

March 30, 2009

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R-1343

Dear Ms. Johnson:

This comment letter is submitted by HSBC Bank USA, National Association (“HSBC”) in response to the Proposed Rule (“Proposal”) to amend Regulation E to address overdraft issues in connection with one-time debit card transactions and ATM withdrawals (“Covered Transactions”) published by the Board of Governors of the Federal Reserve System (“Board”) in the *Federal Register* on January 29, 2009. HSBC appreciates the opportunity to share its views on the Proposal with the Board.

HSBC supports the comments submitted to the Board by the Consumer Bankers Association, the American Bankers Association, and the Financial Service Roundtable.

Opt-Out vs Opt-In

HSBC strongly recommends that the Board adopt an opt-out approach to providing customers a choice in connection with overdraft accommodation. The opt-out approach would provide sufficient opportunity to the customer to avoid being assessed an overdraft fee. HSBC is concerned that the adoption of the opt-in approach would have materially negative consequences for the consumer as well as for the general economy.

The opt-in approach would result in significant customer inconvenience. A debit card transaction that appears to overdraw the consumer's account at the time it is presented would have to be denied, even if a deposit has been made to cover the transaction. Payment systems used by financial institutions are not capable of providing real-time debit card transaction and deposit transaction data. A significant proportion of debit card overdrafts during the day will be covered by deposits by the time deposits are processed in the evening. If a customer has not opted in, and most customers would not opt-in, such transactions would have to be denied, in spite of the fact that the customer may know that a deposit has been made that would cover the debit.

The opt-in approach will have a negative impact on business, especially small business. Under the opt-in approach, many consumers will experience debit card declines that force them to wait to purchase until their next deposit clears. This will result in a decline in business transactions, especially for small businesses, because consumers will not return the following day to complete a transaction that was declined. Thus, the opt-in approach will have not only increased customer inconvenience, but also a significant

negative impact on the consumer economy.

Finally, the opt-in approach would impose a compliance burden on financial institutions, as customers recognize the need to opt-in. After experiencing a denial of payment on a debit card transaction, customers may call the bank to complain and request to opt-in to overdraft accommodation. There will be additional time required to help the customer understand why the debit was not covered and to explain the process to opt-in for accommodation of future debit card transaction overdrafts. This regulatory burden could be considerably reduced if the Board adopts the opt-out approach instead of the opt-in approach.

Opt-Out Procedure

The Proposal would generally prohibit a bank holding a consumer's account from assessing an overdraft fee on a Covered Transaction unless the consumer is given an opt-out notice, is given a reasonable opportunity to opt out, and does not opt out. We believe that this approach is appropriate, and should be retained. The Proposal provides that an institution gives a consumer a "reasonable opportunity to opt out" if it provides: (i) a form the consumer may return by mail; (ii) a toll-free number that a consumer may call; or (iii) an electronic means to opt out, such as a form on a web site provided that the institution directs the consumer to the specific site address as opposed to its home page. In all circumstances, the Board's safe harbor involves a 30-day period to opt out beginning on the day the notice is provided. The Board also indicates that an institution may provide the notice prior to or at account opening and require the consumer to decide whether to opt out as a necessary step to opening the account.

We request the Board to note, as it has in other contexts, that an institution may control the method by which it accepts opt-outs, and that the institution is required to honor the opt-out request only if it is made using the designated channel(s).

The Board has asked for specific comment on whether 30 days would provide customers a "reasonable opportunity" to opt out. HSBC believes that 15 days would be sufficient time. Most customers respond to an opt-out within that period and it would allow a consumer more functionality on a debit card more quickly. During the safe harbor waiting period a bank may not authorize debit card transactions that appear to overdraw an account at the time of authorization. Therefore, the Board may weigh the equities of the circumstances and determine that a 15-day waiting period is more appropriate in the context of this rule.

