**EXHIBIT A**

Capital One

**Capital One Financial Corporation**
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July 23, 2004

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551
Regs.comments@federalreserve.gov

RE: Docket No. OP-1195 – Request for Information for Study on Prescreened Solicitations or Firm Offers of Credit or Insurance – Comments of Capital One Financial Corporation

Dear Sir or Madam:

Capital One Financial Corporation ("Capital One") appreciates the opportunity to comment on the Notice and Request for Public Comment (the "Notice") issued by the Board of Governors of the Federal Reserve System (the "Board") that seeks information regarding (the "Study"). The Study is required by section 213(e) of the Fair and Accurate Credit Transactions Act (the "FACT Act").

Capital One had 46.6 million customers and $73.4 billion in managed loans outstanding, as of June 30, 2004. A Fortune 200 company, Capital One is one of the largest providers of MasterCard and Visa credit cards in the world. 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.

We encourage the Board to conduct the Study, because we believe the benefits of prescreening deserve greater public attention. Our corporate history demonstrates the consumer benefits that the current prescreening system can produce. 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.

In an effort to highlight the significant benefits that prescreening provides to both consumers and lenders, we would like to offer the following comments on the Notice.

## A. Prescreening Provides Significant Benefits to Consumers and Lenders.

Prescreening enables companies like Capital One to better identify potential customers and make better credit decisions that ensure the safety and soundness of the lending institution. Prescreening also benefits consumers by increasing the availability of credit, simplifying access, and reducing prices. In addition, prescreening allows consumers to receive firm offers of credit, which significantly reduces the fear and stigma of rejection that has historically characterized the traditional customer-initiated credit application process.

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.[1] Prescreening accounts for more than two-thirds of all new credit card accounts. These statistics suggest that a substantial portion of all credit cards currently held by consumers were initially obtained through prescreening.

Some have argued that prescreening constitutes "marketing" rather than "underwriting" and, therefore, represents a less important component of our uniform national system. As the discussion below illustrates, this distinction is inappropriate, and misunderstands the vital interdependencies of the current system. Stated more plainly, our current system cannot operate effectively without all of its constituent parts, including prescreening.

### 1. Prescreening Plays a Critical Role in the National Credit Granting Process.

Prescreening enhances the reliability of credit underwriting decisions, helps reduce the cost of credit to millions of consumers, and expands the availability of credit, including to traditionally underserved populations. Moreover, prescreening is one of the most important catalysts for the intense competition in today's consumer credit marketplace, particularly in credit cards, but also increasingly in auto finance and other lending markets. The widespread availability of credit produced by prescreening and

[1] *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.

other factors has contributed to the broad economic growth that the United States experienced in the 1990s and today.

### 2. Prescreening Lowers Costs for Consumers.

Because prescreening is a highly cost-efficient and proven way to help institutions identify prospective customers, both consumers and credit grantors enjoy enormous benefits from this system. Consumers benefit in the form of significantly lower costs for credit, and credit issuers benefit through large reductions in underwriting costs. Economist Robert Turner of the Information Policy Institute has noted in congressional testimony that, since 1997, consumer savings in the cost of credit from the increased competition in the credit card industry – largely enabled by prescreening – is about $30 billion per year.[2]

Specific examples show the significant cost savings that prescreening generates. 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. Capital One's experience supports this position. Processing costs for Capital One's 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.

Prescreening also enables Capital One to pass lower costs along to our customers by offering better products. We could not make certain offers to consumers without the ability to prescreen them. For instance, our Platinum product includes a fixed Annual Percentage Rate as low as 2.99% when offered through the prescreened direct mail channel. This lower rate is a result of the more comprehensive credit risk information we are able to obtain through prescreening. In contrast, where such information is not available, such as through a non-prescreened Internet channel, Capital One must balance the higher risk we assume with a higher rate – for example, an 8.9% fixed rate -- to compensate for this lack of knowledge.

In addition to lowering costs by better managing risk, prescreening also reduces the cost that consumers pay for credit by driving down creditors' costs of finding their desired customers. Prescreening reduces search costs for new customers, enabling creditors to enter new markets. According to the IPI study, in the absence of prescreening, total costs to consumers would increase between $269 million to $1.36 billion per year. These costs would stem from the increase in the costs of acquisition, such as higher mailing costs and higher telephone solicitation costs.

As a consequence of these significant cost reductions, lenders are also able to offer credit to traditionally underserved consumer groups. Consumers with tarnished or less developed credit histories present a higher risk to financial institutions. Prescreening

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[2] Testimony of Michael Turner, The Information Policy Institute before the Subcommittee on Financial Institutions, Committee on Financial Services, U.S. House of Representatives, May 8, 2003.

allows such institutions to understand these risks more fully, thereby allowing them to tailor specific products for these consumers to ensure that both the consumer and the institution do not take on inappropriate risk.

