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Legal Department

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Via E-Mail @ regs.comments@federalreserve.gov
Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
10th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R-1314: Unfair or Deceptive Acts or Practices (Regulation AA)
Docket No. R-1286: Truth in Lending Act (Regulation Z)

Dear Ms. Johnson:

This letter is submitted to the Board of Governors of the Federal Reserve System (the "Board") on behalf of Compass Bank, an Alabama banking corporation ("Compass"), in response to the Board's request for comment on the proposed regulations under Regulation AA, which implements the Federal Trade Commission Act ("FTC Act") and Regulation Z, which implements the Truth in Lending Act ("TILA"), as well as the staff commentary to Regulation Z. In this letter, we refer jointly to the proposed amendments to Regulation AA and Regulation Z as the "Proposed Rules", and to each section within the Proposed Rules as a "Proposed Rule." We also we refer to the proposed amendments to Regulation AA as the "Proposed UDAP Rules".

Compass is a Sunbelt-based, regional commercial financial institution owned by Compass Bancshares, Inc., a bank holding company that is wholly owned by BBVA (NYSE: BBV) (MAD: BBVA). Compass has approximately $60 billion in assets and, through its operating companies, maintains more than 580 branches in Alabama, Arizona, Colorado, Florida, New Mexico, and Texas. Compass is among the top 25 largest banks in the U.S. based on deposit market share.

Comments in this letter relating to Regulation AA specifically address consumer credit card account services; Compass is submitting, under separate cover, a comment letter addressing the proposed amendments to Regulation DD and the proposed rules under Regulation AA specifically relating to overdraft services and the treatment of debit holds.

Compass appreciates the time and effort of the Board, the Office of Thrift Supervision, and the National Credit Union Administration (collectively, the "Agencies") in preparing the Proposed Rules, and hopes that these comments will be helpful to the Board in its effort to promulgate reasonable and workable standards to inform consumers about credit cards and to allow consumers to effectively compare the terms of credit card accounts.

We appreciate the opportunity to comment on those Proposed Rules to Regulation AA and Regulation Z that affect credit cards. We welcome the proposed revisions to the extent that they make the disclosure of credit terms clearer and more meaningful to the consumer. Such disclosures provide consumers with valuable information that assists them both in shopping for new credit cards and in understanding the costs of existing credit card accounts. However, we believe that some of the proposed revisions impose substantial and unwarranted burdens on credit card issuers. Credit card use fuels growth of the American economy by facilitating the sale of consumer goods and services. The imposition of these burdens will increase the issuers' costs of providing credit cards, which will adversely affect both the cost and availability of credit for all consumers, all to the detriment of the American economy. In this letter we comment on or request clarification on those Proposed Rules that we believe present particular problems for credit card issuers and consumers.

I. Proposed Rules Relating to Unfair or Deceptive Credit Card Practices (Regulation AA)

A. General Comments

1. Need for Less Restrictive Remedy

We believe that the Proposed UDAP Rules would regulate practices that should not be considered unfair or deceptive trade practices under applicable statutory standards, the regulatory standards adopted by the Federal Trade Commission (the "FTC"), or the Guidance Regarding Unfair or Deceptive Acts or Practices by State-Chartered Banks that was issued by the Board and the Federal Deposit Insurance Corporation (the "FDIC") on March 11, 2004. These standards provide that:

- An act or practice is unfair where it (1) causes or is likely to cause substantial injury to consumers, (2) cannot be reasonably avoided by consumers, and (3) is not outweighed by countervailing benefits to consumers or to competition. Public policy may also be considered in the analysis of whether a particular act or practice is unfair, but cannot serve as the primary basis for the determination that an act or practice is unfair.

- An act or practice is deceptive where: (1) there is a representation or omission of information that is likely to mislead consumers acting reasonably under the circumstances; and (2) that information is material to consumers.

We believe that the Proposed UDAP Rules, which effectively restrict the terms on which an issuer may contract with its consumer cardholders, far exceed any remedy needed to prevent unfair or deceptive acts or practices related to credit card accounts. In the legal

analysis of each Proposed Rule, the Agencies consistently found that the injuries resulting from the practices and acts to be regulated cannot be reasonably avoided by consumers because disclosure alone may be insufficient. We strongly disagree with the Agencies' assessment. We believe that clear disclosures can be effective and, in the absence of any express legislative mandate to regulate the practices addressed in the Proposed UDAP Rules, are the appropriate method to prevent the risk of any injury to consumers, rather than the more restrictive remedy of regulating the terms on which a bank may choose to make credit available to its consumer customers. For this reason, we believe that the Agencies should their concerns regarding consumer credit card practices through revisions to Regulation Z.

