

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

April 14, 2010

**Re: Docket No. R-1384  
Regulation Z  
Truth in Lending Act  
Credit CARD Act**

Dear Ms. Johnson,

The American Bankers Association (ABA)<sup>1</sup> and the Consumer Bankers Association (CBA)<sup>2</sup> are pleased to provide our comments to the Federal Reserve Board's (Board) proposed amendments to Regulation Z which implements the Truth in Lending Act in order to implement provisions of the Credit Card Accountability Responsibility and Disclosures Act of 2009 (Credit CARD Act), which go into effect on August 22, 2010. The proposed rule would require that penalty fees imposed by card issuers be reasonable and proportional to the violation of the account terms.<sup>3</sup> The proposed rule would also require credit card issuers to reevaluate annual percentage rates (APRs) increased on or after January 1, 2009 at least every six months.

The proposed rule represents the third and final stage of the Board's implementation of the Credit CARD Act and probably the most challenging stage, especially the provision related to setting reasonable and proportional penalty fees. We understand the difficulty in trying to define "reasonable and proportional and the inherent inefficiencies, shortcomings, and inaccuracies of government price controls that displace market forces. The difficulties are more acute in a competitive market where there are so many variables in setting the price and when the price is intended to be designed to actually impact customer behavior.

We believe that the Board has appropriately tackled the provision related to rate increase review so that the provision is manageable and fair to issuers and borrowers. The flexibility to consider current factors in determining an interest rate ensures that rates are not

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<sup>1</sup> The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's \$13 trillion banking industry and its two million employees. The majority of ABA's members are banks with less than \$165 million in assets."

<sup>2</sup> The Consumer Bankers Association is the recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in consumer financial services, including auto finance, home equity lending, card products, education loans, small business services, community development, investments, deposits and delivery. CBA was founded in 1919 and provides leadership, education, research and federal representation on retail banking issues such as privacy, fair lending, and consumer protection legislation/regulation. CBA members include most of the nation's largest bank holding companies as well as regional and super community banks that collectively hold two-thirds of the industry's total assets.

<sup>3</sup> 75 Fed.Reg.12334 (March 15, 2010)

based on outdated or artificial underwriting criteria. Customers are well-protected because, as of August 20, 2009, they have had the choice to avoid interest rate increases on existing balances and always have had the choice to move to a competitor if they are dissatisfied with the rate offered on new transactions. We urge the Board to not require that interest rate increases be reviewed indefinitely given the questionable benefit to customers and the cost and complications associated with compliance and compliance examinations.

However, we have significant concerns about the Board's approach to the price control aspects of the proposal and believe that ultimately, it will again shift the cost of losses from those who do not manage their credit well to those who do, as we have already seen happen due to earlier requirements of the Credit CARD Act. The result will be higher rates and non-penalty fees for all customers and less credit access for many, especially those who have little credit history or who have had trouble managing credit in the past. For example, the inability to incorporate any of the losses into the amount of the late payment fee, in effect, shifts a portion of the losses currently recouped by those who pay late and are more likely to cause a loss to those who pay on time. In addition, by prohibiting inactivity fees, the Board not only exceeds its authority and the letter of the statute, in effect, it mandates that customers who help pay for the system and costs subsidize those who contribute nothing but still derive a benefit. Moreover, the Board's approach puts at risk of challenge rebates and other popular programs.

Finally, we urge the Board to ensure that the provision that permits consideration of the deterrence value of a penalty fee to be meaningful, not only with the initial adoption, but in the future as well. Absent a dispensation from the rule to test the effects of penalty fee amounts, the provision that permits deterrence to be a factor in setting the fee becomes meaningless, contrary to express Congressional intent. We urge the Board to investigate other alternatives based on consumer testing and other potential proxies.

