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

Docket No. R-1136
Proposed Amendments to
Commentary to Regulation Z
Truth in Lending Act

Dear Ms. Johnson,

The American Bankers Association ("ABA") is pleased to submit our comments on the Federal Reserve Board's ("Board") proposal to amend the Official Staff Commentary to Regulation Z (the Truth in Lending Act), published in the *Federal Register* 6 December 2002. The proposal rule addresses treatment of certain optional charges imposed under open-end credit plans, specifically, fees for expedited payment and fees for expedited delivery of credit cards. In addition, it proposes to explain rules for replacing accepted cards with one or more cards in response to new technology that allows card issuers to offer convenient supplementary cards. The notice also seeks information on "bounce protection" programs and their coverage under Regulation Z.

The ABA brings together all elements of the banking community to represent the interests of this rapidly changing industry. Its membership – which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies, and savings banks – makes ABA the largest banking trade association in the country.

Section 226.6 Initial Disclosure Statement
6(b) Other charges.

The staff have proposed additional guidance on the status under Regulation Z of two fees charged to consumers in connection with open-end credit plans: fees imposed for expedited payment and fees imposed for expedited mailing of a credit card. The proposal excludes fees for expedited payment from the definition of finance charge, but adds them to the list of fees considered "other charges" which must be disclosed in the initial disclosure. However, the proposal excludes from the change-in-term notice requirements changes to expedited payment fees.

ABA greatly appreciates the Board's and Board staff's efforts over the last several years to meet with the ABA and review our recommendations to clarify treatment of these two fees under Regulation Z. Card issuers have been frustrated with guessing how to treat and disclose fees for new optional services and products. The lack of guidance or predictability leaves them vulnerable to liability after the fact for good faith interpretations and further hinders addition of new services.

Generally, we believe that the overall result is manageable, but suggest that the final Commentary take a broader approach and provide clearer guidance on the definitions of finance charge and "other charges" for open-end credit as well as closed-end credit so that creditors are better able to analyze how a particular fee will be treated under Regulation Z. We agree that expedited payment fees are not finance charges, but submit that they are also not other charges, whether for open or closed end credit. We also agree that fees for expedited delivery of cards are neither finance charges nor other charges. If staff declines a broader inquiry at this time, staff should make clear that neither fees are finance charges nor “other charges.“

The Supplementary Information acknowledges that the existing regulation and Commentary have been unclear about the status of these fees. We request that staff further explain in the final Commentary that creditors could reasonably and in good faith have concluded that such fees could have been classified differently than the final Commentary provides. This may help avoid liability for good faith, reasonable interpretations of an unclear regulation.

As we have previously submitted, we believe that the critical test for finance charge classification is whether a fee is required by the creditor in connection with the extension of credit. Fees for optional services should not be considered finance charges. For the same reasons, fees for optional services should not be considered other charges. The primary distinction between the finance charge and “other charges” for open-end credit is whether it is appropriate to include the fee in the annual percentage rate ("APR") so that the disclosed APR is useful and meaningful to understand the cost of credit and compare credit terms.

Under Section 226.(4)(a) of the regulation, finance charge includes "any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or condition of the extension of credit." The common meaning and use of the term "imposed" means required. Simply put, a fee for an optional service is not a fee required or imposed in order to gain access to credit. Otherwise a host of various fees for optional services and products would fall under the definition. For example, fees for a duplicate statement or copy of a convenience check would arguably become finance charges.

In addition, treating such fees as finance charges to be calculated into the APR would grossly distort the APR, misleading consumers shopping for credit and misteaching them about the terms of credit. To illustrate, a consumer who has contracted for a 12% APR and one month opts to pay a fee for expedited payment would likely be shocked to see on the periodic statement an APR in the triple digits. Based on this disclosure, the consumer may be very tempted to accept an offer of credit boasting a 21% APR, believing that to be a better deal. In fact, it most likely would not be a better deal.

To avoid calls from aggravated and confused customers as well as the compliance and operation burdens of including fees for optional service in the APR, credit card issuers would simply eliminate or never offer these services, to the detriment and inconvenience of customers. For example, elimination of the expedited payment option would expose customers to late payment fees and derogatory remarks on their credit report. Card issuers would also be reluctant to add other optional valuable services, notwithstanding consumer demand for the service or product and the willingness to pay for the service or product.

The Board would retain discretion to specifically include particular fees in the finance charge, but a clearer general principle will assist card issuers in compliance and avoidance of potential liability for good faith interpretations of the regulation.