2. Risk Presented by Proposed Rules

a. Legal Risk

We believe the Proposed UDAP Rules will have unintended and far-reaching consequences for the banking industry, including significantly increased litigation exposure. By attempting to regulate certain practices and acts as unfair or deceptive, the Agencies are exposing banks to customer claims regarding past conduct that was not prohibited, and may even have been sanctioned by the Agencies or applicable law at the time of the conduct. If the Agencies determine to adopt the Proposed UDAP Rules, all credit card-issuing banks will be subject to actions brought by both states and private parties, including class actions. Such litigation would clearly erode faith and confidence of the consumer in banks, as well as their regulators. The costs of such litigation would ultimately drive up the cost of credit for all consumers.

In order to avoid the risk of expensive and time-consuming litigation, we urge the Agencies to address the acts and practices identified in the Proposed UDAP Rule through revisions to Regulation Z. Alternatively, if the Agencies determine to adopt the Proposed UDAP Rules, we urge them to clarify in the final rules that, as a matter of law, the acts and practices addressed in such rules have not been determined to unfair or deceptive *per se*, but only could be so classified depending on specific facts and circumstances. The Agencies also should clarify that the final rules should be applied only prospectively, and that any past conduct must be viewed in light of all the circumstances surrounding the transaction, including compliance with any then applicable agency guidance. Such clarifications are necessary to help reduce the litigation that is sure to result from the proposed UDAP Rules.

b. Economic Risk

Several of the Proposed UDAP Rules restrict the ability of banks to charge the rates that consumers contracted to pay under their credit card agreements on balances for credit previously extended to consumers. We strongly believe that the application of such restrictions to outstanding balances will improperly deny banks the compensation they

projected in agreeing to extend credit on the terms accepted by the consumers. We appreciate the Agencies' concern that many consumers do not understand the terms of their credit card agreements. However, the Proposed UDAP Rules would require banks to lose significant revenue on which they relied in pricing and extending the credit already provided on consumer credit card accounts. We would ask the Agencies, if they determine to adopt the Proposed UDAP Rules, to provide that any restrictions on the ability of banks to charge rates included in their credit card agreements would be effective only prospectively, and would not apply to balances in existence prior to the effective date of any final version of the Proposed UDAP Rules.

B. Allocating Excess Payments To Highest APRs – 12 CFR §227.23

Proposed Section 227.23(a) requires credit card issuers to allocate any payment that exceeds the required periodic payment amount in a manner that is no less beneficial to the consumer than one of three specified methods. Similarly, proposed Section 227.23(b) provides that, when a consumer credit card account has one or more balances at a promotional rate, the bank must allocate any payment that exceeds the required periodic payment amount to pay off the other balances before allocating any of the excess payment to the promotional rate balances. We believe that, if adopted as written, these Sections would have the unintended consequence of discouraging banks from offering lower promotional rates. Banks and other credit card issuers are able to offer lower rates for certain balances, such as balances resulting from transfers or balances resulting from specified types of purchases, because they can estimate the length of time those lower rates will apply. If issuers are prohibited from allocating payments first to the lowest rate balances, issuers will likely offer lower promotional rates to fewer consumers and may increase other fees associated with lower rate transactions (e.g., balance transfer fees). As a result, promotional rates offered to consumers will not be as low, or will not be offered at all.

In response to the questions on which the Agencies requested comment, if the Agencies determine to prohibit banks from increasing the annual percentage rate on outstanding balances, as provided in 12 CFR §226.24 of the Proposed Rules, we believe that:

- Section 227.23(a) should permit institutions to apply amounts in excess of the minimum payment first to balances on which the institution is prohibited from increasing the rate.
- Consumers should not be permitted to instruct the bank regarding allocation of amounts in excess of the required minimum periodic payment. Banks carefully consider the projected life of the various kinds of credit card account balances (e.g., purchase balances, cash advance balances, promotional rate balances, etc.) in pricing the interest rates offered on those balances. To give consumers the right to instruct banks how to allocate excess payments among their various

balances would significantly and adversely impact the ability of banks to project the life of such balances and to price the applicable rates accordingly.