### ***Section 226.52. Limitation on fees.***

The Credit CARD Act provides that “[t]he amount of any penalty fee or charge that a card issuer may impose with respect to a credit card account . . . in connection with any omission with respect to, or violation of, the cardholder agreement, including any late payment fee, over-the-limit fee, or any other penalty fee or charge, shall be reasonable and proportional to such omission or violation.” It also directs the Board to “establish standards for assessing whether the amount of any penalty fee or charge . . . is reasonable and proportional to the omission or violation to which the fee or charge relates. The Board is authorized to provide a “safe harbor,” that is, an amount for penalty fees that are presumed to be reasonable and proportional to the violation.

In issuing the rules, the Board is to consider: (1) the costs incurred by the creditor from an omission or violation; (2) the deterrence of omissions or violations by the cardholder; (3) the conduct of the cardholder; and (4) such other factors as the Board may deem necessary or appropriate.

***Losses as a factor in determining the cost of late payments.*** The proposed rule permits an issuer to charge a penalty fee if it has determined that the amount of the fee represents “a reasonable proportion of the costs incurred by the issuer as a result of that type of violation.” However, the proposal does not permit losses to be a factor in a calculation of a penalty fee, whether based on the issuer’s determination or on the safe harbor. We strongly object to ignoring the obvious connection between losses and late payments. Any formula for calculating a late payment fee should not only consider general costs attributable directly to customers who pay late, but also incorporate at least a portion of losses into the cost calculation.

Allocating none of the credit losses to late payments as the proposal does is fundamentally, intuitively, and academically unsupportable. While not everyone who is late ultimately causes a charge-off, being late reflects an inattentiveness to obligations and/or inability or difficulty in paying (for whatever reason). Such customers are generally more risky than those who do not pay late and are more likely at some time to default and cause a loss. Those losses should in part be covered by those who pay late. Moreover, inadvertent late payments due to occasional inattentiveness by borrowers who are less likely to actually default will likely diminish given the recently implemented Credit CARD Act provisions which mandate that statements be sent 21 days prior to the due date and that the due date be the same each month. These changes reduce the percentage of late payers who are simply inattentive and less likely to actually default and cause a loss.

While it is not possible to allocate precisely the losses related to late payments, it is possible at least to allocate a portion of them based on data demonstrating a link between late payments and charge-offs. Otherwise, the regulation will mandate that the proportion of losses attributable to late payers will be paid by everyone, regardless of their financial management. If losses are not recouped in part by late fees, they will be recouped elsewhere: they must be recouped as a matter of business theory and business practice. A likely source will be higher interest rates generally.

In effect, all borrowers to some degree pay for the losses caused when other borrowers do not repay their loans. However, risk-based pricing and penalty fees allow lenders to shift some of the cost of those losses to riskier borrowers. The Credit CARD Act has already restricted the ability to charge riskier borrowers higher rates, and in recent months, in part due to these limitations, interest rates on new loans and advertised accounts have increased.<sup>4</sup> Thus, the effect has been to shift more of the cost of losses to those who manage their credit well. This increased burden, in the form of higher interest rates, on those who manage credit well will be increased even more if the late payment fee does not recognize at least a portion of losses. This cost coverage shift, coupled with the expected continued high credit card losses due to high unemployment, means that interest rates will continue to rise and remain higher for everyone.

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<sup>4</sup> According to the Board’s April G.19 Consumer Credit Report, interest rates on all credit card accounts have risen between the third quarter 2009 and February 2010. However, interest rate for customers who actually paid interest went down about a half a point between the third and fourth quarters 2009 (14.90 to 14.37 respectively) and increased about a third of a point to 14.67 in February 2010.

Moreover, for charge cards, higher interest rates are not an option for covering losses as no interest is charged. If losses are not a factor in determining the appropriate late fee for charge cards, it is not clear how losses from charge cards are then recouped, except through higher annual or transaction fees, which may be untenable from a competitive or market perspective.

For these reason, we strongly recommend that the Board permit lenders to use, and itself use for determining the safe harbor, a formula that reflects at least a portion of losses in the permissible late payment fee. We suggest that the Board allow the percentage of losses or charge-offs attributable to those who have been late at least once in the twelve month period prior to the charge-off to be considered part of the cost associated with late payments.

