

GATEWAY

BUSINESS BANK

July 31, 2008

Jennifer J. Johnson
Secretary
Board of Governors of the Federal
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Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
ATTN: OTS-2008-0004

Re: BOARD Docket No. R-1314; OTS Docket No. OTS-2008-0004;
Unfair or Deceptive Acts or Practices; 73 *Federal Register* 28904;
May 19, 2008 (UDAP Proposal)

Ladies and Gentlemen:

Gateway Business Bank provides these comments on the rule proposed by the Federal Reserve Board (Board), the Office of Thrift Supervision (OTS) and the National Credit Union Administration (NCUA) covering Unfair or Deceptive Acts or Practices (UDAP) involving overdraft protection service fees. The Bank opposes the proposed rule on overdraft fees.

The Bank is concerned about this UDAP Proposal and its possible effect on our ability to safely and soundly exercise our risk-based discretion to pay inadvertent customer overdrafts that are otherwise reasonably avoidable when depositors follow prudent account management practices. The Bank believes that the banking industry has acted in the best interests of its customers and the payments system by making overdraft accommodation available.

The fundamental issue is whether customers have reason to know the consequences of their banking activity. Account agreements recite the conditions on which fees will be assessed for certain actions. Notice provides the requisite level of knowledge to enable consumers to avoid overdraft fees even if the account is subject to the bank's accommodation practices. Experience demonstrates that customers successfully act on that knowledge.

Understanding that point, it is not possible to assert convincingly that an opt-out notice is required to avoid action that is already avoidable. That is to say, no remedy is needed for action that already has remedies and can be avoided under current conditions. There are, therefore, no legal grounds under UDAP for the regulators to prescribe a specific opt-out formula as a remedy.

The remedy that is already available is not just an opt-out per se, but rather the availability of other options to overdrawn accounts or incurring overdraft fees. That is, even if there are policy reasons to provide individuals with additional choice, opting out is not the only alternative. Establishing a right of opt out creates an affirmative right to alter the features of the account as offered by the bank. There is nothing in the unfairness analysis in the proposed rule that compellingly argues for the bank to provide choice through the specific opt-out formula—what possibly could be compelled is a choice that does not include overdraft accommodation. The bank can offer a different account bundle of features and fees that excludes accommodation, e.g., a minimum balance account without overdraft protection.

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Indeed, for safety and soundness reasons, banks should not assume the risks arising from an account that has opted out, such as unknowingly paying overdrafts without appropriate compensation. They should be able to adjust practice, prices, and product designs to reflect the risks and costs of opt-out as well as limitations of the systems.

It bears reminding that by definition banks are not required to honor payments ordered by customers for accounts containing insufficient funds. It is an accommodative service provided by banks. Under a regulatory regime that prescribes an opt-out right, failure to opt-out can suggest an entitlement that does not exist in as much as the underlying service is a discretionary accommodation made in the fullness of the bank's risk management authority. On the other hand, it must be understood that even where a customer has opted out of overdraft accommodation, there can be instances where the bank is committed to pay an electronic transaction that happens to settle out of funds. Even if the bank is denied the ability to assess a fee, customers must accept that they are still liable for the overdraft.

Requiring an explicit notice of opt-out at account opening essentially converts all overdraft accommodation services—however minor or informal—into promoted plans—a boundary that prior policy guidance viewed as a trigger exposing banks to more risk and imposing new duties. Eliminating this boundary sends a signal to all banks that there is nothing to lose by promoting formal overdraft protection programs since all the compliance obligations are imposed in either case. This seems a strange result for a proposal intended to de-emphasize overdraft usage. We do not see how a mandate to offer opt-out repeatedly to a customer can be justified as a prescribed remedy under UDAP. What “opt out” means, in the context of this proposal's analysis, is nothing more than the ability to decline the bank's accommodation in advance or in the future. As long as a customer's ability to decline the accommodation service (e.g., by changing accounts or electing other options) is made known initially, the ability to reasonably avoid fees through opt-out is assured. No more elaborate compliance method is legally necessary.

