Bank of America

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20 and C Streets, N.W.
Washington, D.C. 20551

Re: Docket Number R-1384

Dear Sir or Madam:

Customers have told us they want control, choice and clarity in managing their daily finances. At Bank of America, we've already taken action to deliver the solutions and services they need, including:

- providing Clarity Commitment summaries in our lending products;
- simplifying our product offerings including introducing basic, straightforward products;
- delivering enhanced choice and convenience through our industry-leading online, mobile and ATM networks; and
- renewing our commitment to financial education to help customers make more confident financial choices.

Specifically in our credit card business, we have made several changes to better meet our customers' needs and make it easier for them to do business with us, including:

- ensuring a customer's credit card payment is due on the same day every month,
- extending the time a customer has to pay their bill to at least 25 days,
- increasing the number of ways that a customer can pay – by mail, phone, online banking or at one of our more than 18,000 ATMs or 5,900 banking centers across the country,
- extending the cutoff time at our ATMs and online beyond what is required so that a customer can make a payment up to 11:59 p.m. Eastern time on the payment due date and still be considered on time, and
- providing a Clarity Commitment summary, a simple, one-page summary of a customer's account terms and fees, to each of our consumer and small business card customers.

From introducing meaningful principal forgiveness for home mortgage loan modifications to ceasing risk based repricing after the implementation of the CARD Act to helping customers better manage their checking accounts by not allowing overdrafts for point-of-sale debit card transactions, Bank of America is leading the banking industry to refocus on the consumer.

We generally support the CARD Act and the recently proposed changes to Regulation Z. The concepts of "reasonable and proportional" penalty fees and regular reviews of customers' credit pricing are consistent with Bank of America's overall efforts to earn the trust of our customers.

The Board's task of drafting regulations to implement "reasonable and proportional" penalty fees and the six month review of repriced accounts is complex. Because of the variety and complexity of the credit card industry, it is difficult to draft rules that appropriately protect consumers without stifling the industry or inadvertently causing harm to consumers. The Bank offers the following comments and suggestions for how the Board may improve upon its proposed regulations.

Executive Summary

- Customers and Congress understand and accept that fees are warranted for violating a credit contract. The fee, however, must be reasonable and proportional to the infraction. It also must be clear and consistent.
- To that end, the appropriate safe harbor for penalty fees should be a single price point between \$28 and \$34. A single price point is clear and consistent. A fee within this range also is reasonable and proportional in light of the related costs incurred by the industry and the goal of deterrence. A cost analysis of ten large issuers conducted by Argus Information & Advisory Services, LLC ("Argus"), discussed in greater detail below, fully supports a cost-based fee of at least \$28 – and arguably higher. Similarly, a deterrence analysis conducted by Argus supports a fee between \$28 and \$34 as the price point at which late fees effectively deter inappropriate behavior.
- Bank of America recognizes that amounts at or above the high end of this range, whether cost justified or not, may not comport with the goal of the CARD Act related to proportionality.
- Outside of the safe harbor, the Board should clearly establish what costs can be considered under the cost-justification approach.
- The Board's proposed regulations establish rules of broad application that fail to consider some specific situations:
    - Annual fees that are waived in response to customer loyalty and activity should be allowed.
    - Banks should be able to collect returned access check fees.
- The six month review should be able to use current criteria, and not apply to any promotional rates. Banks should be permitted to discontinue the review if the customer has not qualified for a rate reduction after two years.

Discussion:

Customers understand that when they borrow money, both the lender and the borrower must abide by the terms of the agreement. It is well accepted that penalties for breaching the agreement are appropriate. In fact, in the CARD Act, Congress determined that it is appropriate to charge fees to those who breach their contracts. These fees, however, must be reasonable and proportional, as determined through consideration of costs, deterrence, conduct, and other factors at the Board's discretion.

