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March 30, 2009

By e-mail to: regs.comments@federalreserve.gov

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

Attn: Docket Number R-1343

Re: Proposed Rule Regarding Overdraft Practices
74 FR 5212 (Jan. 29, 2009)

Dear Ms. Johnson:

This letter is submitted on behalf of The Huntington National Bank ("Huntington Bank")[1] in response to the above-referenced rule proposed by the Board of Governors of the Federal Reserve System (the "Board") with respect to certain practices in connection with overdraft programs. We appreciate the opportunity to provide the comments set forth below with respect to the proposed rule, which in summary are as follows:

- There is no need to include ATM withdrawals in the proposal since most of them already have a point of transaction opt-in opportunity if the withdrawal would overdraw the account at that time.
- The Board should adopt the opt-out alternative instead of the opt-in alternative, since the opt-in alternative is contrary to expectations of a majority of consumers and would create unnecessary confusion and harm to consumers and merchants.

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[1] The Huntington National Bank ("Huntington Bank") is a national bank and the principal subsidiary of Huntington Bancshares Incorporated, which is a $55 billion regional bank holding company headquartered in Columbus, Ohio. Along with its affiliated companies, Huntington Bank has more than 143 years of serving the financial needs of its customers, and provides innovative retail and commercial financial products and services through more than 600 regional banking offices in Indiana, Kentucky, Michigan, Ohio, Pennsylvania and West Virginia. Huntington Bank also offers retail and commercial financial services online at huntington.com; through its technologically advanced, 24-hour telephone bank; and through its network of approximately 1400 ATMs. Selected financial service activities are also conducted in other states including: private financial and capital markets group services in Florida; and mortgage banking offices in Maryland and New Jersey. Huntington Bank's affiliate, Huntington Insurance, Inc., offers retail and commercial insurance agency services in Ohio, Pennsylvania, Michigan, Indiana and West Virginia. International banking services are made available through the headquarters office in Columbus, a limited purpose office located in the Cayman Islands and another office located in Hong Kong.

- The Board should not adopt either of the "conditioning" rules that would prohibit an "all or nothing" opt-out and would impose practical restrictions on dishonoring overdrafts for types of transactions for which an opt-out right is not provided.
- The Board should not prohibit or restrict different account terms and features between opt-out accounts and non-opt-out accounts.
- The Board should not impair the utility of the exception that allows overdraft fees to be charged even if the consumer has opted out if the transaction was previously authorized into sufficient funds, and thus should not prohibit overdraft fees to be charged for non-authorized transactions and transactions authorized in stand-in mode.
- The Board should eliminate the debit holds provision since it is not workable, or modify it to allow a safe harbor as long as the financial institution has not increased its authorization hold over the amount of the authorization requested by the merchant.

Regulation of Overdrafts Under Regulation E

We support the Board's decision to withdraw its prior proposal to regulate overdrafts and overdraft fees under the Board's unfair and deceptive acts and practices authority under the Federal Trade Commission Act, and instead to issue this revised proposal under the Board's authority under the Electronic Funds Transfer Act and Regulation E. Taking a regulatory approach under Regulation E is better suited to dealing with overdraft fees and other overdraft issues than an enforcement-oriented approach under the Federal Trade Commission Act and the retroactive nature of liability associated with such an approach. Additionally, because the types of transactions that the Board is concerned to regulate are in fact electronic fund transfers, Regulation E is the appropriate context in which to address these issues.

No Need to Include ATM Withdrawals

We do not believe it is necessary for the Board to include ATM withdrawals in this proposal. We have not heard the Board indicate, nor are we otherwise aware, that ATM withdrawals are raising the same concerns—particularly with small dollar transactions—as is the case with one-time debit card transactions.

Moreover, it seems reasonable to assume that most financial institutions have the capability of, and are, providing notices at their own proprietary ATMs alerting their own customers when the proposed withdrawal would (based on the information the financial institution has at that time) overdraw the consumer's account, and that they are providing the consumer with the option to abort the transaction at that time. Providing this kind of notice at proprietary ATMs is one of the "best practices" set forth in the Interagency Joint Guidance on Overdraft Protection Programs issued by the Board and other banking agencies in February 2005. Since this notice at proprietary ATMs already provides a transaction-by-transaction opt-in for ATM withdrawals, it is unnecessary to have a broader account-based opt-out or opt-in for ATM withdrawals. Currently, for one-time debit card transactions there is not the technology in place to do this kind of transaction-by-transaction opt-in at the point of sale, which distinguishes ATM withdrawals from one-time debit card transactions.

We recognize that the capability to provide this transaction-by-transaction opt-in at the ATM may not be available for customers using ATMs not owned by their own financial institution, since the account-holding financial institution cannot control the notices that the ATM-owning institution provides. However, data from ATM withdrawals by our own deposit customers indicates that only a small minority of ATM withdrawals are made at non-Huntington ATMs, and we believe it is reasonable to conclude that this is likely to be the case with most other financial institutions, and thus the impact on consumers should be minimal.

Thus, for the foregoing reasons, we recommend that the Board not include ATM withdrawals in the overdraft proposal.

