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June 23, 2004

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

Re: Regulation DD; Docket No. R-1197

Dear Ms. Johnson:

We appreciate the opportunity to comment on the proposed amendments to Regulation DD[1] issued by the Board of Governors of the Federal Reserve System ("Board"). For over 10 years, Strunk & Associates has consulted with banks, thrifts and credit unions throughout the country in connection with Strunk's Overdraft Privilege[sm] Program. We share the Board's concerns with the practices of some in the industry that may have misled consumers with respect to the true nature of discretionary overdraft protection services, and we agree that the more appropriate vehicle to address those concerns is Regulation DD,[2] which implements the Truth in Savings Act,[3] rather than Regulation Z. While we agree with many provisions of the Proposal, we do have some concerns about certain of the apparent underlying assumptions regarding overdraft protection services. We hope that our comments will be helpful to the Board and its staff in clarifying what we think are misconceptions about such services. Our comments on the Proposal are set forth in detail below and are identified by the title of the section of the Proposal to which they relate.

**Summary**

The Proposal states that "[b]ounced-check protection is an *automated* service that is *sometimes* provided to deposit account consumers as an alternative to a traditional line of

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[1] 69 Fed. Reg. 31760 (June 7, 2004) ("Proposal").
[2] 12 C.F.R. Part 230 ("Regulation DD" or "Regulation").
[3] 12 U.S.C. 4301 et seq.

credit."[4] [5] We believe that it is safe to say that *all* depository institutions have provisions in their transaction account agreements that provide that the depository institutions may, in their sole discretion, pay or return items that are presented against insufficient funds. We also believe that it is safe to say that *all* depository institutions engage in the payment of discretionary overdrafts, employing the same process that has always been utilized by depository institutions, *i.e.*, reviewing account statistics to determine whether to pay or return an item that is presented for payment against insufficient funds. Thus, *all* depository institutions offer a "bounced-check protection" service in some form. The service may be more or less automated, as discussed below, and the institution may or may not disclose the parameters on which decisions are made to pay or return items on the transaction account.[6] It is important, however, that the Board recognize that there is likely not a single depository institution in this country that does not have the option to pay an item presented against insufficient funds and, therefore, that does not offer a "bounced-check protection" service to its customers. Because of the difficulty in distinguishing between "bounced-check protection programs" and the "traditional, *ad hoc*, discretionary payment of overdrafts,"[7] the final rule that the Board adopts will apply not just to a subset of depository institutions that may have entered into contracts with overdraft protection service vendors, but it will likely apply to *all* of the approximately 20,000 depository institutions in the country.

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[4] 69 Fed. Reg. at 31760 (emphasis added).

[5] We would point out that, even if a depository institution provides a traditional overdraft line of credit and/or intra-account transfers for overdraft protection, the depository institution may still rely upon the contractual provision in the transaction account agreement to pay an item presented against insufficient funds if neither of those services is available (e.g., the line of credit is at the maximum credit available or there are insufficient funds in the linked account).

[6] In some states in which guidelines on overdraft protection services have already been adopted, depository institutions are, in fact, encouraged to disclose the details of the service. See Memorandum from A. William Schenck, III, Secretary of Banking, Department of Banking, Commonwealth of Pennsylvania, to the Chief Executive Officers of all Pennsylvania State-chartered Banks, Bank and Trust Companies, and Savings Banks, September 30, 2003 ("Pennsylvania Memorandum"), at p. 4; and, Guidance and Best Practices for Overdraft Protection Programs, State of Washington Department of Financial Institutions, February 26, 2004 ("Washington Guidance"), at p. 3.

[7] The difficulty in articulating the difference between an "overdraft protection program" and the "discretionary overdraft service" that has been employed by all depository institutions for many years is illustrated in the following excerpt from the Pennsylvania Memorandum:

> Almost all depository institutions maintain an overdraft program of some type. In general, these types of overdraft programs are (a) a traditional long-standing discretionary program with an depository institution's payment or non-payment of occasional overdrafts, and with the depository institution assessing or waiving its normal fees applicable to the overdrafts (b) an overdraft program linked to a line of credit product; or (c) a discretionary overdraft program.