One of the key terms of a credit card agreement is that the customer makes promises to make timely payments of the amount due. For customers, a regular payment schedule allows them to appropriately budget and manage their money. A regular payment schedule also allows the customer to appropriately amortize their loan over time. From the lender's perspective, the timely payment is a key indicator of ongoing creditworthiness, and a late payment can be an early indicator of a borrower that may need assistance. From a regulator's perspective, one of the most watched statistics of a bank's performance during the financial crisis over the past two years has been delinquency rates within the consumer credit portfolio. For the customer, for the bank and for the regulators, timely payment is a foundational aspect of responsible consumer credit.

With recent changes to our practices outlined above, it is easier than ever for a Bank of America customer to pay on time. For instance, customers now have the same due dates every month, and have at least 25 days after the close of their statements to make on-time payments. A Bank of America customer can pay their credit card bill online, or at any of our more than 18,000 ATMs, as late as 11:59 PM (prevailing Eastern Time) *on the payment due date itself* and still be on time. Other payment options include over the phone, through any one of our 5,900 branches, or traditional mail. Bank of America has already seen a 20%-25% decrease in late payment volumes since we implemented these changes to our practices (in many cases, ahead of the required timetable). Given these industry improvements, there are few reasons for a borrower to pay late.

We spend this time discussing the importance of timely payment because we believe that the fee for paying late is the appropriate fee around which to consider the CARD Act mandate that fees be "reasonable and proportional." Throughout this letter, we will rely and focus on the late payment as the activity that should be deterred and which costs should be considered.

An appropriate safe harbor for penalty fees will provide clarity, certainty and predictability

Bank of America supports the creation of an appropriate safe harbor amount for penalty fees. Specifically, we propose that the safe harbor for all penalty fees be set as a single price point between $28 and $34. An appropriate safe harbor would lead to clarity, consistency, and predictability across the industry; encourage good payment behaviors; and appropriately compensate for cost and added risk. A safe harbor that is less than that amount would fail to encourage appropriate customer behavior, and would force issuers to recover costs associated with late payments by other means and from other customers, for example, through non-penalty fees charged to customers who meet their payment obligations.

We believe a safe harbor for a fee in this range can be justified on the basis of cost alone. Bank of America participated in the Argus data study along with nine other large issuers of credit cards. A separate comment letter has been submitted by Morrison and Foerster presenting the Argus data; however we would like to draw attention to some of the specific points of information.

The average cost for an issuer of a late fee was $28.40. This number was conservatively derived; another calculation led to a $32 average cost. It is our understanding that these cost analyses did not consider any portion of credit losses associated with customers who pay late.

In addition, we believe a $28-$34 safe harbor amount is high enough to encourage good payment behavior, without overtaxing consumers. Customers who do not pay on time increase the costs of loans for everyone. The safe harbor should be set at a level that encourages borrowers to pay on time.

Argus also gathered some very interesting information related to deterrence. Through a regression analysis, Argus determined that deterrent effect of a late fee drops off significantly at levels below $28. In addition, through a separate survey and a resultant Van Westendorp style survey analysis, fees of at least $30 to $34 would be required for a majority of respondents to state that deterrence from late payment behavior will be achieved.

We refer the Board to the Argus survey for a more detailed explanation behind these numbers– what is important is that they inform and support a safe harbor determination in the range between $28 and $34.

Bank of America recognizes that consumers may perceive fees at the high end of this range as disproportionate to the underlying infraction. No matter the cost or increase in risk to the Bank, customers get very frustrated by fees that don't have a direct relationship to the value they place on the service involved. For that reason, we recognize that, despite sound statistical support for cost and deterrence price points at the high end of the range (or above), we would support a safe harbor at any price point within this range.

Finally, a fixed safe harbor amount (as opposed to fees based on a percentage of the outstanding balance, for example) is simple for customers to understand. Experience in the United Kingdom shows that the safe harbor amount quickly becomes the industry standard, thereby increasing borrower transparency. Having penalty fees vary from one month to the next increases the likelihood of confusion with little incremental benefit for consumers.