Opt-Out or Opt-In

The proposal contains two separate alternatives for exercise of the consumer's choice with respect to overdraft protection and overdraft fees: a right to opt out of overdraft protection or a right not to have overdraft protection provided unless the consumer opts in. We believe that requiring consumers to opt-in to overdraft protection for ATM withdrawals and one-time debit card transactions is the wrong approach to take.[2]

Overdraft protection through automated accommodation services or individual decision by bank officers[3] is provided by financial institutions as a convenience to their customers. Information we have seen, including the Board's research on this topic,[4] indicates that most customers are satisfied with this service. Additionally, we believe it is reasonable to assume that under an opt-in approach the vast majority of consumers will not opt-in, at least initially, partly through conscious choice, but more as a matter of inertia. It is also likely that consumers will not remember that they had not opted in to overdraft protection. Therefore, the first time thereafter that the consumer actually does overdraw his or her account, instead of having the transaction covered and then disputing the overdraft fee with his or her financial institution and most likely obtaining a refund of the fee under such circumstances, the transaction will be denied. Unless the consumer has an alternative means of payment available on the spot, the transaction cannot be completed. In some cases, the transaction will essentially have been completed (consumption of a meal, for example) and the consumer will be left without means to pay. The transaction may have a level of urgency to it, and non-completion will then create a range of difficulties for the consumer, from frustration and embarrassment to potential damage or liability.

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[2] The reasons for the Board not to adopt the opt-in approach apply equally to the opt-in portion of a hybrid approach that would offer opt-out to existing customers and opt-in to new customers, and thus the Board should reject such a hybrid approach as well.
[3] Both types of overdraft protection are included within the Board's proposal.
[4] The Macro International report to the Board notes that consumers indicated that overdraft services were a "positive feature" for those who used it.

Information that is generally available indicates that most consumers do not overdraw their accounts or pay overdraft fees, which corresponds to most consumers being responsible in how they manage their accounts. Thus, it should be assumed that when a consumer attempts a transaction, the consumer actually wants and expects to complete the transaction and is not relying on the financial institution to police the transaction *in loco parentis*. In fact, research we have learned conducted by other financial institutions and banking trade organizations indicates that over 60% of debit card transactions that are authorized into overdraft protection actually settle into good funds, indicating that for a majority of debit card transactions that overdraw at the time of authorization, the consumer knows better than the financial institution what funds will be available to cover the transaction and such consumers know how to take advantage of the float available to them in the way the system works. With an opt-in approach, virtually all of these debit card transactions authorized today into overdraft protection would instead be denied, even though a majority of them would not actually overdraw the account when settled. The intent and practice of the majority of consumers will thus be frustrated. The Board should also consider the wider economic and business effects under an opt-in approach of having probably hundreds of millions of debit card transactions which today are authorized be instead denied and not completed, not only impacting the consumers who are not able to complete the transaction, but also the merchants who are not able to make a sale.

By contrast, an opt-out approach under which probably a majority of consumers will not opt-out (at least until they actually have an overdraft) would leave in place this economic safety net and still allow consumers the opportunity to consciously choose to remove it even though it had already provided a benefit to them. Furthermore, the issues being addressed by the Board's overdraft proposal are not so significant as to warrant an opt-in approach instead of a standard opt-out approach. For example, privacy choices under the Gramm-Leach-Bliley Act and the Fair Credit Reporting Act, and choices to avoid telemarketing phone calls under the Telephone Consumer Protection Act, operate effectively under an opt-out approach, and there are no greater policy reasons—such as consumer safety—why a consumer's choice about overdraft protection should require the more restrictive opt-in standard. To the extent consumer safety—or at least convenience—is a policy issue, it favors opt-out over opt-in by providing an economic cushion for all those consumers who take no action, rather than depriving them of that cushion when the unexpected need for it arises.

The opt-in approach is also likely to confuse customers into thinking that, when they opt in, they will have all of their overdrafts paid, which is not correct. This misunderstanding is more likely under the opt-in alternative than the opt-out alternative because the action and formal communication needed to consent compared to refraining from opting out will lead consumers to believe that they are entering into an agreement for a service or benefit, instead of agreeing to let their institution decide if it wants to cover an overdraft. In addition to confusing the consumer, the financial institution may then become liable to pay all overdrafts, or be subject to litigation from the customer claiming that the opt-in and documents used in connection therewith create an obligation on the financial institution to pay all overdrafts. The Board's proposed form of disclosure for opt-in lends support to such a claim because it implies that all overdrafts will be covered: "We will not pay your overdrafts for ATM withdrawals and debit card purchases you make at a store, online or by telephone, unless you tell us you want overdraft coverage for these transactions. See below for more information, including how to contact us if you want overdraft coverage to apply to your ATM withdrawals and debit card purchases."