Memorandum from A. William Schenck, III, Secretary of Banking, Department of Banking, Commonwealth of Pennsylvania, to the Chief Executive Officers of all Pennsylvania State-chartered Banks, Bank and Trust Companies, and Savings Banks, September 30, 2003. We submit that (a) and (c) as written are indistinguishable.

We are unsure what the Board intends when it characterizes overdraft protection services as "automated" services. All depository institutions, whether or not they have contracted with a third-party vendor, have automated at least part of the process related to the payment or return of items presented against insufficient funds. The American Bankers Association has stated that "[f]or some years, the trend has been to automate this practice [of handling overdrafts], using algorithms to minimize risks and identify those accounts most likely to be brought to positive balance."[8] Typically, that part of the process dealing with the gathering, analysis and reporting of data relating to individual transaction accounts is automated. The level of complexity and objectivity of the process varies widely from institution to institution and is affected by the size of the institution and the volume of items processed in a single day. The data, of course, is used to forecast the likelihood that an overdraft will be recovered by the depository institution and reflects the institution's own individualized assessment of acceptable risk. Under such processes, control reports are generated automatically and may be reviewed by personnel who make the ultimate determination to pay or return the items or who may override the system's recommendations in certain cases. In addition, depository institution personnel are routinely involved in account maintenance functions to suspend, remove or reinstate discretionary overdraft services on transaction accounts. Moreover, a*ll* depository institutions have processes for manual review of items that exceed a certain threshold amount and have the discretion to either pay or return those items. Accordingly, the question arises, what does the Board mean by "automated service?" And, more importantly, what is the significance of the automation of the process in relation to the issues that the Board addresses in the Proposal? In our opinion, the presence or absence of "automation" in any part of the overdraft process is irrelevant to the issues that the Board addresses in the Proposal.

If the Board assumes that the automation of part or all of the process in some way divests the depository institution of its discretion to pay or return the item, we respectfully disagree. Even though part or all of the overdraft payment process may be automated, the depository institution always retains discretion to change any of the criteria it uses to make the determination of whether to pay or reject an item or to raise or lower its risk tolerance level in connection with the payment of overdraft items. Moreover, other factors unrelated to the criteria used to generate reports, recommendations for payment or ultimate decisions may also be relied upon by a depository institution to refuse to pay an item. Depository institutions may receive information relating to the financial condition of a customer from any number of sources, direct or anecdotal and, based on that information, decline to pay overdrafts on that customer's account. And, as indicated above, all depository institutions retain the capability to override the decision or recommendation resulting from an overdraft payment system's analysis and to return, rather than pay, items. Thus, the depository institution always retains the discretion to alter the system criteria as a whole or alter the outcome of the application of those criteria to a single item. The decision to pay or return an item is, therefore, always at the sole option and discretion of the depository institution, in accordance with the terms of the transaction account agreement.

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[8] Comment to Board of Governors of the Federal Reserve System on Docket No. R-1136, by Nessa Feddis, Senior Federal Counsel, American Bankers Association, January 27, 2003, p. 8.

**Concerns About Bounced-Check Protection Services**

The Proposal states that

> [m]ore recently, third-party vendors have developed and sold automated programs to institutions, particularly to smaller ones. What generally distinguishes the vendor programs from the institutions' in-house automated processes is the addition of marketing plans that appear designed to promote the generation of fee income by stating a dollar amount that consumers would be allowed to overdraw and by encouraging consumers to overdraw their accounts and use the service as a line of credit.[9]

In our view, the foregoing statement is inaccurate and potentially misleading in several respects. Generally speaking, third-party vendors, like Strunk, do not "develop[] and sell automated programs." Rather, vendors serve as consultants to assist depository institutions to develop additional, or refine existing, internal reporting systems. Strunk assists its customers in improving their evaluation of the empirical data that is already available to the depository institution but that, in many instances, is underutilized. The result is a more reliable, highly-predictive, risk-based analysis of whether or not to pay overdrafts. Over the years, Strunk has also developed strategic alliances with third-party processors who, working in conjunction with Strunk, develop the necessary interface with the depository institution's existing systems to deliver reports that are designed to enhance and improve the depository institution's ability to make better decisions on whether to pay or return items.