On balance, we recommend a $29 safe harbor amount for penalty fees. While this amount would represent a significant reduction in the amount of current penalty fees for our bank and the industry overall, we believe this amount aligns with industry data around deterrence and costs.

The Board should clarify that lenders may consider all costs related to a late payment, including at least a portion of credit losses, in establishing reasonable and proportional fees.

If the Board chooses to set a safe harbor significantly below the range described above, we believe most major issuers in the industry will likely conduct their own cost-based analysis and establish fees in accordance with each institution's own analysis. To ensure a level playing field for all issuers and equal treatment for all customers, the Board's proposed regulation should set out with specificity all of the permissible elements of a cost-justified fee, and this calculation should include at least some portion of credit losses.

Some portion of credit losses should be included in the cost calculation.

The proposed regulation would not allow issuers to include any portion of credit losses in the cost calculation. The Board is rightfully concerned that allowing all loan losses to be considered in the determination of costs would overstate true costs. The Board notes that 93% of customers who are late do not default within the next 12 months. Conversely, 7% of customers who go late do in fact default. The Board appears to think it unfair that 93% of late customers will have to shoulder the burden caused by only 7% of this population. Moreover, if all credit losses were fully included in the cost analysis, late fees well in excess of current levels would be cost justified.

While it is true that not all late payers default, their payment behavior suggests higher levels of risk, for which the industry can no longer protect itself through re-pricing. We propose that some percentage of credit losses, for example that proportion that relates to payers that default, should be included in the cost structure. The compromise would allow recognition of the increased risk of default that correlates with late payment without transferring the whole burden of default to this population.[1]

The Board should set out, with specificity, all the permissible elements of a cost-justified fee.

The Board also should provide additional guidance regarding other allowable components of cost. The Bank is concerned that without additional guidance (a) fees will not be established consistently across the industry; and (b) the issue may ultimately be determined by courts.

In addition to the credit costs discussed above, the Board should clarify that expenses associated with the following activities should be included:

- Collection expense (call centers, letters, debt sales costs);
    - Direct administrative expenses, direct call center expenses, outsourced call center expenses for collections and recoveries; debt sale expenses including broker and other third party costs; collection letter expenses including lasering and postage; commissions related to third party recovery activities;
- Systems expense, risk department expenses, attributable corporate costs to these areas;
    - Information technology expenses including telecommunications, desktop, network and information security; modeling expenses and file maintenance expenses
- Funding costs of charged off balances; and
- Workout program concessions
    - Forgone interest on accounts in workout programs; and
- Allocated or indirect overhead / corporate expenses and support functions including legal, finance, audit and compliance related to credit card collections and loss

In calculating costs, the amount of the fee must be set to reflect the collectible fees, not the gross potential fees. The Board has proposed that an issuer may calculate its costs on a per violation basis by dividing the total costs incurred associated with a particular violation by the total number of violations. The Bank proposes that the appropriate divisor is the number of violations that are likely to result in collectible fees. Specifically, the Bank requests that Comment 1.A. to §226.52(b)(1)(i) be clarified to note that the divisor is the number of violations of a particular type during a particular period–net of expected waivers and chargeoffs (*i.e.*, uncollected fees). This is an important modification that reflects

[1]The Board may have been influenced by the United Kingdom's late fee analysis, which excluded credit losses as an allowable cost. We note, however, that UK issuers retained the ability to modify the APR on risky accounts, a fact that was considered by the Office of Fair Trading when it considered industry impacts. See, Paragraphs 3.17 and 3.18 in the April 2006 Calculating fair default charges in credit card contracts, A statement of the OFT's position by the Office of Fair Trading (UK) http://www.newham.gov.uk/NR/rdonlyres/62C39A6D-86A1-41F5-B1C9-7010A1980A08/0/OFTCalculatingFairDefaultChargesInCreditCardContracts.pdf.
Card issuers in the United States no longer have the same level of flexibility to modify the APR on risky accounts.

the simple reality that a waived late fee is not a late fee (and close to half the time is a required adjustment, such as in response to a backdated payment), and a charged-off late fee is not a fee that is covering incremental risk or any costs whatsoever.