**Other costs.** The proposal permits issuers to impose a fee for violating the terms of the account if they have determined that the dollar amount of the fee represents a reasonable proportion of the total costs incurred by the card issuer as a result of that type of violation. The proposed Commentary includes as examples of costs associated with late payment fees, “costs associated with notifying consumers of delinquencies and resolving delinquencies (including the establishment of workout and temporary hardship arrangements).” We agree that these costs should be permitted to be reflected in the fee and suggest the Commentary provide other examples. For example, issuers rely on tools and systems to help them monitor late payments, review credit histories of late payers, track and predict their performance and risk, and determine the appropriate way to respond to individual late payers. The Commentary should make clear that these systems may be considered direct costs associated with late payers. In addition, the Commentary should specify that issuers may consider as part of costs the time spent by customer representatives responding to customer inquiries and discussing and potentially waiving the fee.

**Deterrence as a factor in determining amount of late payment fee.** The Credit CARD Act and the proposal allow for the fee to be based on its deterrence value. The proposed rule allows issuers to base a penalty fee on the deterrence value “if the card issuer has determined that the dollar amount of the fee is reasonably necessary to deter that type of violation using an empirically derived, demonstrably and statistically sound model that reasonably estimates the effect of the amount of the fee on the frequency of violation.”

The Board acknowledges in the Supplementary Information that “as a general matter, the imposition of a fee for particular behavior (such as paying late) can reduce the frequency of that behavior.” Indeed, rationally and intuitively, we expect that the amount of a fine does impact behavior, much as parking tickets discourage illegal parking. If parking illegally in rush hour were \$10, we would expect many would find commuting times much longer. Indeed, the government and many businesses use penalties in order to influence taxpayer or consumer behavior. The IRS, for example, not only uses potential imprisonment to ensure taxpayers not only pay taxes, and file their returns on time, it also imposes penalties for filing late or not paying in full. Taxpayers who do not file their returns by the due date usually pay 5 percent of

the unpaid taxes for each month or part of a month that a return is late, not to exceed 25% of unpaid taxes.<sup>5</sup>

Moreover, setting the rate too low may actually encourage the behavior the fee is intended to discourage, as studies have demonstrated. For example, a study showed the reaction of parents when a flat \$3 fee was imposed on parents arriving more than 10 minutes late to retrieve their children from day care. The result was not fewer late parents, but rather the opposite: more late parents than when there was no charge for late retrieval. The number of parents arriving late actually doubled.<sup>6</sup> The fee in fact became a *license* to arrive late. A more substantial fee was warranted to actually reduce late retrieval behavior.

Measuring the threshold amount when a credit card penalty fee becomes effective is challenging, particularly in the short time permitted by the statute and proposal. First, for any test or standard, the deterrence amount will be on a sliding scale. The threshold will not be the same for everyone, and it is not clear where the appropriate cut-off should be. Second, there may be significant shortcomings to the proposed “empirically derived, demonstrably and statistically sound model that reasonably estimates the effect of the amount of the fee on the frequency of violation” that will make it difficult if not impossible to use.

For example, the current data may understate the threshold amount that changes customer behavior, as much of the analysis available relies on pre-August 20, 2009 data. The environment has since changed. Since that date, issuers are very limited in their ability to raise rates on existing balances based on customer behavior, which served as a deterrent to late payments and other behavior. Absent that tool, they must now rely more heavily on penalty fees such as late payment fees as deterrents and to encourage timely payments and other behavior.

More importantly, as the Board recognizes, it is not clear how issuers may use any model going forward absent dispensation from the rule, noting in the Supplementary Information that in order to develop the empirically-derived estimates, issuers must have data regarding the effect of different fee amounts on the frequency of violation and that therefore it will be necessary for issuers 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. To test any threshold would by definition potentially mean violating the rule requiring that penalty fees be “reasonable and proportional.” In addition, for over-the-limit fees, it will be impossible to take deterrence into account because customers must specifically consent to have transactions over the limit paid.