Thus, for all of the reasons set forth above, we strongly recommend that the Board adopt the opt-out alternative.[5]

Conditioning the Opt-Out

The Board has proposed in the alternative two "conditioning" rules as part of this proposal. Under one alternative, the first conditioning rule would prohibit a financial institution from conditioning a consumer's opt-out of overdraft protection for ATM withdrawals and one-time debit card transactions on the consumer also opting out of overdraft protection for other types of transactions, such as checks or ACH debits. In other words, the Board is proposing to prohibit the "all or nothing" opt out approach for overdraft protection. The second conditioning rule would prohibit a financial institution from refusing to pay checks or items not subject to the opt-out right for the reason that the consumer exercised his or her opt-out right with respect to overdraft protection for ATM withdrawals and one-time debit card transactions. Under the other alternative, the Board proposes to permit both conditioning practices. For the reasons discussed below, we urge the Board not to adopt the prohibition alternative and either to adopt the permission alternative or not to address the issue at all.

With respect to the first conditioning prohibition, we believe that distinguishing the opt-out right based on type of transaction inappropriately focuses the consumer's attention on type of payment or access vehicle rather than on proper overall management of the consumer's account. Overdrafts are caused not because a particular type of payment or access device (check, ACH, debit card, ATM, etc.) was used, but because the consumer used more funds than were available. An "all or nothing" approach to opt-out requires the consumer better to focus on account management to avoid overdrafts for all types of transactions, whether the consumer opts out or not.

Moreover, creating distinctions based on the payment or transaction type also runs into serious technical issues for financial institutions and issues of confusion for consumers because it is difficult actually to isolate and identify which types of transactions are in or out of the requirement. This is certainly the case with the Board's current proposal. The opt-out right is being proposed for ATM withdrawals and one-time debit card transactions. However, the Board has not defined "debit card transaction" and thus apparently would include within the opt-out choice the so-called "decoupled" debit cards offered by institutions other than the account-holding institution and which consumers use as they would use any other debit card, even though

[5] In the remainder of this letter, we refer to the consumer's choice in this proposal as the opt-out so as not to continually have to refer to both the opt-out and opt-in possibilities.

transactions using these cards are processed as ACH transactions. Furthermore, the Board refers to the kind of debit card transactions included in the opt-out choice both as "one-time debit card transactions" and as "debit card purchases",[6] making it unclear whether or not one-time bill pay transactions using debit cards are in or out of the proposal. Additionally, the Board has indicated that recurring debit card transactions are not included in the opt-out proposal, meaning that, under the "all or nothing" conditioning prohibition, financial institutions would not be able also to require opt-out of recurring debit card transactions. However, under the card association and payment systems currently in place, financial institutions have no method of determining if a debit card transaction presented for settlement is a one-time transaction or a recurring transaction and neither can the institution tell the difference between a one-time debit card transaction that is a bill payment from a recurring debit card transaction that is a bill payment. Even assuming all different types of debit card transactions could be identified by the financial institution, there is the further very significant problem of how to describe in a meaningful way such distinctions to consumers without simply confusing them or providing information overload.

Unfortunately, the Board in the preamble to the proposed rule generally characterizes these problems solely as "programming" issues, and focuses only on concerns by financial institutions with the costs of implementing the "all or nothing" conditioning prohibition or finding ways to distinguish recurring debit card transactions from one-time debit card transactions.[7] But the issue is clearly broader than just "programming" costs and the time to accomplish "programming" changes. The "all or nothing" conditioning prohibition will put financial institutions into the position of having to make distinctions about which the Board itself is not being clear, which do not take into account future product development and capabilities, and which under current card association networks and financial institution systems are not just expensive to change, but either cannot be changed at all, or cannot be changed without cooperation from all participants in these transactions, which is well beyond the ability of financial institutions individually to control, nor is the financial institution industry monolithic enough to mount a uniform effort to coordinate such changes, not to mention the need for cooperation of all of the other participants in these transactions.

While we believe the costs of "programming" changes are likely to be significant and the Board should give more weight to that concern, the larger issue is the ability to make the kinds of distinctions the Board is trying to make in ways that are possible, clear and flexible. The Board's proposal does not meet this goal, and we seriously question whether this is a goal that will ever be possible to meet. Thus, we strongly recommend that the Board not adopt the first conditioning prohibition.

We believe it is a better policy decision for the Board to allow competition and product development expertise among financial institutions to determine the conditions to the consumer's exercise of the opt-out right. If in fact there is significant consumer desire to opt-out of ATM withdrawals and one-time debit card transactions and not opt-out of other types of transactions,

[6] See the Board's model form of opt-out notice.
[7] 74 FR, at 5218.

as the Board indicates is the case, then consumers will be drawn to financial institutions that give them that choice, rather than institutions that require an "all or nothing" approach.

The Board's second conditioning rule would prohibit a financial institution from refusing to pay checks or items not subject to the opt-out right for the reason that the consumer exercised his or her opt-out right with respect to overdraft protection for ATM withdrawals and one-time debit card transactions. This conditioning prohibition is likely to have an adverse impact on the financial institution's ability to dishonor those other items, creating additional risk and potentially raising safety and soundness issues for financial institutions. While automated overdraft protection products may be more or less objective in their determination of how much of an overdraft "cushion" to allow for a particular customer's account, certainly the one-off kinds of discretionary overdraft decisions (and these are also covered by the Board's proposed rule) are just that—discretionary. This particular prohibition against dishonor of the items for which this proposed rule does not provide consumer choice is likely to provide a basis to call into question any exercise of discretionary overdraft—even the automated type, because that too is contractually discretionary—as a retaliation for the consumer's exercise of the choice provided by this proposed rule.