The Bank contends that that customers are not injured in net affect by mainstream overdraft accommodation practices and in any case can reasonably avoid overdraft fees by engaging in prudent account management consistent with long standing public policy. Accordingly, there is no foundation for the assertion that assessing overdraft fees without an advance or continuing opt out choice or notice is unfair. Without this foundation the proposals on partial opt-out and debit holds under UDAP also fail. The agencies seek additional comment on aspects of the partial opt-out. First, a rule that only compels an opt-out covering only ATM and POS transactions, if predicated on UDAP, is still flawed. In addition, the technical hurdles that currently exist to implementing such a limited opt-out generate costs that further outweigh the benefits of such a rule. Even accepting for the sake of argument the proposal's unfairness analysis, a full opt-out eliminates the offense and a partial opt-out cannot be separately compelled.

Even if the only unfair practice were assessing fees for accommodating debit/ATM overdrafts without offering opt-out, the bank would not be compelled by UDAP to offer a tailored opt-out instead of a general opt-out of its accommodation practices that encompassed debit/ATM as well as other transactions. A partial opt-out cannot properly be enforced under UDAP because the exercise of partial opt-out is only an election of a discretionary overdraft service and is not a contractual promise to pay overdrawn checks and ACH transactions. Consumers cannot effectively say, “Do not pay my POS, but pay my checks,” because they have no right under law to write bad checks and compel the bank to pay them. In other words, UDAP cannot be used to require the provision of overdraft accommodation for checks or ACH under the guise of a partial opt-out of debit transactions.

Currently, banks that allow customers to opt out of having overdrafts paid are only able to provide an opt-out on an “all-or-nothing” basis, that is, within the limits of their systems; overdrafts from all payment channels are returned or denied. While technically, with enough time and money, it may be feasible to allow customers to opt out by payment channel, for the vast majority of banks like ourselves, the cost differential could be so significant that we would be forced to decline to offer customers overdraft accommodation rather than carry the costs of an expensive multi-option program.

More problematic is that the challenge is not just distinguishing debit card transactions from ACH, but also distinguishing card present POS transactions from recurring payment uses of debit cards. The technical challenges are not matters of simply implementing existing fixes. Because there really is no readily available methodology for offering a partial opt-out that can distinguish between card present POS and scheduled recurring payments that mimic ACH, there is no reasonable horizon that can be projected for achieving compliance with such a requirement. Such mandates would cause the bank to cease engaging in the accommodation service altogether thereby depriving the majority of customers who would elect the coverage and the benefits thereof. Such compliance costs that are passed on to consumers are a recognized countervailing factor under the standard unfairness criteria. Therefore, the countervailing compliance costs and implications for service outweigh any limited benefit of a limited POS opt-out for the foreseeable future.

Additional countervailing obstacles arise to making an effective partial opt-out for debit transactions. For example, even under a partial opt-out process, there will still be instances when banks will end up paying debit card transactions that may cause an overdraft. The proposal recognizes two such occasions. But more exist. For example, banks may not be able to avoid overdrafts caused when deposited checks are returned unpaid. In such a case, a customer who has made a deposit and relied on Regulation CC availability rules may spend funds by debit card that ultimately are not collected. This would result in an overdraft that the bank could not have stopped (absent a longer hold.)

Unavoidable overdrafts can also arise when computer systems go down. In these cases, customers often continue to have access to their funds based on an approximation of their prior balance, not on their actual balance. However, when the debit transaction is later presented, there may not be sufficient funds to pay the obligation and an overdraft occurs. These are just a couple of many examples of numerous contingencies that may arise in payment processing that can result in unintended debit overdrafts even though no overdraft accommodation program is in place.