It is our understanding that Oliver Ireland is submitting credit card data analyzing the deterrence value of penalty fees such as late fees. He will also be submitting a survey of consumers that tests deterrence points. That data may provide the Board with guidance on the threshold amount that affects customer behavior, but the issues discussed above must be

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<sup>5</sup> See <http://www.irs.gov/newsroom/article/0,,id=205326,00.html>

<sup>6</sup> Steven .D. Levitt Stephen J. Durner, *Freakonomics: A Rogue Economist Explores the Hidden Side of Everything* (HarperCollins, New York 2005) pp 15, 16, 19.

addressed, particularly the question of testing thresholds going forward without violating the rule. In any case, the regulation should permit institutions to use third parties for modeling much as lenders universally use third-party credit scores. While it is unlikely that consumers' behavior varies significantly depending on the card held, the benefit of a third-party vendor is that it has the opportunity to analyze much more data and consumer behavior so that the conclusion will be more reliable and universal.

Because of the potential shortcomings of a standard based on "empirically derived, demonstrably and statistically sound model that reasonably estimates the effect of the amount of the fee on the frequency of violation" discussed above, the Board should study and consider other alternatives. For example, it may be possible to determine the appropriate threshold based on consumer testing. Another alternative may be to review fines used by other industries and government entities (taking into account other variables and factors such as other incentives or deterrents) and any data that demonstrate the effectiveness of such fees as a deterrent.

Investigation of alternatives will require additional thought and time, which is unlikely to be accomplished before the Board must issue a final rule, and we certainly do not wish any delay in adoption of a final rule. However, the deterrence component should not be ignored or dismissed by adoption of an unworkable or unusable standard. Such a result would be contrary to the specific and clear language in the statute and to Congressional intent. Accordingly, the Board could retain the proposed standard, but investigate other more feasible alternatives.

***Other safe harbor considerations.*** The Board should be cautious in relying on the average penalty fee amount of certain issuers, such as credit unions in determining the safe harbor. There are important factors and potential differences among issuers charging different fees. For example, the Board should compare not only the amount of the fee, but also the rate of fee waivers as well as the customer credit profiles and corresponding losses. Moreover, in recent years, some credit unions have been exiting the credit card market because of costs. Joann Johnson, Chair of the National Credit Union Administration testified before the Subcommittee on Financial Institutions and Consumer Credit on June 7, 2007, "Rising variable costs and fixed interest margin potential may have persuaded many federally insured credit unions to sell or discontinue their credit card programs in recent years."<sup>7</sup>

***Tiering fees.*** The Board is soliciting comment on whether the regulation should permit issuers to base penalty rate fees on consumer conduct by tiering the dollar amount of the fee based on the number of times a consumer engages in particular conduct during a specified period. We recommend against that approach. The value in a single fee is its simplicity and predictability for customers. The clearer and more predictable the amount is, the greater the deterrence value.

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<sup>7</sup> She further testified, "As interest rates and credit union cost of funds for federally insured credit unions have risen, the net interest margin earned on all loan types has declined. Since all federal credit unions are prohibited from increasing their loan rates beyond a current regulatory 18 percent cap and market interest rates have increase, the interest margin available to cover the losses from higher risk borrowers has declined for many insured credit unions. (p.7)

**Prohibition against fees that exceed dollar amount associated with violation.** Under Section 226.52(b)(2)(i) card issuers may not impose a penalty fee that exceeds the dollar amount “associated with the violation at the time the fee is imposed.” This provision presents a number of issues.

First, in comment 2 to this section, the Board explains that the dollar amount associated with a returned payment is the amount of the required minimum payment due during the billing cycle in which the payment is returned to the card issuer. It is not clear what fee is permitted if no minimum payment is due for that month. For example, the borrower might have already paid the minimum and is making a second payment during the same billing period, may have a \$0 balance, but is attempting to pre-pay in order to increase the line of credit available, or may be subject to a “skip” payment offer.

