



PINNACLE
FINANCIAL STRATEGIES

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Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Via email: regs.comments@federalreserve.gov

Subject: Docket No. OP-1198
Interagency Guidance on Overdraft Protection Programs

We are pleased to respond to the Federal Financial Institutions Examination Council's five member agencies' request for comment concerning the proposed "Interagency Guidance on Overdraft Protection (ODP) Programs" (the Guidance). We note that this proposed Guidance appears to attempt to address two pressing needs: the need as stated by many consumer groups to provide more clear information to customers about the costs and functions of ODP programs, and the regulatory and industry need for consistent treatment by the regulatory agencies during their review of these programs in light of existing safety and soundness and risk management concerns, as well as consumer protection laws, regulations, and policies.

Pinnacle Financial Strategies (PFS) is a third party provider that offers such a program, marketed under the following service marks, "*Bounce ProtectionSM*", "*No Bounce AdvantageSM*", "*No Return BenefitSM*", and "*Member Privilege?*" PFS currently has in excess of 500 financial institutions successfully using our ODP program. These institutions include commercial banks, thrifts, and credit unions.

Our institutions continue to report that consumer demand and acceptance of this service is very high with strong customer appreciation of the service. While the media and some consumer groups are prompt to provide isolated examples of consumers who have been harmed by similar programs, examples that may have been justified in some cases to expose to criticism poorly run ODP programs, our institutions note few complaints and numerous accounts of customers' favorable comments concerning the personal benefits received from the program. We believe the success of these programs is because they clearly fill a valid consumer need that is not always met by the more traditional forms of

overdraft protection programs. As such, courtesy ODP programs are intended to complement the traditional programs, not replace them.

We are pleased that the agencies also recognize the widespread consumer acceptance of, and desire for, well run consumer oriented ODP programs. We strongly support the need for consistent examination treatment and the need for full disclosures and clear communications by financial institutions with their customers. For the most part, we are very supportive of the agencies' efforts to protect consumers and provide consistent examination treatment as presented in the draft Guidance. We are also pleased to provide constructive commentary on several issues that we believe warrant further consideration by the agencies before final Guidance is issued.

Traditional interagency guidance has typically been used to provide expanded requirements that institutions must follow as an augmentation to existing rules and regulations or other established procedures based on safety and soundness standards. This Guidance is broken down into three primary sections that financial institutions must pay close attention to: Safety and Soundness Considerations, Legal Risks, and Best Practices.

The first and second sections, "Safety and Soundness Considerations" and "Legal Risks" we view as the regulators' more traditional form of guidance. These first two sections clearly identify safety and soundness risk assessment areas and existing financial reporting requirements, as well as existing compliance regulations and legal issues that an institution must address when adopting an ODP program. Financial institutions and examiners will be expected to closely comply with these sections as they clearly provide specific guidance that represents safety and soundness examination standards and existing regulations that may be cited as apparent violations of law if not followed.

The third section is presented as "Best Practices" that are used in, or are recommended by, the industry. This section appears to be less formal and suggests that the industry self-regulate ODP programs by considering the adoption of as many best practices as possible. The introduction paragraph that precedes the listing of the best practices states that; "Institutions that establish overdraft protection programs **should take into consideration the following practices** that have been implemented by institutions and that may otherwise be required by applicable law." Such language indicates that a failure to comply with any individual suggested best practice should not by itself be considered subject to examination criticism provided management had documented its serious "consideration" of the practice and has documented, demonstrated good reasons for not implementing it.

During the recent June 24,2004, meeting of the Federal Reserve Board Consumer Advisory Council, several banker members noted that they believed this language would be problematic because examiners may use the individual Best Practices as a checklist to determine required compliance with the Guidance, rather than as a general guideline for best practices worthy of management consideration. Recent examination experiences communicated to us by our client institutions indicate that this is clearly a legitimate concern. We have already heard of criticisms being made by examiners on specific

practices without regard to bank management's reason for not adopting certain practices (for example, not adopting certain best practices because of technical data processing limitations).

For this reason, we suggest the agencies make clear to their examiners that suggested best practices are practices management should consider, but are not practices they are required to adopt in every instance. We also believe this and related concerns warrant additional commentary on certain of the suggested best practices.

Our commentary and recommendations are provided under the specific section as presented in the proposed Guidance sections and listed items.

Safety & Soundness Considerations

- The Guidance establishes a clear safety and soundness standard that overdrafts must be charged-off within 30 days.