We take strong exception to the Board's statement that "generally" the distinction between "vendor programs" and "in-house" programs is that the former encourage consumers to overdraw their accounts and use the service as a line of credit. Strunk is the largest provider of overdraft protection consulting services in the country. The Strunk disclosures identify in bold print that the depository institution is not obligated to pay any item presented for payment if the account does not contain sufficient collected funds. The disclosures indicate, again in bold print, that the depository institution may refuse to pay an overdraft at any time, and in italics, even if the account is in good standing and even though the depository institution may have previously paid overdrafts. In all capital letters and bold print, the disclosures indicate that the service is always a discretionary service, and, in bold print and underlined, the fact that the service is purely a discretionary privilege or courtesy and that it may be withdrawn or withheld at any time without prior notice, reason or cause. None of the foregoing disclosures is consistent with the characterization of the overdraft protection service as a line of credit. In addition, the Strunk disclosure advises the consumer that "[o]f course, overdrafts should never be used to finance ordinary or routine expenses and you should not rely on overdrafts to cover these expenses. If at any time you feel you need help with your financial obligations please contact a customer service representative at (telephone number of depository institution)." While there may be vendor programs in use today that do encourage consumers to overdraw their transaction accounts and

[9] 69 Fed. Reg. at 31760.

use the service as a line of credit, aggressive marketing is not, as the Board seems to suggest, the exclusive province of vendor-assisted programs. We believe, therefore, it is a inaccurate to say that such practices distinguish vendor programs from "in-house" programs.

The Board indicates that one of its major concerns relates to the adequacy of the information that is provided to consumers about bounced-check protection services. On the other hand, the Board expresses concern about depository institutions' "marketing practices" and includes in the list of those concerns the practice of disclosing the maximum aggregate dollar amount of overdrafts the institution will pay. All of the other examples listed, we believe, are universally accepted as questionable practices. We are perplexed, however, by the Board's position on the disclosure of the maximum aggregate limit on overdrafts. If a depository institution elects to provide more details about its overdraft policies and procedures, we fail to see how the disclosure of the maximum aggregate limit on overdrafts could be viewed in a negative light. We would assume that if information is provided to the consumer about the bounced-check protection service, one of the most important pieces of information that could be given is the maximum limit on overdrafts that would be paid. Apparently, we are not alone in that assessment since the guidance published by the Commonwealth of Pennsylvania and the State of Washington urge depository institutions to disclose those limits.[10] We submit that it may come as a surprise to many people that the internal overdraft limits are as low as they are.[11] That fact alone may encourage consumers to seek alternative means of overdraft protection.

**Concerns About Uniform Disclosure of Overdraft Fees**

The Board acknowledges that "[m]any institutions already provide timely information to consumers about overdrafts in their accounts and the fees imposed, including notices that are sent at the time the overdraft occurs and on the periodic statement."[12] The Board later expresses the concern, however, that "some consumers may not be aware of the total amount of fees being imposed and the amount by which the account is overdrawn until the next periodic statement is received."[13] Based on our experience, in excess of 90% of our customers provide notice of the payment of overdrafts and assessment of overdraft fees on a per occurrence basis. We suspect that the overall industry standard is at least that high or higher. The notices provided usually disclose the amount of the item, the date the item was presented, the disposition (whether the item is paid or returned), the amount of the overdraft created if the item is paid (or, if payment of the item increases the amount of the overdraft, the total amount of the overdraft), the amount of the fee imposed, and the fact that the total amount of the overdraft is payable immediately. Moreover, if additional charges are imposed on the outstanding overdraft until it is paid in full, those charges are typically disclosed as well. The issuance of such notices is not currently required by federal law; however, because federal financial institution regulators generally require that unpaid overdrafts be charged-off within 30 days, depository institutions, in most cases, do not wait until delivery of the periodic statement to notify customers of the amount of