Varying Terms and Conditions

The Board is concerned that institutions may circumvent the proposed opt-out requirement and discourage consumers from opting out by, for example, imposing higher fees, paying lower interest rates, or limiting the features of the opt-out account. Therefore, the Board requests comment on whether institutions that currently offer an opt-out from overdraft services implement that opt-out at the account level (i.e., within

the same type of account) or at the product level (i.e., by placing the consumer in a separate opt-out account). HSBC believes that financial institutions must preserve the right to vary terms and conditions of accounts based upon the services and other features that attach to the account.

Exceptions to Fee Prohibition

The proposed Commentary provides several examples of when an institution may have a reasonable belief that a consumer's account may have sufficient funds. We believe these examples are reasonable and appropriate. The Board should retain them. The Board notes in the Commentary, however, that the exception for a "reasonable belief" does not apply if the transaction is not submitted to the institution for authorization, such as if the transaction is below a floor limit or the institution is relying on "stand in" authorization. We ask the Board to reconsider these distinctions.

HSBC believes it is entirely appropriate for an institution to have the ability to assess an overdraft charge in those circumstances in which the institution does not have the opportunity to decline the transaction in the first place. In these circumstances, the institution has absolutely no ability to control the risks associated with a transaction that may overdraw an account, while the consumer does have control over the risk. We do not believe it is fair or equitable to shift the risk of the transaction onto an institution that cannot control the risk when the consumer is in the better position to control it. Therefore, an institution temporarily relying on stand-in authorization, or an institution that is forced to pay a transaction that is not otherwise authorized (*e.g.*, the transaction is below a certain floor), should have the ability to assess an overdraft fee if the transaction overdraws the account.

HSBC recommends that the Board adopt an exception in those circumstances in which an institution does not authorize the transaction. Specifically, the Board states "[f]rom the perspective of the consumer who has opted out, it is reasonable to expect that the transaction would be declined if he or she did not have sufficient funds in the account. The merchant's decision not to seek authorization for small dollar transactions generally is not transparent to the consumer." Regardless of whether the lack of authorization is transparent to the consumer, a consumer cannot presume that there are sufficient funds in the account simply because the consumer believes the transaction was authorized. The Board recognizes this fact insofar as it has provided exceptions to the fee prohibition when the transaction has, in fact, been authorized. As the Board notes, an authorization does not mean that funds will be available when the transaction settles. We strongly urge the Board to reconsider its position in this regard, or at least to amend its reasoning. Consumers should not expect that a transaction will be declined if it will settle into overdraft and the Board should not encourage such an expectation.

We also ask the Board to consider the logistical issues and costs that will arise if an institution must discern whether an overdraft fee relates to a transaction that was not authorized, or authorized pursuant to stand-in processing. This would require significant systems revisions, time and costs, as banks do not generally have reasons to make these

determinations today. We ask the Board to expand the exception to the fee prohibition to include transactions not authorized by the institution and transactions authorized pursuant to stand-in processing. As an alternative to avoid the risk of assessing a prohibited fee, banks may decide not to process transactions during a stand in, and that would result in a bad experience for the customer.

Notice Timing

For accounts opened on or after the effective date of the final rule, the Proposal would require an institution to provide the opt-out notice, and a reasonable opportunity to opt out, prior to the institution imposing an overdraft fee in connection with a Covered Transaction (“Initial Notice”). For any account, including accounts opened prior to the effective date, for which an opt-out is not in effect, the institution must provide the notice following the assessment of an overdraft fee in connection with a Covered Transaction (“Subsequent Notice”). The Subsequent Notice may be provided on the periodic statement that reflects the overdraft fee, in close proximity to the overdraft disclosures required by Regulation DD, or it may be provided separately at least once per statement cycle on any notice sent promptly after the institution’s payment of such transaction during the statement cycle.

HSBC agrees that these notification requirements are appropriate, and we urge the Board to retain them. We especially agree that institutions should not be required to send millions of Initial Notices to existing accountholders prior to the effective date. We believe this would be extremely costly and unnecessary, especially since many of these consumers have been provided with information regarding the institutions’ overdraft policies as part of an account agreement or other disclosure.

