American Express
General Counsel's Office
World Financial Center
New York, NY 10285

Via E-mail
April 14, 2010

Jennifer J. Johnson
Secretary, Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention: Docket No. R-1384
regs.comments@federalreserve.gov

Re: Federal Reserve Board Docket No. R-1384
Regulation Z (Truth in Lending)

Dear Ms. Johnson:

This letter is submitted by American Express Travel Related Services Company, Inc., on behalf of itself and its U.S. affiliates American Express Centurion Bank and American Express Bank, FSB (collectively "American Express"), in response to the proposed amendments to 12 C.F.R. Part 226 ("Regulation Z") regarding limitations on fees, reevaluation of rate increases, and related matters (the "Proposal") published in the Federal Register on March 15, 2010, by the Board of Governors of the Federal Reserve System (the "Board").

American Express appreciates the Board's work in developing the Proposal and the opportunity to comment on it. American Express supports the goals of the Proposal and, as we have affirmed in previous letters, of the Credit CARD Act of 2009 (the "Act"). We commend the Board for issuing a Proposal that is generally well-crafted and evenhanded. At the same time, the Board should refine certain aspects of the Proposal, including but not limited to those on which the Board has solicited comment. The refinements recommended below would further the goals of the Act while appropriately balancing the interests of issuers and cardholders.

First, this letter recommends that the Board revise proposed §226.52(b) to conform to the plain language of the Truth in Lending Act ("TILA") and Congress' specific intent. Next, the letter responds to the Board's request for comments regarding charge cards. The letter then turns to parts of the Proposal regarding rate reevaluation, to provisions on late payment costs and fees, and finally to selected other parts of the Proposal.

1. IMPLEMENTING SECTION 149(c) of TILA

Proposed §226.52(b) would require charge and credit card issuers to set fees based on either costs or deterrence. The Board should revise this provision to conform to the plain language of TILA and to Congress' specific intent.

Section 149(c) of TILA plainly states that in issuing its rules, the Board must consider cost, deterrence, cardholder conduct, "*and* such other factors as the Board may deem necessary or appropriate" (emphasis added). The Board acknowledges that the factors listed in section 149(c) "reflect Congressional intent with respect to the implementation of section 149(a) and therefore provide useful measures for determining whether penalty fees are 'reasonable and proportional.'" Thus, Congress provided that reasonable and proportional fees could take account of cardholder conduct and necessary or appropriate other factors, and that such fees could take account cumulatively of all the factors identified in section 149(c).

Congress specifically intended that certain "other factors" be taken into account. The Senate Committee on Banking, Housing and Urban Affairs reported that the "Committee understands that the Federal Reserve Board, in determining reasonable relation to cost, will take into account *a number of factors*, including . . . *credit risk associated with both the portfolio and the individual*" (emphasis added). S. Rep. No. 111-16 at 7 (2009). The italicized text clearly refers both to credit losses embedded in the portfolio and the costs associated therewith, including but not limited to the costs of holding appropriate reserves, and to the costs of credit risk management relating to individual accounts that may or may not be charged off.

Accordingly, the Proposal is inconsistent with the statutory language and with specific Congressional intent in several respects – because the Proposal does not authorize issuers to take into account cardholder conduct or other factors specified by the Board; because it does not authorize them to take account of all the statutory considerations cumulatively; and because it does not authorize issuers to take account of the "other factors" that Congress intended, particularly risk management considerations, portfolio losses and associated funding costs, and the costs of managing credit risk on individual accounts. The Board should revise §226.52(b) to eliminate these inconsistencies and reflect Congress' intent regarding fees assessed by charge and credit card issuers.

2. CHARGE CARDS AND §226.52(b)

American Express commends the Board for soliciting comment specifically on charge card accounts. Because charge card account balances are required to be paid in full each month, these accounts promote financial responsibility. This same straightforward monthly repayment requirement, together with clear terms and conditions and annual fees based on product value, provide consumers with transparency. Charge card accounts also provide consumers with significant value, including embedded card benefits, such as retail purchase protection programs, special events access, rewards programs and travel insurance. At the same time, consumer charge card accounts generally are not subject to finance charges or overlimit fees. Charge cards provide consumers with important tools to manage their spending. And issuers have begun to make more charge card choices available in response to consumers' renewed focus on value and prudent spending. [1]

A. Risk Management

The Board asks about "the methods used by issuers to manage risk with respect to charge card accounts." Late fees are a critical risk management tool for charge card issuers. Materially altering the late fee structure of charge cards would result in adverse consequences for both charge card issuers and consumers and would dissuade issuers that do not currently offer charge card accounts from doing so in the future.