It would be unsafe and unsound for banks to assume these risks of debit card overdrafts without appropriate compensation. Were banks to change their practices to minimize these occasions—such as not permitting the use of debit card when systems go down—customers with adequate funds (i.e., most customers by far) would be unnecessarily denied use of their payment option of choice. Under some circumstances, it may even be necessary to re-design account features or re-price the account bundle to properly manage the bank’s risks from overdrafts that arise due to the limitations of the systems. This and similar countervailing effects demonstrate why existing bank overdraft accommodation of debit transactions are not unfair. The debit holds proposal is fraught with problems. First, it is predicated on circumstances that involve two parties that are not encompassed by the current reach of the proposal—card systems and merchants. These are key players in the debit hold story. In fact, the more one studies the situation, the more one realizes that the supposed problem is on its way to a market solution. Recent changes by Visa to processing options for fuel merchants will reduce the time between authorization and clearance. This process will allow any holds to be cleared within two hours. This fast turnaround will enable

many banks to decide not to place a hold on automated fuel dispenser transactions in view of the fact that a final transaction message will be transmitted in a known short time frame thereby minimizing risk exposure.

Second, the complexity of debit holds defies simple solutions and exacerbates the expense of developing alternatives. Numerous exceptions would need to be devised to address the variety of presentation contingencies—and they would all further complicate the operational and compliance challenges of implementation. This reality translates to countervailing compliance costs that outweigh the benefits that might come from implementing changes. Third, the complexity of debit holds practices defies detailed disclosures that customers can readily understand. Rather, the path should be to pursue simplification and encourage merchants (like many hotels have done) to advise patrons that use of debit cards may impact their funds availability earlier than, and beyond the amount of, their final transaction. This could be more readily achieved under Regulation E. The agencies fail to recognize that restricting when in the decision-making process banks can charge fees for overdrafts that follow in time those debit card authorizations that generate open holds creates a burdensome and unworkable clearance and fee assessment process.

The agencies also solicit comment on the impact of requiring banks to pay smaller dollar items before larger dollar items when received on the same day for purposes of assessing overdraft fees on a customer's account. Under such an approach, the agencies suggest that a bank could use an alternative clearing order, provided that it discloses this option to the customer and the customer affirmatively opts in. Many banks clear different items using different rules at different times during the day to take advantage of different processing capabilities. There is simply no one way that banks currently process payments and no one way that could be imposed on all banks that would achieve payment system efficiency. In a world that is moving toward near real-time clearance for transactions conducted in the on-line electronic environment, imposing a rule that requires a payment order based on looking back to the size of all same-day items is a payments disaster that is absolutely contrary to real-time processing. Conducting separate payment processing order calculations for fee purposes amounts to inefficient and burdensome redundancy and for that reason is not commonly found in the industry.

It would be operationally very hard to give individual customers the right to alter the bank's clearance process. In addition, many of these clearance processes are too complex to explain in understandable terms in any customer disclosure. Moreover, the Bank believes that regulatory consideration of payment processing order is a matter that should only be made through the Board's normal payment systems authority. Interposing a UDAP rule on such fundamental payment systems issues would be extremely disruptive and an unjustifiable application of UDAP authority.

In summary, the Bank believes that the Board, the OTS, and the NCUA should proceed cautiously in establishing unfairness rules under their UDAP rule-making authority. UDAP situations are often characterized by case specific facts that defy industrywide generalization. In exercising their FTCA Section 18(f)(1) rule-making authority, the agencies must be mindful to apply standards that properly consider the unique attributes of the banking sector and take extra care in performing their analysis, because it will have precedent setting application far beyond the particular practices at issue.

Ultimately providing overdraft accommodation is not an injury but a benefit and any associated fees are reasonably avoidable by customers exercising normal care—the kind described in Federal Reserve and Interagency consumer publications. Our customers see real value when the

bank stands behind their payment decisions, and they understand that the fee is a source of compensation to the bank for that accommodation. Customers have the tools to manage their accounts and the responsibility to track their transactions. Bank overdraft accommodation is a convenience that customers who use it value and one that they can avoid if they choose by exercising common care as the vast majority of customers do every day.

Gateway Business Bank urges the agencies to take special care in considering appropriate standards for this inaugural exercise of banking agency initiated FTCA Section 18(f)(1) rulemaking. We ask the agencies to conclude that the banking industry's mainstream overdraft practices are not unfair to customers. We therefore recommend that any new regulatory mandates for consumer protection for debit card transactions be evaluated within the established regulatory framework for electronic transactions, funds availability, and account disclosures.

Sincerely,

Gateway Business Bank