Even though the Board indicates that this rule is not intended to provide a contractual requirement to pay these other overdrafts, it is nonetheless likely to lead to little room for discretion. As a result, financial institutions, out of an abundance of caution, will necessarily create more objective and narrower standards for paying these other kinds of overdrafts, and that is likely to result in just the contraction of overdraft allowance on these other items that the Board is trying to prevent by this rule. Furthermore, such lowest common denominator objectivity is also likely to conflict with the first conditioning rule, namely, prohibiting an "all or nothing" approach, since the more objective and restrictive the institution has to make its overdraft rules in order to avoid conflict with the second conditioning rule, the closer the institution comes to being inconsistent with the first part of the conditioning rule. Thus, we also strongly recommend that the Board not adopt the second conditioning prohibition.

We note further that not adopting these conditioning prohibitions would also eliminate some of the most difficult system and programming issues that financial institutions face with this proposal, and would allow the rule to be adopted more quickly than otherwise is the case under the Board's current proposal.

Implementation Through Product Design Restrictions

The Board's proposal offers two alternative approaches for how financial institutions will be permitted to implement account terms for accounts for which the customer opts out of overdraft protection for ATM withdrawals and one-time debit card transactions. Under the first alternative, the Board is requiring that accounts with and without the opt-out be identical except for the difference in payment of overdrafts. Under the second alternative, the account opting out of overdraft protection for ATM withdrawals and one-time debit card transactions could have different terms, provided that the differences are not so substantial as to discourage a reasonable consumer from exercising the right to opt out.

We recognize the Board's concern that, at least theoretically, a financial institution could design alternative products which are essentially punitive for customers who exercise their choice under this rule, but such a concern flies in the face of the Board's underlying reason for proposing this rule in the first place. The Board is proposing this rule because of what the Board indicates is significant consumer desire for this type of choice and likelihood that a significant percentage of consumers will exercise even an opt-out right if offered in the segmented way the Board is here requiring for ATM withdrawals and one-time debit card transactions. If in fact it is a significant percentage of consumers who want and will exercise this choice, then it is highly unlikely that financial institutions would succeed in trying to saddle those consumers with punitive alternative products. It appears to us much more likely that financial institutions will be required instead to compete against each other for these consumers as customers, and do so with their own product design that offers something better than—or at least as good as—the competition.

Thus, we believe that neither alternative is appropriate as they will ultimately harm consumers by requiring financial institutions to offer accounts with higher prices, fewer feature differences among institutions, and less competition and product innovation. The Board's first alternative that allows no differences between accounts with or without the opt-out means that consumers who do not opt-out will be subsidizing the risks associated with consumers who do opt-out, particularly when it is still possible for the account with the opt-out to have many transactions that overdraw the account and are required to be paid by the financial institution without the ability to charge an overdraft fee. It is easy to see how pricing, for example, may need to be different to cover the overdraft risk for accounts that opt-out. The financial institution could imposed a minimum balance fee on the opt-out account which would encourage the consumer to maintain sufficient balances that make it much less likely that an overdraft would occur, and such a minimum balance fee would not be necessary for the non-opt-out account since on that account the financial institution could charge an overdraft fee for transactions that overdraw the account. Without the ability to price the accounts differently, the pricing for both accounts will need to be sufficient to cover the uncompensated overdraft risk of the opt-out account.

The Board's second alternative would at least theoretically allow for the kinds of pricing differences needed to cover the risks of each account, but the standard established here is that the differences cannot discourage a reasonable consumer from opting out. Unfortunately, as a practical matter that standard leaves open to dispute any degree of difference in terms between an opt-out account and a non-opt-out account and is an invitation to broad class-action litigation over factual determinations that will be unable to be resolved on summary judgment, ultimately increasing cost and risk for institutions who venture to offer accounts with different terms, making it most prudent for financial institutions to have very little difference between opt-out and non-opt-out accounts and thus having the effect of the Board's first alternative.

We believe the Board should not pre-judge this issue and assume at the outset that most financial institutions will opt for punitive account terms in order to discourage consumer exercise of the opt-out right. Instead, the Board should allow financial institutions to compete with each other for these customers in ways governed by the market that will allow the institution to balance its need to manage its risk against customer demand that will require financial institutions to offer favorable and attractive products.

Exceptions

We support the Board's proposed exception which allows the financial institution to charge an overdraft fee for an ATM withdrawal or one-time debit card transaction that overdraws the account if the institution had a reasonable belief that there were sufficient funds available to cover the transaction at the time the institution received the authorization request (referred to herein as the "authorization exception"). We also support the Board's proposed more general exception from the notice and opt-out requirements when the financial institution has a policy and practice of declining all authorizations into overdraft for ATM withdrawals and one-time debit card transactions (the "decline exception"). However, we strongly object to the Board's proposal that would prohibit charging an overdraft fee for any ATM withdrawal or one-time debit card transaction that is presented for settlement without having first obtained an authorization or that is authorized in stand-in mode. The Board's position on this latter point will have a serious adverse impact on the ability of a financial institution to use the authorization exception and may force institutions to use the decline exception which is then likely to cause a significant contraction in the overall number of debit card transactions, ultimately discouraging this form of payment.