PFS Comment: The Guidance appears to indicate that a 30 day charge-off policy is justified because of the lack of underwriting standards used in courtesy ODP programs as opposed to those generally applied to traditional overdraft lines of credit. PFS performs a credit risk assessment of the various classes of deposit accounts and recommends overdraft limits using a validated risk approach that has historically resulted in minimal and manageable overdraft losses. Based on our institutions' collective experience, we believe this 30 day charge-off requirement is unnecessary, very consumer-unfriendly, and in contravention of existing regulatory guidance concerning the classification of unsecured consumer debt. The uniform classification of unsecured consumer credit does not suggest a "loss" classification until delinquency reaches 120 days. The OCC Comptroller handbook on "check credit" similarly lists the same 120 day charge-off requirement for unsecured lines of credit initiated by overdrafts.

PFS suggests a more consumer-friendly approach than is proposed in the Guidance that is based on safety and soundness standards requiring prompt notifications to the customer of the overdraft and an encouragement coupled with appropriate collection and work out procedures to bring the account to a positive balance as soon as possible. For example, under PFS' program the overdraft privilege is suspended at the 30 day mark with continued customer letters (and in some institutions additional telephone calls) used to further collection efforts. By suspending the privilege at the 30 day mark, consumers are provided with a "cooling off" period where they are not able to continue creating additional overdrafts and are allowed to return their account to a positive balance with normal activity. PFS' best practices and model procedures do provide for the charge off of the overdrawn balance at 70 days, at which time additional collection efforts are made. At this point our institutions are encouraged to work with those customers who arrange to repay their overdraft balances that are maintained as off balance sheet receivables. Customers in this category are generally allowed to participate in our "Fresh Start" program where they are counseled and are able to retain their open checking account as

long as it is maintained with a positive balance. They are not provided with overdraft privilege and they are not reported to the credit bureaus as long as they continue to maintain their account balance and continue to repay their former overdraft. No additional fees are charged for this convenience and only the charged off overdraft amount is collected.

Recovery rates are reported as much higher than historical recoveries before this program was initiated at many of our institutions with increased customer loyalty resulting. In addition, PFS' approach has the positive public benefit of keeping the customer in the banking system by avoiding premature charge-offs, the closing of accounts, and the consequent creation of an adverse credit history which might prevent the consumer from opening an account at another institution.

Furthermore, based on the experience of many of our institutions, shortening the charge-off period from an accounting viewpoint will only increase the number of charge-offs and recoveries detailed in the Allowance for Loans and Leases Loss (ALLL) account. Net losses in a given quarter would be expected to remain the same. Operationally, however, many institutions that do not participate in the PFS program would be inclined to close the customer account and remove it from the demand deposit trial balance when it is charged off. In such institutions this regulatory accounting requirement may actually result in an increase in net losses to the institution.

We would also like to provide our observations concerning the existing 45 day charge-off rule imposed on Federally insured credit unions for the benefit of the NCUA. Credit union members are not currently accorded the same amount of time to resolve their financial difficulties when working with their credit union as are customers of their commercial bank competitors. This presents special difficulties for those credit unions where the primary membership consists of members of the armed forces who are currently serving overseas. Should the interagency Guidance follow these existing practices of the longer charge-off periods, the NCUA may also want to consider forbearance in their review of their institutions charge-off practices.

For the aforementioned reason, PFS supports a longer charge-off policy than the 30 days proposed and recommends that 60 or 90 days would allow for the reasonable collection of a depositor account while maintaining transparency in the regulatory and financial reporting of the institution. This longer charge-off policy, as noted above, is also more favorable to the consumer since no credit damage would be done to depositors by the premature reporting of charged off accounts to the credit bureaus.

- Institutions should adopt rigorous loss estimation processes to ensure that any allowances related to earned fees reflect all estimated losses and that earned but uncollected fees are accounted for accurately.

PFS Comment: PFS institutions are already encouraged to monitor their overdraft losses, to make appropriate provisions to the ALLL as necessary, and adjust account limits if needed. Net losses are also reported to PFS monthly. PFS monitors net losses

for abnormalities as an added service to its institutions and provides peer comparison data to its member institutions. NSF fees earned and uncollected rarely remain in an overdraft balance for longer than 30 days before collection and in most case are charged off or reversed at the 70 day mark.

- When an institution routinely communicates the available amount of overdraft protection to depositors, these available amounts should be reported as “unused commitments” in regulatory reports. The Agencies also expect proper risk-based capital treatment of outstanding overdrawn balances and unused commitments.