ABA also recommends that staff clarify the definition of "other charges" by explaining that "other charges" only covers fees required for the extension of credit and excludes fees for optional services. A more definitive principle will assist creditors in analyzing and determining how fees for optional services should be treated under Regulation Z. The Commentary should specifically exclude fees for expedited payment from the definition of “other charges.”

According to the statute and regulation, "other charges" refers to any charge which "may be imposed as part of the plan." As explained earlier in the discussion of the definition of finance charge, we submit that "imposed" means required. Thus, in order to fall within the category of "other charge," the fee must be required as a condition of the plan.

The distinction between optional service fees and "other fees" currently delineated in the Commentary, such as payment fees and over the limit fees, is that the latter are intended to discourage certain behavior and the consumer does not make a conscious choice to accept the fee at the time it is charged. In contrast, consumers make a conscious choice and specifically request and initiate optional services such as expedited payment or expedited delivery of a credit card.

It can also be argued that certain fees are charged pursuant to an agreement separate from the credit card "plan" and therefore are not "other fees . . .imposed as part of the plan." For example, card holders can agree to a charge for expedited payment or expedited delivery of a card at the time they make the request. This agreement would be subject to usual contract law and would be considered separate from the plan.

If staff declines to address the broader issue of guiding principles for defining finance charge and "other charge" as suggested above, we encourage it to specifically add to the list of fees excluded from other charges both fees for expedited payment and expedited delivery of credit cards. We agree with the proposal that a fee for expedited delivery of a card is not an "other charge" because, as the Supplementary Information explains, "the card is also available to consumer by standard mail service without paying the fee."

Similarly, a fee for expedited payment is not an "other charge" as it is possible "by standard mail service without paying the fee." The Supplementary Information notes that the expedited payment allows the cardholder to avoid a late payment, but this does not change the fact that the consumer has the choice to send payment by standard mail without charge, albeit to avoid the late fee, payment must be sent in a timely fashion to arrive by the due date. It is tempting to conclude that the consumer has no choice when faced with paying by standard mail and incurring a fee and paying for expedited payment. However, the consumer had the choice upon receipt of the statement. That the consumer has delayed payment does not negate the fact the consumer had the opportunity to pay by standard mail in a timely fashion without charge and did not. Accordingly, fees for expedited payment should be excluded from other charges.

In addition, we suggest that the final Commentary delete the proposed condition for exclusion, "provided that method of payment was not established as the regular payment method for the account." Our concern is that the language is susceptible to interpretation. It is not clear when a method would be "established . . . as the regular payment method." Is it when the customer has made a series of payments in a particular fashion? Is it what was established in the written contract?

Accordingly, we suggest that the phrase read, "provided that the consumer may avoid the charges through another reasonable payment method." It should also be made clear that the "reasonable payment method" may not deliver the payment as quickly and may not avoid any late fee. The Commentary could provide as an example the U.S. Postal Service.

In the alternative, the Commentary could read, “[c]harges imposed for expediting a consumer’s payment provided that method of payment was not established in advance under the plan as the regular payment method.” This may help make clear how the method is established.

Finally, with regard to the proposal to specifically exclude from “other charges” fees for expedited delivery of cards, the final Commentary should omit any repetition or reference to the statement in the Supplementary Information to the proposal, "[W]here a creditor merely passes through a third party delivery charge. . . the fee is not a finance charge or other charge." It contradicts the proposal, raises additional questions, and creates ambiguities. Moreover, it is not always possible to ascribe a particular fee to an individual customer. Payment schedules for courier services can vary depending on a variety of factors, including volume. For example, one rate might apply for the first lot of deliveries and a lower rate for the second lot, and so on.

Section 226.12 Subsequent Disclosure Requirements

12(a) Issuance of Credit Cards

Section 132 of TILA, implemented by Section 226.12(a) of Regulation Z generally prohibits creditors from issuing credit cards except in response to requests or applications for cards. Section 132 explicitly exempts from this prohibition credit cards issued as renewals of or substitutes for previously accepted credit cards. Comment 12(a)(2) - 5, the "one-for-one rule," interprets these provisions by providing that in general, a creditor may not issue more than one credit card as a renewal of or substitute for an accepted card. An exception is provided for accepted credit/debit cards replaced by separate credit and debit cards.

The Supplementary Information notes that advances in technology now offer cards in different sizes and formats. However, merchant card readers may lack the capability to read all types of credit cards. For example, card issuers have recently issued cards smaller than the standard card which are suitable for key rings. Card issuers seek guidance on how they can issue such cards which are intended to supplement rather than replace an existing card.

