

CITIZENS NATIONAL BANK

August 4, 2008

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 Citizens National Bank. We are a National Bank with 19 branches throughout East Texas.

Standards for Unfairness under the FTC Act. CNB would respectfully suggest that the predicate for the FTC Act is not met for the overdraft privilege proposals. That 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 worst practices and then crafts a solution for those, ignoring the most common scenarios and the potential that a reduction in available overdraft courtesy will have on the typical consumer as opposed to the least responsible consumer. Currently, overdraft courtesy programs actually bring traditional services to many customers who might otherwise be “unbanked.”

One way to evaluate the injury to consumers is to look at the complaint data. 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. Since July 2007, bank customers with overdraft privilege coverage have received comprehensive data regarding NSF charges for the statement cycle and year to date. This report, however, does not appear to have disturbed consumers such that they have filed complaints with the primary Texas banking regulator.

The element relating to “reasonably avoidable” can be appropriately handled with an initial opportunity to opt-out from overdraft courtesy. CNB strongly recommends that this be offered at the later of account opening or at the time the service is first offered. This assures that consumers have a reasonable opportunity to make an appropriate decision. However, CNB does not believe that an annual opt out (or more frequent notice) should be offered.

As noted in the preamble to the regulation, the typical overdraft courtesy program in Texas banks is automatic without broad underwriting at the time it is offered. For check transactions, only one fee is charged, and it is the same fee regardless of whether the item is paid or returned. As noted in our prior comment, the Texas usury laws assure that there is no differential in the fees. Since payment of an overdraft is an extension of credit, an additional charge for paying (rather than handling the insufficient item) constitutes interest under Texas law. Accordingly, the fees are the same whether or not the item is returned or paid. 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. 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. 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. Of course, if the merchant does accept a check on the account, the consumer will be overdrawn, triggering the same NSF charge.

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 run the gamut of consequences

from inconvenient to devastating to that person. Likewise, at the grocery store, the lack of a payment method will cause a spectrum of consequences ranging from embarrassing and inconvenient (i.e. the items being returned to the shelf) to devastating (i.e. the inability to buy baby formula or medicine). While this may be merely 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.

Furthermore, the preamble and analysis presumes that the overdraft courtesy is a form of “high cost form of lending.” Consumer advocates have complained that overdraft courtesy is somehow equivalent to payday lending. In fact, the most predatory practices in the payday lending arena involve the repeated renewals of a single loan. Bank experience does not support the notion that, for the most typical consumer, there are repeated overdrafts as a result of a transaction (which would be the functional equivalent of the “flipped” payday loan). Furthermore, most community banks are willing to work with customers and will in fact waive NSF charges where appropriate.

Next, the preamble seems to imply that there is some form of lower cost credit product that would provide similar instant access to funds desired by those persons utilizing overdraft courtesy. 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 a comparable, simple to use product.

Sweeping between a savings account and a checking account is significantly limited by federal law and Regulation D. Thus, this “alternative” is somewhat illusory in practice. In addition, Texas law 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 banks.

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, 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. Thus, the depository bank may not offer its own credit cards.

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 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.

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 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. Finally, with more channels (such as mobile banking) available to customers, opt out by channel becomes ever more cumbersome, and frankly, unmanageable.

Another practical concern for banks is the problem of joint accounts. If one party opted out and the other did not, there is currently no practical way to manage that for partial opt out of debit card coverage. Further, a periodic statement for the joint account will not distinguish between debit transactions by joint tenant. Thus, there is the potential for the customer to be confused when the non-opt out party accesses the overdraft privilege via a debit card. Bank customer service representatives will have a big challenge in adequately explaining the account activity to the disgruntled party.

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 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.

Document Processing Issues. In order to support the FRB proposal to allow opt out of overdraft protection services by debit card, significant code changes to the account posting process would be required. Some data processors currently support opt out of overdraft services at the account level in accordance with the February 2005 Joint Guidance. However, they cannot currently support opt out by payment type as suggested in the proposed rules.

The account posting process would have to be re-written to look at the transaction type to determine whether or not to assess a fee for overdraft protection in the event the transaction amount exceeds the available funds in the account. Data processors have not completed an analysis of the business requirements or the number of development hours necessary to support the proposed changes but the effort will be significant and costly.

The additional steps required in the account posting process could potentially lengthen the nightly processing cycle and add operational costs to a financial institution.

The difference between authorization process and posting process should be noted. Certain data processor systems currently support the ability to authorize ATM and debit transactions against a balance that does not include overdraft protection. However, to insure compliance with the proposed rules, changes in the posting process would be required as noted above.

In a real time processing environment, debit card transactions are authorized and memo posted to the account as they occur. Theoretically, a transaction authorized for a certain amount against a balance that did not include overdraft protection would never result in an overdraft or incur an overdraft fee. However, in reality the final transaction amount for posting could actually result in an overdraft situation. For example, a customer with a balance of \$105 uses their debit card to buy dinner for their family that costs \$100. The transaction is authorized for \$100 but the tip is added for \$20 so the final transaction amount to be posted to the account is \$120 thereby overdrawing the account by \$15. Further example, a customer with \$10 in their account uses a debit card at a gas pump. Many gas stations send a pre-authorization for \$1. In this example the transaction is authorized by the financial institution, but the customer dispenses \$45 worth of gas. The final amount for posting is \$45, thereby overdrawing the account by \$35. These situations happen regularly, and financial institutions bear the risk.

The proposal acknowledges that there are situations in which the preauthorization is for less than the actual transaction and would permit fees in this situation. As noted above in the

discussion of joint accounts, there is still the potential for significant customer confusion and backlash against the bank.

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

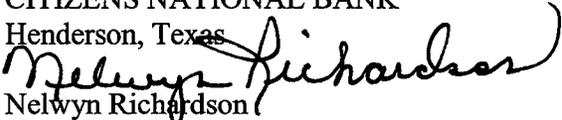
Prospective Date. Institutions will need a significant amount of time to reprogram for the changes contemplated by this rule if partial opt-out is authorized. In addition, time will be necessary to educate the merchant community as to the impact on them with regard to accepting debit cards. The ultimate 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. CNB 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.

I appreciate this opportunity to comment.

Sincerely,

CITIZENS NATIONAL BANK
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Nelwyn Richardson
Senior Vice President