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October 28, 2004

Federal Trade Commission
Office of the Secretary
Room H-159 (Annex R)
600 Pennsylvania Avenue, N.W.
Washington, DC 20580
https://secure.commentworks.com/ftcprescreen/

RE: FACTA Prescreen Rule, Project No. R411010 –
Comments of Capital One Financial Corporation

Dear Sir or Madam:

Capital One Financial Corporation ("Capital One") appreciates the opportunity to comment on the Notice of Proposed Rulemaking and Request for Public Comment (the "Proposed Rule") issued by the Federal Trade Commission (the "FTC") proposing new disclosures regarding consumers' right to opt out of prescreened solicitations. The Proposed Rule is required by section 213(a) of the Fair and Accurate Credit Transactions Act (the "FACT Act").

Headquartered in McLean, Virginia, Capital One Financial Corporation (http://www.capitalone.com) is a holding company whose principal subsidiaries, Capital One Bank and Capital One, F.S.B., offer consumer lending products and Capital One Auto Finance, Inc., offers automobile and other motor vehicle financing products. Capital One's subsidiaries collectively had 47.2 million accounts and $75.5 billion in managed loans outstanding as of September 30, 2004. Capital One, a Fortune 500 company, is one of the largest providers of MasterCard and Visa credit cards in the world. Capital One trades on the New York Stock Exchange under the symbol "COF" and is included in the S&P 500 index. Capital One makes many of its offers to consumers through prescreened solicitations. Prescreening allows Capital One to send offers to consumers that are more likely to appeal to their specific needs and interests.

Overview of Comments

We appreciate the FTC's efforts to make the prescreening disclosure "simple and easy to understand," as required by Section 213(a) of the FACT Act. However, we

believe the proposed layered-notice approach would not effectively educate consumers about the benefits of prescreening and would distort consumer choices regarding the prescreening opt-out. Consumers may also wrongly perceive such a conspicuous and cautionary notice as a "do-not-mail" opt-out.

Our corporate history demonstrates the significant consumer benefits of the current prescreening system. We have built a large, successful business by offering consumers the best product and terms possible based on our understanding of their unique credit history. By understanding a consumer's credit characteristics before making them an offer, Capital One can make credit available to a larger population at a lower cost than if prescreening were not available.

Because the layered notice focuses much more closely on the opt-out process than on the benefits of prescreening, we oppose the layered-notice approach taken by the Proposed Rule. We support the improved notice ("version 2") in the Proposed Rule, because we believe it would effectively satisfy Congress's instruction that the FTC make the prescreening disclosure "simple and easy to understand" by allowing consumers to make a balanced choice about opting out of prescreened solicitations. In fact, the FTC's own study does not appear to support the need for the layered approach. For example, the study appears to demonstrate that the FTC's "improved version" of the prescreened solicitation that does not rely on a layered approach conveys the notion that the consumer could opt out of prescreening virtually as effectively as the layered version.[1] The study suggests that equal numbers of consumers understand the right to opt out regardless of whether they received the layered notice or the improved notice. Furthermore, of those who are interested in reading further (or, as measured by the study, those who are forced to read the prescreen disclosures), roughly equal numbers understood how to opt out, again regardless of whether the layered notice or the improved notice was provided. It would appear, therefore, that the layered notice provides little to no advantage over the improved notice tested by the FTC.

Our more detailed comments below (1) highlight the unintended harms that the Proposed Rule would generate for consumers and (2) explain costs and difficulties associated with the layered notice approach that the Proposed Rule does not take into account.

A. The Layered Approach Would Generate Significant Negative Impacts for Consumers.

We recommend that the FTC adopt the proposed "improved" version 2, which uses simpler and clearer language than the layered notice approach, which requires a short-form notice on the front page that largely restates the content of the segregated longer notice. Contrary to the FTC's intent, the layered notice will harm consumers because the prominence of the front-page notice which includes the 800 opt-out phone

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[1] According to the study, approximately 31% of respondents who saw the layered notice said the notice told them they could opt out of prescreening. Approximately 28% of respondents who saw the improved notice said the same thing.

number will encourage consumers to opt-out of prescreened solicitations without understanding the benefits of prescreened offers. Capital One's experience supports the findings of a June 2003 study by the Information Policy Institute (the "IPI study"), which found that prescreening has helped to dramatically lower interest rates on credit cards and to increase consumer access to such products.[2]

Our main concerns with the layered notice are: (1) it does not adequately educate consumers about the benefits of prescreening; and (2) worse, consumers may reasonably misinterpret the prescreening opt-out as a "do not mail" opt-out, which is not the case.