Nevertheless, there are costs and risk associated with handling any returned payment, even if no balance is due, as the Board acknowledges. Issuers must investigate, notify the customer, and capture the fact of the returned item for future analysis, some of which involves human intervention and review. Therefore, this prohibition against imposing any fee when no balance is due should not apply to returned payment fees. In addition, varying the amount based on a minimum amount is confusing and unpredictable to consumers who better understand and remember a single fee for a particular violation. Predictability and clarity of the consequences discourages violations and helps avoid imposition of the fee.

For these reasons, we recommend that the Board not apply to returned payment fees the prohibition against a fee exceeding the amount associated with the violation. A fee based on costs will be greater than \$0, but we would not expect it to be excessive so as not to be proportional to the violation.

Second, under comment 1 to 226.52(b)(2)(i), the dollar amount associated with a late payment is the amount of the required minimum periodic payment “that was not received” on or before the payment due date, requiring the issuer to take into account partial payment. This means that the amount of the late payment fee will vary: if the minimum payment is \$25 and the borrower pays \$10, the maximum fee is \$15. If the borrower pays nothing, the fee increases to \$25, a startling and inexplicable difference from the consumer’s perspective.

We recommend that the Board base the maximum late payment fee on the minimum periodic payment that was due during the billing statement, rather than the amount that was not received before the due date. This makes the amount of the fee more predictable and easier for customers to determine and verify the correctness of the fee as it requires fewer calculations.

**Inactivity fees.** In addition to outlining guidelines on permissible penalty fees, in proposed Section 226.52(b)(2)(i)(B), the Board also proposes to prohibit certain fees, including account inactivity fees. We strongly oppose this proposed interpretation, especially the prohibition against inactivity fees.

First, an inactivity fee is by no reasonable interpretation or definition, legal or common usage, a “violation” or “omission” related to the agreement. In order to be a “violation” or “omission” related to an agreement, the customer must have agreed to do something and not performed. We are not aware of any credit card agreement in which the consumer agrees or is obliged to use the card. There is no actionable breach of contract claim for failure to use the card. In contrast, the customer is obliged by contract to pay the minimum payment by the due date and is subject to a claim of contract breach.

Second, the inactivity fee is intended to allow issuers to recover the costs of making the credit line available and to encourage – but not require -- its use, in part to help offset those costs. For example, there are costs associated with ensuring that funds are available any time the customer chooses to use the card. Also, holding funds for a nonuser may also mean that credit is not available to someone who might use it and pay for its use. In addition, any open account, whether used or not, is periodically reviewed to ensure the customer continues to qualify. Any open account is also subject to the accounting, compliance, auditing, processing and other systems that are part of the general overhead costs to support all accounts. Privacy statements, for example, must be provided annually, whether or not the account is used.

Customers who pay inactivity fees even if they do not use the card or use it occasionally receive a benefit from having an open account: they have the peace of mind that credit is available when they need it, which is especially valuable in an emergency. It also helps them to build a credit score.

Not allowing issuers to recover costs created by non-users means that issuers have less flexibility in allocating costs among those creating the expense. The result is that customers who help pay for the system and costs must subsidize those who contribute nothing but still derive a benefit.

Finally, prohibiting inactivity fees sets a dangerous precedent because, in effect, it puts at risk of challenge common rebate programs as well as other fees. The argument will, and has already been made by consumer activists, that an annual fee that is rebatable based on activity is the same as an inactivity fee, on the basis that the outcome is similar: those who use the card do not pay a fee and those who do not use the card pay a fee, regardless of the fee label. This in turn raises questions about any cash rebate programs based on activity. If the issuer may not rebate the amount of an annual fee based on activity, may it rebate any amount based on activity? In both cases, the customer who uses the card is potentially at an economic advantage for using the card.

