

July 21, 2008

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Via E-Mail

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

Re: Docket No. R-1314
Regulation AA Amendments

Dear Ms. Johnson:

The following comments are submitted on behalf of the bank subsidiaries of International Bancshares ("IBC banks"), a multi-bank financial holding company headquartered in Laredo, Texas with over 260 facilities and more than 400 ATMs serving over 100 communities in Texas and Oklahoma. IBC is the largest minority-owned financial holding company in the continental United States with over \$11 billion in assets. By separate letter, comments have been drafted addressing the issues in Docket No. R-1315 relating to amendments to Regulation DD. That letter and the comments therein are incorporated by reference into this letter. The purpose of this separate comment is to focus on the issues relating to the standards for unfairness under the FTC Act, the predicate for the rule, and our observations regarding its support or lack thereof.

Standards for Unfairness under the FTC Act. The FTC Act provides the Federal Reserve Board with responsibility for prescribing regulations defining unfair or deceptive acts or practices. Congress has codified standards developed by the Federal Trade Commission (FTC) in determining which acts are unfair. According to the preamble to this docket item, the FTC has no authority to declare an act or practice unfair unless (1) it causes or is likely to cause substantial injury to consumers; (2) the injury is not reasonably avoidable by consumers themselves; and (3) the injury is not outweighed by countervailing benefits to consumers or to competition. In order to meet this test, this proposal assumes the most egregious practices and then crafts a solution for those, ignoring the most common scenarios and the potential that the reduction in availability of overdraft courtesy will have on the typical consumer as opposed to

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the least responsible consumer. Furthermore, IBC banks' experience indicates that the volume of overdraft courtesy accounts has exploded, representing over 90% of consumer accounts, i.e. this is the product of choice for new IBC consumer customers and has been for the better part of the last decade. The number of complaints thus may be statistically insignificant when considered in the context of the total number and dollar balances. With approximately 300,000 domestic retail accounts having overdraft courtesy, for example, 300 complaints in one year would only be 0.1% of accounts. However, in reality, there were only 3 complaints relating to NSF charges reported to IBC by the Department of Banking in 2007. In 2007, 70.6 million items were processed by IBC. In 2008, there have only been 6 reported complaints. According to the most recent Texas Department of Banking report to the Texas Finance Commission, there were a total of 573 complaints as to all state chartered banks in Texas between September 2007 and April 2008. Of these, 57 were related to NSF fees and overdrafts according to the Texas Department of Banking Director of Strategic Support. This is clearly a very low level of dissatisfaction.

The element relating to "reasonably avoidable" can be appropriately handled with an initial opportunity to opt-out from overdraft courtesy. This assures that consumers have a reasonable opportunity to make an appropriate decision. The timing and context of that opt-out are more particularly discussed in the comment letter to Docket No. R-1315. As noted above, this is the product of choice for IBC customers. Each bank consumer has a variety of simple (and free) means of keeping up with their balance. By assuming personal responsibility for their bank account activity, each may readily avoid overdrafts.

The IBC Banks believe that this Regulation AA proposal has been drafted assuming that the worst types of practices are generally in effect without regard to what may be more common overdraft coverage practices in different jurisdictions. In order to put this into context, it is appropriate to briefly review the typical overdraft protection or courtesy program available through the IBC Banks, which is fairly representative of the overdraft courtesy available through Texas institutions generally.

As noted in the preamble to the regulation, the typical overdraft courtesy program is automatic without broad underwriting at the time it is offered. However, if customers do not manage their accounts in a reasonable fashion by bringing their overdrafts current within thirty (30) days, then the overdraft courtesy is revoked as a matter of safety and soundness principles. Customers that are offered this program are advised as to the amount of "coverage" that is provided. For check transactions, only one fee is charged, and it is the same fee regardless of whether the item is paid or returned. Thus, there is no "consumer injury" in the payment of the item. Rather, there is a consumer benefit.