C. Application of Increased APRs to Outstanding Balances – 12 CFR 227.24

Section 227.24 would prohibit the application of an increased annual percentage rate ("APR") to any outstanding balance on a consumer credit card account, except in certain limited circumstances. The term "outstanding balance" is defined to mean the amount owed on a consumer credit card account at the end of a fourteenth day after the bank provides notice of either a change in the terms of the account under 12 CFR 226.9(c) or notice of increased rates due to delinquency or default, as required in the Proposed Rules amending Regulation Z. The general prohibition would not apply where the APR is increased due to: (1) the operation of an index that is not under the bank's control and is available to the public; (2) the expiration of a promotional rate; and (3) the consumer's failure to make the required minimum payment within thirty days after the due date.

We understand the Agencies' concern about rate increases resulting from circumstances over which consumers have no direct control, such as a drop in the consumer's credit score. However, we believe that this Proposed Rule is an unwarranted and inappropriate restriction of both the terms on which a bank may choose to make credit available to its consumer customers and the bank's ability to enforce those terms.

1. Application of Changed Terms to Outstanding Balances

State law generally determines the conditions under which a credit card issuer may change the terms of a credit card account. For example, under Alabama law, a bank that desires to modify any term of a credit card account must provide at least 30 days' prior written notice of such modification to the debtor, and that notice must disclose that the debtor has the option (i) to surrender the credit card and to pay off the credit card account under the existing terms and conditions; or (ii) to hold the credit card after the 30-day period has elapsed, or to use the credit card during such period, either of which shall constitute the debtor's consent to the modification. Ala. Code §5-20-5. In our experience, whenever we have changed the terms of our credit card accounts, we have had a small but consistent number of customers who chose to exercise their right to opt-out of the change and pay off their balances under existing terms. We believe that this statute establishes a method for changing the terms of credit card accounts that is fair to both banks and cardholders. This Proposed Rule seeks to supplant this and all other state laws that regulate the application of changed terms to outstanding balances.

As discussed above, we question using the FTC Act to regulate the practices addressed by the Proposed UDAP Rules. We also question the enforceability of this Proposed Rule in the absence of federal law expressly regulating the conditions under which a credit card issuer may change account terms. We would ask the Agencies, if they determine to

adopt this Proposed Rule, to include options comparable to those under Ala. Code §5-20-5, which have proven workable for both consumers and banks.

2. Definition of "Outstanding Balances"

Assuming the Agencies have the authority under the FTC Act to regulate the conditions under which a credit card issuer may change account terms, the inclusion of the 14-day period provided in the current definition of "outstanding balances" of this Proposed Rule creates an incentive for consumers to obtain additional (and perhaps excessive) credit on their cards before the APR increase becomes effective, which in turn increases the bank's risk of non-payment. We believe that the definition of "outstanding balances" must be modified to mean the amount owed on a consumer credit card account at the time the bank provides notice of the increased APR. If banks are prohibited from increasing the APRs on outstanding balances, they must not be doubly penalized by having to bear the additional risk of cardholders' running up balances in anticipation of increased rates.

3. Index Outside Bank's Control

Under Section 227.24(b)(1) of this Proposed Rule, interest rate adjustments resulting from changes in the index for a variable rate may apply to outstanding balances only if the index is not under the bank's control. Many banks, including Compass, have established their own proprietary "prime rates" that more accurately reflect the prevailing interest rates in their markets. We believe that, as long as such proprietary prime rates are readily available to the public and change only when and to the extent of any change in a base rate outside the lender's control (e.g., the federal funds rate set by the Board or the prime rate reported by the Wall Street Journal), these prime rates should be not considered "under the bank's control" for the purposes of this Proposed Rule. We request the Agencies to modify this Proposed Rule to clarify this fact.

4. Delayed Implementation of Default Rates

Under Section 227.24(b)(2) of this Proposed Rule, if a consumer who has a balance at a promotional rate fails to make a timely payment, a bank may begin applying the regular rate that otherwise would be applicable to such a balance, but the bank may not apply any default rate to that balance, even if the consumer's credit card agreement permits the bank to impose the higher default rate. Similarly, Section 227.24(b)(3) of this Proposed Rule provides that a bank may apply default rates to outstanding credit card balances only if the consumer failed to make a required minimum payment within thirty days after the due date for that payment.

These Sections not only represent inappropriate and unwarranted regulation of the terms on which a bank may choose to make credit available to its consumer customers, they also significantly restrict the ability of banks to manage the risk resulting from cardholder delinquency. Banks need the flexibility to establish pricing commensurate with the credit

risks they are undertaking. By prohibiting banks from applying default rates to outstanding balances unless a consumer credit card account is more than thirty days past due, the Agencies are effectively substituting their judgment regarding the risk presented by delinquent account for that of the bank extending the credit.

