

California Bankers Association 1303 J Street, Suite 600, Sacramento, California

March 30, 2009

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

Re: Regulation E (Overdrafts); Docket No. R-1343

Dear Sirs and Madams:

The California Bankers Association ("C B A") writes this letter on behalf of the F D I C-insured depository financial institutions in the state of California. C B A is a professional non-profit organization established in 1891, and frequently provides comments to regulatory proposals by the federal banking agencies. This letter addresses the Federal Reserve Board's proposal under Regulation E affecting bank overdraft activity (the "Proposal").

C B A concurs with the Board's decision to seek regulation of overdraft activities through Regulation E and not through its unfair and deceptive acts and practices (UDAP) authority. As C B A discussed in its previous letter, regulation under UDAP exposes banks to unwarranted legal risks, including for practices that have not been previously deemed unfair or deceptive. The Proposal seeks to limit the ability of a bank to assess an overdraft fee in connection with ATM withdrawals and "one-time" debit card transactions unless the consumer is given an opportunity to opt-out or, alternatively, opt-in. The Proposal also seeks to prohibit overdraft fees assessed by reason of the placement of a debit hold in an amount that exceeds the actual amount of the transaction.

#### **Opt in vs. opt out**

The Proposal seeks comment on two alternatives. An opt-out approach largely maintains consumer expectations: if overdrafts are allowed in connection with A T M withdrawals and one-time debit card transactions, they will continue to be allowed unless the customer wishes otherwise. An opt-in approach upends practices and expectations and restores them only if the consumer affirmatively acts. Among other things, an opt in approach would create consumer confusion. We support the opt-out alternative.

We understand that a small number of consumers may be surprised by an unintentional overdraft in connection with A T M and debit card transactions. However, our member banks confirm (and the Board has not provided any evidence to the contrary) that a great majority of consumers do not overdraw their accounts and, when they do, covering overdrafts benefits them despite the overdraft fee. A mandatory opt-in rule would result in more declined transactions, and we understand that a significant percentage of transactions appear to overdraw an account at the time of the transaction but eventually clear without an overdraft.

Preventing banks from providing an add-on service like overdraft protection unless a consumer opts in substantially eliminates that service. With the default being no service, any bank would find it difficult to offer, let alone tailor, a service to suit a small percentage of consumers that take the effort to opt in, assuming they become aware of the service. As to whether the final rule should reflect an opt out approach for existing customers and opt in for new customers, this would provide some relief from the burdens of mailing notices to existing customers and handling responses. However, a hybrid approach would entail tracking different groups of customers and applying different requirements, and thus be expensive to execute. C B A strongly believes that an opt out system is more appropriate in all circumstances.

The Proposal includes an exception where a bank has a policy and practice of declining A T M and debit card transactions if they would overdraw the account. We support such an exception since providing notice and opportunity to opt out or opt in would be superfluous for those institutions.

### **Debit holds**

The Proposal regarding debit holds is an improvement over the UDAP Proposal in that it allows banks that inadvertently impose a fee to refund it promptly, and provides a safe harbor if the bank releases the hold on certain authorizations within two hours of the authorization request being made. Banks cannot know for certain if an authorization request exceeds the actual amount of the transaction because the final amount is not known at the time the card is presented for payment . Nevertheless, we still question whether a rule on debit holds is necessary. It is our understanding that a small percentage of signature debit transactions involves the need for debit holds. Only a portion of those transactions involves held amounts that exceed the final amounts sufficient to cause an overdraft.

Also, banks are striving to make their online banking functions as up-to-date as possible, reflecting accurate balances shortly after the authorization is requested. Banks are not aware of the amount of the transaction at the time it is made; only the customer and merchant know. We appreciate that the Board has proposed a safe-harbor for banks that release holds within two hours of the authorization of the transaction. Unfortunately, the effectiveness of this rule, which must consider the accuracy of balances displayed during this period, depends on other participants in the payment system, including the merchant and processors. Merchants typically batch process their signature debit transactions at the end of the day. Similarly, most issuing banks do not process transactions in real time, but rather, gather all transactions conducted or received during a day in a batch, and process them at night. It makes no sense and it is unfair to

place restrictions on banks without addressing the responsibilities of merchants and other parties to process transactions within specified times. Therefore, C B A suggests that the Board consider a rule that for merchants and banks that conduct batch processing, the safe harbor is extended to the end of the day.