### 3. Prescreening Greatly Enhances the Ability of Credit Grantors to Accurately Assess Risk and Avoid Losses.

Our experience confirms that losses from customers obtained through prescreened offers of credit are significantly lower than losses from customers obtained through non-prescreened channels.[3] The reason is that prescreening allows lenders to determine more accurately the credit risk of individual consumers. Unlike other retail businesses where money is paid at the time of purchase, lending involves the provision of money in exchange for the promise to pay. Prescreening permits us to obtain the necessary information to properly assess risk, and to mail an offer that best suits the needs and circumstances of particular customers. In doing so, we can make prudent determinations regarding the probability of repayment and the appropriate credit line or loan amount to be offered.

Consequently, we know that customers acquired via prescreening are, on average, less likely to default than consumers acquired via other means. For example, customers acquired through prescreening have a loss rate of approximately one-fourth to one-half of those customers whose accounts were obtained through other means.[4] Charge-off rates are important determinants for the pricing of credit offerings and acceptance rates, and reductions in charge-offs improve the safety and soundness of the national lending system.

### 4. Prescreening Fosters Competition in the Credit Card Industry.

We believe that prescreening is the most important factor driving competition for consumer credit. Because prescreening allows financial services firms to identify the credit characteristics of individuals with whom customer relationships are sought, credit issuers are able to offer their credit products with tailored terms and conditions specifically designed to "beat the competition." The attractiveness of our offers necessarily depends upon the quality of the data we have about a particular consumer's credit standing.

Increased transparency for the lender translates into more competition among suppliers of credit. Lenders know that consumers can compare prescreened offers effectively and must make their offers as attractive as possible in order to compete. This competition leads to lower rates and innovative ways to attract consumers. For example, vigorous competition in the credit card industry, due in large part to prescreened offers, has resulted in the development of literally tens of thousands of credit card products

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[3] Examples of such non-prescreened channels include "invitation to apply" direct mail, in-store "take-one" applications, and the Internet.

[4] Testimony of Clinton W. Walker, Chief Administrative Officer and General Counsel, Juniper Bank, June 4, 2003, before the House Committee on Financial Services.

targeted at consumers in all economic strata who have widely divergent interests and needs. Current credit card products now range from the popular airline miles rewards cards to cards that respond to the interests of consumers in being identified with popular philanthropic causes.

The success of prescreening in the credit card market has also fostered innovation in the auto finance market. Some of our successful auto refinance products, which can save consumers up to four percentage points on their loans, are made possible through prescreening. Bureau data allows us to determine which consumers would benefit from a reduction in their Annual Percentage Rate, and helps to ensure that our offering will, in fact, save them money.

Among the chief barriers to entry for potential new entrants into the market for consumer credit is the cost associated with finding qualified credit applicants. Finding consumers to whom an aspiring lender can make an offer of credit at rates that are competitive and profitable is difficult. Prescreening offers a mechanism for small, medium, and large lenders to acquire reliable and current information regarding qualified borrowers on a national basis. Prescreening gives lenders access to a nationwide group of consumers, which creates significant opportunities for competition that did not exist when banking occurred primarily at local branches and focused on relationships and localized credit data-gathering. Without access to such information, the cost of entry into credit markets could be prohibitively high. Restrictions on prescreening would make it harder for new players to enter the market for consumer credit, thereby reducing competition, which would in turn increase the price of credit and reduce access to credit.

As noted above, prescreening also fosters innovation. The many benefits attached to modern credit card products are largely a function of prescreening. Airline miles, cash rebates, contributions to college savings plans, store discounts, merchandise – all of these reward programs have become commonplace to the point of being expected, if not demanded, by consumers. Few, if any, such programs existed just two decades ago. Such programs are naturally dependent on information about consumer preferences, but they also depend largely on improved risk analysis to keep losses – and costs – down. The importance of lower costs in this context is significant – benefits such as airline miles cost lenders money. These programs will be less viable if high credit losses limit lenders' ability to create, market, and support the types of programs that consumers value.

### 5. Prescreening Improves the Consumer's Buying Experience.

Prescreened solicitations generate fewer adverse action notices for consumers. Capital One experiences significantly higher approval rates for prescreened solicitations than for non-prescreened solicitations, which greatly improves the consumer's experience and satisfaction. Prescreened solicitations are approved more than twice as often as non-prescreened solicitations, and prescreened solicitations are approved almost twice as often as indirect/branch solicitations.

A consumer who receives a prescreened offer is also more likely to receive a more attractive offer of credit. Because the lender has been able to review the consumer's credit characteristics prior to making the offer, the lender can offer the consumer a set of product terms that the consumer is more likely to accept. Depending on how a non-prescreened offer is structured, a consumer is more likely to be declined for such an offer or to receive different terms than the terms contained in the original offer. While lenders who make prescreened offers may provide a consumer with terms that are different from the original offer if their creditworthiness has changed, the nature of the prescreening process makes this outcome much less likely than for non-prescreened offers.

## B. Prescreening Is Not Associated with Increased Identity Theft, and Prescreening by its Nature Actually Reduces the Incidence of Identity Theft.