With regard to electronic items, it is true that if there were no overdraft courtesy on a debit card point of sale transaction, there would simply be a rejection of the transaction. [If, as has been suggested in Best Practices, the consumer must be given a notice and choice to proceed with the transaction, the cost of that option is likely to result in a fee for that service.] However, we would suggest that it is not necessarily true that there is no consumer benefit by virtue of the transaction. First, we would note that there are approximately 7.5 million merchant terminals in the United States, reflecting the widespread acceptance and usage of debit cards. Next, we would share the fact that in 2007, there were 42.5 million point of sale transactions by IBC customers alone. In reviewing the debit card scenario with merchant organizations, it seems clear that if the debit card transaction is rejected, then the merchant will need to request an alternative form of payment. A check will not be acceptable payment. If the debit card will not pay because it is overdrawn, then a check is not likely to pay either. The prudent merchant will not take the business risk of accepting a hot check. Rather, the consumer will then have to produce sufficient cash, acceptable credit card (which carries interest and possibly fees if it is over limit) or deal with undoing the transaction.

Many debit transactions occur in restaurants or other eating establishments. In a restaurant, the meal is already consumed, and the transaction cannot be unwound. Thus, there is some significant cost to the consumer in not having access to the debit card overdraft availability. The other typical and frequent debit card point of sale transactions are at grocery stores and gas stations. If the consumer at the gas station has an essentially empty tank, then the lack of an

optional way to pay will be devastating to that person. At the grocery store, the items will simply have to be returned to the shelf. While this may be embarrassing to the consumer, the retailer will experience significant costs in rekeying those items through the system to restore them to inventory and then restocking the merchandise. The cashier line is slowed down, resulting in additional costs to the merchant. Ultimately, these very real costs of doing business are translated into higher prices passed along to the consumer.

The preamble suggests that the debit card transaction is unfair because a high fee can be imposed on a small dollar transaction. The preamble also reflects a belief on the part of consumer advocates that overdraft transactions are unfair to students and the elderly. The data on overdraft programs would indicate that in fact overdraft courtesy is utilized by the entire gamut of customers throughout all of the IBC branching network, which includes large numbers of minorities. Furthermore, customer satisfaction surveys conducted by the IBC Banks reflect a very high degree of satisfaction with the bank products. Similarly, a recent survey conducted by Harris Interactive on behalf of the American Society for Quality indicates that 96% of adults rate the customer service at their financial institution as above average or average. Furthermore, 85% are very satisfied or satisfied with the products and services available. While there is not a separate analysis for the overdraft courtesy product itself, that product is a significant offering of financial institutions today and, we believe, is reflected in the satisfaction data. In fact, 82% of IBC customers choose this product.

Furthermore, the preamble and analysis presumes that the overdraft courtesy is a form of "high cost form of lending." This would seem to imply that there is some form of lower cost credit product that would provide the instant access to funds desired by those persons utilizing overdraft courtesy. As noted in our companion letter, this is not necessarily true. First, any explicit credit arrangement must be individually underwritten. A significant segment of the population using overdraft courtesy may not qualify for a loan. Also, the credit product may not have the capacity to deliver an immediate benefit like overdraft courtesy or be available at millions of distribution points world wide at no additional costs and with minimal identification requirements. Further, overdraft courtesy is available in any currency for customers traveling

overseas and at the most favorable exchange rate. For IBC customers, many of whom live along the Texas border with Mexico, this is an important factor.