In addition, this may not be the best solution for consumers. This is because if banks simply remove the holds and the related transactions from the displayed available balance, the consumer will have less accurate information. For reasons beyond banks' control, holds are sometimes not removed until days after the transaction was conducted. This would result in customer confusion and may cause more overdrafts. Therefore, C B A believes the debit hold rule is not necessary and, in fact, may be disadvantageous to consumers. As an alternative, the Board could consider prohibiting banks from imposing a hold that exceeds the authorization amount submitted by the merchant.

### **Partial vs. full opt-out**

Banks that do not offer a formal overdraft protection service do not currently offer an opt out option. No banks that we are aware of have the technical ability to support a partial opt-out by transaction type as proposed. To do so would require significant changes to banks' systems. It would be extremely difficult for banks to differentiate between one-time and recurring debit card transactions and, even if they could, they would still be dependent on the merchant to distinguish recurring debit card transactions with a unique transaction identifier. Merchants do not universally comply with this rule, and there is no practical way to ensure that they do. If the final rule imposes such a distinction, then banks will require a safe harbor to charge fees where a transaction has not been properly identified.

C B A does not support including A C H transactions in the final rule. A C H transactions are very similar to check transactions, which are now frequently converted by merchants into A C H transactions for processing. Most consumers do not consider recurring debit card transactions to be significantly different from one-time debit card transactions. Also, unlike debit card transactions, A C H transactions are not authorized or approved by the bank prior to submission, and this prevents a consumer from substituting another form of payment at the time of the transaction. If a customer had opted-out, the A C H transaction could be returned unpaid the consumer could experience all of the consequences incident to a bounced check (i.e., N S F fee from the bank, returned check fee from the merchant, etc.). Banks cannot effectively distinguish A C H debits from check transactions to provide overdraft services on A C H transactions for those customers who elect overdraft services. If A C H transactions are included, then the most practical course is for banks not to allow partial opt-out, but treat an opt-out direction to apply to all transactions

### **Separate notice**

C B A urges the Board not to require a separate notice to consumers outlining the overdraft services direction. We do not wish to unduly minimize the importance of this issue, but banks are required to provide a myriad of disclosures. Since most bank customers do not incur

overdraft fees, we see no justification for the heightened emphasis implicated by a separate notice. We appreciate the Board's provision of a sample notice but we request that the final rule give banks the discretion to modify the disclosure to make it accurate and clear as it relates to a given bank's particular overdraft service.

### **Stand-in processing**

The Board proposes that debit card transactions authorized during payment system "stand-in-processing" are not eligible for the fee exception. In the event of a system link failure, which is rare and could occur with a merchant, processor, or bank, a stand-in balance is used. In these situations, banks' systems are unable to determine accurate balances and overdraft preferences, and it would be costly to make the necessary programming changes. The transactions identified by the Board as needing to have a fee waiver are extremely rare and we do not believe that the cost-benefit analysis justifies the requirement. Many banks have fee waiver policies that can address these situations when they arise.

### **Method of opting out or revoking opt-out.**

C B A supports the Proposal that notice may be provided through a variety of means. This kind of flexibility benefits both consumers and banks. We oppose a requirement that a toll-free number be dedicated exclusively to the function of handling opt-outs.

### **Implementation period**

C B A strongly suggests a minimum of 24 months to implement the final rule after its issuance. Banks are working to implement a number of new regulatory proposals, including revisions to Regulation A A, Regulation D D, and Regulation Z, which require systems development, modification of policies, and training. Banks will need time to develop systems to distinguish between covered and non-covered transactions.

We appreciate this opportunity to provide comments to the Board's Proposal. We concur with the Board's decision not to pursue regulation under UDAP. Regulation E is the proper vehicle. If you have any questions, please contact the undersigned.

Sincerely,

signed. Leland Chan  
General Counsel