Even if the Board determines that an inactivity fee is a penalty fee, that fee should not be \$0. The statute did not prohibit penalty fees or suggest that the Board should do so. In addition, \$0 is not a “proportional and reasonable” fee as there are costs associated with an inactive account, as enumerated above. It simply is not “reasonable” for the regulation to *require* that one group of card customers subsidize another. An analysis of the proportionality should reflect that customers gain from having the card available. As discussed above, there is value in having the credit available and in building a credit score. Accordingly, if the Board

deems an activity fee to be a “penalty fee,” which we strenuously argue it is not, there should be a permissible fee.

***Prohibition against multiple fees.*** Section 52(b)(2)(ii) of the proposal provides that issuers may not impose more than one fee for violating the terms or other requirements of a credit card account based on a single event or transaction. Comment 1.ii.B illustrates with an example. If a card issuer receives a check past the due date and the check is returned unpaid, the issuer may not impose a late fee and a non-sufficient funds fee. We believe that issuers should be able to impose both fees in this circumstance because the fees are addressing two separate issues and two separate risks and costs.

The proposal treats a late payment that is later returned as a single event on the basis that imposing two fees is “unreasonable and disproportionate to the conduct of the consumer because the same conduct may result in a single or multiple violations, depending on how the card issuer categorizes the conduct or on circumstances that may not be in the control of the consumer.” It is not clear what conduct or circumstance is not in the control of the consumer. First, the billing statement is sent 21 days prior to the due date, providing more than adequate time to ensure prompt delivery of the payment, and the due date must be the same each month, which makes payment due dates very predictable. Second, consumers have control over whether or not their bank accounts have sufficient funds to cover transactions they initiate and authorize. They are in the best position to know which transactions they have authorized, even if those transactions have not yet reached the paying bank. In addition, it is not clear at all how the issuer’s categorization of the conduct influences whether one or two fees are imposed. If the payment arrives late and also is then returned, the issuer’s categorization of the conduct is immaterial: the payment was both late and returned.

The situation described in the proposed example and described above is different from the situation where the payment arrives on time and is returned as unpayable. In this case, the customer may have less control because there may be insufficient time for the customer to learn of the return and send a second payment by the original due date. However, in the proposed example, the customer had clear control and opportunity to avoid both the late payment and the returned payment.

The Board notes in the Supplementary Information that it understands that a card issuer may incur greater costs as a result of an event that causes multiple violations than one that causes a single violation, but believes the issuer may recover those costs by spreading them evenly among all other consumers whose payments are returned. We believe this argument misses the point. There are separate costs and risks associated with each type of violation. Issuers should be able to recover costs in a manner equitable to all customers. The regulation should not insist that those who create additional costs and risks make other customers responsible for those costs and risks.

***Over-the-limit fees.*** The Board has included in the definition of penalty fees over-the-limit fees. While the statute includes over-the-limit fees as an example of a penalty fee, another section of the statute is in direct conflict with such a classification. Section 102(a) provides that

no over-the-limit fee may be charged unless the customer has “expressly elected” to permit over-the-limit transactions to be completed. Thus, because of the Credit CARD Act, going over-the-limit is not a “violation” of the agreement: it is an expressly requested and agreed to service. Accordingly, we recommend that the Board resolve the contradiction in the statute by excluding over-the-limit fees from the definition of penalty fee.

### ***Section 226.59 Reevaluation of rate increases***

***Ability to use previous or current factors.*** Under the proposal, generally, card issuers that have increased APRs on or after January 1, 2009 based on credit risk, market conditions or other factors must evaluate whether those factors have changed, and based on such a review, reduce the APR applicable to the consumer’s account, as appropriate. Card issuers must review the changes in factors not less frequently than once every six months. Card issuers are not required to base their review on the same factors on which an increase in an APR was based. At its option, a card issuer may “review the factors that it currently considers when determining the APRs applicable to its credit card accounts. . . .”