To address this matter, comment 12(a)(2)-6 would be revised to provide that card issuers may replace an accepted card with more than one renewal or substitute card on the same account where the consumer's total liability for unauthorized use with respect to the account does not increase. In addition, any replacement cards must access only the account of the accepted card and all cards issued under the account must be governed by the same terms and conditions.

Comment is requested on whether it is appropriate to apply this view to additional cards issued for an existing account on the conditions specified in the proposal even when there is no renewal of or substitution for the cardholder's existing card. We strongly recommend that the final comment extend this common sense approach to additional cards.

We appreciate the Board staff's willingness to address this issue and its recognition of the evolution of the credit card, but believe that the Commentary should be more permissive than proposed and allow card issuers to provide additional cards to existing cardholders, whether the card is being renewed or not, without violating the prescription against sending unsolicited cards. Excepting additional cards from the prohibition will encourage development and adoption of new convenient services that pose no potential harm or negative element to consumers.

As the staff notes in the Supplementary Information, the prohibition against unsolicited cards was passed in response to the practice of mailing unsolicited credit cards to consumers. Critics of these practices were concerned that the cards would encourage some consumers to spend beyond their means, were inconvenient to dispose of, and were too easily stolen in the mail. In addition, though consumers were not responsible for unauthorized transactions, they would still suffer the inconvenience of refuting unwarranted claims of liability.

Sending an additional card to a customer who has already requested and received a prior card prompts none of these concerns. Providing an additional card presents no greater risk than sending the first -- which the customer has requested. Also, there is no greater risk sending an additional card than sending a renewal card. Consumers, as a practical matter, do not know when to expect a renewal card: they are often unconscious of the expiration date, especially if they hold several cards which most cardholders do, and the card often arrives well in advance of the renewal to ensure that the card arrives prior to the expiration date. Moreover, as staff notes, security practices and features have greatly improved to reduce the risk of an interceptor's use of a card, e.g., requiring cardholders to call in order to activate the card, a common practice, and sending subsequent notices alerting customers that the card was sent earlier and requesting that they contact the issuer if it wasn’t received.

Moreover, mailing an additional card is akin to allowing access to the account through alternate means, no different than using the account numbers for phone, mail, and internet transactions. Arguably, the latter are more significant with regard to the usability of the account than an additional card, yet the ability to use the account numbers to access the account does not require the specific consent of the customer.

Restricting additional cards will deprive consumers of creative and valuable conveniences which we do not believe Congress intended. For example, the value of the key ring card is obvious. Because of its intended attachment to a key ring and its size, it may be easier to carry without losing and easier to locate. Already key ring size cards have proven very popular with frequent buyer programs. Constraints in distributing the card will artificially delay acceptance of the card, risking its abandonment.

We can identify no negatives for the consumer as the Commentary makes clear that the terms and conditions remain intact and liability for unauthorized use does not increase.

Card issuers should not have to wait until the current card expires or send out a replacement standard card with the additional card, when the existing card is perfectly good. Such waste and cost is simply not justified, given the added consumer convenience and lack of consumer harm. The regulatory restriction will also inhibit innovation, to consumers' detriment.

Because sending an additional card poses none of the dangers that prompted Congress to prohibit the issuance of unsolicited credit cards and because consumers may be deprived of valuable convenience, we urge staff to expand the proposal to also except from the prohibition, additional cards sent to existing accountholders, whether as at the time of renewal or not, subject to the same condition as proposed.

“Bounce Protection.”

The Board is also requesting information on “bounce protection” programs associated with transaction deposit accounts. Questions have been raised about whether there are circumstances in which such services might be covered by TILA and Regulation Z.

As the Board describes these programs, the institution generally reserves the right not to pay particular items under these programs, but typically establishes a dollar limit for the account holder and then “routinely” pays overdrafts on the account “without a case-by-case assessment.” Account holders pay a fee for overdrafts that are paid, usually the same amount as for an overdraft item that is returned unpaid.

The Board notes that such fees may or may not meet the definition of finance charge and seeks more information on how “bounce protection” services are designed and operated and how they should be treated for purposes of Regulation Z.

Generally, we believe that most automated bounce protection programs do not merit Regulation Z coverage. Most are simply the automation of banking's long tradition of paying overdrafts under certain circumstances and charging a fee for the overdraft, whether the overdraft is paid or not. The automation of this historical practice reduces costs associated with manual intervention and ensures consistent treatment for all customers. Any concerns about unclear disclosures or deception should be addressed by other appropriate regulations and laws. As one banker noted, "There are enough regulations to go around." If Regulation Z is amended to cover such programs, many banks, to avoid compliance costs and complications, will be compelled to return *all* overdrafts, to the great cost and aggravation of customers.

