**COMMENTS to the Federal Reserve Board**
**[Regulation Z; Docket No. R-1399]**
**12 CFR Part 226: Truth in Lending**

**Proposed Rule on Increasing Thresholds for Exempt Transactions**

**by the National Consumer Law Center**
**on behalf of its low-income clients**

**and for the**

**Americans for Financial Reform**
**Consumer Federation of America**
**Consumers Union**
**Empire Justice of New York State**
**National Association of Consumer Advocates**
**National Fair Housing Alliance**

**February 1, 2011**

The National Consumer Law Center[1] ("NCLC") respectfully submits the following comments on behalf of its low income clients, as well as for the National Association of Consumer Advocates,[2] on the Board's proposed rule[3] implementing the Dodd-Frank increase in thresholds for exempt transactions under the Truth in Lending Act.[4]

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[1] The **National Consumer Law Center, Inc. (NCLC)** is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending*, (7th ed. 2010), *Cost of Credit: Regulation, Preemption, and Industry Abuses* (4th ed. 2009), and *Foreclosures* (3rd ed. 2010), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to address predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of the all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws. These comments were written by NCLC attorneys Carolyn Carter, Margot Saunders, and Chi Chi Wu.

[2] **Americans for Financial Reform** is a coalition of more than 250 consumer, labor, civil rights, senior, community, business, academic, and other groups working together to hold Wall Street accountable and reforming our financial system so it serves our families and our communities. AFR played a leading role in strengthening and winning passage of the Dodd-Frank Consumer Protection Act, and is now focused on tough and effective implementation to fulfill the promise of that legislation, and on continuing efforts to transform our financial system.

**Consumer Federation of America** is a nonprofit association of about 300 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through research, advocacy and education.

**Consumers Union of United States, Inc.,** publisher of *Consumer Reports* ®, is a nonprofit membership organization chartered in 1936 to provide consumers with information, education, and counsel about goods, The proposed rule addresses numerous details to implement both the new threshold for exempt transactions and the inflation adjustment at the end each year. While there is much in the proposed rule that will benefit consumers, we have serious concerns about potential loopholes that could enable creditors to evade the Truth in Lending Act.

## I. GENERAL ISSUES

### A. Easy Access to Threshold Amounts

The general public should have easy access to the current threshold as well as historical threshold amounts. To accomplish this, the text of Reg. Z § 226.3(b) should include the specific citation to a Board-maintained website containing this information.

### B. Rounding

The Board proposes that all amounts be rounded to the nearest $100. We agree that this approach is consistent with the statutory language. Over the long run, rounding to the nearest $100 will produce the same average threshold as rounding to the nearest $1,000, but rounding to the nearest $1,000 will reach that threshold with larger and fewer jumps. Rounding to the nearest $100 more closely reflects the underlying policy goal that the threshold be sensitive to changes in the Consumer Price Index.

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services, health and personal finance. Consumers Union's publications and services have a combined paid circulation of approximately 8.3 million. These publications regularly carry articles on Consumers Union's own product testing; on health, product safety, and marketplace economics; and on legislative, judicial, and regulatory actions that affect consumer welfare. Consumers Union's income is solely derived from the sale of *Consumer Reports* ®, its other publications and services, fees, noncommercial contributions and grants. Consumers Union's publications and services carry no outside advertising. Consumers Union does not accept donations from corporations or corporate foundations.

**Empire Justice of New York** is a statewide, multi-issue, multi-strategy non-profit law firm focused on changing the "systems" within which poor and low-income families live. We represent and advocate on behalf of individuals in a number of areas including Consumer Housing and Community Development (CHCD). The CHCD unit has been representing victims of predatory lending since 2000 and analyzing Home Mortgage data since 1994.

The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

Founded in 1988, the **National Fair Housing Alliance** is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights agencies, and individuals from throughout the United States. Headquartered in Washington, D.C., the National Fair Housing Alliance, through comprehensive education, advocacy and enforcement programs, provides equal access to apartments, houses, mortgage loans and insurance policies for all residents of the nation.

[3] 75 Fed. Reg. 78632 (Dec. 16, 2010).

[4] Dodd-Frank § 1100E, *to be codified at* 15 U.S.C 1603.

## II. EXEMPTION FOR OPEN-END CREDIT

### A. An Account Should Not Be Exempted Unless the Actual Extension of Credit Is Over $50,000.

Section 1603 of the Truth in Lending Act (TILA), as revised by Dodd-Frank Act, exempts from its coverage:

> (3) Credit transactions, other than those in which a security interest is or will be acquired in real property, . . . , in which the *total amount financed* exceeds $50,000. (emphasis added).