PFS Comment: This particular instruction appears to be in contradiction with other sections of the Guidance and with Federal Call Report Instructions. Courtesy ODP programs by nature, when properly structured, are non-contractual courtesy payment programs that contain clear language that the institution reserves discretion over the payment of all items and the right to discontinue the program at any time. Call Report instructions indicate the need for reporting of contractually binding obligations such as traditional overdraft lines of credit or other formalized credit facilities as evidenced by a formal documented loan commitment or overdraft agreement (which are for that reason subject to Regulation Z.) Internal matrix driven overdraft programs expose institutions to a similar level of potential payments; however, since these amounts are not communicated to the customer they are not required to be reported under the proposed Guidance. In both situations, additional “draws” on the non-contractual limits should not reasonably be expected to increase loan volumes beyond the normal average overdraft GL balances already reported on the balance sheet. It is also unclear what the term “routinely communicates” the available amount of ODP to depositors means. This language appears to create an unnecessary reporting requirement for only those instructions with a disclosed OD limit that is more typical of the smaller less complex community financial institution. It is recommended that this language be dropped or changed to match the existing instructions that cover contractual agreements. Should the agencies desire to change these reporting requirements, it is recommended that the change be further documented in the appropriate instructional booklet for financial reporting to assure consistency of reporting among the agencies.

Legal Risks

PFS Comment: The proposed Guidance appears to have appropriately addressed the various legal risks institutions should assess in adopting and implementing ODP programs.

Best Practices

- Institutions that establish overdraft protection programs **should take into consideration** the following practices that have been implemented by institutions and that may otherwise be required by applicable law.

PFS Comment: PFS applauds the agencies for adopting a best practices approach to allow the industry to self-manage new products that are evolving. We support the idea that examiners should review each institution in light of the presented best practices. We further suggest as previously noted that they should exercise discretion in the criticism of institutions that may be more limited in their technology options when they are able to serve their customers in other ways. We believe the Guidance put out by the OCC and separately by the FDIC and FRB jointly on unfair and deceptive practices is good guidance for the review of ODP programs. This Guidance suggests that no one component of a program be reviewed in isolation and that all aspects of the program should be reviewed “as a program” to determine the fairness and reasonableness of a program. Such an approach would preclude the fears that examiners will look at each practice as a check list subject to isolated criticism.

Marketing and Communications with Consumers

- **Avoid promoting poor account management.** Do not market the program in a manner that encourages routine or intentional overdrafts; rather present the program as a customer service that may cover inadvertent consumer overdrafts.

PFS Comment: PFS supports this best practice.

- **Fairly represent overdraft protection programs and alternatives.** When informing consumers about an overdraft protection program, inform consumers generally of other available overdraft services or credit products, explain to consumers the costs and advantages of various alternatives to the overdraft protection program, and identify for consumers the risks and problems in relying on the program and the consequences of abuse.

PFS Comment: PFS supports this best practice. However, PFS suggests that institutions that do not offer such additional products should not be subject to criticism if their ODP program adequately meets the needs of their customers.

- **Train staff to explain program features and other choices.** Train customer service or consumer complaint processing staff to explain their overdraft protection program’s features, costs, and terms, including how to opt out of the service. Staff also should be able to explain other available overdraft products offered by the institution and how consumers may qualify for them.

PFS Comment: PFS supports this best practice.

- **Clearly explain discretionary nature of program.** If the overdraft payment is discretionary, describe the circumstances in which the institution would refuse to pay an overdraft or otherwise suspend the overdraft protection program. Furthermore, if payment of overdrafts is discretionary, information provided to consumers should not contain any representations that would lead a consumer to expect that the payment of overdrafts is guaranteed or assured.

PFS Comment: PFS supports this best practice. However, PFS suggests that the requirement to provide information on "when an NSF item might not be paid" be limited to a general description so as to maintain, and be consistent with the discretionary nature of the institution. This practice appears to be part of the amendment to Regulation DD and as such the Regulation DD language should take precedence over the Guidance language, with the proposed Staff Commentary to Regulation DD providing a reasonable example of the level of disclosure required.

- **Distinguish overdraft protection services from "free" account features.**
Avoid promoting "free" accounts and overdraft protection services in the same advertisement in a manner that suggests the overdraft protection service is free of charges.

PFS Comment: PFS supports this best practice; however, this practice also appears to be part of the amendment to Regulation DD and as such the Regulation DD language should take precedence over the Guidance language, again with the Staff Commentary to the Regulation providing a reasonable explanation of the requirement.