To prohibit application of default rates as provided in these Sections will have the untended consequence of increasing the cost of credit for all consumers, not just those who become delinquent on their accounts. For example, many banks currently provide rehabilitation programs that allow previously delinquent cardholders placed on default rates to return to regular rates after having made timely payments for some period of time. Banks may be less willing to provide such beneficial programs if they cannot be compensated for the increased risk presented by delinquent consumers who are less than thirty days past due.

We believe that clear disclosures of when and why default rates may be imposed can effectively prevent the injury intended to be regulated by this Proposed Rule.

5. Restrictions on Re-Pricing High-Risk Consumers

Banks may choose to increase the APRs for a variety of reasons, including the need to adjust the compensation being charged in light of the credit risk that the bank is undertaking. Such an adjustment may be necessary for an entire portfolio, or only with respect to particular cardholders who present an increased delinquency risk to the bank. This Proposed Rule would prohibit a bank from increasing the APRs of any high-risk consumer unless the consumer failed to make a required minimum payment within thirty days after the due date for that payment, in which case the bank could impose any agreed upon default rate. In prohibiting such an increase, the Agencies are effectively presuming that a bank faces no increased credit risk until an account is thirty days past due and preventing the bank from exercising its own judgment regarding the risk presented by any particular consumer. Risk-based pricing has become an important tool by which all lenders manage their credit risk. By pricing according to the risk presented by the debtor, lenders are able to offer lower interest rates to consumers who present less credit risk. Any restrictions on the ability of banks to adjust pricing to reflect its credit risk will increase the cost and reduce the availability of credit for all consumers.

Again, we believe that clear disclosures of when and how APRs may be increased can effectively prevent the injury intended to be regulated by this Proposed Rule. Alternatively, we would ask the Agencies, if they determine to adopt this Proposed Rule, to permit banks to re-price any or all cardholders on the condition that each cardholder is given the option (i) to surrender the credit card and to pay off the credit card account under the existing terms and conditions; or (ii) to retain the credit card after a reasonable notice period has elapsed, or to use the credit card during that period, either of which shall constitute the debtor's consent to the modification.

D. Firm Offers of Credit – 12 CFR §227.28

Section 227.28 would require banks making firm offers of credit that include multiple APRs or credit limit ranges to disclose the factors that determine whether a consumer will qualify for the lowest APR and highest credit limit advertised. The Proposed Rule provides that, if presented in a manner that calls attention to the nature and significance of the information, the following will satisfy the requirements of this Section: "If you are approved for credit, your annual percentage rate and/or credit limit will depend on your credit history, income, and debts."

We believe that the factors banks consider in determining the APRs and credit limits to be offered to consumers are proprietary information. Although we appreciate the Agencies' desire to help consumers understand how their behavior may affect the credit terms, banks should not be required to reveal to the specific factors they use to make these or other credit decisions. We believe this language should be revised to reflect that the consumer's credit worthiness will determine the APRs and credit limit offered to the consumer.

II. Proposed Rules Relating to Truth in Lending Act (Regulation Z)

A. Revised and Additional Disclosures

The Proposed Rules include significant and far-reaching changes to the disclosures that banks must give in connection with credit card accounts. The Agencies should recognize that banks will need a reasonable period of time to prepare the forms they will use to make the revised and additional disclosures and to train personnel in the use of the disclosures. We anticipate that it will take us at least twelve months to implement use of the new disclosures, and we request the Agencies not to set an effective date that is earlier than sixteen months from the publication date of the final rules regarding these new disclosures.

B. Investigation of Alleged Unauthorized Use or Transaction – Official Staff Interpretations of 12 CFR §226.12(b) and §226.13(f)

Where a cardholder claims unauthorized use of a credit card, the card issuer must conduct a reasonable investigation if the cardholder reports a billing error related to the unauthorized use and, in any case, before imposing liability on the cardholder for the unauthorized use. The Proposed Rules insert a new Comment 3 to the Official Staff Interpretations of Section 226.13(f). This new Comment 13(f)-3 is substantially similar to Comment 3 that already appears in the Official Staff Interpretations of Section 226.12(b), which relates to the requirements of a reasonable investigation. Comment 12(b)-3 currently provides that:

- The card issuer "may not automatically deny a claim based solely on the cardholder's failure or refusal to comply with a particular request…." The Proposed Rules would insert the following after this statement in both Comment 12(b)-3 and Comment 13(f)-3: "…, including providing an affidavit or filing a police report…."
- "… actions such as the following represent steps that a card issuer may take, as appropriate, in conducting a reasonable investigation: … 'Requesting a written, signed statement from the cardholder or authorized user.' " The Proposed Rules would insert the following after this statement in both Comment 12(b)-3 and Comment 13(f)-3: "However, a creditor may not require an affidavit as a part of a reasonable investigation."