[10] See Note 6 supra.
[11] According to the Proposal, the limits are generally between $100.00 and $500.00. 69 Fed. Reg. at 31761.
[12] Id.
[13] Id. at 31762.

their overdrafts and the associated fees. Thus, we do not believe that consumers are unaware of the total amount of fees being imposed or that they are unaware of the amount of the overdraft being created. In the vast majority of cases, as discussed in greater detail below, consumers whose overdrafts are paid under a discretionary overdraft service receive disclosures that are much more timely and more detailed than the disclosures provided in connection with advances paid under overdraft lines of credit.

**Section 230.6 Periodic Statement Disclosures**

*Overdraft and returned-item fees.* The Board proposes to require depository institutions to disclose on the transaction account periodic statement a total amount for all overdraft fees and a total amount for all returned-item fees for the statement period and year-to-date totals for such fees.[14] We suggest that the Board compare the immediate disclosure of the creation of the overdraft and the fees associated with the discretionary payment of overdrafts with the notices received in connection with overdrafts under a typical overdraft line of credit.

Overdraft fees are disclosed upon account opening pursuant to Regulation DD;[15] the overwhelming majority of depository institutions send notices which disclose the imposition of the overdraft fees and other fees that will accrue, if any, immediately upon creation of the overdraft; and, the transaction account periodic statement, pursuant to Regulation DD, discloses the fees imposed during the statement cycle.[16] In most cases, no notice is provided to a consumer of an advance from an overdraft line of credit until the monthly periodic statement is delivered. Thus, it is possible for an entire month to elapse before the customer receives notice that an advance or advances have been made, that a transfer fee or fees have been incurred, and that periodic interest charges have accrued from the date of the advance(s).[17] Considering the fact that some customers do not review their transaction account statements and make no attempt to reconcile the statements with their own records, it could be months before some customers become aware of an advance from the credit line and the accruing finance charges. In addition, most overdraft lines of credit require automatic payment from the transaction account of the minimum payment due on the overdraft line of credit. As long as there are sufficient funds available in the transaction account on the due date, the balance owing plus accrued charges could be paid in full and the consumer may never be aware that there was an advance. Finally, even if the consumer reviews the periodic statement on the overdraft line of credit, the transfer fees or transaction charges are likely to be disclosed in the very same fashion that overdraft fees are currently disclosed under Regulation DD, *i.e.*, individually, not in the aggregate.[18]

The change in the periodic disclosure of overdraft fees would require substantial reprogramming of systems and redesign of transaction account periodic statements which will

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[14] Id. at 31766.
[15] 12 C.F.R. § 230.4(b)(4).
[16] 12 C.F.R. § 230.6(a)(3).
[17] In connection with an overdraft line of credit, a depository institution may impose both a transfer or transaction fee for each advance from the line of credit and assess a periodic rate of interest on the outstanding balance from the date of the advance.
[18] See 12 C.F.R. Part 226, Supp. I ¶7(f)-2.

obviously result in significant costs. There are approximately 20,000 insured banks, thrifts and credit unions subject to the requirements of Regulation DD that would be required to make changes to their systems and periodic statements to implement the changes in the Proposal. Ultimately, those costs will likely be passed on to consumers. The modicum of additional disclosure does not, in our view, justify what is likely to be a sizeable cost, particularly in light of the fact that there are numerous times at which consumers currently receive the disclosure of the costs of overdrafts. It would seem that, even where no comprehensive disclosure requirement is in place, depository institutions provide more information about the occurrences and costs of discretionary overdrafts than is provided under overdraft lines of credit that are subject to the disclosure requirements of the Truth in Lending Act and Regulation Z.