<u>The Board should clarify that deterrence of risky behavior may require a fee amount over and above the costs associated with the risky behavior.</u>

As noted above, in determining the reasonableness of fees, the CARD Act specifies that the Board shall consider the cost incurred *and* the deterrence of such omission or violation by the cardholder. Instead, the Board has proposed a structure that measures *either* costs *or* deterrence. Congress recognized deterrence should be viewed as independent of cost, and one test should not preclude the other. We suggest that the final rule should comport with the statute: Specifically, issuers should be allowed to take the cost model and add to that additional amounts not captured by that model that are appropriate for deterrence.

While time did not allow for a more precise analysis, we know that penalty fees deter undesirable behavior. For instance, our Canadian operations, which have no late fees, show approximately 50% higher first stage delinquency than the U.S., even though all other subsequent delinquency stages are lower than the U.S. We believe this is because the absence of an appropriate late fee causes more customers to disregard the payment due date.

Our understanding of customer behavior continues to evolve. The Federal Reserve rule should be sufficiently flexible, to allow consideration of more refined statistical analyses of the deterrent effects of fees on customer behavior that are certain to be developed in the future. Such an approach appears consistent with Congressional intent.

<u>Other issues related to fees</u>

This next section covers very specific concerns and recommendations we have regarding the proposed regulation and its implementation.

Any safe harbor should be a set dollar amount for a violation– amounts that vary based on undisclosed (or disclosed) calculation create confusion and destroy clarity and simplicity

The Board has created a complex structure around the safe harbor. The Board will first establish a safe harbor that equates to either a set amount or 5% of the underlying transaction. This structure alone allows for the possibility that the amount of the fee will vary by transaction. Layered on top of this structure, however, is the prohibition against (a) any fee exceeding the amount of the underlying transaction that violated the agreement; and (b) any duplicate fees derived from the same transaction. The strict prohibitions mean that the same violation may receive different treatment in different months.

Since one of the purposes of the safe harbor is to provide certainty and clarity to the industry without imposing undue cost, the safe harbor should also be simple enough that significant technology changes or a complicated compliance infrastructure is not needed to comply. Having the multi-pronged, multi-layered approach that the Board has proposed does not achieve this purpose of the safe harbor proposal. We also believe this situation is rife for consumer confusion at a time where the focus has been to make credit card terms less complex and easier for customers to understand.

Therefore, the Bank suggests that if the Board establishes a safe harbor, the Board establish an appropriate, single dollar figure that applies in all situations, irrespective of the amount of the underlying transaction amount or duplication of fees.

If the Board feels that proportionality requires it to establish a cap of the amount of the underlying transaction, then the Bank requests that the Board clarify the commentary it has provided on this topic. Specifically, in its discussion that a Late Fee cannot exceed the associated Minimum Payment, the Board should clarify that this is the required payment amount, as shown on the statement to which the payment relates, rather than using the ambiguous "amount of the required payment that was not received." If a customer is late, a partial payment does not change that fact. A customer who receives a reduced late fee because of the partial payment will be shocked when the full late fee is assessed in the future if there are no payments whatsoever.

Similarly, the safe harbor should not be based on alternative measures, such as a percentage of the minimum payment, or a calculation based on number of days late, or the presence or lack thereof of prior violations. A single set amount, a known consequence for a readily identifiable and understood failure to meet one's obligations is the best approach. [e.g. See the Argus survey information where 58% of customers think that a single, set fee is the most fair fee structure.]

Returned Cash Advance Checks are different than POS declines and hence, should not be subject to the rule against fees for declined transactions.