Consumer Benefits

Prescreening generates significant benefits that consumers should know about when they make their opt-out decision. Capital One recently responded to a request for comment by the Federal Reserve regarding its ongoing study of prescreening. Our letter outlines in detail the significant consumer benefits of prescreening, and disproves the hypotheses that prescreening generates more paper mail or leads to an increase in identity theft. **We have attached our letter to the Federal Reserve dated July 23, 2004 regarding the benefits of prescreening as Exhibit A.**

The key points in our letter to the Federal Reserve are:

- Prescreening plays a critical role in the national credit granting process.
- Prescreening lowers costs for consumers, because of vigorous price competition among issuers.
- Prescreening improves the consumer's buying experience by providing targeted, firm offers of credit, rather than untargeted "invitations to apply."
- Accounts obtained through prescreening have a loss rate of approximately one-fourth to one-half of those associated with accounts obtained through other means.
- Fraud losses on prescreened accounts, including those attributable to identity theft, are approximately one-seventh of those associated with accounts obtained through other means.
- Fewer consumers are victimized by identity thieves and other fraudulent operators when prescreening is used as a vehicle to provide them credit.

In light of the significant benefits generated by prescreening, we disagree with what appears to be the fundamental underlying premise of the Proposed Rule: that the primary goal of the prescreening opt-out disclosure should be to maximize the total number of consumers that opt out of receiving prescreened solicitations. We believe that

[2] *The Fair Credit Reporting Act: Access, Efficiency & Opportunity*, Information Policy Institute, June 2003. In particular, the IPI study indicated that in 1990, only 6 percent of card balances were below 6.5 percent APR, and 93 percent were above 16.5 percent APR. By 2002, 74 percent of all outstanding balances were at interest rates below 18 percent, 15 percent of balances were at interest rates under 5.5 percent, and only 24 percent of outstanding balances had interest rates above 18 percent.

the goal of the prescreening opt-out disclosure is to allow consumers to make a balanced, informed choice about opting out. We do not believe that the layered approach would effectively accomplish that goal, and would result instead in several significant negative consequences, which we outline below.

1. The Layered Notice Would Generate Significant Consumer Confusion about Whether Opting Out of Prescreened Solicitations Would be Beneficial.

Unlike the "Do Not Call" list, opting-out of prescreening will not reduce the flow of mail to consumers. Instead, lenders would likely revert to the untargeted mass-mailing practices prevalent before prescreening was developed. Consumers would likely receive more non-prescreened "invitations to apply" that will result in lower approval rates, or less attractive and more expensive offers. Unlike such "invitations to apply," prescreened offers under the Fair Credit Reporting Act ("FCRA") require a lender to provide a potential customer with a firm offer of credit. Such firm offers greatly improve approval rates and thus reduce the potential uncertainty or stigma of rejection. Furthermore, greater reliance on non-prescreened offers would result in consumers being more likely to apply for credit without knowing the precise terms for which they are eligible, which, in turn, could lead to more consumer complaints by those not eligible for the best terms. We believe that consumers who have read only the short form notice provided in the layered notice approach would be extremely surprised and confused by this result.

We believe the layered notice is flawed, because it will encourage ill-informed decisions that may harm consumers and competition. Solicitations based on prescreening are one of the primary drivers of credit card competition, which has created a robust and highly competitive market. It allows consumers to become informed about other options, to shop for, select, and obtain better terms, particularly as their credit scores improve. Encouraging them to opt out with an inappropriate and unwarranted "warning label" style notice on the first page, without a balancing explanation of the potential benefits of inclusion, would harm consumers and competition. The layered notice would likely lead many of these consumers to opt out without a full understanding of the consequences of that decision.

In addition, the reference to the term "prescreening" on the front page may also be confusing because it is likely that some consumers will be unfamiliar with the term or not appreciate that it is a term of art. For example, many consumers may not understand that "prescreening" refers to an offer that includes an obligation on the part of the lender to provide the consumer with a firm offer of credit. Consumers may not appreciate the important distinction between such offers and non-prescreened alternatives that do not include firm offers, and thus typically result in higher turn-down rates. The front-page notice would do nothing to educate consumers about this vital point, thus contributing to potentially uninformed decisions about whether to opt out.

