Credit One
BANK

April 16, 2010

By Electronic Delivery

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

Re: Docket No. R-1384 - Proposed Rule Implementing Provisions of the CARD Act of 2009 effective August 22, 2010

Dear Ms. Johnson:

This comment letter is submitted in response to the proposed rulemaking and request for public comment issued by the Board of Governors of the Federal Reserve System ("Board") and published in the Federal Register on March 15, 2010 ("Proposed Rule"). Accordingly, please find enclosed our response to the requested comments below.

I. PENALTY FEES:

REQUESTED COMMENT 1: *The Board solicits comment on the safe harbor approach in proposed Section 226.52(b)(3), which would permit a penalty fee of the greater of (i) a specific dollar amount or (ii) 5% of the dollar amount associated with the violation (up to a maximum amount).*

> **RESPONSE:** The Bank believes that 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. Credit Unions are not required to pay taxes in comparison to national banks. Moreover, in recent years, some credit unions have been exiting the credit card market because of costs. There are other 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.
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> The Bank also strongly recommends that the Board use a formula that reflects no less than a portion of losses in the permissible late payment fee for determining the safe harbor amounts. However, the safe harbor amount should actually be determined by considering full costs associated with the violation, including losses. Further, in order to operate safely and soundly, the intent should be to cover the actual expenses incurred either due to operating expenses or loss expenses. The Bank suggests that in calculating the true cost, the expense should be spread among expected payers, otherwise it will not actually cover the cost. For example, if the Bank added up all of its collection costs and divide by the customers that were assessed but only 90% of them actually paid the cost, then the Bank would not able to actually recover the cost of collecting on the late accounts. Thus, if the cost is not spread among payers, then the Bank will not be able to

recover actual expenses incurred, thereby putting the Bank in a position to lose income (reduce capital) through the process.

REQUESTED COMMENT 2: *The Board specifically asks for comment on (and any data supporting) the appropriate dollar amount, percentage and maximum amount.*

RESPONSE: There is a detrimental risk in setting the safe harbor rate too low because it may actually encourage the unwanted behavior that the fee is intended to discourage. Therefore, the Bank suggests that the final rule should permit a penalty fee of no less than: the greater of (i) $**30.00** or (ii) **5%** of the dollar amount associated with the violation (up to a maximum amount). Any lower amounts would not be a sufficient deterrent to the enumerated violations. We believe that the amounts above are reasonable and proportional to the omission or violation to which the fee or charge relates. That being said, the Bank is opposed to any language that would be "the lesser of" (i) $**30.00** or (ii) **5%** of the dollar amount associated with the violation (up to a maximum amount) because the percentage amount would not be equitable to the loses incurred as a result of the violation.

REQUESTED COMMENT 3: *The Board also seeks data regarding (i) costs incurred as a result of each type of violation of the terms of a credit card agreement (itemized by the type of cost) and (ii) dollar amounts reasonably necessary to deter violations and methods used to determine those amounts, if known.*

RESPONSE: The Bank is unable to supply the requested data based on the limited amount of time that was allowed to provide comments.

REQUESTED COMMENT 4: *Whether issuers should be permitted to base penalty fees on consumer conduct by (i) tiering fee amounts based on the number of violations (e.g., charging a higher fee for the second late payment in a 12-month period) or (ii) imposing incremental fees (e.g., a fee of $5 for each day a payment is late).*

RESPONSE: The Credit Card Act requires the Board to consider the conduct of the cardholder. Thus, the Bank suggests that the final rule should permit the charging of a penalty fee based on the individual consumer conduct associated with the violation. In order to accomplish this, the Rule should be drafted to allow for: (1) tiering fee amounts according to the number of repeat violations in a 12-month period. For example, it should be permissible to charge a higher fee than normally permitted for the type of violation, if there is more than one violation in a 12-month period; (2) In the alternative, we suggest that the Rule could also be drafted to allow for charging incremental fees based on the type of violation. For example, a fee of $___ for determined period or frequency the violation occurs but increasing as the length of the violation increases. In any case, we believe that options should account for the issue of repeat or continuing violations.

