



August 6, 2004

Docket No. OP-1198  
Jennifer J. Johnson  
Secretary of the Board  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street & Constitution Avenue, NW  
Washington, DC 20551

**RE: Proposed Guidance on Overdraft Protection Programs**

Dear Ms. Johnson:

The Conference of State Bank Supervisors (CSBS)<sup>1</sup> is pleased to have the opportunity to comment on the interagency proposed guidance (Proposal) to assist financial institutions in the responsible disclosure and administration of overdraft protection services. The Proposal was issued by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision (collectively referred to as the FFIEC). The Proposal highlights potential safety and soundness considerations to ensure financial institutions adopt adequate policies and procedures to address credit, operational, and other risks associated with these programs. The Proposal alerts financial institutions regarding the need to comply with various state and Federal laws and sets forth examples of best practices that are currently observed in, or recommended by, the industry.

CSBS applauds the FFIEC's effort to provide guidance to financial institutions that elect to offer overdraft protection programs. We concur with the FFIEC that, as part of their due diligence, financial institutions should carefully consider the significant safety and soundness, compliance, legal and reputational risks that are associated with overdraft protection programs. At the same time, we recognize that many banks offering such programs are simply formalizing a traditional practice of covering an inadvertent overdraft

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<sup>1</sup> CSBS is the national organization of state officials responsible for chartering, regulating and supervising the nation's 6,343 state chartered commercial and savings banks and over 400 state-licensed branches and agencies of foreign banks.

and thereby saving a customer the embarrassment and additional costs associated with bouncing a check.

CSBS has commented to the Federal Reserve Board in the past regarding overdraft protection programs and highlighted our concerns with the approach some financial institutions are using to promote their overdraft protection programs<sup>2</sup>. Various state banking departments (such as Colorado, Indiana, Wyoming and Washington) have also issued guidance to state chartered institutions on such issues as marketing materials relating to overdraft protection programs. In fact, the State of Washington's Department of Financial Institutions conducted an extensive examination of all financial institutions in their state to identify the use and the characteristics of overdraft protection programs. The results of Washington's study and the Department's own 'best practices' guidance are both accessible on their website at [www.dfi.wa.gov](http://www.dfi.wa.gov).

In addition to individual states' guidance, CSBS, through our Regulatory Committee, has also focused on overdraft protection programs. Generally, we have directed our attention to the marketing practices financial institutions are using to promote such programs; the disclosures financial institutions provide to consumers; the means of access to the programs; and consumers' ability to "opt-out" of having overdraft protection placed on their account.

### **Description of Overdraft Protection Programs**

The FFIEC guidance indicates that the availability and customer acceptance of overdraft protection programs has increased, but notes that certain aspects of marketing, disclosure and implementation of the programs have drawn the attention of state and Federal regulators as well as the general public. The Proposal describes historical and traditional approaches that financial institutions have used to provide overdraft protection. The Proposal then draws a comparison between traditional approaches and more recent models of overdraft protection programs and describes why there may be a need to provide guidance to financial institutions. The Proposal indicates that overdraft protection programs vary from institution to institution and will vary over time. Accordingly, the FFIEC is unable to precisely differentiate between traditional overdraft protection approaches and more recent programs that have raised questions. The Proposal, nonetheless, describes certain characteristics associated with newer, evolving programs that are different from traditional overdraft protection programs which have been generally administered with more informal procedures. Among other things, the Proposal notes that with the newer, evolved overdraft protection programs financial institutions generally inform consumers that: overdraft protection has been placed on their account (including the aggregate dollar limit of the protection); that coverage is automatic for consumers who meet certain criteria; and that the financial institution generally pays the overdraft and charges a flat fee.

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<sup>2</sup> Our letter, dated January 27, 2003, is available at [http://www.csbs.org/government/regulatory/comment\\_ltrs/cl\\_01.27.03.htm](http://www.csbs.org/government/regulatory/comment_ltrs/cl_01.27.03.htm)

CSBS is concerned that the language used in the description of overdraft protection programs could apply to more financial institutions than regulators truly intended. Many financial institutions use specific parameters to pay customers' overdrafts, but do not market or even inform their customers of this courtesy. CSBS believes that, even if a financial institution has automated this process for better efficiency, it seems no different than the traditional approach when bankers manually reviewed occasional overdrafts and determined which to pay.

We suggest that the FFIEC explicitly state that examiners will evaluate a financial institution's adherence to principles contained in the guidance on a risk focused basis. Institutions should adopt the appropriate review and controls relating to the size and complexity of their overdraft protection program. In other words, a financial institution that is not advertising or promoting its overdraft protection program, permits the consumers to access the program solely by check, and continues to monitor and limit the use of its program would be subject to existing safety and soundness reviews that are currently considered during an examination. CSBS is greatly concerned about the growing regulatory burdens being placed on financial institutions. With new and revised regulatory requirements being issued on a regular basis, the compliance burden is becoming overwhelming, especially for small community banks. If the financial institution is limiting its customers' use of the program, there seems to be limited safety and soundness or compliance risk involved. Accordingly, it would be unnecessary for institutions to be held to many of the additional standards and practices suggested in this Proposal.

### **Disclosures for Overdraft Protection Products**

CSBS believes that providing clear disclosures is important and previously expressed concerns about the "discretionary" nature of some overdraft protection products. Due to a concern that providing customers with written agreements that describe the terms governing overdraft protection programs would trigger Regulation Z disclosures, many financial institutions did not provide clear written agreements. Regulation Z acknowledges that when overdrafts are paid, credit is extended. However, fees associated with paying an overdraft item are not considered finance charges under Regulation Z if the institution has not agreed in writing to pay overdrafts. The FFIEC notes that even where the institution agrees in writing to pay overdrafts as part of the deposit account agreement, fees assessed against a transaction account for overdraft protection services are finance charges only to the extent the fees exceed the charges imposed for paying or returning overdrafts on a similar transaction account that does not have overdraft protection. Accordingly, so long as financial institutions do not charge more in overdraft protection fees than they charge for returning overdrafts for customers that do not have overdraft protection, they may clearly provide in writing the specifics governing their overdraft protection program without triggering Regulation Z disclosure requirements. .