The fraud risk associated with prescreening has been greatly mischaracterized and is unsupported by factual data. Because the process of prescreening involves additional confirmation of a consumer's identity, prescreening actually works to reduce identity theft and other forms of fraud in connection with the opening of new or additional accounts. Our data demonstrates that rates of application fraud are ten to fifteen times lower for credit generated through prescreening than from credit generated through other channels, such as the Internet and in-store brochures. Our experience is supported further by research contained in the IPI study, which concluded that prescreened credit card solicitations are significantly less likely to result in fraud than other forms of account acquisition. According to the IPI study, prescreening-specific procedures identify between 60% and 80% of all fraudulent applications before accounts are opened – a considerably higher rate of prevention than with other application channels.[5] Furthermore, additional fraud prevention techniques are applied when prescreened applications are accepted.

The assumptions underlying the argument that prescreening increases the risk of identity theft are incorrect. This argument usually assumes that prescreened solicitations make it easier for someone to apply for credit in someone else's name. For instance, some have argued that prescreening facilitates identity theft, because a thief merely has to steal and sign a prescreened response form and add a new address, and the request will be approved and a credit card sent to the thief. This argument assumes that the original offers contain sufficient information about individual consumers so that the response form need not be completed with additional personal data. It also does not acknowledge that credit requests in response to prescreening are put through the same security processes as non-prescreened credit applications. Both of these assumptions are incorrect.

Prescreened offers do not contain enough information to permit someone to commit identity theft. Prescreened offers contain only names and addresses, which is less information about a consumer than can be found in a telephone book. Such solicitations do not contain social security numbers, dates of birth or other sensitive

[5] See IPI Study, page 61.

information. In reality, consumers themselves must supply any additional information required by completing a blank response form, typically data used in the identification process. To commit identity theft, therefore, the potential criminal would need additional information that a prescreened solicitation does not contain.

The process that lenders use to process prescreened solicitations also provides a vital additional layer of protection for consumers. Once an applicant has provided data back to the lender, lenders verify the information supplied by the applicant and obtain updated credit report information. In practice, lenders use the same types of security procedures to verify the identities of consumers who respond to prescreened offers as they use for consumers who respond to non-prescreened credit applications. Thus, lenders have two opportunities to check the consumer's identity for prescreened applications—at the time of prescreening and at the time of response.

The IPI study confirms that the incidence of identity theft is lower for accounts established through prescreening than for accounts established by other means. As the IPI study states, losses from fraudulent credit card applications "account for significantly less than one-hundredth of one percent of credit card sales volume and less than five percent of *all* credit card fraud."[6] [Emphasis in the original] Therefore, prescreened solicitations are far less likely than other solicitations to contribute to identity theft, and they also appear to result in an insignificant contribution to the overall amount of identity theft.

Other data shows that prescreened solicitations are not a significant factor in cases of identity theft. Prescreened solicitations, whether made via mail or telephone, are a factor in less than 1% of reported cases of the identity theft. As discussed above, this limited incidence of identity theft reflects the fact that customers acquired via prescreening are subject to additional screening mechanisms above and beyond those required of other applicants. This screening process makes it significantly more likely that a lender will solicit the intended recipient and not someone else. According to a 2002 GAO report,[7] less than 0.7% of the cases of identity theft (where the method by which the information was stolen was known) involved a telephone or mail solicitation. "Prescreened" credit solicitations represent an even smaller fraction of this category.

In light of the frequent assertions by some groups regarding the identity theft risks posed by prescreening – unsupported, to our knowledge, by statistical research – we respectfully request that the Board include in its final report a discussion of this data and the protections that the prescreening process provides to consumers.

## C. The Board Should Not Recommend any Additional Restrictions on Prescreening.

The Board requests comment on whether further restrictions should be placed on the ability of lenders to provide prescreened solicitations and asks how these restrictions

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6 See IPI study, page 60.
7 See GAO-02-363 (2002).

would benefit consumers, how they would affect the cost consumers pay to obtain credit or insurance, the availability of credit, consumers' knowledge about new or alternative products and services, the ability of lenders to compete with one another and the ability of creditors to offer credit to consumers who have been traditionally underserved.

We believe that additional restrictions on prescreened solicitations would not be in the best interests of consumers. Congress has recognized that some consumers may not wish to receive offers of credit that result from prescreening. To address this concern, the Fair Credit Reporting Act provides for an opt-out mechanism that must be clearly and conspicuously disclosed to any consumer who receives a written prescreened solicitation. This opt-out mechanism has balanced the desires of some consumers not to receive prescreened offers while preserving the broader benefits of prescreening for all consumers. In addition to the statutory opt-out requirements, consumers can also take advantage of other ways to opt out of prescreening. Furthermore, Congress recently directed the Federal Trade Commission to issue regulations with respect to the prescreening opt-out disclosures and to publicize the availability of the right to opt out of prescreening. Given the benefits to consumers of prescreening, and the ability to opt out of receiving prescreened solicitations, we do not believe that any additional changes to the prescreening process are necessary at this time.

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In conclusion, Capital One believes that prescreening provides consumers with significant benefits, and it does not heighten the risk of identity theft. In fact, both the nature of prescreening and industry data show that prescreened mail solicitations are less likely to result in identity theft than typical mail solicitations. We respectfully request that the Board reflect our analysis and positions in its final report to Congress.

We appreciate the opportunity to respond to the Notice. 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