REQUESTED COMMENT 5: *Whether issuers should be permitted to include losses and associated costs in the determination under proposed Section 226.52(b)(1)(i) (i.e., fees based on the issuer's determination of costs and not the safe harbor).*

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RESPONSE: The Bank should be permitted to include losses and associated costs in the determination under proposed Section 226.52(b)(1)(i). Basically, the proposed rule shifts 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.

As the Board is aware, all borrowers to some degree pay for the losses caused when other borrowers do not repay their loans. In the past, risk-based pricing and penalty fees have allowed lenders to shift some of the cost of those losses to riskier borrowers. Unfortunately, the Credit CARD Act has 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. Thus, the effect has been to shift more of the cost of losses to those who manage their credit well. This is unfair. Further, 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 a portion of losses. This cost coverage shift, added to the expected continued high credit card losses due to high unemployment, means that interest rates may continue to rise and remain higher for everyone.

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. At a minimum, the Board should 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.

As previously mentioned, the Bank also strongly recommends that the Board use a formula that reflects no less than a portion of losses in the permissible late payment fee. However, the amount should actually be determined by considering full costs associated with the violation, including losses. Further, in order to operate safely and soundly, the intent should be to cover the actual expenses incurred either due to operating expenses or loss expenses. The Bank suggests that in calculating the true cost, the expense should be spread among expected payers, otherwise it will not actually cover the cost. For example, if the Bank added up all of its collection costs and divide by the customers that were assessed but only 90% of them actually paid the cost, then the Bank would not able to actually recover the cost of collecting on the late accounts. Thus, if the cost is not spread among payers, then the Bank will not be able to recover actual expenses incurred, thereby putting the Bank in a position to lose income (reduce capital) through the process.

REQUESTED COMMENT 6: *Whether issuers should be permitted to test the effect of fee amounts exceeding amounts otherwise permitted by proposed Section 226.52(b)(1)(ii) (i.e., fees based on the issuer's determination of deterrence and not the safe harbor).*

RESPONSE: The Credit Card Act requires the Board to consider the deterrence of violations by the cardholder. However, it is not clear how the Bank 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 violate the rule by 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.

Therefore, the Bank suggests that the final rule should allow the ability to test the effect of fee amounts exceeding amounts otherwise permitted by proposed Section 226.52(b)(1)(ii). Without testing the effect of different fee amounts, it is not feasible to determine the specific amount necessary to deter customers from that type of violation. Further, the Board requires issuers who base their penalty fees on deterrence, to use an empirically derived, demonstrably and statistically sound model that reasonably estimates the effect of the amount of the fee on the frequency of violations. Testing is essential to accomplishing this requirement and would further provide a more accurate model that would reasonably estimate, independent of other variables, that the imposition of a lower fee amount would result in a substantial increase in the frequency of that type of violation. Finally, without testing, compliance with proposed rule 226.52(b)(1)(iii), which requires reevaluation of fees based on deterrence every twelve months, is virtually impossible.

Therefore, 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.

REQUESTED COMMENT 7: *What costs do issuers incur as a result of late payments, returned payments and over-the-limit transactions?*

RESPONSE: Late fee costs have already been discussed above. In regards to returned payments, there are costs and risk associated with handling any returned payment. The Bank must investigate (including fraud investigations of unauthorized payments to an account that are returned), notify the customer, and capture the fact of the returned item for future analysis, some of which involves human intervention and review. Further, the Bank's data indicates that customers who have returned payments also have higher credit losses.

REQUESTED COMMENT 8: *Is 12 months an appropriate interval for the reevaluation of penalty fee amounts under proposed Section 226.52(b)(1)(iii)?*

RESPONSE: The proposed requirement that the Bank must reevaluate a determination made upon either (1) fees based on costs or (2) fees based on deterrence, at least once every twelve months, is unnecessary, burdensome and costly. The Bank suggests that the final rule should only require a period of review no earlier than every **24 months**.