We strongly agree with the Board’s proposed approach. It provides appropriate flexibility that avoids mandating use of an artificial or outdated form of underwriting. In addition, limiting the rate review to factors considered at the time of the rate increase is not necessary or appropriate. In a market as competitive as the credit card market, issuers have every incentive to provide the best rate possible: customers meriting a better rate will go elsewhere as experience has demonstrated. Moreover, consumers are already protected from rate increases by the 45-day advance notice, the general limitation to future transactions, and the choice to not use the card and/or find an alternative from another card issuer. Indeed, without flexibility, issuers are more likely to close the account, to the detriment of the customer. Any arguable benefit to the customer is quite outweighed by the costs and complexities of preserving, tracking, reconstructing, and defending to examiners the exact factors used since January, 2009 into the future, possibly indefinitely.

Underwriting standards change and improve, based on new information, experience, and technology, and neither issuers nor their customers should be stuck in time by outdated information and systems that are less predictive, efficient, or fair. For example, at one time, having unused open-end credit line was considered a negative factor in reviewing a loan application, on the assumption that customers with unused credit available would be more tempted and more likely to incur unmanageable debt. However, experience has shown otherwise. Apparently, those who only use what credit they can manage, even if additional funds are available, are less likely to default. Inability to use current underwriting standards and pricing models on existing and *new* loans means that pricing will be less accurate and efficient, putting upward pressure on interest rates generally and increasing the subsidization by those who manage credit well of those who do not.

Furthermore, lenders have a compelling incentive to provide the best rate they can justify, because they risk losing the customer to a competitor. Dissatisfied customers who believe they merit a better rate can simply open one of the applications mailed from a

competitor, peruse the internet, or simply walk into a bank branch to find a better rate. Accordingly, lenders should be able to review increased interest rates based on current factors to ensure the most predictive and accurate score.

Moreover, the cost of creating and maintaining systems to identify, preserve, and apply factors used in the past to existing reviews and then explain and defend them to examiners is very expensive and challenging. It is virtually impossible to preserve or replicate the exact models or factors used for every decision. It is not clear how examiners will be able to review or analyze or what they will expect issuers to produce and prove. The task is even more challenging when the rule is applied to acquired accounts. In many cases, the reason the accounts are being sold is the seller did not price accounts properly or well. Compelling the acquirer to rely on the same factors is not only difficult as a practical matter – it assumes the seller has tracked and preserved such information – but it also puts the acquirer in the peculiar position of having to repeat the mistakes of the seller.

More important, consumers are well protected. It is noteworthy that any rate increases only apply going forward, that is, to new loans. Since August 20, 2009, borrowers have received 45-day advance notices of any rate increase, with the option to decline the increase. Since February 22, 2010, there is no need to “opt out” of any rate increase on existing balances: the original rate automatically applies to the existing balances except in very limited circumstances. Thus, since August 20, 2009, interest rate increases generally have been avoidable. Also, as noted, customers who believe they merit a better rate have alternatives. They can easily approach a competitor. If the lender is not able to price appropriately and rationally, it will simply close the account, which harms consumers.

In sum, any perceived benefits to limiting issuers’ ability to use appropriate factors or compelling them to use only the factors used to justify the original rate increase are simply outweighed by the costs and complexities of proving and defending a system to comply and demonstrate compliance.

***Requirement for continued review.*** ABA and CBA also believe that issuers should not be compelled indefinitely to review a rate increase every six months. While the concept of indefinitely reviewing rates may seem attractive, as a matter of practice it is unwieldy, expensive, and challenging from a compliance perspective. The result will be higher rates and fees across the board for all borrowers generally and more closed accounts.

The proposal would require issuers to review the APRs applicable to covered accounts indefinitely unless the rate is reduced to the rate in effect prior to the increase. In many cases, a return to the original rate is unlikely given the low rates that had been in effect prior to the Credit CARD Act and that interest rates on credit cards are expected to be higher for some time in light of the Credit CARD Act and current economic conditions.

