



Office of Thrift Supervision
Department of the Treasury

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March 30, 2009

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

SUBJECT: Comments on Proposed Amendments to Regulation E
Docket No. R-1343

Dear Ms. Johnson:

The Office of Thrift Supervision (OTS) has reviewed the Federal Reserve Board's proposed amendments to Regulation E implementing the Electronic Fund Transfer Act. Our agency is encouraged by the many features of the January 29, 2009 proposed rule designed to provide consumers with greater transparency and more control over the fees they pay for overdrafts when they initiate electronic transactions at terminals and at the point of sale. To provide assistance with this effort, we have enclosed Staff Commentary on the proposed rule.

If you have any questions regarding our comments, please contact either April Breslaw, Consumer Regulations Director at (202) 906-6989 or Suzanne McQueen, Consumer Regulations Analyst at (202) 906-6459.

Sincerely,

Montrice G. Yakimov
Managing Director for
Compliance and Consumer Protection

Enclosure

Office of Thrift Supervision
Staff Commentary on Proposed Regulation E Amendments
FRB Docket R-1343

The Office of Thrift Supervision (OTS) is taking this opportunity to comment on the proposal by the Board of Governors of the Federal Reserve System (Board) to amend Regulation E,¹ which implements the Electronic Fund Transfer Act (EFTA).² We support the Board's effort to strengthen Regulation E to provide consumers with the opportunity to choose whether to participate in overdraft protection services. As explained in more detail below, OTS supports requiring that a consumer affirmatively consent, or opt-in, before an institution may charge a fee for paying an overdraft created through the electronic transactions addressed in the Regulation E proposal.³ In addition, OTS recommends that the Board finalize the proposal in a manner that fully recognizes the rights afforded consumers under the Equal Credit Opportunity Act (ECOA) as implemented by Regulation B, when they choose not to participate in overdraft services.

Enrollment in overdraft coverage programs should require consumer consent.

Because many institutions automatically enroll consumers in their overdraft protection programs,⁴ the federal financial institution regulatory agencies have long been concerned about a lack of consumer choice in this area. As early as 2005, all of these agencies recommended that institutions provide consumers with the opportunity to opt out of overdraft protection programs.⁵

When the OTS, Board, and National Credit Union Administration (NCUA) (collectively, the Agencies) proposed a rule prohibiting unfair and deceptive acts or practices, in May 2008, the Agencies anticipated formalizing the opt-out guidance into a rule.⁶ However, consumer testing revealed that most consumers would not choose to opt out of overdraft protection if that meant that their checks would be returned unpaid.⁷

¹ Electronic Funds Transfer; Proposed Rule, (Regulation E Proposal) 74 FR 5212 (January 29, 2009).

² 15 U.S.C. 1691(a)(3).

³ OTS has previously articulated this position in testimony provided to the House Financial Services Subcommittee on Financial Institutions and Consumer Credit hearing on the Credit Cardholders' Bill of Rights Act of 2009 and the Consumer Overdraft Protection Fair Practices Act of 2009 (March 19, 2009) (available at: http://www.house.gov/apps/list/hearing/financialsvcs_dem/yakimov031909.pdf).

⁴ FDIC Study of Bank Overdraft Programs at p.5 (Nov. 2008) (FDIC Overdraft Study) available at: http://www.fdic.gov/bank/analytical/overdraft/FDIC138_Report_FinalTOC.pdf (75.1 % of studied institutions automatically enroll customers in automated overdraft programs).

⁵ See OTS Overdraft Guidance, 70 FR 8428, 8431 (February 18, 2005) and OCC, FRB, FDIC, and NCUA Joint Guidance on Overdraft Protection Programs, 70 FR 9127, 9132 (February 24, 2005).

⁶ See Unfair or Deceptive Acts or Practices; Proposed Rule, 73 FR 28904, 28929-31 (May 19, 2008).

⁷ Unfair or Deceptive Acts or Practices; Final Rule, 74 FR 5498, 5546 (January 29, 2009).