Charge card issuers, unlike credit card issuers, do not manage credit risk through upfront annual percentage rates, nor do they impose penalty interest rates in response to increased risk. Moreover, late fees on charge card accounts are episodic and do not continue if the violation is cured and are therefore not equivalent or even analogous to penalty interest rates on credit card accounts.

The Board recognizes that charge card accounts "typically require payment of an annual fee," but at present annual fees are used largely to contribute to the funding of product value, not to manage risk. Additionally, based on market testing, it is clear that increasing annual fees would entail reconfiguring charge card products, and their current risk management tools, in ways that would make them undesirable or unavailable to many consumers.

Charge card issuers manage credit risk through tools such as:

- *Late fees* – charging late fees on delinquent accounts.
- *Underwriting* – opening charge card accounts only for consumers who pose an acceptable level of risk.
- *Account monitoring* – carefully monitoring account activity for changes in risk profiles and signs of fraud.
- *Point of sale approval* – reviewing each charge at the point of sale to assess the likelihood of that charge being repaid.
- *Suspension* – suspending cardholders' charge privileges when their behavior signals increased risk.

Late fees are a critical risk management tool. They often incorporate a percentage of the delinquent balance.[2] Adverse consequences would result from materially altering the late fee structure of charge cards because charge card issuers would be forced to amplify their use of the other risk management tools identified above. Inevitably, issuers would reduce their credit risk by, among other actions, shortening the amount of time a cardholder has to pay before a late fee is assessed, approving fewer new charge card accounts, suspending more accounts, and declining more transactions. Further, valuable product features and rewards programs

[1] Tamer Cards for Tougher Times, *The Wall Street Journal*, December 23, 2009.
[2] *E.g.,* for American Express charge cards, the late fee is the greater of $35 or 2.99% of the delinquent balance after 60 days, and, we understand, for Diners Club charge cards, the late fee can be 2.5% of the delinquent balance plus $30.

would likely be scaled back, and the charge card model would be fundamentally altered. These changes would significantly inconvenience many consumers as well as reduce the product value received by all charge cardholders. Issuers that do not currently issue charge card accounts would almost certainly choose not to do so going forward.

B. Recommended Adjustments

The Board asks "whether any adjustments to proposed §226.52(b) are necessary to permit charge card issuers to manage risk." We believe that the Board should exempt charge card accounts from §226.52(b). If the Board is unwilling to exercise its authority to do so, we urge the Board to adjust §226.52(b) to accommodate such accounts' special characteristics and to create a safe harbor specifically to preserve the proportionality of late fees on charge accounts.

i. *Exemption*

Material constraints on charge card issuers' ability to assess fees, particularly late fees, would, as noted above, cause adverse results for both charge card issuers (and potential issuers) and consumers. Accordingly, an exemption is necessary and appropriate.

The Board has ample authority to exempt charge cards pursuant to sections 105(a) and (f) of TILA and section 2 of the Act. This authority is demonstrated by the exemption of home-secured plans from proposed §226.52(b); the Board has exempted such plans in many other Act-derived provisions, in each instance recognizing the fundamentally different nature of those plans from the plans addressed in the regulation issued by the Board.[3]

The special characteristics of charge card accounts make the Board's proper implementation of section 149(c) with respect to such accounts a matter of particular importance. Accordingly, if the Board is unwilling to exercise its authority to exempt charge card accounts from §226.52(b) – and is also unwilling to revise that provision to accord with the explicit mandate of section 149(c) of TILA with respect to both credit and charge cards – the Board should at least adjust §226.52(b) to reflect section 149(c) with respect to charge card accounts.

ii. *Cardholder Conduct*

The Board should permit charge card issuers to "base penalty fees on cardholder conduct," including cardholder repayment behavior. For example, consumers with delinquent balances on their charge cards also tend to have far larger balances on their credit cards. Those credit card balances accrue periodic finance charges and, if delinquent, late payment fees. Reasonably substantial late fees are necessary to encourage equitable repayment behavior by charge cardholders relative to their other debt obligations. Limiting such fees will inherently disadvantage charge card issuers because it will have an inequitable impact on this payment behavior. This will ultimately reduce the availability of charge card products. The Board should explicitly permit charge card late fees to increase based on the duration of the delinquency, as the Board is considering.