The front page notice also includes a sizable toll-free number which consumers may mistakenly assume can also be use to contact the lender and/or reply to the credit offer. This could lead to further consumer frustration and confusion. In addition, it may

require the toll-free operators to redirect consumers to the lender's toll-free number to apply for credit.

The risk of confusion is greatly reduced if consumers read the *full* disclosure before deciding to opt-out. The "warning label" required by the layered-notice approach makes it far less likely that a consumer would read the longer notice, realize the benefits of prescreening, and make a more educated decision about whether to opt-out of receiving additional prescreened solicitations. This result clearly reflects the intent of Congress, as expressed in the statute and its unequivocal legislative history.

In amending the FCRA in 2003, Congress directed the FTC to increase the public awareness of not only the right to opt out, but also of the benefits and consequences of this decision. Specifically, Congress recognized that a consumer's decision to opt out of receiving prescreened offers of credit has greater consequences than "simply deciding to limit the number of direct mail pieces delivered to the" consumer.[3] For instance, Congress recognized that many consumers will become aware of their eligibility for better credit terms only after receiving prescreened credit offers.[4] As a result, Congress sought to ensure that a consumer's decision to opt out was made in an informed manner because of the possible consequences of this decision.

To minimize consumer confusion, we therefore support a single disclosure that informs consumers about the benefits and costs of prescreening, such as version 2 in the Proposed Rule.

2. The Layered Notice Would Limit Consumers' Access to Credit and Would Increase the Cost of Credit.

Consumers who opt-out of prescreened solicitations would likely receive more expensive offers of credit, because credit issuers would not be able to verify in advance the creditworthiness of that consumer. Prescreening allows lenders to review a consumer's creditworthiness at two different points in time:

1. Marketing Stage – when identifying creditworthy consumers using prescreen criteria.

2. Application Stage – when reviewing credit applicants using the prescreen criteria and information supplied on the application.

Having two snapshots of a consumer's credit profile, rather than one, gives lenders the ability to track changes in their profile from marketing to application stage and use this information to more accurately gauge the consumer's true credit risk to the institution. Lenders can then make precise adjustments to offer terms like Annual Percentage Rate ("APR") or credit line (subject to UDAP limitations) that increase the likelihood an applicant will be approved and minimize the lender's credit risk. This refinement keeps the cost of credit low.

[3] Letter from Representatives Bachus and Kanjorski to Chairman Majoras, FTC (Oct. 12, 2004).
[4] *Id*.

The cost of credit is also impacted by processing costs. According to a recent Visa Functional Credit Study, credit processing costs are approximately $10 per account for prescreened solicitations, $25 per account for non-prescreened solicitations, and $18 per account for branch/indirect solicitations. For example, processing costs for internet non-prescreened offers are approximately seven times greater than the costs associated with similar prescreened offers. We transfer these cost efficiencies to our customers through lower interest rates and better product terms.

Because the prescreening opt-out now lasts for five (5) years, it is likely that consumers who opt-out of prescreened solicitations will miss the opportunity to receive better credit offers as their credit improves over that period. This will disadvantage consumers who are new to the credit reporting system, such as recent immigrants and young people. It is particularly important for those with little credit history to become aware of new products. The eligibility of these consumers improves fairly rapidly, as they demonstrate their ability to repay debts successfully. Without prescreened solicitations, those consumers will be unaware of products with better credit terms and products that better suit their needs. Similarly, consumers who improve past poor credit performance will become eligible for more attractive products over time. Again, the layered approach, with its inappropriate focus on the incomplete "warning label" notice, fails to inform such consumers adequately of this consequence

We believe that the goal of the prescreening opt-out disclosure should be to educate consumers in a balanced fashion about the merits of prescreening, the potentially negative consequences of opting out, and method by which a consumer may opt out. The layered notice would focus the consumer's attention on the method of opting out by prohibiting lenders from explaining the other points mentioned above on the front page. We do not believe that such an approach effectuates or balances the clear intent of Congress in asking the FTC to make the disclosure fully informative, as well as "simple and easy to understand."

3. The Layered Notice Would Be Inconsistent with Regulation Z and Would Create a Systemic Conflict with Disclosures that Must Be Clear and Conspicuous.