We note at the outset that the ability to use the authorization exception depends on the financial institution being able to determine at the time of settlement of a debit card transaction that overdraws the account that the transaction (i) was in fact previously authorized by the financial institution and (ii) that such authorization was into sufficient funds available in the account at the time of such authorization (in other words, the authorization was not granted because of an accommodation overdraft protection "cushion" made available to the account). The Board's proposal does not appear to acknowledge the practical difficulties with being able to do this. There are several reasons why the financial institution will not be able to match a debit card transaction presented for settlement with a prior authorization for that transaction: for example (i) the match is actually made to the authorization hold and that hold typically drops off after three days, so that merchant delays in presenting debit card transactions that cause those transactions to be presented after that three-day period will not have an authorization to match to; (ii) merchants do not always code the debit card transaction with the proper authorization code that was used to authorize the transaction, making it impossible to match the incoming debit card transaction with the pending authorization hold; and (iii) the file for that day's incoming debit card transactions is typically run against the last three days of authorization data, which will miss authorizations provided more than three days ago. As a result, many overdrawing debit card transactions that were authorized into sufficient funds will not be able to be matched and thus the financial institution will not be able to assess an overdraft fee on those transactions pursuant to the authorization exception.

The process works best if the circumstances are such that the financial institution can know without having to run a match that any debit card transaction presented for settlement was previously authorized into good funds. If the financial institution's authorization system operates so that for opt-out accounts authorizations will never be given unless sufficient funds are available at the time of authorization (which we believe is feasible to accomplish), then the institution would be able to assume without having to conduct a match that all debit card transactions presented for settlement into overdraft could be charged an overdraft fee as long as the financial institution is also permitted to charge an overdraft fee for debit card transactions settling into overdraft that were never authorized by the merchant or were authorized in stand-in mode. The Board's proposal, however, prohibits charging any overdraft fee for such non-authorized or stand-in transactions. Under the way in which the card association systems currently work, there is no way for the financial institution to determine that any given debit card transaction being presented for settlement was never authorized or was authorized in stand-in mode. Thus, the Board's proposal effectively requires financial institutions to match incoming debit card transactions with pending authorization holds in order to be able to use the authorization exception, leaving the institution unable to charge overdraft fees pursuant to the exception on a significant number of transactions which are otherwise covered by the authorization exception.

We believe it is not the right policy decision for the Board to prohibit financial institutions from assessing overdraft fees on non-authorized transactions that settle into overdraft. The choice by the merchant not to seek an authorization (typically for smaller dollar transactions) is a choice provided by the card associations to benefit the merchant and the customer—not to benefit the financial institution. Yet, it is the financial institution that as a practical matter bears the risk and cost of such non-authorized transactions. While there may be rights of chargeback under card association rules for non-authorized transactions, such rights are generally not feasible for the financial institution to exercise because they must be manually processed and typically cost more to process than the value of the transaction itself. Furthermore, there is generally no way for the financial institution even to find them if it wanted to charge them back, since there is nothing that distinguishes a settling debit card transaction as being non-authorized, and there is no common or universal floor limit for all merchants and no universal practice dictating which merchants will or will not seek authorization. In fact, it appears to us that the Board's position on prohibiting overdraft fees on non-authorized transactions is likely to incent merchants to do more non-authorized transactions, since the consumer will be able to overdraw with impunity for such non-authorized transactions that exceed the balance in the consumer's account at the time of settlement, there is no risk of the financial institution denying the transaction at the point of sale, and there is little risk of the financial institution charging the transaction back to the merchant.

The Board's first stated reason for prohibiting financial institutions from charging for non-authorized ATM withdrawals and one-time debit card transactions that overdraw the account is that "[t]he merchant's decision not to seek authorization for small dollar transactions generally is not transparent to the consumer."[8] If that is in fact a correct statement of fact, it could easily be addressed in the Board's proposal by requiring merchants who do not seek authorizations for small dollar transactions to post a notice at the check-out register alerting consumers of this practice and that as a result, the consumer's transaction could overdraw the consumer's account if there are insufficient funds in the consumer's account at the time the transaction is settled with the consumer's bank. The posted notice could also indicate that settlement can take from a few to several days depending on how often the merchant processes transactions for settlement. The Board's second stated reason could also be addressed by such a posted notice. That reason is that "because small-dollar transactions are those most frequently not submitted for authorization, prohibiting institutions from assessing overdraft fees in these circumstances would reduce the possibility that the consumer will incur overdraft fees that exceed the amount of the overdraft."[9] We understand the need for the Board in this proposal to address the circumstance where overdraft fees can exceed the amount of the transaction, but the solution does not have to be the one proposed by the Board, which simply imposes risk and cost to the financial institution for choices made by merchants and for the poor account management practices of one segment of the institution's customers that will then be subsidized by those customers who handle their accounts properly. Instead, the above-proposed merchant notice would alert the consumer that use of a debit card may result in an overdraft, and the consumer being thus reminded, can then make an informed choice as to whether or not use of a debit card would be prudent in that particular circumstance.