Banks use a variety of programs and practices in handling overdrafts. Under the long established traditional treatment, banks manually review overdrafts and decide to return or pay based on a variety of factors. Factors include the history and age of the account, the amount of the overdraft, the tendency of the individual branch, and the personal relationship with the customer. The same factors may be used to determine whether to waive the overdraft fee.

For some years, the trend has been to automate this practice, using algorithms to minimize risks and identify those accounts most likely to be brought to positive balance. Automation of the practice offers, 1) significant reduction in costs by eliminating expensive manual intervention and review by staff and 2) more consistent and fair application so that some customers are not inadvertently favored based on inappropriate factors.

For large institutions, the systems are often fairly sophisticated and based on actual experience. The parameters are usually not disclosed.

Smaller institutions have more recently installed automated bounce protection systems for handling overdrafts. However, rather than being developed internally, many have purchased systems from various third party vendors. In some cases, the product is simply a software package. In others, the vendor continues to be involved in the program in some fashion. In addition to the software to establish the parameters for paying overdrafts, the vendors may provide legal and compliance guidance, risk management, monitoring capabilities, and customer communication tools such as formatted and tailored response letters.

While the criteria for the vendor solutions may be less complicated than those developed by individual institutions, they allow small institutions to automate a traditional practice, thereby reducing costs and ensuring more consistent application.

Typically, under these programs, banks disclose that they *may* pay overdrafts, usually between $100 and $500, depending on the customer, under certain circumstances. (See attached examples.) The main difference between the traditional practice and the newer programs, is that the criteria are disclosed to the customer.

Examples of typical criteria for eligibility for the service include:

- Monthly deposit of $300 or more
- Periodic direct deposit
- No outstanding debts to bank
- Account opened for at least 30 days.

Usually, the feature is available to all those eligible to open an account. There is no “creditworthiness” test as there is for overdraft lines of credit. A flat fee is charged, regardless of amount.

If any negative balance is not brought to a positive status, e.g., within 15 days, letters are sent advising the customer to bring the balance to a positive position. Reminders and requests continue for 30 to 40 days after which time the account is closed. A few institutions offer the customer the option to repay the overdraft through an installment loan (subject to Regulation Z) if the customer has difficulty in paying the lump sum.

Under the programs, whether to pay an overdraft remains discretionary on the banks’ part. Disclosures provide that the bank “may” pay the overdrafts and outline the parameters. However, banks reserve and exercise the right not to pay any particular overdraft notwithstanding that the particular overdraft otherwise fits within the disclosed parameters.

Banks may choose not to pay an overdraft that otherwise fits within the disclosed criteria for a variety of reasons. For example, banks may choose to return an overdraft if: several checks deposited into the account have been returned unpaid; the balance is already in a negative position; periodic deposits have ceased; the customer has had multiple overdrafts in a single month. In addition, overdrafts would not be paid if there are reasons to suspect fraud, either by the customer or the payor of a check deposited into the account.

Bounce protection products are popular with consumers for a number of reasons. Paying an overdraft can save the customer fees imposed by the recipient of an unpayable check, such as a merchant or creditor. It might also save them additional interest and late payment fees. They also avoid adverse reports to credit bureaus and databases of bad check writers. Consumers avoid the embarrassment as well as the hassle and time wasted to straighten out the transaction involving a returned check.

These programs contrast with overdraft lines of credit, which are subject to Regulation Z, in a number of ways.

Overdraft line of credit	**"Bounce protection" program**
Written agreement.	No written agreement.
Bank obligated to pay overdraft. No discretion. While bank may not pay if fraud is suspected, threshold is higher because of contract and liability for failure to pay.	Bank retains discretion to pay or return any overdraft. Threshold for not paying due to fraud suspicions is lower.
Potential bank liability for failure to pay overdraft.	No liability for failure to pay overdraft.
Overdraft may be repaid over time and in installments.	Entire overdraft must be repaid in short period.
Consumer must meet creditworthiness standard to obtain product.	Consumer need only meet eligibility standard for opening the account.
Interest charged for overdrafts. May be per item, application, or annual fee.	No fees other than flat per item overdraft fee, unrelated to the amount of the overdraft.

Some consumers prefer the bounce protection programs to the overdraft lines of credit. For example, the line of credit requires more time and paperwork to initiate. Consumers do not expect to overdraw other than on an occasional basis and do not want the temptation of a line of credit. More customers are eligible for the bounce protection programs than for a line of credit, which has stricter eligibility criteria.