With respect to the Subsequent Notice, we ask the Board to provide a safe harbor with respect to sending a notice “promptly” if it is not included in the periodic statement. Specifically, we believe that if the notice is sent no later than the next periodic statement that reflects the underlying transaction, it should be deemed to have been sent “promptly.”

The Board has requested comment on whether the opt-out notice should be segregated from other account disclosures. HSBC does not believe the notice should be segregated. We believe the Board has proposed the correct standard, *i.e.*, that the disclosure be clear and conspicuous, and it should be retained in the final rule. The overdraft opt-out notice is no more important than a variety of other account terms and disclosures that are provided to the consumer in connection with a transaction account. Further, due to a consumer’s finite attention span, we do not believe the Board should elevate this disclosure’s profile, at the expense of other disclosures.

The Board has also requested comment on whether the final rule should permit institutions to provide the opt-out notice on periodic statements in any cycle in which the consumer has incurred an overdraft fee not related to a Covered Transaction or, alternatively, on all periodic statements. We do not believe the Board needs to provide

institutions express permission to provide consumers with this information. Indeed, we believe it would be troubling if the Board were to prohibit an institution from disclosing a consumer's rights on any communication with the consumer, including the periodic statement. We do not believe that consumers will dismiss the substance of the notice on periodic statements, especially since the consumer will actively look for overdraft information on the periodic statement if he or she is dissatisfied with the fee.

Content and Form of Notice

HSBC asks the Board to provide express flexibility for an institution to provide other overdraft opt-out choices on the notice in addition to those relating to Covered Transactions. For example, an institution may provide separate opt-outs for ATM withdrawals and for debit card transactions. Or an institution could provide an opt-out for Covered Transactions and another for paper checks. We do not believe the institution should be required to segregate the overdraft notices, as a consumer would expect to see an integrated disclosure. HSBC therefore asks the Board to provide such flexibility in the final rule.

Overdraft Fees and Debit Holds

The Proposal would prohibit an institution from assessing an overdraft fee if the overdraft would not have occurred but for a "hold" placed on funds in the consumer's account in connection with a debit card transaction if the actual amount of the transaction can be determined by the merchant or other payee within a short period of time after the transaction is authorized. HSBC asks the Board to decline adoption of this portion of the Proposal in the final rule. If adopted, the debit hold portion of the Proposal could result in significant costs on institutions with relatively few benefits for consumers.

Before commenting on the substance of the Proposal, HSBC asks the Board to clarify the scope of the debit hold portion of the Proposal by defining a "debit hold." Based on the examples provided in the Commentary, it appears the Board believes that a "hold" results from actions taken by the issuer to hold funds in excess of an authorization amount. It does not appear that the Board intends to consider a merchant's authorization request amount to be a "hold" for purposes of the Proposal. Indeed, such an interpretation would hold the institution responsible for the authorization behavior of the merchant. This would be an unusual result, especially since the Board could address merchant-related concerns directly to merchants under Regulation E. We agree that a "hold" is limited to the actions of an issuer, and we ask the Board to provide explicit clarification of this fact in any final rule.

Regardless of how a "hold" is defined, there are significant costs associated with the Proposal that we believe can be mitigated with a relatively straightforward revision by allowing institutions a safe harbor if they do not hold funds exceeding the authorization request. In this regard, an institution could not comply with the debit hold portion of the Proposal without significant systems changes that allow the bank to "look back" to the transactions that could have an impact on an account's overdraft status and determine if

the overdraft would not have occurred but for a merchant hold that exceeded the final settlement amount. A more appropriate solution that would not result in these systemic and operational costs would be to provide an institution with a safe harbor if the institution has adopted reasonable policies and procedures to hold funds equal to (or less than) an authorization request. If an institution has such policies and procedures in place, it would not violate the prohibition, even if an overdraft fee is assessed due to a hold that exceeded the final settlement amount. If the Board were to take this approach, it would impose obligations on an institution, but only to the extent the institution can control and manage them.