We likewise believe that it is not the right policy decision for the Board to prohibit overdraft fees for debit card transactions settling into overdraft that were authorized in stand-in mode. Stand-in mode is for the convenience of the consumer to allow the consumer to continue to use his or her debit card during times that the authorization system is down. We continue to believe that the correct policy decision by the Board is one that primarily encourages consumers to be responsible in how they manage their accounts, and as indicated earlier in this letter, the authorization system is not intended to operate as an *in loco parentis* mechanism that polices consumer conduct and relieves consumers of their primary responsibility only to spend what they have in their account. After all, it is the consumer, rather than the bank, who ultimately knows what his or her balance is and what transactions are pending that have not yet reached the bank.

The authorization exception itself is a recognition of that primary responsibility of the consumer to manage his or her account. The Board's departure from that approach in the case of both non-authorized transactions and transactions authorized in stand-in mode is not only inconsistent with that recognition, but significantly impairs the utility of the authorization exception, and does so when there are other alternatives that can reasonably address the Board's concerns without having that adverse impact.

[8] 74 FR, at 5221, col. 2.
[9] 74 FR, at 5221, col. 2.

Such limitations on the utility of the authorization exception may lead financial institutions to consider complying with the Board's decline exception, which would then allow the institution to charge for all non-matchable authorized transactions, as well as all non-authorized transactions and stand-in transactions, that settle into overdraft. While we appreciate that the Board offers this decline exception and that it makes compliance easier for the financial institution, use of that exception can result in a significant number of what would otherwise be good transactions being declined, which the institution may determine is not an acceptable practice as a customer service matter.[10] In order to use the decline exception, the financial institution must have a policy and practice of declining authorizations for all ATM withdrawals and one-time debit card transactions that do not have sufficient funds in the account at the time of authorization, whether or not the consumer has opted out—in fact, use of the decline exception means that no opt-out notice or opportunity has to be given, since all of the institution's deposit customers must be subject to this practice. As a result, the customers of financial institutions who adopt this exception are likely to have a significant overall decrease in the number of debit card transactions, and for what is likely to be the majority of those customers who would not have opted-out, such a result is likely to be contrary to their expectations or preferences. As a result, there is likely to be significant customer and competitive pressure for financial institutions not to use the decline exception.

We note that the section 904 of the Electronic Funds Transfer Act requires the Board, when issuing regulations under that Act to "take into account, and allow for, the continuing evolution of electronic banking services and the technology utilized in such services" and to consider "the cost and benefits to financial institutions, consumers, and other users of electronic fund transfers, including . . . the effects upon competition . . . and the availability of such services". Particularly because there is here another feasible and less restrictive alternative that the Board could adopt (the merchant notice proposed above), and that the best policy decision for the Board is one that encourages consumers to manage their accounts responsibly rather than rely on financial institution authorization systems to exercise parental control over their spending behaviour, we believe the Board should reverse its position in the proposal and instead allow financial institutions to charge for non-authorized transactions and stand-in authorized transactions that settle into overdraft.

Debit Holds

As currently proposed by the Board, the debit holds provision will prohibit a financial institution from charging an overdraft fee on a overdraft transaction intervening between authorization and settlement of a debit card transaction if (i) the overdraft on the intervening transaction would not have occurred but for an authorization hold on the debit card transaction that is larger that the settlement amount of the debit card transaction for which the hold was placed and (ii) the actual amount of the debit card transaction for which the hold was placed can

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[10] See the discussion in the letter above indicating that a majority of debit card transactions that today are authorized into insufficient funds at the time of authorization actually settle into good funds.

be determined by the merchant (not the financial institution) within a "short period of time" after the authorization. It is the second part of this formulation that is different in the Board's current proposal from what was proposed by the Board last summer. Unfortunately, this difference is ultimately not significant, meaning that the Board's current proposal is essentially the same as the one from last summer, and has all of the same problems and deficiencies. We strongly recommend that the Board either eliminate this debit holds rule or revise it in ways that make it reasonable to comply with.

The Board's proposal only removes the debit hold overdraft fee prohibition under circumstances where the merchant (not the financial institution) can determine the actual amount of the debit card transaction within a short period of time. Thus, debit holds placed by the financial institution on authorizations from hotels, resorts, or car rental agencies, for example, would presumably not be subject to the debit holds rule since the merchant presumably does not know the actual amount of the transaction within a short period of time, but our institution and many other financial institutions do not place debit holds on the basis of authorizations for transactions at such types of merchants because of the potentially wide variation between authorization amount and actual amount and the problems such a hold would cause our customers. Generally, the risks of not placing holds on such types of transactions are minimal because customers making such purchases typically have sufficient funds in their accounts. Furthermore, consumers generally use credit cards, rather than debit cards for these types of transactions, and some of these types of merchants even maintain signs or notices at their counters warning consumers not to use debit cards.[11] Thus, this formulation of the debit holds rule only helps for circumstances in which (i) many financial institutions would not be subject to the rule anyway because they do not place holds on such transactions, (ii) merchants warn against or do not accept debit cards for such transactions, or (iii) consumers do not normally use debit cards for such transactions.