REQUESTED COMMENT 9: *What compliance burdens would result from the prohibition on fees that exceed the dollar amount associated with the violation under proposed Section 226.52(b)(2)(i)(A)?*

RESPONSE: Under Section 226.52(b)(2)(i) the Bank 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 Bank. However, 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.

Thus, the Bank 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. The Bank's experience is that predictability and clarity of the consequences discourages violations and helps avoid imposition of the fee. Accordingly, the Bank recommends 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. Depending on how it is interpreted, the proposed rule may require the Bank to take into account partial payments. This means that the amount of the late payment fee will vary. For example, if the minimum payment is $25 and the borrower pays $10, the maximum fee is $15. However, if the borrower pays nothing, the fee increases to $25, which could be a startling and inexplicable difference from the consumer's perspective. Therefore, the Bank recommends 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.

This is inherently inequitable and results in unrecovered costs that will inevitably be passed on to all customers as the cost of doing business. Thus, good paying customers will be forced to pay for the system and costs by subsidizing those who do not contribute but still derive a benefit. This simply is not "reasonable" and it may be unconstitutional for the regulation to *require* that one group of card customers subsidize another.

REQUESTED COMMENT 10: *Is additional guidance needed regarding the dollar amounts associated with violations other than late payments, returned payments and extensions of credit in excess of the credit limit?*

RESPONSE: No.

REQUESTED COMMENT 11: *Is a prohibition on penalty fees appropriate where there is no dollar amount associated with the violation (see proposed Section 226.52(b)(2)(i)(B)), and specifically when an issuer imposes a fee based on (i) declined transactions, (ii) account inactivity or (iii) account closure or termination?*

RESPONSE: The prohibition on penalty fees where there is no dollar amount associated with the violation makes assumptions that are not accurate. Therefore, the prohibition on penalty fees under this proposed rule is not appropriate because there *is* a dollar amount associated with the delineated violations.

First, there is a cost for "transactions that the card issuer declines to authorize," because every time a card is swiped to determine approval or decline, there is a cost to the Bank for that transaction.

Second, We strongly oppose the proposed rule interpretation regarding inactivity fees. The inactivity fee is intended to allow the Bank to recover the costs of making the credit line available. Thus, there is a cost for "account inactivity." 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 and Annual Fee Notices, for example, must be provided annually, whether or not the account is used.

It is important to note that customers, who pay inactivity fees, even if they do not use the card or use it occasionally, still receive a benefit from having an open account. One of the benefits is that they have the peace of mind that credit is available when they need it, which is especially valuable in an emergency. A further benefit is that it helps them to build a credit score. Not allowing the Bank to recover costs created by non-users means that the Bank has 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. It simply is not "reasonable" for the regulation to *require* that one group of card customers subsidize another. Therefore, the Bank suggests that that 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.

In any case, even if the Board determines that an inactivity fee is a "penalty fee," which the Bank strenuously argues it is not, that fee should not be $0, there should be a permissible fee. 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.

Third, there is a cost for "closure or termination of an account," when that account has a remaining balance. As previously mentioned, the Bank is required by law to provide notices on these accounts such as the monthly periodic statement, annual fee notice and the annual privacy notice. Further, the Bank also provides customer service to accounts which have account balance (whether closed or not) via live agent, IVR and through our website.

REQUESTED COMMENT 12: *What methods do issuers use to manage risk with respect to charge card accounts?*

RESPONSE: Not applicable to the Bank, who only offers credit card products.

REQUESTED COMMENT 13: *Are any adjustments to proposed Section 226.52(b) necessary to permit charge card issuers to manage risk?*

RESPONSE: Not applicable to the Bank, who only offers credit card products.