- **Clearly disclose program fee amounts.** Marketing materials and information provided to consumers that mention overdraft protection programs should clearly disclose the dollar amount of the overdraft protection fees for each overdraft and any interest rate or other fees that may apply. For example, rather than merely stating that the institution's standard NSF fee will apply, institutions should restate the dollar amount of any applicable fees in the overdraft protection program literature or other communication that discloses the program's availability.

PFS Comment: PFS supports this best practice; however, this practice also appears to be part of the amendment to Regulation DD and as such the Regulation DD language should take precedence over the Guidance language.

- **Clarify that fees count against overdraft protection program limit.**
Consumers should be alerted that the fees charged for covering overdrafts, as well as the amount of the overdraft item, will be subtracted from any overdraft protection limit disclosed, if applicable.

PFS Comment: PFS supports this best practice.

- **Demonstrate when multiple fees will be charged.** Clearly disclose, where applicable, that more than one overdraft protection program fee may be charged against the account per day, depending on the number of checks presented on and other withdrawals made from the consumer's account.

PFS Comment: PFS supports this best practice.

- **Explain check clearing policies.** Clearly disclose to consumers the order in which the institution pays checks or processes other transactions (e.g., transactions at the ATM or point-of-sale terminal).

PFS Comment: PFS has no objection to this requirement and notes that some states already require a similar disclosure. However, it should be noted that often the payment order is complicated and many consumers will not easily understand the payment process. This is another example where an institution would need to exercise caution in its disclosure so as not to appear to be bound by a specific payment order that it may need to alter for valid business reasons, such as the return of certain items when a check kite is suspected or other operational reasons. A general disclosure should be allowed under this Guidance if this practice is adopted.

- **Illustrate the type of transactions covered.** Clearly disclose that overdraft protection fees may be imposed in connection with transactions such as ATM withdrawals, debit card transactions, preauthorized automatic debits, telephone-initiated transfers or other electronic transfers, if applicable. If institutions' overdraft protection programs cover transactions other than check transactions, institutions should avoid language in marketing and other materials provided to consumers implying that check transactions are the only transactions covered.

PFS Comment: PFS supports this best practice.

Program Features and Operation

- **Provide election or opt-out of service.** Obtain affirmative consent of consumers to receive overdraft protection. Alternatively, where overdraft protection is automatically provided, permit consumers to "opt out" of the overdraft program and provide a clear consumer disclosure of this option.

PFS Comment: PFS supports the "opt out" option as a best practice and was one of the first third party vendors to adopt this practice. On the other hand, obtaining an affirmative "opt-in" consent by consumers goes against the discretionary nature of the privilege and could be construed as establishing a contract with the customer which is clearly how these programs are not structured. We recommend the affirmative consent language be dropped from the best practice. We also suggest that language be added to the Guidance that requires the "opt out" offer contain all of the information needed to opt out without the need to look to other documentation for additional instructions.

- **Alert consumers before a non-check transaction triggers any fees.** When consumers attempt to use means other than checks to withdraw or transfer funds made available through an overdraft protection program, provide a specific consumer notice, where feasible, that completing the withdrawal will trigger the overdraft protection fees. This notice should be presented in a manner that permits consumers to cancel the attempted withdrawal or transfer after receiving the notice. If this is not possible, then post notices on proprietary ATMs

explaining that withdrawals in excess of the actual balance will access the overdraft protection program and trigger fees for consumers who have overdraft protection services. Institutions may make access to the overdraft protection program unavailable through means other than check transactions.

PFS Comment: PFS supports all efforts to provide more information to consumers to allow them the ability to make well informed choices. This is another area where PFS was one of the first to adopt similar best practices. In this regard one of our core platform business partners currently has adapted its ATM system to provide a stop panel to inform customers that they are about to overdraw their account and incur a fee, and it gives them the option to cancel. This is an area, however, where many institutions are more severely limited by their technology providers, and we assume the agencies recognize this reality by the inclusion of the term "where feasible" in the suggested best practice. PFS is continuing to work with other technology providers to urge them to develop similar programs on a cost effective basis to enable the notices suggested in this best practice.

We also note that this section is intended to address "non-check" transactions which would include point of sale (POS) terminals and the use of debit cards. Most POS terminals are located in retail stores throughout the country. This Guidance should recognize that current technology does not provide for the notification at POS terminals of a potential overdraft situation. PFS client's customers are clearly told that their ODP limit will be available when applicable and that the NSF fee will be charged. In most cases, the ATM and POS systems are driven by the same balance files. Clearly, customers want access to their ODP limits at these locations, so regulatory forbearance is needed until technology catches up with new banking products. Alternative means of communication and disclosures should be considered as acceptable best practices in lieu of the technology solutions suggested that are currently limited or unavailable.