Moreover, just because the merchant can determine the actual amount of the debit card transaction within a short time does not mean that the financial institution will be any more informed about the actual amount of the transaction so as to conform its hold to that amount and avoid the debit hold consequence of placing the hold for the types of transactions that financial institutions do place debit holds. For example, for signature debit card pay-at-the-pump gas purchase transactions where the merchant elects to comply with Visa rules newly issued last fall, the financial institution will first receive a pre-authorization amount, which will be followed within a few minutes when the customer has finished pumping gas with the actual amount of the transaction. However, all that means for the financial institution is that there is no reason for the institution to place a debit hold based on the pre-authorization amount, not because the merchant can determine the actual amount within a short period of time, but because the financial institution can determine the actual amount within a short period of time and can thus place a hold on the actual amount of the transaction until it is presented for settlement and thus avoid

[11] As another example, the individual authoring this letter is currently looking at a car rental form from a major car rental agency which states: "I have been advised that ALL drivers must have major credit card in their name (No Debit Card)."

triggering the debit holds rule for that hold. As another example, a restaurant authorizes a $100 meal tab for $125 in anticipation of a tip, and then a few minutes later the restaurant determines the actual amount of the transaction as $115 when the customer provides a $15 tip. Just because the merchant has within a short period of time determined the actual amount of the transaction does not help the financial institution in this case, since the restaurant merchant will then process the $115 transaction which will settle with the financial institution within a few days, while in the meantime the financial institution has a debit hold in place for $125 which is larger than the actual amount of the transaction, and thus the financial institution is prohibited from charging any overdraft fee for an intervening transaction going overdraft as a result of that debit hold.

The Board's short period of time rule does not provide any help where financial institutions need help, *i.e.*, for transactions where the merchant knows the actual amount of the transaction "within a short period of time" and the financial institution does not, and where it is possible or likely that the authorization hold placed by the financial institution on the consumer's account will exceed the actual amount of the transaction when it later settles. We recognize that if the Board were to change the debit holds rule to apply where the financial institution can determine the amount of the transaction in a short period of time, the rule as so revised would essentially be meaningless, since it would then on the one hand provide the financial institution with relief under circumstances for which no relief is needed (since the institution could then place a hold on the actual transaction amount), and on the other hand would make the debit hold rule not applicable to all of the transactions for which the financial institution might have a debit hold larger than the actual settled amount of the transaction (*i.e.*, those transactions for which the financial institution places a hold based on the authorization amount and does not know the actual amount of the transaction until it is presented for settlement).

The safe harbor provision of the debit holds rule adds little as well, since it only provides a safe harbor for circumstances under which the financial institution releases its authorization hold within two hours and is intended to protect the institution against a subsequent transaction that may be authorized in the window between pre-authorization and transmission to the institution of the actual amount of the transaction. However, that window is likely to be only a few minutes in duration and thus creates little risk to the financial institution. Furthermore, upon receiving the updated actual transaction amount, the institution, rather than release any non-existent hold placed on the pre-authorization, will instead first place an authorization hold on the updated actual amount of the transaction through the remainder of the processing day, which will then be converted into a posting hold that evening during account processing, which will be eliminated when the transaction is presented for settlement a few days later.

The Board provides in the proposed Official Staff Commentary that a financial institution does not violate the debit holds overdraft fee prohibition if it "promptly waives or refunds any overdraft fees", but "the institution may not require the consumer to provide notice or other information that an overdraft fee was caused by a debit hold on funds in the consumer's account before the institution waives or refunds the fee."[12] However, the financial institution has no currently feasible way to determine that it charged an overdraft fee it was not permitted to charge caused by a prior debit hold without complex new programming requiring multiple reposting of items based on all possible scenarios for every account to determine if a prohibited charge has occurred—in other words, in order to know that such a prohibited overdraft fee has been charged, the institution would have to have in place all of the programming and processes that would be needed to prevent the charge in the first place. The most likely way for the institution to find out about the charge is when the institution's customer brings it to the institution's attention, which the Board's proposal does not permit as a solution.

The Board's new proposal has not addressed the major problem with this debit holds prohibition, namely, that the depository institution cannot know whether the hold on the pending transaction will be "excess" or not until after the other intervening transactions have posted, and thus the institution cannot know until it is too late whether or not it is prohibited from charging any overdraft fee on those other intervening transactions that are paid into overdraft. Furthermore, the fact that an authorization hold is larger than the settled amount of the transaction is a matter completely beyond the financial institution's control unless the institution has itself set a hold that is larger than the amount of the authorization request from the merchant. *Thus, the debit holds rule requires financial institutions to prevent overdraft fees for circumstances where the facts causing the prohibition are beyond the institution's control and cannot be known until after it is too late to prevent the fee from being charged.*

A true safe harbor that would be fair and reasonable for financial institutions to comply with would be for the Board to provide a safe harbor if the financial institution has policies and procedures pursuant to which it only places a hold on the consumer's account as a result of an authorization request in connection with a debit card transaction in an amount that is not in excess of the authorization amount requested by the merchant. Such a solution would leave the financial institution responsible for what it can control and manage, namely, any increased hold by the financial institution in excess of the amount of the authorization request and would avoid the significant "look back" problems with the Board's current proposal.

