent disclosure practices. However, for the reasons discussed in detail above, we believe the Board should provide further clarification regarding the aforementioned provisions of the Proposed Rule prior to its February 22, 2010 effective date.

These comments represent our personal views and the views of Davenport, Evans, Hurwitz & Smith, L.L.P., but do not necessarily represent the views of our clients. We thank you for the opportunity to comment on the Proposed Rule and for your consideration of these comments.

Sincerely,

*/s/ Dixie K. Hieb*

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For the Firm

*/s/ Monte R. Walz*

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