For those institutions that will not take advantage of a safe harbor, HSBC believes it is important for the Board to provide a definitive list of the merchant transactions that would be subject to the prohibition. The Board currently proposes that the prohibition would relate to transactions if the actual amount of the transaction can be determined by the merchant or other payee within a short period of time after the transaction is authorized. The Commentary then indicates that transactions at pay-at-the-pump terminals and at restaurants would be of the type of transaction covered by the Proposal. The Supplementary Information states that multi-night hotel stays would not be covered by the Proposal. HSBC appreciates the guidance that the Board has proposed, but we believe that institutions will face difficult choices now and in the future when trying to determine whether a transaction is covered by the final rule or not. Indeed, it may be that one institution comes to one conclusion, but other institutions conclude differently, leaving uneven application of the consumer protections envisioned by the Board. We therefore request that the Board provide a list of merchant categories whose transactions would be subject to the prohibition in the Proposal.

If the Board retains an example of transactions that are not subject to this portion of the final rule—which would be helpful if the Board does not provide a definite list of transactions that are subject to it—we ask that the Board revise the example relating to a hotel stay. The nature of *all* hotel stays is such that the merchant may not know the final transaction amount within a short period of time. Yet, the Supplementary Information refers to a multi-night hotel stay as a transaction that would be excluded from coverage under the debit hold prohibition, which suggests that a single night stay may not be excluded. We ask the Board to provide the appropriate clarification if the example is retained. We also ask that the Board provide the example in the Commentary to provide institutions with greater certainty regarding the applicability of the example.

By including certain transactions by merchant type within the prohibition, the Board clearly expects that an institution will be able to identify the type of merchant that initiated the debit card transaction. HSBC has policies and procedures to identify the type of merchant involved in a transaction, but cannot identify the type of merchant that initiated the transaction. Without this clarification, the Proposal could be read to impose liability on an institution even if the institution had no reasonable means of recognizing the transaction as being subject to the debit hold/overdraft fee prohibition. In particular, an institution knows only what information it is provided as part of a transaction authorization and settlement process. The best an institution can do is properly identify

the merchant category code (or similar code) accompanying a transaction, and handle it accordingly. The institution cannot make an independent judgment regarding the nature of the transaction. Therefore, we ask that the institution not be tasked with determining with precision the type of merchant that originated the transaction, but that the institution use reasonable policies and procedures to identify relevant transactions, such as by reviewing merchant category codes or similar codes that may accompany a debit card transaction.

HSBC appreciates the fact that the Board has offered a safe harbor for institutions if they have procedures and practices in place designed to release a debit hold within a reasonable period of time, such as two hours. We believe the safe harbor, described above, for institutions that do not hold more than the authorized amount may be more reasonable. The safe harbor in the Proposal is technically feasible, as the Board indicates. However, it is costly and would apply only if all merchants and acquirers were *required* to clear and settle the specified types of transactions within two hours, such as by imposition of such requirements by the payment card networks. This would be a costly undertaking, especially for merchants and acquirers. We also note that the Proposal assumes continual clearing and settlement cycles, 24 hours a day, 7 days a week. This may not be the case. If the Board intends to keep this safe harbor, it may be able to mitigate the costs by providing a more realistic timeframe on the release of the debit hold. Specifically, it is our understanding that institutions generally assess overdraft fees as part of their batch processing at the end of the day. It would seem reasonable to allow an issuer to retain its own hold and either disregard it for purposes of assessing overdraft fees or release the hold prior to the time the bank calculates the account activity for purposes of assessing the overdraft fee.

Effective Date

HSBC will have to modify existing software and systems and install new ones, and test these systems. In addition, we will have to train employees and educate our customers. Moreover, the regulation may require card network rule changes which cannot occur until after adoption of the final regulation. For these reasons, HSBC asks the Board to provide two years to implement the final rule before compliance becomes mandatory.

Conclusion

HSBC appreciates the opportunity to comment on the Proposal.

Very truly yours,

Andrew Ireland
Executive Vice President

bcc:

Kevin Martin
Adrian Martinez
Patti Thompson
Karin O'Neill
Gea Tung