We also believe that the layered approach would have the unintended, yet detrimental effect of overshadowing more important terms and disclosures, thereby creating a potential legal conflict with competing "clear and conspicuous" notice requirements. For instance, requiring lenders to disclose the short notice and toll-free number on the front page undermines the legally-mandated prominence of Regulation Z disclosures like the Schumer Box. The front page notice would draw the consumer's attention away from the more important Regulation Z disclosures and description of terms that are critical for the consumer to understand before applying, such as APR. We do not believe that the typical consumer would find the prescreening opt-out to be a more important element of the credit transaction than the pricing terms.

In addition to the conflict with the specific requirements of Regulation Z, we are very concerned about the proliferation of legal standards regarding credit disclosures and the tremendous difficulty, if not impossibility, of judging which disclosures should be more conspicuous than others. The layered approach arguably would constitute the most clear and conspicuous disclosure in a credit or insurance solicitation. It is becoming increasingly unclear to lenders and insurers how to assess which disclosures should be more conspicuous than others, and the layered approach would add to this systemic uncertainty.

B. The Cost Estimates of Compliance in the Proposed Rule Are Too Low, Because The Estimates Do Not Reflect Many Significant Costs to Lenders.

The costs to the industry are many dozens of times higher than the estimate contained in the Proposed Rule, because the Proposed Rule does not account for a number of costs. The Proposed Rule estimates that the time to revise the notice and re-format the solicitation is about eight (8) hours and that about seven hundred fifty (750) entities will be affected. Incredibly, the Proposed Rule estimates that the cost to the entire industry of the layered notice will be between $110,000 and $167,000. The per-bank cost estimate would therefore be approximately $537.24. This is based on two hours of professional's time (at $31.55 per hour) and 6 hours of technical labor. We do not understand the source of these estimates and believe these figures are far too low. In addition to grossly understating the operational costs and disruption to large scale lenders like Capital One, these estimates also do not account for a number of costs to lenders and consumers.

Specifically, the Proposed Rule does not account for the following costs, in addition to the costs associated with adding the layered notice to solicitations. Lenders would face costs associated with sending less-targeted solicitations to potential customers. These less-targeted solicitations would be far less efficient at matching the consumer to the right product, and would therefore generate significant additional marketing costs. As discussed above, issuers would be likely to mass-mail these less-targeted solicitations as "invitations to apply." In addition, other costs are difficult to quantify, but would surely be borne by the industry, such as having to build new credit risk models to compensate for opt-out populations and training call center associates to be prepared for the consumer confusion discussed earlier in this letter. We believe that these costs could run in the millions of dollars for each lender, thereby costing the industry tens or hundreds of millions of dollars. The Proposed Rule does not account for any of these costs, and their exclusion suggests that the FTC should significantly re-evaluate the Proposed Rule.

C. The Final Rule Must Provide Lenders More Time to Comply with the Disclosure Requirements.

Lenders would need more than sixty (60) days to comply with the new regulation, because solicitations are planned several months before mailing, and last-minute copy revisions are operationally disruptive and extremely expensive. In addition, consumers

are often asked to respond to prescreened solicitations by a certain date. Mail delays caused by last-minute copy revisions would cause lenders to also alter these expiration dates and their application decision models. Also, many prescreened solicitations are based on templates that are "locked-down" to prevent inadvertent errors that may lead to disclosure violations. Lenders may revise these templates as infrequently as once or twice per year.

For the foregoing reasons, we request that the FTC allow the financial services industry at least nine (9) months to comply with any new disclosure requirements.

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In conclusion, we support the version 2 disclosure contained in the Proposed Rule. We oppose the layered notice approach, because we believe it will distort consumers' choices and lead to unintended consequences that consumers will neither expect nor desire. We also believe that the Proposed Rule does not account for significant costs that the layered notice would generate for lenders and consumers. Finally, we believe that the final rule should allow companies at least nine (9) months to comply with any new disclosure requirements.

We appreciate the opportunity to respond to the Proposed Rule. If you have any questions about this letter, please contact me at (703) 720-2266.

Sincerely,

/s/ Andres L. Navarrete

Andres L. Navarrete
Director and Associate General Counsel
Capital One Financial Corporation

EXHIBIT A

Attached letter dated July 23, 2004 from Capital One Financial Corporation to the Board of Governors of the Federal Reserve System regarding the Federal Reserve's prescreening study