II. RATE "LOOK BACK" AND DECREASE:

REQUESTED COMMENT 1: *The Board solicits comment on the operational issues associated with reducing rates, appropriate transition guidance for reviewing increases imposed prior to August 22, 2010.*

RESPONSE: It is unreasonable for the Board to require the Bank to review changes that took place prior to the Card Act implementation. Simply, Change-In-Terms is not an easy task to implement and can take many months to organize and execute. Many of the changes that were done after January 2009 and before February 2010 were already in the works before the Card Act was passed. Therefore, the Bank suggests that only changes that occurred after February 22, 2010 should be included in the "look back" requirement. Further, issuers should be given 6 months to complete the review, after August 22, 2010.

REQUESTED COMMENT 2: *Whether a timing standard other than that proposed in Section 226.59(a)(2) for how promptly rate changes must be implemented (i.e., 30 days after completion of the evaluation) should apply.*

RESPONSE: The 30 day timeframe under the proposed rule is insufficient. Basically, the communication, decision and approval process for the new rates may take 30 days by itself. Then time is needed to code the changes into the systems, test the changes and coordinate with our internal implementation calendar may take an additional 60 days. Accordingly, no less than **90 days** is required to implement changes, if they apply.

REQUESTED COMMENT 3: *Whether additional guidance is needed regarding what policies and procedures are "reasonable" under proposed Section 226.59(b).*

RESPONSE: Additional guidance is not needed regarding what written policies and procedures are reasonable. The Bank suggests that the Board should refrain from mandating prescriptive rules regarding what constitutes "reasonable" policies and procedures.

REQUESTED COMMENT 4: *Whether an express safe harbor is needed for a "brief transition period" following a change in factors considered in evaluating accounts under Section 226.59(a) and (d).*

RESPONSE: Yes, the Board should establish an express safe harbor for a "brief transition period" following a change in factors considered in evaluating accounts under the proposed section 226.59(a) and (d). A transition period of no less than **90 days** would allow the Bank time to evaluate and determine if changes in factors are relevant across its entire customer base.

REQUESTED COMMENT 5: *Whether the "look back" obligation should terminate after some specific time period (e.g., after five years).*

RESPONSE: The Bank should not be compelled indefinitely to review a rate increase every six months. The concept of indefinitely reviewing is unwieldy, expensive, and challenging from a compliance perspective. Accordingly, the resulting effect may be higher rates and fees across the board for all bank customers generally and more closed accounts.

The proposed rule requires the Bank to review the APRs applicable to covered accounts indefinitely unless the rate is reduced to the rate in effect prior to the increase. Practically speaking, 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. Simply, 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. Additionally, with no time constraint, the Bank would be required to maintain data and history indefinitely in order to have the information to continue reviewing.

It is important to note that the Board indicates 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." The Board 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." The Bank strongly agrees.

Therefore, the Bank recommends that the Board limit the requirement to "look back" to no more than **2 years**. After two years, customers will have had the opportunity to rehabilitate their credit history, and the Bank 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.

REQUESTED COMMENT 6: *Whether consumers would significantly benefit from requiring card issuers to continue reviewing factors under proposed Section 226.59 even after an extended period of time.*

RESPONSE: As mentioned above, the concept of indefinitely reviewing is unwieldy, expensive, and challenging from a compliance perspective. Accordingly, the resulting effect may be higher rates and fees across the board for all customers generally and more closed accounts. Thus, customers would not benefit from an extended review period. In fact one could argue that customers might even be harmed the longer the review period continues since each review adds processing costs to the Bank which will in turn be passed along to the customer.

REQUESTED COMMENT 7: *Whether proposed Section 226.59(g) appropriately addresses acquired accounts and if any alternatives would better balance the burden on card issuers against consumer benefit.*

RESPONSE: No comment.

REQUESTED COMMENT 8: *Whether additional guidance is needed regarding the requirement to review acquired accounts "as soon as reasonably practicable" after the acquisition.*

RESPONSE: No comment.

Please do not hesitate to contact me if you have further questions.

Sincerely,

Allan J. Shutt
Chief Compliance Office

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