Thus, the statutory language of TILA itself does not state that the exemption applies when a creditor merely makes an "express written commitment" to extend credit beyond the monetary threshold. Quite the contrary – TILA states that the exemption applies when the "total amount financed" exceeds the threshold. In other words, TIL's statutory language provides that the exemption is met when the credit actually extended is above $50,000.

The "express written" or firm commitment provision of the monetary threshold exemption was created by the Board when it promulgated Reg. Z § 226.3 many years ago. We urge the Board to take this opportunity in implementing the Dodd-Frank Act change to revise Reg. Z § 226.3, and require that an open-end transaction is not exempt unless the actual amount of credit extended exceeds $50,000.

There is ample reason to require that the amount of credit actually extended be the criterion considered in determining whether the $50,000 threshold has been met. First, in general, consumers who receive credit card accounts with credit limits over the monetary threshold are often not sophisticated wealthy individuals, but ordinary middle-class Americans. For example, one of the authors of this comment was provided with two credit cards with limits at the current $25,000 threshold, without seeking these limits or reporting a high income. Almost 20% of the accounts for three of the largest issuers have credit limits of over $20,000.[5] Advertisements for credit cards with $100,000 limits are easily found on the Internet.[6]

In a particularly egregious example, a credit card issuer called CapNet is sending unsolicited credit cards with a $100,000 credit limit to consumers.[7] While this would normally violate TILA's prohibition against unsolicited credit cards, 15 U.S.C. § 1642, CapNet appears to be evading TILA by issuing high limit cards. CapNet appears to be targeting physicians,[8] who may have high incomes but are not always financially sophisticated with respect to consumer credit issues.

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[5] J. Hibbs, *Recent Credit Line Data Highlight Contrasts in Trust Composition, Strategies*, Moody's Credit Card Statement, Jan. 20, 2011, at 8 (Figure 2).
[6] See http://www.elite-credit-cards.com/high-credit-limit-cards.html (visited Jan. 21, 2011).
[7] Email from Mohammad Ahmed Faruqui, Esq. to National Consumer Law Center, Jan. 23, 2011.
[8] *See also* http://runningahospital.blogspot.com/2008/08/real-premier-gold-card.html.

Furthermore, consumers granted credit limits over the statutory threshold often do not use anywhere near the full line of credit. Indeed, the credit scoring company FICO reports that more than half of cardholders use less than 30% of their card limit.[9] According to Moody's, for three of the largest issuers, the average balance on a credit card account with a limit over $20,000 is only about $3,000 to $6,000.[10] Moreover, conventional wisdom advises consumers to use only 30% of their full credit line on a credit card, so as to keep their credit scores higher.[11] A consumer who uses only 30% of the threshold limit ($15,000) should receive the full protections of TILA, both disclosure and substantive.

Requiring that only the amount of credit actually extended be considered for exemption is especially critical for credit card accounts that are used to buy "big ticket" items, because such accounts are vulnerable to the problem of spurious open-end credit. Consumer advocates have written to the Board many times about the need to adequately address spurious open-end credit.[12] With the changes made by Dodd-Frank to the monetary threshold exemption, unscrupulous creditors will have more incentive to disguise a closed-end transaction as an open-end one.

A creditor could purport to make a firm commitment by providing a credit card account with a limit over $50,000, which would be exempt from all of TILA's protections, including both disclosures and substantive credit card protections. The purchase amount could be much less than $50,000 – for example, a $10,000 extension to finance the purchase of an automobile. Then in about a week, the creditor could reduce the credit line significantly, to the amount of the purchase.

Under the Board's proposal, it is true that at the point the credit line is reduced, the account loses its exempt status. However, the problem is that the consumer is already stuck with the $10,000 balance and committed to the purchase. If the consumer reviews the TIL disclosures and does not like the terms, he or she likely will not have the means to repay that $10,000 immediately to pay off the credit line. (Furthermore, as discussed below, the Board has proposed permitting creditors who reduce the credit line, in lieu of TIL compliance, to simply allow the consumer to pay off the balance under the existing terms of the agreement - a proposal to which we have serious objections).

Thus, we urge the Board to require in Reg. Z § 226.3 that an open-end transaction is not exempt unless the actual amount of credit extended exceeds $50,000. In the alternative, we suggest a rule against subversion discussed in Section I.C below.

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[9] FICO, Average Credit Statistics, www.myfico.com (visited Jan. 21, 2011), at http://www.myfico.com/crediteducation/averagestats.aspx.

[10] J. Hibbs, *Recent Credit Line Data Highlight Contrasts in Trust Composition, Strategies*, Moody's Credit Card Statement, Jan. 20, 2011, at 8 (Figure 2).