- **Prominently distinguish actual balances from overdraft protection funds availability.** When disclosing an account balance by any means, the disclosure should represent the consumer's own funds available without the overdraft protection funds included. If more than one balance is provided, separately (and prominently) identify the balance without the inclusion of overdraft protection.

PFS Comment: PFS supports this practice as a best practice; however, we believe this practice is worded in such a way as to discriminate against the less complex smaller community institutions that, because of cost and technological limitations, cannot provide multiple balances to their ATM systems. In some systems, a positive balance file that contains only one customer balance is provided to the POS and ATM networks. These systems use this balance for authorizations as well as balance inquiries. Should the institution make the ODP limit available at the ATM, the balance displayed must also reflect the limit amount in the available balance. In such cases PFS intuitions are encouraged to provide clear disclosures to their customers that their balance will include their ODP amount. The series of notices has worked well and customers who use the service in these intuitions understand it and appear pleased with the service.

Local proprietary ATMs include reminders that customers' balances may include their ODP limit amounts. In these instances, we believe that institutions that make good faith efforts to notify customers by providing notices on their bank owned ATMs, using pre-printed receipts for balance inquiries advising of their limit inclusion, and by providing clear prior disclosures, should be allowed to continue providing ODP at their ATM without undue criticism. We encourage additional guidance for institutions that are unable to provide multiple balances and request that the agencies exercise forbearance until the technology catches up with the needs of the industry.

- **Promptly notify consumers of overdraft protection program usage each time used.** Promptly notify consumers when overdraft protection has been accessed, for example, by sending a notice to consumers the day the overdraft protection program has been accessed. The notification should identify the transaction, and disclose the overdraft amount, any fees associated with the overdraft, the amount of time consumers have to return their accounts to a positive balance, and the consequences of not returning the account to a positive balance within the given timeframe. Institutions should also consider reiterating the terms of the overdraft protection service when the consumer accesses the service for the first time. Where feasible, notify consumers in advance if the institution plans to terminate or suspend the consumer's access to the service.

PFS Comment: PFS supports this best practice in substance. Typically PFS clients send a series of letters to customers after a set number of days overdrawn. These letters clearly explain the program and its consequences. The original "NSF or OD notice" is sent the day of the initial overdraft, but it is often standardized and generated by the host system with no available options to customize it to contain all of the suggested information on the first notice. Again, examiner discretion should be used in the review of this practice or the practice language should be modified to more closely match the available technology.

- **Consider daily limits.** Consider limiting the number of overdrafts or the dollar amount of fees that will be charged against any one account each day while continuing to provide coverage for all overdrafts up to the overdraft limit.

PFS Comment: The PFS position is that this is an institutional business decision. PFS has several institutions that have implemented this practice with positive results.

- **Monitor overdraft protection program usage.** Monitor excessive consumer usage, which may indicate a need for alternative credit arrangements or other services, and should inform consumers of these available options.

PFS Comment: PFS supports this best practice. PFS also recommends financial institution managements consider the adoption of financial education programs for consumers, such as the FDIC's Money Smart Program, in conjunction with the offering of an ODP program. Such programs could address the possible adverse consequences of

excessive OD usage. In this regard PFS, is currently developing procedures to assist those of its client institutions who may be interested in implementing such programs.

- **Fairly report program usage.** Institutions should not report negative information to consumer reporting agencies when the overdrafts are paid under the terms of overdraft protections programs that have been promoted by the institutions.

PFS Comment: PFS supports this best practice and actively promotes the adaptation of our Fresh Start program to all of our clients.

We appreciate the opportunity to respond to the agencies' proposal to provide guidance to the industry and to the regulatory agency examiners for the proper implementation of an ODP program. We hope that the agencies will consider the areas where we have made suggestions or recommended regulatory forbearance. We also respectfully request that the agencies attempt to coordinate their monitoring and enforcement of these programs using this Guidance in a uniform and consistent manner so that all institutions, regardless of their charter or regulatory agency, are treated fairly and equally.

Sincerely,

A handwritten signature in black ink, appearing to read 'J. Gillen', is positioned above a light gray rectangular box. The signature is fluid and cursive.

Joseph V. Gillen
Chief Executive Officer