[3] See, e.g., 75 Fed. Reg. 7664 (Feb. 22, 2010) (interpreting the term "credit card account under an open-end consumer credit plan" to exclude home-secured plans even when accessed by a credit card).

iii. *Other Factors*

As discussed above, Congress directed the Board to consider "other factors" that are "necessary or appropriate." With respect to charge cards, it is both necessary and appropriate for the Board to permit issuers to take account of risk management factors, such as the cost of float and losses and associated costs.[4] Charge card issuers bear the cost of float because, unlike credit card issuers, they do not assess finance charges. Charge card issuers incur substantial funding costs on overdue balances. Naturally, these costs grow larger the longer repayment is delayed. Moreover, charge cards entail more intensive account monitoring and management activities than credit cards, including additional account reviews, development of segmentation strategies for accounts (including scoring models and algorithms) and testing of new recovery tools.

In addition, charge card issuers, unlike credit card issuers, do not assess finance charges that would help to mitigate portfolio losses and associated costs, including the costs of holding reserves. These losses and costs are substantial. As noted above, Congress specifically intended that such losses and costs be taken into account in setting late fees.

iv. *Safe Harbor*

As discussed further below, the Board should establish safe harbors for fees that are reasonable and proportional to the applicable violation. The Proposal includes a safe harbor for fees that do not exceed the greater of a specific dollar amount or five percent of the dollar amount associated with the violation (up to a specific dollar amount).

For charge card accounts (if the Board does not exempt charge card issuers from §226.52(b)) a safe harbor consisting solely of a percentage of the dollar amount associated with the violation would be reasonable and proportional. A percentage-based safe harbor would necessarily be proportional to the dollar amount of the violation. A percentage-based safe harbor would also be reasonable – we agree with the Board that five percent is an appropriate level – because it would permit charge card issuers to continue using late fees to manage risk and cardholder conduct, mitigate losses, and help to recover costs, including float. Of course, a late fee imposed under this safe harbor would be subject to proposed §226.52(b)(2), and could not exceed the dollar amount of the violation. But for charge cards, including a maximum dollar cap in the safe harbor provision would frustrate proportionality. Further, a cap would be unreasonable because it would hobble charge card issuers' ability to set fees in accordance with the factors enumerated in the Act. Accordingly, the Board should establish, as new §226.52(b)(3)(iii), a safe harbor for charge card late fees that do not exceed five percent of the dollar amount associated with the violation, without imposing any dollar cap.

3. REEVALUATING INTEREST RATE INCREASES UNDER PROPOSED §226.59

Section 148(a) of TILA requires an issuer to consider factors including "the credit risk of the obligor, market conditions, or other factors in determining whether to reduce a cardholder's rate, if the issuer previously increased the rate based on such factors."

[4] Proposed comment 52(b)(1)(i)-2 provides that "losses and associated costs (including the cost of holding reserves against potential losses) are not costs incurred by a card issuer as a result of violations of the account terms." If the Board's definition of "costs" excludes credit losses and associated costs, then these items must be included in "other factors" to be taken into account for charge cards.

The Board proposes to implement this section through proposed §§226.59(a) and (d), which reflect the statutory list of factors. Additionally, §226.59(d) states that, in reviewing a rate increase, an issuer, at its option, may "review the factors on which the rate increase was originally based, or may review the factors that it currently considers when determining the . . . rates applicable to its" credit card accounts. Comments 59(d)-1 and 59(d)-2, however, imply that the permissible factors are limited to those used originally or those used in underwriting new credit card accounts.

A. Factors

We share the Board's desire to avoid "a prescriptive rule that sets forth certain factors or excludes other factors." As the Board observes, "the particular factors that are the most predictive of the credit risk of a particular consumer or portfolio of consumers, and the appropriate manner in which to weigh those factors, may change over time. Moreover, the factors can vary greatly among institutions."