The Board notes in the Supplementary Information that it “believes that the intent of TILA Section 148 is not to impose a permanent requirement on card issuers to review changes in factors for a consumer’s account.” It further notes its concern that “an obligation to continue to review the rate applicable to a consumer’s account many years after the rate

increase occurred would impose significant burden on issuers, and might not have a significant benefit to consumers.” We agree. While the concept of indefinitely reviewing rates may be attractive on the surface, as a matter of practice, it is unwieldy, expensive, and challenging from a compliance perspective, as discussed earlier.

The longer the 6-month review is required, the greater the upward pressure on interest rates and fees generally, and the more likely that some accounts will simply be closed. We recommend that the Board limit the requirement to two years. After two years, customers will have had the opportunity to rehabilitate their credit history, and issuers should not be compelled to continue to incur costs – which other customers absorb in part. Moreover, competition will oblige lenders to lower rates, and customers believing they merit a better rate can always request a lower rate and if dissatisfied with the response, obtain credit elsewhere.

**Promotional fees.** The proposal requires a review of interest rate increases, going back to January 1, 2009 for any rate increase subject to 226.9(c)(2) or (g)’s 45-day advance notice requirement. Generally, promotional rates are exempt from the 45-day advance notice under certain circumstances, but, for example, since February 22, 2010, they generally may not increase as a result of the customer’s behavior such as paying late.<sup>8</sup>

There are some long-term promotional rates that were in effect before the 45-day advance notice and general prohibition against rate increases went into effect on February 22, 2010. After January 1, 2009 but prior to the February 22, 2010 effective date, a long-term promotional rate might have changed to a standard rate due to the customer’s behavior. We recommend that the Board clarify that the requirement to review rate increases does not apply to the resumption of standard rates.

For example, assume that a three-year promotional rate was accepted in September 2008, but due to a late payment, the promotional rate was replaced by the standard rate in March, 2009. Unless exempt, the proposed rule may require issuers to determine whether the current rate should be decreased to the promotional rate based on previous or current factors to determine interest rates. However, by definition, the promotional rate is usually a sub-standard rate, as the Board recognized in its since withdrawn Regulation AA which addressed certain credit card practices.<sup>9</sup> Accordingly, it is not possible to determine whether the customer is eligible for the original promotional rate based on prior or current factors. Of course, the issue disappears as time goes by and these pre-Credit CARD Act promotional rates expire.

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<sup>8</sup> As of August 20, 2010, the 45-day advance notice was generally required, but the rate increase was not prohibited unless customer opted out.

<sup>9</sup> See 74 Fed.Reg 5515 (January 29, 2009) In discussing payment allocations and promotional rates, the Board notes that a requirement to allocate payments *pro rata* would enhance competition because institutions “would no longer be forced to compete with institutions offering rates that are artificially reduced...”

## **Conclusion**

ABA and CBA appreciate the opportunity to comment on this precedent-setting rule-making. We understand the difficulty in promulgating such a rule, especially given the subjective nature of determining the meaning of terms such as “reasonable and proportional” and the inherent shortcomings and frustrations when government price controls substitute for market forces. While we believe that the Board has appropriately tackled the provision related to rate increase review so that the provision is manageable and fair to issuers and borrowers and strongly encourage it to retain that flexibility, we have significant concerns about the Board’s approach to the price control aspects of the proposal. If adopted as proposed, it will again shift the cost of losses from those who do not manage their credit well to those who do, as we have already seen happen due to earlier requirements of the Credit CARD Act. The result will be higher rates and non-penalty fees for all customers and less credit access for many, especially those who have little credit history or who have had trouble managing credit in the past.

Sincerely,

Nessa Eileen Feddis



Vice President and Senior Counsel  
American Bankers Association  
(202) 663-5433  
nfeddis@aba.com

Steven Zeisel



Vice President and Senior Counsel  
Consumer Bankers Association  
(703) 547-3871  
szeisel@cbanet.org