Linkage between a savings account and a checking account is significantly limited by federal law and Regulation D. In addition, Texas law (again as more particularly described in a companion letter) significantly eliminated the alternative of open end consumer credit in Texas, and such credit has been slow to get re-established as an available product in Texas institutions. One other option is to use credit cards instead of debit cards. For years, customers who realized that their checking account was overdrawn could elect to use their credit card instead of their checks. However, they have chosen overdraft courtesy through debit card transactions in increasing numbers. In addition, the alternative of sweeping the overdraft balance to a customer's credit card is not without its limitations. Although the interest rate on a credit card transaction will be less than the effective rate of an NSF charge, the consumer still faces the potential for an "overline" fee if they are not monitoring their credit card usage. The overline fee under Texas law is the greater of \$15 or five percent (5%) of the amount by which the credit limit is exceeded. While \$15 is less than the typical NSF charge, 5% could be significantly more. (See § 346.103 Texas Finance Code) It is also worthy of note that very few credit cards are issued under Texas law, but rather are issued under other regimes which may be more onerous with regard to fees or may not limit them at all. Regardless, credit cards are a product most consumers can acquire for a price. However, the usage volumes reflect that customers prefer using their debit card connected to their checking account with overdraft courtesy in ever increasing numbers. As noted previously, total point of sale transactions by IBC customers in 2007 were 42,445,625 items.

Legal analysis for the consumer right to opt out states " . . . a consumer cannot know with any degree of certainty when funds from a deposit or a credit for a return purchase will be made available." While a consumer may not have absolute certainty with regard to a credit for a return purchase, certainly the Expedited Funds Availability Act implemented by Regulation CC provides clarity with regard to when funds from a deposit will be made available. Since 1987, consumers have been receiving notices about funds availability policies and specific information

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about deposit availability as well as specific hold notices. The most common practice among Texas community banks is next day availability. It should be further noted that the level of activity in processing items electronically is dramatically increasing, thus accelerating availability. With the adoption of Check 21 clearing, approximately 63% of items are processed electronically at IBC, resulting in immediate availability of deposits. Most consumer deposits are payroll, which is commonly handled through direct deposit and is immediately available. For IBC, 45.07% of accounts with overdraft courtesy receive at least one direct deposit per month. Once again, the proposal seems focused on the exception rather than the norm. The vast majority of consumer deposits come from payroll deposits, which receive immediate credit. There is in fact no mystery associated with the long held practice of giving these immediate credit. In short, our consumers do know with certainty when their funds are available. In fact, in 2008 through June, of IBC's 280,532 domestic retail accounts (64%) had zero account overdrafts, presumably at least in part because customers know when their funds are available.

As noted also in our companion letter, there are significant countervailing benefits to consumers. In the typical "overdraft courtesy" account, the consumer receives a bundle of free services including free checking, free online banking, free debit card, free online bill pay plus overdraft courtesy. The average annual benefit is \$540. In addition, the consumer receives significant other benefits including avoiding criminal prosecution for hot checks, protection of credit rating, avoidance of personal embarrassment, and savings on merchant hot check fees. Considering the fact that approximately 50% of IBC's account holders had at least one overdraft during 2007, this benefit impacts a large number of consumers.

Consumers clamor for convenience and innovation. The bundled free checking/overdraft courtesy product has met consumers' demands. At the same time, the popularity of the product has resulted in increased volumes of accounts and deposit balances for IBC banks. The income from these accounts only partially offsets the costs of providing the complete array of services. Also, with increased debit card usage has come increased debit card fraud. The fee income from these accounts has helped to offset those losses in part. Looking at the bottom

line impact, all consumers have received a benefit in the form of more competitively priced account services.

Next, the increased volume of deposits has been critical as a source of funding for IBC banks' lending program. Further, fee income has helped to offset squeezed net interest margins in loan portfolios. While this may not constitute a "countervailing benefit" to an individual depositor, in the aggregate, the overdraft courtesy program has created a significant countervailing benefit to consumers generally through lower interest rates and greater product diversification.