The testing brought a further distinction to light. When asked if they would opt out if the choice was limited to not participating in overdraft protection for ATM withdrawals and debit card purchases, half of the participants indicated that they would consider doing so.⁸ In situations where consumers did not have sufficient funds to avoid overdraft fees, several participants affirmatively stated that they would prefer that institutions decline these types of transactions.⁹ This finding is supported by a separate survey that found that approximately 80 percent of participants preferred that their institution decline debit transactions if paying them would result in a fee.¹⁰

The Agencies did not take action in the final UDAP rule on the overdraft protection opt-out provisions that we had proposed, recognizing that other regulatory approaches might be used to address concerns, including amendments to Regulation E. Through this proposal, the Board has offered amendments to Regulation E that would provide consumers with the opportunity to avoid the payment of overdrafts through ATM withdrawals and one-time debits at point-of-sale (POS) terminals.¹¹ The Board has solicited comment on whether consumers should be permitted to opt-out of the payment of overdrafts paid for such transactions, or whether institutions should be prevented from paying overdrafts unless consumers “opt-in.”

OTS supports requiring that a consumer affirmatively consent, or opt-in, before an institution may charge a fee for paying an overdraft caused by the electronic transactions addressed in the Regulation E Proposal. Among the institutions that participated in a recent FDIC study, POS/debit transactions accounted for 41%, the largest share of overdraft transactions.¹² Moreover, as noted above, many institutions automatically enroll their customers in overdraft protection programs. Studies have shown that under this strategy, the power of inertia and lack of attention on the part of consumers can result in high participation in a program.¹³ However, half of the consumers tested in connection with the UDAP Rule said that they would consider removing overdraft protection from their electronic transactions if given such an opportunity.¹⁴ These consumers should be given that choice when they open their accounts.¹⁵

Studies suggest that young adults and low income consumers would particularly benefit from such an approach. For example, the FDIC Overdraft Study found that

⁸ Id.

⁹ Regulation E Proposal, 74 FR at 5219 n.28.

¹⁰ Parrish, Leslie, Consumers Want Informed Choice on Overdraft Fees and Banking Options, Center for Responsible Lending Research Brief, April 2008, available at: <http://www.responsiblelending.org/press/releases/comparison-of-crl-and-aba-overdraft-surveys.html>.

¹¹ Regulation E Proposal, 74 FR at 5212.

¹² FDIC Overdraft Study at p.78.

¹³ Madrian, Brigitte C., and Shea, Dennis F., The Power of Suggestion: Inertia in 401(K) Participation and Savings Behavior, Working Paper 7682, National Bureau of Economic Research, Cambridge, MA, May 2000 (available at: <http://www.nber.org/papers/w7682>).

¹⁴ See Regulation E Proposal, 74 FR at 5215 (citing *Review and Testing of Overdraft Notices*, Macro International, December 8, 2008 (Macro Overdraft Testing)).

¹⁵ Research also revealed that the term “opt-out” was confusing to some consumers who assumed that it meant “opt in.” See Macro Overdraft Testing at p. 8.

although they held only 7.6 % of the accounts offered by the institutions participating in the study, young adults paid 61.5% of the overdraft fees originated at point of sale (POS)/debit terminals.¹⁶ Among participating institutions, 46% of young adult customers had overdrafts, and 25% had more than four overdrafts.¹⁷ Similarly, low-income consumers were more likely to incur overdraft fees and to have multiple overdrafts than higher-income consumers.¹⁸ As with young adults, most of the overdrafts by low-income consumers resulted from POS/debit transactions rather than checks.¹⁹

As ATM and POS transactions are generally small – around \$20.00 – the typical \$27 fee often exceeds the typical cost of the transaction.²⁰ Institutions should be required to presume that consumers are willing to shoulder such expenses only when they have specifically indicated that they are willing to do so, *i.e.*, when they opt-in. This approach is consistent with the manner in which institutions require express consumer agreement for other forms of overdraft protection, such as linked accounts and lines of credit.²¹

The ECOA non-discrimination protections for consumer choice should not be weakened.