With respect to the disclosure of the fees on the periodic statement, the standards of Regulation DD and Regulation Z are the same.[19] We do not believe it is necessary to increase the amount of disclosure on discretionary overdrafts when, as discussed above, the disclosure with respect to discretionary overdrafts is already more timely and more detailed than disclosures relating to advances on formal overdraft lines of credit. We believe that the Board's focus would be better directed at the Board's underlying concerns regarding the promotion of overdraft protection services which prompted the Proposal. To the extent that there are abuses relating to the marketing of overdraft protection services, the Board and the other federal depository institution regulators should concentrate on the enforcement of existing laws rather than requiring more disclosure of fees that are already adequately disclosed.

The Board has requested comment on whether the requirement to disclose cumulative year-to-date fee totals should be limited to institutions that "market overdraft payment services, and thereby encourage the routine use of the service."[20] The Board's assumption that the marketing of overdraft payment services automatically encourages the routine use of the service is simply unfounded and untrue. Strunk is the largest provider of overdraft protection consulting services to depository institutions, and, as discussed above, the advertising that Strunk prepares for its customers contains numerous statements that, in fact, discourage routine use of the service. The other concern that we have with the Board's suggestion that the cumulative fee disclosures be limited to institutions that "market" overdraft protection services is the ambiguity in the term "marketing." We would draw the Board's attention to the fact that, under the Washington Guidance, institutions are encouraged to provide "complete *disclosure* of all terms of Overdraft Protection at account set up or when the customer meets 'automatic eligibility' requirements."[21] The Washington Guidance indicates that such disclosures should include, among other things, the overdraft limits and the discretionary nature of the institution's decision to honor an overdraft. Moreover, the Washington Guidance identifies as a "best practice" the provision of a separate brochure, apart from the deposit contract. A depository institution that provides a separate brochure describing its overdraft protection service in compliance with the Washington Guidance, could be deemed to be "marketing" its discretionary overdraft protection service. Under the current definition of "advertisement" in Regulation DD, brochures of the type

[19] Id.
[20] 69 Fed. Reg. at 31763.
[21] Guidance and Best Practices for Overdraft Protection Programs, at p. 3 (emphasis added).

suggested by the Washington Guidance would, we believe, be deemed to be advertisements.[22] The Washington Guidance does not distinguish between depository institutions that "market" their services and those that do not. Thus, to engage in the "best practice" described under the Washington Guidance, all institutions in the State of Washington should deliver a separate brochure that discloses all terms of their overdraft protection services. The applicability of disclosure provisions under the Regulation must be based on a standard that can be clearly articulated. In our view, the Proposal fails to distinguish between disclosure in accordance with state guidance and best practices and "marketing" or "promotion" of overdraft services.

**Section 230.8 Advertising**

*Additional disclosures in connection with automated overdraft services.* The Proposal provides that any advertisement for an "automated overdraft service" should include certain information about the overdraft service.[23] As a preliminary matter, we would urge the Board to clarify what it means by the term "automated overdraft service." As discussed above, all institutions have automated some part of the process of reviewing and making decisions on the payment of overdrafts. How does a depository institution that relies upon system-generated reports to make decisions on the payment of overdrafts determine whether its overdraft service is "automated" under the Proposal?

Irrespective of the answer to what "automated overdraft services" means, we do not believe that whether part or all of the process is "automated" has any bearing on whether the information relating to the process is confusing or misleading or ultimately whether information regarding the overdraft process should be disclosed at all. The Board appears to be concerned that the automation of the overdraft payment process is inherently detrimental.[24] The American Bankers Association has stated that "[a]utomation of the [overdraft payment process] offers, 1) significant reduction in costs by eliminating expensive manual intervention and review by staff and 2) more consistent and fair application so that some customers are not inadvertently favored based on inappropriate factors."[25] Automation of the process allows depository institutions to instantaneously compare large amounts of empirical data with enormous numbers of items[26] and