The Board notes that questions have been raised about whether such programs may be covered by TILA and Regulation Z. We believe that generally they should not, assuming that they meet the criteria currently outlined in Regulation Z for excluding overdraft fees from Regulation Z. Any concerns about misleading or confusing messages should be addressed under other appropriate regulations and laws. The Board should not try to artificially force these programs into Regulation Z. It will only result in vagueness, uncertainty, confusion, and unnecessary compliance headaches, as well as the elimination of the practice of paying *any* overdrafts except for select customers.

Comment 4(b)(2) to Regulation Z provides that a checking account charge imposed with a credit feature is only a finance charge to the extent it exceeds the charge for a similar account without credit features. Comment 4(c)(3) further explains:

> A charge on an overdraft balance computed by applying a rate of interest to the amount of the overdraft is not a finance charge, even though the consumer agrees to the charge in the account agreement, unless the financial institution agrees in writing that it will pay such items.

Thus, under existing Regulation Z, the fees under bounce protection programs are not subject to Regulation Z if: 1) the fee is imposed whether or not the bank pays the overdraft; and 2) the bank does not agree in writing that it will pay such overdrafts.

Tampering with the writing requirement risks recreating regulatory chaos. There will be constant challenges questioning whether the bank has "agreed" to pay such overdrafts.

In addition, most financial institutions make clear that the institution "may" pay the overdraft under certain circumstances. Use of the term "may" is sufficient. "May" does not mean "will." However, if the agreement otherwise implies that the institution *will* pay such items, then the program may be subject to Regulation Z. As discussed earlier, financial institutions generally do reserve the right not to pay an item and indeed exercise that right. That the process has been modernized for efficiency and fairness through automation should not alter the analysis. To insist that decisions be made on a "case-by-case" basis to avoid Regulation Z treatment relegates financial institutions to inefficient and outdated systems.

Any distinction between the historical manual practice of paying overdrafts and automated systems will be artificial and unclear. To avoid significant risks of violating an unclear distinction, financial institutions will have to choose 1) to comply with Regulation Z, or 2) to pay no overdrafts except for select customers. Compliance with Regulation Z would certainly chill any automated systems: Regulation Z compliance is complicated, expensive, and burdensome, and financial institutions risk bumping up against usury laws because overdraft amounts are typically small relative to the fee. Financial institutions would have to choose between denying a valued and popular service to all but select customers and the perils of Regulation Z compliance.

Any concerns about programs related to confusion or deception about the terms and conditions should be addressed under other appropriate regulations and laws. For example, it has been suggested that the literature describing some programs are contradictory or misleading in that they promise to pay certain overdrafts in one place, but retain discretion not to pay in another place. We do not believe that this is a Regulation Z issue unless it is clear that the institution will pay the overdraft, as explained above. Rather, such literature, as the OCC has stated in Interpretive Letter #914, September 2001, may violate the Federal Trade Commission Act, which prohibits deceptive acts or practices. Contradictory or misleading messages are more appropriately addressed under that Act, not Regulation Z.

Further, the Truth in Savings Act and Regulation DD address disclosures related to checking accounts. They require that at account opening, institutions disclose, "The amount of any fee that may be imposed in connection with the account and the conditions under which the fee may be imposed." (Section 230.4(b)(4)). In addition, Section 230.6(a)(3) requires that any fees debited to the account during the statement period be disclosed on the periodic statement. Section 230.3 requires that these disclosures be made "clearly and conspicuously in writing and in a form the consumer can keep."

We believe that clear communication of fees is critical and that the requirements of Regulation DD are sufficient to alert consumers to any overdraft fees, whether the check is paid or not. We also believe that customers are informed and understand that the overdraft fee will be imposed. Even if some customers overlook the fee in the initial disclosure, the periodic statement will certainly alert them. Those with low or overdrawn balances are most likely to notice this charge and question it if it is incorrect. In any case, the first overdraft charge certainly alerts consumers to potential future overdraft charges.

Conclusion.

Generally, ABA supports the approach the proposed Commentary has outline with regard to treatment of fees for expedited payment and expedited delivery of credit cards. However, we strongly recommend a broader review to clarify principles for establishing whether fees related to credit accounts are considered finance charges, "other charges," or neither. If staff declines to address the broader issue at this time, it should exclude both from finance charge and "other charge."

In addition, we recommend that the Commentary extend the proposed section regarding credit card issuance to card issuers to send additional cards, whether provided at the time of renewal or not, without violating the general prescription against sending unsolicited cards.

Finally, we have provided general descriptions of various bounce protection programs. We strongly believe that these programs are not covered by Regulation Z. Any concerns relating to unclear or deceptive materials should be addressed under other appropriate regulations and laws.

The ABA appreciates the opportunity to comment on these important matters and is happy to provide additional information or comments.

Regards,

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