The Board has proposed a broad pronouncement that issuers may not impose fees for declined transactions. The Bank cautions the Board against such a broad pronouncement because it appears to capture transactions that clearly have costs associated with them that issuers should be able to recoup. Specifically, consumers find checks that access their credit card line of credit to be effective and useful tools for specific purposes (e.g., balance transfers; third-party payments when the third-party does not accept credit cards). Issuers that provide convenience checks to their customers have to build an infrastructure to process checks that is not dissimilar to check-processing for a deposit account. Checks drawn on a credit card are negotiable instruments and carry the same UCC warranties of any other drafts. Unlike declines of a point-of-sale credit card transaction, which have relatively nominal costs associated with a given decline, there are real costs associated with processing convenience checks. If a customer has a $1,000 credit line, and writes a $1,500 cash advance check, the issuing bank will decline that check and return it. Comment 1.i.D. to §226.52(b) could be read to prevent the bank from charging a returned check fee for this transaction, because it is a transaction that the card issuer has declined to authorize. Comment D should be clarified that it applies only to transactions made with the credit card that the bank declines to authorize, and the return of checks accessing the account can incur a fee.

Rewarding customers for loyalty and activity by waiving fees, particularly annual fees, should be allowed or encouraged.

The Board has proposed that inactivity fees of any type are inappropriate. The Board specifically ties this rule to annual fees. The Board, however, does not provide compelling logic as to why inactivity fees are inherently unreasonable or disproportionate. Comment 1.ii.D. to §226.52(b) creates unnecessary and counterproductive uncertainty around popular and logical annual fee programs. This comment should be modified to say that annual fees are not subject to §226.52(b), striking any condition related to inactivity.

Banks, as with most businesses, desire to reward valued and engaged customers. As a matter of competition in a capitalist structure, winning and retaining customers by recognizing loyalty is a foundational strategy. Credit card issuers have adopted this approach with different methods, including rewards programs and treatment of annual fees. Issuers that impose annual fees often will waive the annual fees as a courtesy to valued customers. An annual fee that is rebated or waived based on a certain level of transactions, or based on maintaining certain balances, is a concept that customers understand, embrace, and frankly, expect. But given that the absence of a certain transaction level, or maintained balance, could be construed as an annual fee based on account inactivity, this traditional positioning of the fee product is imperiled by this language, for no discernable gain for consumers. An unused credit card is still an accessible line of credit with associated benefits to consumers and costs to issuers. Customers get the advantage of knowing they have access to a cash flow if they face unexpected expenses. Issuers need to incur the costs of maintaining the account, including maintaining reserves against the line, issuing statements, and replacing the card if it is lost or stolen. Importantly, under the requirements of Reg. Z, consumers receive an annual notice of an annual fee, and can reject the annual fee and cancel the card any year in which they do not perceive the value of the card to be worth the cost of the annual fee. A consumer who does not use their card can and should cancel their card rather than pay an unwanted annual fee. To say this another way, a conditional annual fee is fully avoidable by the consumer.

So long as the annual fee is assessed, then regardless of whether it is waived based on activity or some other measure of customer loyalty, that adjustment should not change its regulatory stature.

Reevaluation of fees should take place every five years

The proposed §226.52(b)(1)(iii) requires an annual reevaluation of determinations of fee amounts. Under this proposed rule, banks who utilized the cost approach to fees would need to re-validate that the cost basis continues to support the fee structure every year. If Banks were in a position to adjust upward as well as downward, this provision would perhaps make some sense. But because any increase in fees is subject to a "significant change" right to reject, this re-evaluation becomes a one-way street. The costs analysis undertaken to comply with the requirements is a significant burden, and should only be undertaken once every five years. That way changing trends can be fully identified and incorporated into the analysis.

The proposed rule related to re-evaluation of rate increases should exclude promotional rates and should not require perpetual re-evaluation of non-promotional balances.