However, many financial institutions still use what is referred to as a non-contractual courtesy concept. Using this concept, a financial institution will inform its customer that it will pay overdraft checks, while also noting that the institution is not contractually obligated to pay an overdraft and reserves the right to pay only those checks it deems appropriate.

CSBS believes that this non-contractual courtesy concept can be misleading to consumers and, therefore, is inappropriate. Several state banking commissioners have issued guidance to their institutions indicating that if the financial institution informs consumers of the criteria that determine whether the financial institution will pay an overdraft check, the institution is providing customers information on which they can rely.

CSBS would suggest that the Proposal provide more information addressing practices associated with the overdraft protection programs that may mislead consumers or cause confusion. The designation of “automatic” or “program” indicates that the financial institution has set forth regular criteria for determining whether an account qualifies for the protection. The consumer should be able to rely on payment of an overdraft check if the circumstances meet the parameters disclosed by the financial institution.

On a related note, we fully support the FFIEC’s suggestion that, when overdraft protection is automatic, financial institutions clearly disclose the ability of consumers to “opt-out” of the program. Financial institutions should make this disclosure prior to activating any overdraft protection program.

The best practices guidance suggests that when consumers attempt to use means other than checks to withdraw or transfer funds made available through an overdraft protection program, the financial institution should provide a specific consumer notice, where feasible, that completing the withdrawal will trigger overdraft protection fees. CSBS is concerned that, because of the way checks are generally batch processed, a bank may have received a check that it has not yet processed and the financial institution may, therefore, be unaware that a particular ATM withdrawal is overdrawing the account. Additionally, many non-proprietary ATMs or merchant point-of-sale terminals may be unaware of the consumer’s account balance or may be unable to display the suggested opt-out disclosure. Although we appreciate the concept of providing consumers advance notice of the fee about to be placed on their account, CSBS does not believe financial institutions could consistently comply, which could consequently also result in confusion for consumers who relied upon such a disclosure.

### **Access to Overdraft Protection Programs**

CSBS believes that the elements of the Proposal relating to accessing overdraft protection in non-check transactions should also be reconsidered. The Proposal recommends that financial institutions provide their customers with some form of advance disclosure that describes fees that will be incurred in certain non-check transactions. Similar to the treatment of ATM surcharges, the Proposal suggests that financial institutions provide consumers with a choice to opt-out or cancel the transaction if the withdrawal will result in an overdraft or related overdraft protection fees. As indicated in the previous section of this letter, CSBS would be concerned about how consistently such an electronic notification could be provided.

However, we believe that if financial institutions give consumers the opportunity to purposefully overdraft their account through an ATM or a teller, then the financial institution is clearly extending credit.

The nature of overdraft protection programs is to provide a service to financial institution customers that overdraw a checking account. If financial institutions allow their customers to access overdraft protection programs through a teller or an ATM, they begin to call into question the validity of the Regulation Z disclosure exemption relating to inadvertent overdrafts. Financial institution regulators and bankers should carefully evaluate the appropriateness and the potential impact associated with allowing overdraft protection programs through non-checking transactions. Due, in part, to potential unintended consequences, we suggest that the Proposal be amended to strongly discourage access to overdraft protection programs through an ATM or teller transaction where the financial institution allows consumers to consciously and knowingly overdraw their account.

### **Relation to the Proposed Amendments to Regulation DD**

CSBS also applauds the Federal Reserve Board's efforts to include overdraft protection programs in Regulation DD, implementing the Truth in Savings Act. Many of the comments in our letter could also apply to the proposed amendments to Regulation DD. For instance, CSBS believes the number of institutions that will need to comply with many aspects of the proposed amendments is more than the Federal Reserve initially anticipated. We would suggest that a distinction should be made between those institutions that actively promote the consumer's ability to overdraw their account and those that do not market their use of the product. Additionally, a distinction could be drawn between financial institutions that allow access to their overdraft protection programs through an ATM or teller and those that only use the product for an occasional bounced check, either in paper form or via an off-line debit card transaction. As indicated above, when a financial institution allows and/or acknowledges a consumer *consciously* overdrawing an account, it may fall outside the exception initially created in the Truth in Lending Act for institutions that pay an occasional NSF check.

We ask that the Federal Reserve Board take these differentiations into account when finalizing its Regulation DD. Financial institutions are currently facing an ever increasing volume of regulatory requirements. We suggest that the Federal Reserve make every effort to avoid unnecessarily or unintentionally adding to that burden. Many small community banks offer overdraft protection truly as a courtesy for their customers, without promoting the program. These institutions are not conducting business any differently than they did in the past, but would appear to have additional disclosure burdens if these amendments are adopted as proposed.

### **Conclusion**

CSBS believes that cooperative efforts between state and Federal authorities to ensure that financial institutions fully understand compliance requirements involved in creating and maintaining overdraft protection programs will have a greater impact than individual efforts at either the state or Federal level. We would welcome opportunities to work with the Federal regulatory agencies to develop joint initiatives and guidance in this area. Thank you

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for your consideration and we invite you to call on us if we can provide additional information on any of the state initiatives noted in our letter.

Best Personal Regards,

A handwritten signature in black ink that reads "Neil Milner". The signature is written in a cursive, flowing style.

Neil Milner  
President and CEO

Cc: Docket No. R-1197