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[22] See 12 C.F.R. § 230.2(b) and 12 C.F.R. Part 230, Supp. I ¶2(b)-1,
[23] 69 Fed. Reg. at 31766.
[24] See also 67 Fed. Reg. 72618, 72620 (December 6, 2002)("Under these bounce protection programs, the institution typically establishes a dollar limit for the accountholder, and then routinely pays overdrafts on the account up to that amount without a case-by-case assessment.") (Emphasis added.)
[25] Comment to Board of Governors of the Federal Reserve System on Docket No. R-1136, by Nessa Feddis, Senior Federal Counsel, American Bankers Association, January 27, 2003, p. 8.
[26] In 2000, 42 billion checks were paid by commercial banks, savings institutions and credit unions. Geoffrey R. Gerdes and Jack K Walton II, "The Use of Checks and Other Noncash Payment Instruments in the United States," Federal Reserve Bulletin, August 2002, p. 362. Approximately 251 million interbank (non-on-us) checks were returned in 2000, or about 0.85 percent of interbank checks paid. Id. at 365. Gerdes and Walton indicate, however, that the estimate includes checks that may be returned more than once, leading to some double counting. It is estimated that of the 42 billion checks paid in 2000, 29 percent were "on us" checks, or 25.6 billion checks. Id. at 364. If we assume the same percentage of on-us checks were returned as interbank checks (0.85 percent), the number of on-us checks returned would be approximately 139 million. Thus, the total number of checks returned would be approximately 390 million.

to make decisions to pay or return those items based on non-discriminatory, risk-based criteria. In light of the clear benefits to both the industry and consumers, we urge the Board to reevaluate its apparent conclusion that automation of the decision making process is necessarily harmful or disadvantageous to consumers.

Subsection (f)(4) would require that a depository institution disclose, clearly and conspicuously, "the circumstances under which the depository institution would not pay an overdraft."[27] The proposed revision to the Official Staff Commentary on Regulation DD[28] indicates that "a general description will *typically* satisfy the requirement, for example, statements such as 'overdrafts will not be paid if your account is not in good standing, or you are not making regular deposits, or you have too many overdrafts.'"[29] We would submit that a regulatory provision that requires disclosure of the circumstances under which the institution would not pay an overdraft implies that the circumstances should be articulated with some particularity. That, of course, is antithetical to the discretionary nature of overdraft protection services, and it appears that the proposed Commentary provision recognizes that fact. We believe, however, that, if the Board intends that a general description will satisfy the requirement, the Regulation should be drafted accordingly.

More important is the question of whether the delineation of circumstances, general or otherwise, is, in itself, misleading. We believe that, unless properly qualified, a description of the circumstances under which overdrafts will not be paid, even in general terms, may give consumers the impression that, if they meet the general criteria outlined, their overdrafts will be paid, which, of course, is not the case since depository institutions retain the discretion to pay or not pay the items. If the Board is concerned about consumers being misled about overdraft protection services, we believe a better approach would be to require that depository institutions make clear that, *even if* certain general qualifications are met, *e.g.*, an account meets the depository institution's definition of "good standing," items may still be returned unpaid because the depository institution retains the discretion to do so. The emphasis, it seems to us, ought to be on the discretionary nature of the service, not on disclosing the circumstances in which the discretion will be exercised. Because "discretion" cannot be adequately defined, any attempt to describe the circumstances in which it may be exercised may only serve to add to the confusion rather than alleviate it.

[27] 69 Fed. Reg. at 31766.
[28] 12 C.F.R. Part 230, Supp. 1.
[29] 69 Fed. Reg. at 31767 (emphasis added).

Thank you for the opportunity to submit our comments on the Proposal to the Board. We would be happy to answer any questions the Board might have regarding our comments and are available to meet with staff of the Board at any time to further explain details of Strunk's program.

Respectfully submitted,

Sam Davis
President

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