The Board has proposed rules to implement the CARD Act's mandate that issuers must review every six months any rate increase imposed on a consumer after January 1, 2009. The Bank posits that the Board's proposal inadvertently applies to changes related to promotional rates. In addition, in response to the Board's specific request for comment, the Bank proposes that the review only be required for two years after the re-pricing event if the customer has not qualified for a rate reduction.

Review should not include promotional rates

Under the proposed rule, credit card issuers will need to review all rate increases imposed on customers after January 1, 2009. Specifically, commencing in 2011, lenders will need to review accounts every six months. As proposed, the rule appears overly broad because it appears to require review of promotional rates that cannot be returned to their promotional status because of other limitations in the CARD Act. It is possible that a promotional rate, turned off because of a late event after January 1, 2009, had a duration that extends into 2011 and the required review period. For example, a bank may have introduced a 48 month promotional offer in November, 2008. In May of 2009, the customer may have been late, and in accordance with the terms of that offer, the promotional rate ended and the standard rate applied. The promotion would otherwise have continued on until November 2012. We think the resumption of the standard rate is not a rate increase subject to this review, but we think the proposed language is ambiguous on this point and should be clarified.

The review should be limited in time

The Board has specifically requested comment on whether the obligation to review accounts should be perpetual or limited after a period of time. Accounts should not be subject to a perpetual review; it distorts data and wastes resources. In our view, after two years of review (inclusive of the 6 month mandatory cure when applicable) without any change, an account need not be considered further. After two years of not qualifying for even incremental price improvement, market forces will be adequate protection to a consumer who subsequently becomes more credit worthy. This will mean that every account will have had four reviews, and if there is no improvement in the terms of that account, then it should no longer be considered. We want our review energies to be focused on accounts on which we think there is a possibility of an action being taken, and including accounts perpetually does not foster that. In addition, because these accounts will artificially inflate the denominator, over time statistics tracking the number of adjustments made will become increasingly skewed for no purpose other than deceptively painting our review efforts as inadequate. We also believe we should not be required to review any $0 balance accounts, even if there is subsequent use. These accounts have paid off, and subsequent use under the known and disclosed terms should not trigger ongoing review for rate reduction.

Current factors are critically important

The board has appropriately permitted banks to include current factors in assessing risk and market-based re-pricings of the past. The lessons of the current downturn reinforce the notion that past criteria may not always be the most relevant in assessing risk. Moreover, the lender's current standards are the only practical way in which to evaluate an acquired portfolio.

Acquired portfolio reviews should take place shortly after conversion, not acquisition.

Again, purely as a practical matter, some acquisitions are not immediately brought onto the buyer's platform. The seller may be unable or unwilling to execute a strategy based on the buyer's credit criteria (and indeed, the buyer may not wish to share such strategic and proprietary information with the seller) while these accounts reside on the seller's platform for what is commonly termed "interim servicing." Therefore, the time in which the acquirer must conduct a re-evaluation should be measured from the date of conversion to the buyer's platform.

Conclusion

As noted at the outset, we support the Board's rulemaking, which is largely consistent with steps Bank of America has been taking to regain customer trust. We believe the suggestions details above help facilitate these goals. Specifically,

- If the Board determines that it seeks to establish a safe harbor, then we believe the appropriate safe harbor for penalty fees is a price point between $28 and $34. This represents a significant reduction in current fees, and aligns with industry data around deterrence and cost.
- The Board should also clearly establish what costs can be considered under the cost-justification approach.
- Waiver of annual fees as an expression of appreciation to loyal customers should not be discouraged.
- The six month review should be able to use current criteria, and not apply to any promotional rates. Banks should not be required to continue this review past the two year mark if the customer has not qualified for a rate reduction.

Again we recognize the complexity of the Board's undertaking. Such are the challenges when regulations touch pricing decisions. We appreciate the opportunity to share our thoughts with the Board.

Sincerely,

Henry Moncure, III
Associate General Counsel