[11] *See, e.g.*, Liz Pulliam Weston, *7 fast fixes for your credit scores*, MSN Money, March 18, 2010, at http://articles.moneycentral.msn.com/Banking/YourCreditRating/7FastFixesForYourCreditScore.aspx.

[12] *See, e.g.*, Center for Responsible Lending, Comments to the Federal Reserve Board's Advanced Notice of Proposed Rule-making, Regulation Z Open-end Review, Docket No. R-1217 (Mar. 28, 2005), at 25-33.

## B. Subsequent Changes When the Exemption is Based Upon a Firm Commitment

### 1. *The Board should not permit the creditors who lower a credit limit below the threshold to continue to be exempt from TIL protections.*

The Board has proposed in Comment 3(b)-2.iv.A to require that, if the account is exempt because of a firm written commitment to extend credit in excess of the threshold, and the creditor subsequently reduces its commitment to less than the threshold, the creditor must either begin complying with Reg. Z, or must permit the consumer pay off the existing balance on the existing terms without any additional extensions of credit. As stated above, we oppose the exemption for open-end accounts based on a firm commitment to extend credit over the monetary threshold.

However, if the Board permits exemptions based on a firm commitment, it must at a minimum adopt the proposal that an account loses its exempt status if the creditor reduces its commitment to below the threshold. Otherwise, it would be far too easy for creditors to avoid the requirements of TILA, especially the substantive protections of the Credit Card Accountability, Responsibility and Disclosures (CARD) Act that Congress recently enacted to protect consumers from credit card abuses.

Furthermore, we strongly object to the Board's proposal in Comment 3(b)-2.iv.B to provide creditors with an alternative to compliance with TILA. The Board has proposed giving creditors the option of letting the consumer pay off the balance on the account under the existing terms, without needing to comply with TILA, if no further extensions of credit are made. We oppose this proposal because it permits the creditor to easily evade the requirements of Reg. Z. The creditor could offer an account with a credit limit over $50,000, then reduce that credit limit the very next week, with only the condition that the account terms remain unchanged. If the terms of the account are abusive (such as permitting retroactive rate increases) or the consumer has been deceived as to their terms, requiring that the terms remain unchanged is hardly a benefit to consumers.

We understand from the Supplementary Information that "[t]he Board believes that additional flexibility is necessary in these circumstances, so that creditors that do not have the systems in place to comply with Regulation Z do not close the account and require the consumer to immediately repay the outstanding balance." Yet protection against acceleration of the balance is something the consumer should entitled to under Reg. Z's substantive protections anyway. Once the account is covered under TILA, it should be subject to the provisions of Reg. Z, § 226.55(c)(2). In the alternative, the Board could prohibit acceleration using its authority under 15 U.S.C. § 1604(a).

### 2. *The specific requirements for TIL compliance after the creditor reduces a firm commitment must be specifically set forth in the Commentary.*

Proposed Comment 3(b)-2.ii states that if an account loses its exemption, the creditor must comply with the requirements of Regulation Z, including the account opening disclosures required by Reg. Z § 226.6. We support this provision; otherwise, a creditor could reasonably argue that it is required to comply with TILA on a going-forward basis, but need not comply with requirements that would have been compulsory prior to the time it lowered the commitment.

However, the Board should also specifically state in the Comment that certain other Reg. Z provisions in addition to § 226.6 apply if the creditor lowers the firm commitment below the threshold. These include stating that:

- The existing balance on the account is now subject to protections against retroactive rate increases in Reg. Z § 226.55, even if the balance was accrued while the account was exempt;
- Any late fees or penalty rates triggered by a late payment that was made less than 21 days after a statement was mailed or delivered must be reversed; and
- Any over-the-limit fees that were charged without the consumer's opt-in for such transactions during for past 6 months must be reversed.

Finally, we agree with the Board's statement in proposed Comment 3(b)-2.iv.A that if the credit limit for an account is under the threshold, but the account balance exceeds the threshold, the account is not exempt. This is consistent with the general rule that consumers should not be penalized for accidentally exceeding their credit limits unless they have consented to such transactions.

**C. The Board Must Establish a Minimum Period for a Firm Commitment in Order to Combat Subversions of TILA.**

As stated in Section I.A., the Board should eliminate the exemption for open-end accounts based upon a firm commitment by the creditor, as opposed to an actual extension of credit, that exceeds the statutory threshold. If the Board does not do so, it must establish a minimum amount of time that a firm commitment remains in effect, such as six months, in order to qualify for the exemption.

There is precedent for mandating a minimum time period for an account term to be in effect. Section 1666i-2(b) of TILA, as established by the Credit CARD Act, mandates that any promotional rate must have a minimum term of six months.