The significant adverse impact of the debit holds prohibition on financial institutions appears to be out of all proportion to the likely incidence of holds on pending debit card transactions causing other intervening transactions to overdraft the account. The Board appears to be primarily concerned that consumers may not know that holds for pending items are placed on the account or how long such holds remain in place, but financial institutions provide many different means for consumers to track their transactions and balances in ways that generally enable consumers to know that a hold is in place and when the transaction settles. By continuing to propose this debit holds prohibition, the Board has provided a remedy that is out of all proportion to the problem intended to be addressed, since the occurrence of excess holds that potentially cause other intervening transactions to overdraw the account is relatively infrequent,

[12] 74 FR, at 5242, col. 2.

and the Board is not adequately recognizing the complexity of the payments systems involved or the balancing and other mechanisms that are part of those payments systems and their customary ability to adapt and improve to the mutual benefit of all participants.

Disclosure Forms

The Board's forms of opt-out or opt-in notice continue to be confusing and potentially misleading to consumers and require significant revision.

The form of opt-out notice starts with the statement: "We currently provide overdraft coverage for your account." Even if it were clear that this means accommodation or transaction-by-transaction overdraft protection (which it is not), not all of the financial institution's customers on any given day have any such "coverage", and many do not. That sentence should be deleted and the remainder of the paragraph revised.

The second section of the Board's notice focuses on the consumer's right to tell the financial institution not to pay overdrafts, but this is simply inaccurate, confusing and potentially misleading. It is not a matter of paying or not paying ATM withdrawals or one-time debit card transactions. If the institution authorizes them, they must be paid, and if the merchant never seeks an authorization, they also will be paid because the financial institution has no way of identifying non-authorized transactions when they are presented for settlement. Thus, to give the consumer a notice that says the consumer can tell the institution not to pay these transactions is factually incorrect, since they will all be paid, and will create misleading expectations that will simply confuse the consumer, who will then be upset with the financial institution. Instead, what will happen if the consumer opts out is that the financial institution will no longer authorize transactions if there are not sufficient funds in the account at the time of authorization, which will mean the consumer will not be permitted to complete the transaction even if the consumer knows that in the posting routine that evening there will be sufficient funds because of, for example, a direct deposit being credited that day. The notice fails to tell the consumer that bad news, but instead conveys only the good news that the consumer will pay fewer overdraft fees. Moreover, even if the transaction is authorized, that does not mean that it will not overdraw the account when later presented for settlement. If the transaction does overdraw the account at the time of settlement, the institution will nonetheless have to pay it notwithstanding the Board's language to the consumer that the consumer can tell the institution not to pay overdraft items and transactions.

Still another significant problem with the notice in the context of the Board's "conditioning" prohibitions is how to describe for consumers in a way that is accurate and concise what types of transactions the consumer has a right to opt-out of overdraft protection for and what types of transactions may still be given overdraft protection by the financial institution even if the consumer opts out, realizing as indicating above that even the types of transactions for which the consumer does opt out will still be paid if presented for settlement when the account is overdrawn.

Thus, the Board's form of opt-out notice needs substantial revision. One possible revision, assuming the Board retains the "conditioning" prohibitions (which we have argued above the Board should not adopt), and which attempts to address a broader description of covered transactions, is as follows:

> What Happens If You Overdraw Your Account
> If you attempt to spend or withdraw more money than you have in your account, we may, in our sole discretion, decide to pay the item or transaction that causes the overdraft. We are not required to do so. Just because we pay some overdraft items or transactions does not mean we will pay others. If we do pay overdraft items or transactions, we will charge you fees.
>
> Your Right to Opt-Out of Overdraft Protection
> You have the right to opt out of our discretionary overdraft protection for transactions for which you use an ATM or debit card (such as ATM withdrawals, debit card purchases, and one-time or recurring bill payments using your debit card or card number). If you opt out, we will decline these transactions at the time of the transaction or sale. As a result, you may pay fewer overdraft fees, but you will not be able to complete any declined transactions.
>
> If we approve the transaction at the time of the transaction or sale, it may take several days for the transaction to settle with us. If that transaction overdraws your account at the time of settlement, we may still have the right to charge you overdraft fees even if you have opted out.
>
> Your decision to opt out of ATM or debit card transactions will not affect whether we pay overdrafts for other types transactions, including checks. We may still pay these other types of transactions if they overdraw your account, and if we do so, we will charge you fees.
>
> See below for more information about how to opt out and other ways we offer overdraft protection for your account.
>
> [Remainder of notice the same.]

Similar problems to those discussed above are also applicable to the Board's form of opt-in notice, with the additional problem (discussed above in this letter) that the Board's form of opt-in notice appears to be an agreement with the consumer for the financial institution to pay overdrafts if the consumer opts in. If the Board adopts the opt-in approach, the form of notice will need to address these concerns.

Effective Date

We believe that the overdraft rule as proposed by the Board should have at least two years for implementation after the date of any final rule. Several of the recommendations above in this letter would simplify compliance by financial institutions and significantly reduce programming and other required system changes, which in turn would permit compliance to be implemented sooner than under the Board's proposal.

*   *   *

Thank you for the opportunity to provide these comments.

Very truly yours,

Daniel W. Morton

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