In keeping with this approach, the Board should revise §226.59(d) and the related Official Staff Interpretations (the "Commentary") to clarify that an issuer applying factors other than those applied at the time of the rate increase need not use only the factors currently used in setting rates for new accounts, but instead may apply factors currently used in pricing accounts or other factors relevant to the cardholder's credit risk (so long as the issuer remains in compliance with comment 52(d)-3 by using the same factors for similar credit card plans). Also, the Board should move all statements about the "factors" into §226.59(d) and the related Commentary. In particular, statements such as "the card issuer's policies and procedures . . . should take into account any reduction in the consumer's credit risk"[5] properly belong in the discussion of §226.59(d) rather than in the provision on policies and procedures.

B. Billing Cycles

Proposed §226.59(c) speaks in terms of "months." However, both issuers and consumers manage their card accounts based not on calendar months but billing cycles. The Board should exercise its authority to revise §226.59 and the related Commentary to clarify that the review required by §226.59(a) must be completed on or prior to the end of the sixth billing cycle after the effective date of the increase. The Board takes this approach in proposed §226.59(e), providing that for a rate increase pursuant to §226.55(b)(4) the issuer need not engage in the review prior to the payment due date of the sixth billing cycle after the effective date of the increase. Extending this approach to the balance of §226.59 and the related Commentary will increase transparency and clarity for consumers about the review and will address operational challenges associated with using months.

C. Termination of Review Requirement

The Board states that it believes the intent of section 148(a) of TILA "is not to impose a permanent requirement," specifically soliciting comment on whether the obligation to reevaluate rate increases "should terminate after some specific time period following the initial increase, for example five years." The Board's reading of section 148 in this regard is correct, but the review requirement should terminate three years following the initial rate increase. The

[5] Proposed comment 59(b)-1.

burden on issuers of continuing to review cardholders' rates more than three years after an initial increase exceeds the consumer benefit of such reviews.

4. LATE PAYMENTS

Proposed comment 52(b)(1)(i)-4 defines the costs incurred by a card issuer as a result of late payments as those "associated with the collection of late payments, such as the costs associated with notifying consumers of delinquencies and resolving delinquencies (including the establishment of workout and temporary hardship arrangements)." The referenced costs are indeed among those borne by issuers as a result of late payments. However, having asked for comment on "whether card issuers incur other costs as a result of late payments," the Board should clarify the proposed comment, as discussed below. The Board should also refine §§226.52(b)(2)(ii) and (b)(1)(iii) as they apply to late payments.

A. "Establishment" of Temporary Arrangements

In referring to "the establishment" of "workout and temporary hardship arrangements," the Board should clarify that the term "establishment" includes not only the costs incurred by the issuer to support the process of establishing such arrangements, but also the costs incurred by the issuer through concessions, such as finance charge or late fee reversals and waivers, as necessary to resolve the delinquency. The Board should also clarify that "workout and temporary hardship arrangements" include one-time concessions, as well as more elaborate arrangements over multiple billing cycles. Incurred directly as part of an effort to resolve a cardholder's late payment behavior, these costs are "costs incurred by the creditor" under section 149(c)(1) of TILA. Moreover, not taking account of such costs in comment 52(b)(1)(i)-4 could deter issuers from making such concessions, adversely affecting both issuers and consumers.[6]

B. "Single Event"

Proposed §226.52(b)(2)(ii) provides that an issuer must not impose more than one fee for violating the terms of a plan "based on a single event or transaction" and that the issuer may, to ensure compliance, opt to impose only one fee per cycle for all violations of such terms. The Board is rightly concerned that some issuers may game their fee practices to extract multiple fees from violations that the cardholder reasonably sees as involving a single act, and the Board should prevent this practice.

However, the proposed "single event" standard will be difficult for issuers and examiners to understand and apply without additional guidance from the Board, particularly with respect to events that could arguably be related to a prior cycle. For example, a cardholder fails to make any payment in a billing cycle (cycle 1). In the next billing cycle (cycle 2), the cardholder makes a payment, and that payment is returned for insufficient funds later in cycle 2. It is impossible for the issuer to know whether the payment in cycle 2 was intended for an amount due in cycle 1 or cycle 2, or both. The Board should clarify that it is appropriate and permissible for the card issuer to assess a late fee in cycle 1 and a late fee or a returned check

[6] This recommendation does not address concessions on the outstanding loan balance, which we believe are appropriately included in the late fee. Comments regarding the interplay of penalty fees and credit losses appear at part 1 above.

fee (but not both) in cycle 2. The Board should further clarify that a payment is attributable only to the billing cycle during which it is received.