We understand that the Board may be concerned that a minimum six month period may present safety and soundness issues. An exception could be made in the case of – and only in the case of - an individualized, case-by-case determination that a consumer's creditworthiness or income has declined to the point where failure to lower the line of credit would present a risk to safety and soundness. However, this exception would not permit credit limit reductions on a wholesale basis by the creditor of hundreds or thousands of accounts. Nor would it permit a pattern or practice by a creditor, in connection with retail sales, of granting credit limits over the threshold, then lowering them quickly after the purchase.

**D. The Exemption Should Not Continue to Apply if the Initial Extension of Credit Exceeds the Threshold and the Creditor Subsequently Reduces the Limit**

The Board has proposed in Comment 3(b)-2.iv(C) that an account can retain its exemption if there is an initial extension of credit over the threshold, even if the creditor subsequently lowers the credit limit. Again, this proposal raises concerns about spurious open-end credit. A creditor could make an extension of $52,000 for an automobile or motorcycle on a purported "credit card" account. This transaction, which involves an initial extension of over $50,000, would be exempt from all of TILA's protections, including disclosures and substantive credit card protections. Critically, it also would not have the benefit of a closed-end transaction for which, even when exempt from TILA, state contract law generally does not permit the creditor to retroactively raise interest rates.

Then the creditor could close the credit line or reduce it significantly. Yet even without the ability to "draw" on the account, the account is still exempt from TIL coverage, and the creditor is free to retroactively raise the interest rate and not comply with other substantive protections for credit cards. We urge the Board to delete the proposed Comment.

**E. The Board's Proposed Phase-In Period Is Unnecessary.**

The Board's proposal for an extended phase-in period for open-end accounts that were exempt under the old threshold, but that will not be exempt under the new threshold, is unjustified. The Dodd-Frank Act became law on July 21, 2010. It clearly set forth the new threshold, and it specified its effective date as the date of transfer of authority to the new Consumer Financial Protection Bureau.[13] On September 20, 2010, the transfer date was established as July 21, 2011.[14]

Accordingly, creditors have known since July 21, 2010, that any existing open-end accounts would be subject to a new threshold, and they have known since September 20, 2010, that the effective date of the new threshold would be July 21, 2011. Yet the Board has proposed to give these creditors an additional full year to comply with TILA. The claim that some creditors would have difficulty retooling their systems to provide TIL disclosures is hard to believe. In all probability, almost all of the issuers for exempt accounts also issue credit cards that are not exempt and already have systems in place for complying with TILA. If they do not already comply with TILA, surely there are third-party vendors to assist them with such systems.

Even if creditors could claim credibly that it would be difficult to retool their systems to make TIL disclosures, the Board's proposal is far too broad. The Board's proposal would allow these creditors not only to avoid making TIL disclosures, but also to ignore all of TILA's important substantive protections for credit card users. Since the only justification cited by the Board in its proposal is creditors' claim that it will be difficult to make TIL disclosures, there is no reason to provide an extended phase-in period for any other TIL requirements.

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[13] Pub. L. No. 111-203, § 1100G, 124 Stat. 1376 (July 21, 2010).
[14] 75 Fed. Reg. 57252 (Sept. 20, 2010).

## III. CLOSED-END CREDIT

The only complexity for the threshold when applicable to closed-end credit involves credit extensions for products like construction loans in which the total amount of credit is not actually provided at consummation. We agree with the Board's proposed application of the threshold to these products.

The only caution we suggest is that the Board should ensure that contracts are not structured just to qualify for the exemption. Consumers will not have any real way of knowing and understanding the effect of agreeing to a transaction above the threshold. So creditors should be prohibited from deliberately providing a loan commitment in an amount above the threshold, when the amount over the threshold is unlikely to be drawn, just to avoid coverage of the loan.

For example, assume a consumer requests a construction loan on a vacation home in the amount of $30,000. The terms of the loan would only permit draws to accomplish the work outlined in an attached construction proposal, and there is no reasonable expectation that the costs of this work will exceed $40,000. Because of the restrictions in the loan contract triggering draws on the loan commitment, there is no foreseeable way in which more than $40,000 could be drawn. In this instance, the creditor should be prohibited from taking advantage of the exemption for a credit extension of $51,000, because setting the loan amount this high would appear to be for the sole purpose of evading coverage under the statute.

To accomplish this prohibition, the Board should add a Comment to § 226.3(b) that outlines such a scenario and states that in this type of circumstance the exemption would not apply, and the loan would be considered covered by TILA.

We do agree with proposed Comment 3(b)-5 that the exemption to the threshold does not apply to loans secured by a mobile home used or expected to be used as the principal dwelling of the consumer.