Both of these proposed insertions give us considerable cause for concern. Unauthorized transactions and consumer fraud are closely monitored and managed by banks. In order to protect innocent consumers and the credit card industry against such fraud, banks must have the authority to make determinations of whether or not any card transaction is authorized based on the specific facts of that transaction. The willingness of a cardholder to provide an affidavit or file a police report is often a revealing indication of whether the card user had been given implied or apparent authority to use the card. We acknowledge that both Comment 12(b)-3 and Comment 13(f)-3 also recognize that, if a bank otherwise has no knowledge of facts confirming the unauthorized use, the lack of information resulting from a consumer's failure or refusal to comply with a particular request may lead the bank reasonably to terminate the investigation. However, we believe that the first proposed insertion described above creates a confusing ambiguity. With this insertion, these Comments could be read to indicate that, as long as the consumer complies with the bank's other requests, the consumer's refusal to provide an affidavit or file a police report may not be used as the basis to deny the consumer's claim. We recommend deleting the phrase "…, including providing an affidavit or filing a police report…" from both Comment 12(b)-3 and Comment 13(f)-3 to avoid this ambiguity.

With respect to the second insertion described above, we understand that the Board seeks to strike a balance between a consumer's need for simple methods to report claims and a bank's need for meaningful ways to investigate those claims. We believe, however, that prohibiting affidavits is an inappropriate and unnecessary limitation on the ability of banks to prevent, control and investigate unauthorized and fraudulent transactions. As previously recognized, the willingness of a cardholder to provide an affidavit is often a revealing indication of whether the card user had been given implied or apparent authority to use the card. Asking consumers to affirm their allegations of fraud is not an unreasonable requirement. Consumers routinely are required to swear to the accuracy of information they provide in loan applications, federal, state and local income tax forms and filings, requests for driver's licenses, and insurance claims. Consumers understand that affidavits bolster the credibility of their claims. We do not believe that requiring an affidavit produces a chilling affect that either intimidates or unduly burdens a consumer

who has valid claims of unauthorized transactions. A sworn affidavit not only encourages the consumer to be accurate in his representation of facts, it also serves as the foundation for a fraud file to be relied upon by the bank, as well as by law enforcement agencies. Our banking and credit system emphasizes verification and documentation of information throughout the credit process. The resolution of billing disputes should not be an exception. We believe restricting the use of affidavits as proposed by these rules would be a mistake, to the detriment of consumers, lenders, and law enforcement.

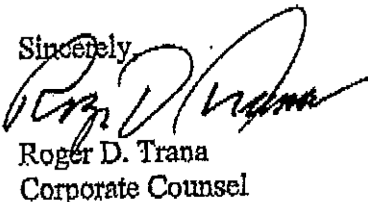
III. CONCLUSION

We would like to remind the Board of the important role that the responsible use of credit cards plays in fueling a healthy American economy. Credit cards give consumers greater opportunities and flexibility. Clearer disclosure of credit card terms can further promote more responsible behavior by cardholders and reduce the cost of credit for everyone. Shifting regulatory enforcement away from Regulation Z and to the FTC Act may send consumers the inappropriate message that credit card issuers routinely engage in "unfair and deceptive" behavior. At this critical time, when our economy is under unusual stresses, the public's faith in credit card lending and the American banking system should not be subjected to unnecessary controversy and complexity. An extensive rewriting and shifting of regulations, such as has been proposed here, must take into consideration the effect of the message on consumers, the costs and impact on creditors and the resulting impact on the credit system and the American economy.

We thank the Agencies for considering our comments to the Proposed Rules and appreciate the Agencies' challenge in promulgating reasonable and workable standards to inform consumers about consumer credit card accounts and allow consumers to effectively compare the terms of different credit card products. We urge the Agencies to reconsider regulating credit card account practices under Regulation AA, and instead to follow long-standing policy to enforce the FTC Act on a case-by-case basis. Additionally, we appeal to the Agencies to consider the multitude of unintended consequences of the Proposed Rules. Lastly, we request that any disclosure requirements adopted under Regulation Z give institutions sufficient flexibility to provide consumers with all the information they may need to make educated choices about credit cards.

If you have any questions concerning this letter or if you would like us to provide any additional information, please do not hesitate to contact me.

Sincerely,



Roger D. Trana
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