Specific Comments. The request for comment specifically asks about the scope of the consumer's opt-out and the alternative of partial opt-out. We would incorporate our comments on Regulation DD and suggest that permitting an opt-out by a particular payment method such as debit card presents both technological challenges and significant adverse consequences to the consumer. In addition, if opt-out is permitted on certain modes, there is concern among bankers that there is the significant opportunity for complexity in permitting opt-out by each and every potential channel. For example, in today's marketplace, more consumers are utilizing online bill pay. Other consumers use bill pay services offered by their utility company or other vendor. Would opt-out be required separately for each of these options? If so, the potential complexity in terms of coding transactions, complying with NACHA rules, and dealing with the consequences is significant. In addition, there would need to be appropriate consumer education. For example, a customer who elected to opt-out of ACH transactions would need to understand that this means that a direct payment set up with their mortgage company could be rejected. It also means they could get sued for violating their contract for failing to make their payments in a timely fashion as originally authorized. Finally, with more channels (such as mobile banking) available to customers, opt out by channel becomes ever more cumbersome, and frankly, unmanageable.

A recent debit card innovation creates another potential compliance nightmare. With so-called "decoupled debit," one institution offers the consumer a debit card that is paid against the

consumer's checking account at his primary financial institution using ACH functionality. With debit card opt out, would the institution offering "decoupled debit" be required to offer "opt out" of overdraft privilege, thus impacting the bank with the checking account? Alternatively, could the bank with the primary checking account amend its contract with the consumer to provide that the decoupled debit card could not be used to access the overdraft courtesy?

The cost/benefit analysis of opt-out that applies only to ATM transactions and debit card point of sale has been discussed in our companion letter and in our analysis above.

The request for comment also asks whether there are circumstances in which an exception might be appropriate even though the consumer has opted-out. The ability to craft that exception and the technology to implement is mind-boggling. Is this question intended to contemplate a scenario in which the customer at the gas station at midnight can somehow override their opt-out?

The proposal also makes certain suggestions with regard to debit holds. These are unworkable for several reasons. First, the bank is not in control of the debit hold; the merchant is typically. Next, it is simply not feasible to reverse fees that were incurred due to a debit hold. This must be handled manually under the proposal in .32(b). Some scenarios allow the fees and others do not. This complexity is nightmarish for the community banker and his data processor.

Transaction Clearing Practices. Although this is not the subject of the rule, the proposal asks for input on the impact of requiring institutions to pay smaller dollar items before larger dollar items when received in the same day. The "normal" method of processing items is to clear electronic items first. Furthermore, even in real time those items are processed on a provisional basis and then batched and presented at the end of the day for payment. Would a proposal to pay the smallest items first differentiate between electronic and paper items? If so, this could present some significant challenges with regard to point of sale transactions that have been approved, but because they are large would need to be reversed. If this rule is intended to only apply to checks, with which the institution has a bit more flexibility, then it does not resolve the

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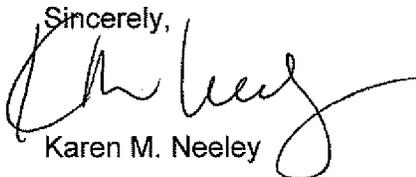
issue discussed above with regard to small point of sale items such as a cup of coffee which triggers an overdraft fee.

Prospective Date. Institutions will need a significant amount of time to reprogram for the changes contemplated by this rule if partial opt-out is authorized. In addition, time will be necessary to educate the merchant community as to the impact on them with regard to accepting debit cards. The ultimate result is likely to be a resistance to the use of debit cards generally. An implementation period of one year would be appropriate. In addition, if opt out is permitted at point of sale, then millions of devices will need to be replaced at all retail locations. The time and cost needed for this is unknowable at this time.

Conclusion. IBC Banks would respectfully suggest that the required predicate mandated for identifying and prohibiting unfair or deceptive acts or practices is simply not satisfied by this rule. Protecting a consumer from inadvertent overdrafts does not cause substantial injury to consumers. Assuming that the consumer receives the opportunity to opt out initially, the injury (if any) is reasonably avoidable. Also, the consumer can avoid NSF charges by simply being responsible in managing their account. Finally, any alleged injury is significantly outweighed by countervailing benefits to consumers. In short, we believe that the rules do not meet the requirements of law.

Thank you for this opportunity to comment.

Sincerely,

A handwritten signature in black ink, appearing to read 'Karen M. Neeley', written over the typed name.

Karen M. Neeley

KMN:bw