The Board has previously taken the position that when overdrafts are paid, credit is extended.²² Consequently, the Board has concluded that ECOA and Regulation B apply to overdraft protection programs.²³ Based on this assessment, ECOA and Regulation B would prohibit a creditor from discriminating against an applicant because the applicant has in good faith exercised any right under EFTA.²⁴ Under the Regulation E Proposal, the EFTA serves as the legal basis for providing consumers with a right to choose whether to participate in overdraft protection for certain electronic transactions.²⁵ Institutions would therefore be prohibited from discriminating against consumers who either opt out or do not choose to opt in by treating them less favorably than other consumers with respect to any aspect of a credit transaction.²⁶ Yet, that is what some of the alternatives in the proposal would allow.

¹⁶ FDIC Overdraft Study at p.80.

¹⁷ *Id.*

¹⁸ *Id.* at pp. 76–78.

¹⁹ *Id.* at p. 78.

²⁰ *Id.* at p. 79.

²¹ Regulation E Proposal, 74 FR at 5217.

²² See Joint Guidance on Overdraft Protection Programs, 70 FR 9127, 9129 (Feb. 24, 2005).

²³ *Id.* at 9131.

²⁴ ECOA and Regulation B prohibit discrimination based on the good faith exercise of any right afforded under the Consumer Credit Protection Act. 15 U.S.C. 1691(a)(3); 12 C.F.R. § 202.2(z). The EFTA is title IX of the Consumer Credit Protection Act. 12 C.F.R. § 205.2(c).

²⁵ Regulation E Proposal, 74 FR at 5233 (authority citation).

²⁶ See 12 C.F.R. § 202.4(a).

Specifically, under both Alternative 1 and Alternative 2 of the proposal, where a consumer either opts out or chooses not to opt in to overdraft coverage:

- § 205.17(b)(2) would allow an institution to refuse to extend credit in the form of payment of overdrafts for checks, ACH transactions, and other types of transactions.²⁷
- § 205.17(b)(3) (Alternative B) would permit an institution to vary the terms, conditions, and features of an account, “provided that the differences in the terms, conditions, or features are not so substantial that they would discourage a reasonable consumer from exercising his or her right to opt out of the payment of such overdrafts.”²⁸

Apparently, these alternatives have been devised to address operational issues associated with: (1) implementing an opt-out or opt-in rule that applies to ATM withdrawals and one time debit card transactions, but not to overdrafts caused by other types of transactions;²⁹ and (2) the preference by some institutions to provide consumer choice at the product level by offering special accounts that feature an opt-out or opt-in to overdraft coverage.³⁰

However, efforts to resolve operational issues should not take precedence over the enforcement of the fair lending laws and rules.³¹ Such matters do not provide a legal basis for setting aside the protections afforded by ECOA and Regulation B, *i.e.*, permitting less favorable treatment of consumers who exercise their EFTA rights in good faith. Adopting a standard that ECOA and Regulation B permit discriminatory credit terms if they, “are not so substantial that they would discourage a reasonable consumer from exercising his or her right” would cause particular concern. Such a standard seems to confuse the use of discriminatory terms with conduct that discourages consumers from seeking credit. Such activities constitute separate violations of Regulation B.³² The OTS therefore recommends that the Board decline to adopt the proposals for § 205.17(b)(2) and § 205.17(b)(3) (Alternative B) that are described above.

²⁷ Regulation E Proposal, 74 FR at 5234 (setting forth § 205.17(b)(2) under Alternative 1) and 5235 (setting forth § 205.17(b)(2) under Alternative 2).

²⁸ See Regulation E Proposal, 74 FR at 5234 (setting forth § 205.17(b)(3) under Alternative 1.B) and 5235 (setting forth setting forth §205.17(b)(3) under Alternative 2.B) .

²⁹ *Id.* at 5219 and 5226.

³⁰ *Id.* at 5219 and 5227.

³¹ This is particularly true where, as the Board has noted, the benefits of enabling consumers to have a choice about the payment of overdrafts for these electronic transactions may outweigh the associated costs. See Regulation E Proposal, 74 FR at 5218.

³² Compare 12 C.F.R. § 202.4(a) (discrimination) with 12 C.F.R. § 202.4(b) (discouragement).