C. Fee Reevaluation

Proposed §226.52(b)(1)(iii) requires issuers to "reevaluate a determination made under [§§226.52(b)(1)(i) or (b)(1)(ii)] at least once every twelve months," to implement a resulting decrease within 30 days after completing the reevaluation, and to implement an increase in accordance with §226.9(c). The Board asks whether 12 months is an appropriate interval for the reevaluation. While the purposes of the proposed rule are appropriate, both the 30-day and 12-month periods should be lengthened, particularly in the context of late payment fees.

- *30-day period.* Issuers have adjusted their systems to permit compliance with §226.9(c), i.e., to permit 45-day notice of fee increases. Mandating asymmetric treatment of fee decreases would be burdensome. Issuers would also find it burdensome to be required to decrease fees on a 30-day schedule, which could be mid-cycle for some cardholders. Moreover, these burdens would not yield a corresponding consumer benefit, since that benefit would be limited to an additional 15 days of a reduced fee that may not be applied in any case.[7] Additionally, asymmetric timing rules for rate increases and decreases are inequitable.

- *12-month period.* The Board should set the 12-month period so as to optimize several factors – not only those identified by the Board, i.e., the use of relatively current data and the avoidance of too frequent changes, but also limiting the burden on issuers by not requiring continuous recalibration, and permitting methodologically sound testing and analysis. In light of all these objectives, it would be advisable for the Board to specify a longer period (*e.g.* 18 to 24 months).

5. OTHER MATTERS

A. Safe Harbor

Using its authority under section 149(e) of TILA, the Board proposes in §226.52(b)(3) to establish a safe harbor for compliance with §226.52(b)(1). The safe harbor would be the greater of a specific dollar amount – left open in the Proposal – or five percent of the dollar amount associated with the applicable violation (up to a specific dollar amount). The Board requests comment on what the specific dollar amount should be and also on whether the safe harbor should permit issuers to impose escalating or accumulating penalties for repeated or protracted cardholder violations. The Board should establish a safe harbor, provided that the safe harbor reflects Congress' intent.

As noted above, section 149(c) of TILA reflects Congress' intent that the Board, in adopting rules on reasonable and proportional penalty fees, should take account of costs, deterrence, cardholder conduct, and specified other factors. The specific dollar amount in the safe harbor should reflect all these considerations. With respect to the cost factor, the components of issuers' costs are more numerous, and their aggregate costs are greater, than contemplated in the Proposal. Also, consistent with part 2.B.iv above, the safe harbor, when ultimately

[7] See proposed comment 59(a)-2 (limiting the burden to issuers with respect to rates that are not actually applied).

adopted, should expressly permit issuers to impose escalating or accumulating penalties for repeated or protracted violations.

B. Testing

The Board has proposed that deterrence-based fees be determined using "an empirically derived, demonstrably and statistically sound model that reasonably estimates the effect of the amount of the fee on the frequency of violations." The Supplementary Information implies that the only way to arrive at such a model is by testing fees of different amounts on current customers.[8] However, we do not believe that such testing would be practical given the customer experience and other issues that it would entail. The Board should therefore clarify that it does not mean to imply that testing on actual customers is necessary to arrive at a model that meets the proposed regulatory standards.

Once again, American Express thanks the Board for its work on the Proposal and the opportunity to comment on it. We would welcome the opportunity to discuss our comments further with Board staff. Toward that end, any staff member should feel free to call me at any time.

Sincerely,

/s/

Thomas J. Ryan
Senior Counsel

[8] See 75 Fed. Reg. 12343 (Mar. 15, 2010) ("Specifically, in order to comply with §226.52(b)(1)(ii), it will be necessary for a card issuer to test the effect of fee amounts that are lower and higher than the amount ultimately found to be reasonably necessary to deter a type of violation.")